

AB ŽEMAITIJOS PIENAS

FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31
DECEMBER 2004

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF AB ŽEMAITIJOS PIENAS

We have audited the accompanying consolidated balance sheets of AB Žemaitijos Pienas (a joint stock company registered in the Republic of Lithuania, “the Company”) and its subsidiaries AB Telšių Autoservisas, UAB Žemaitijos Pieno Žaliava, ŽŪK Tarpučių Pienas, ŽŪK Sodžiaus Pienas (“the Group”) as of 31 December 2004 and the related statements of income, cash flows and changes in equity for the year then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing as set forth by the International Federation of Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2004 and the results of its operations and the cash flows for the year then ended in accordance with International Financial Reporting Standards, as published by the International Accounting Standards Board.

UAB ERNST & YOUNG BALTIC
Audit company’s licence No. 000514



Jonas Akelis
Auditor’s licence
No. 000003



Rokas Masiulis
Auditor’s licence
No. 000168

The audit was completed on 1 March 2005.

Balance sheets



	Notes	As of 31 December 2004	As of 31 December 2003
ASSETS			
Non-current assets			
Intangible assets	5	240	396
Property, plant and equipment	6	43,722	84,566
Investment property	7	4,924	-
Investments for sale		20	148
Non-current receivables	8	2,188	2,664
Deferred income tax asset	21	104	466
Total non-current assets		51,198	88,240
Current assets			
Inventories	9	52,780	56,512
Prepayments		1,430	1,381
Trade receivables	10	12,922	10,069
Receivables from related parties	25	2,807	-
Other receivables		3,134	4,383
Cash and cash equivalents	11	12,934	16,141
Total current assets		86,007	88,486
Total assets		137,205	176,726

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

Balance sheets (cont'd)

	Notes	As of 31 December 2004	As of 31 December 2003
LIABILITIES AND SHAREHOLDERS' EQUITY			
Shareholders' equity			
Share capital	1	37,000	37,000
Share surplus	12	2,760	2,760
Legal reserve (results)	12	3,700	2,874
Other reserves	12	3,540	-
Own shares	12	-	(1,137)
Retained earnings (deficit)		6,075	40,759
Total shareholders' equity		53,075	82,256
Minority interest		1,037	4,791
Non-current liabilities			
Grants received	13	5,834	7,677
Non-current borrowings	14	46,550	27,889
Non-current borrowings from related parties	25	2,040	-
Leasing liabilities	15	1,787	1,505
Non-current liabilities		901	1,155
Total non-current liabilities		57,112	38,226
Current liabilities			
Current portion of non-current borrowings	14	2,196	21,953
Current portion of non-current leasing liabilities	15	758	945
Trade payables		15,452	20,257
Payables to related parties	25	3,135	-
Income tax payable		1,131	1,718
Other current liabilities	17	3,309	6,580
Total current liabilities		25,981	51,453
Total liabilities and shareholders' equity		137,205	176,726

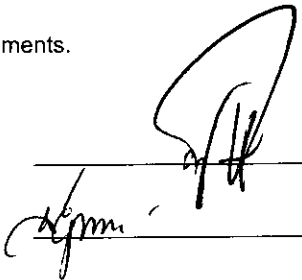

The accompanying notes are an integral part of these financial statements.

General Manager	Algirdas Pažemeckas		1 March 2005
Chief Accountant	Dalia Gečienė		1 March 2005

Income statements

	Notes	2004	2003
Sales	4	337,867	254,576
Cost of sales		(259,696)	(194,266)
Gross profit		78,171	60,310
Operating expenses	18	(60,396)	(50,014)
Other operating income (expenses), net	19	(3,595)	(1,871)
Profit from operations		14,180	8,425
Income (expenses) from financial and investment activities, net	20	(31)	1,111
Profit before income tax and minority interest		14,149	9,536
Income tax	21	(2,718)	(2,253)
Profit before minority interest		11,431	7,283
Minority interest		(241)	(191)
Net profit		11,190	7,092
Basic and diluted earnings per share (LTL)	22	3.07	2.01

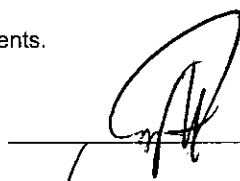
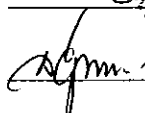
The accompanying notes are an integral part of these financial statements.

General Manager	Algirdas Pažemeckas		1 March 2005
Chief Accountant	Dalia Gecienė		1 March 2005

Statements of changes in equity

Notes	Share capital	Share surplus	Legal reserve (results)	Other reserves	Own shares	Retained earnings (deficit)	Total
Balance as of 31 December 2002	37,000	2,760	2,874	-	(1,137)	33,667	75,164
Net profit for the year	-	-	-	-	-	7,092	7,092
Balance as of 31 December 2003	37,000	2,760	2,874	-	(1,137)	40,759	82,256
Dividends paid	-	-	-	-	-	(529)	(529)
Transfer to reserves	-	-	826	39,394	-	(40,220)	-
Transfer during reorganisation	1	-	-	(35,854)	-	(5,125)	(40,979)
Sale of own shares	-	-	-	-	1,137	-	1,137
Net profit for the year	-	-	-	-	-	11,190	11,190
Balance as of 31 December 2004	37,000	2,760	3,700	3,540	-	6,075	53,075

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

General Manager	Algirdas Pažemeckas		1 March 2005
Chief Accountant	Dalia Gecienė		1 March 2005

Cash flow statements

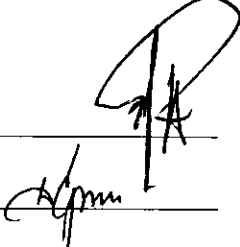
	2004	2003
Cash flows from (to) operating activities		
Net profit	11,190	7,092
Adjustments for non-cash items:		
Depreciation and amortisation	15,256	16,412
Amortisation of grants received	(1,843)	(1,624)
Impairment of property, plant and equipment	157	(638)
Loss / (profit) from disposal and write-offs of property, plant and equipment and intangible assets	62	2,109
Allowance for receivables	80	1,272
(Adjustment) / increase of decrease of net realisable value of inventories	(1,617)	1,015
Minority interest	241	225
Other non-cash (income) / expenses	(207)	1,351
	<u>23,319</u>	<u>27,214</u>
Changes in working capital:		
Decrease (increase) in inventories	3,938	(1,571)
(Increase) in receivables	(8,315)	(2,781)
(Increase) in prepayments and other current assets	(391)	(402)
(Decrease) in trade payables, payables to related parties and payables to subsidiaries	(591)	(3,580)
Increase in other current liabilities	1,080	1,181
Net cash flows from (to) operating activities	<u>19,040</u>	<u>20,061</u>
Cash flows from (to) investing activities		
(Acquisition) of property, plant and equipment and intangible assets	(13,879)	(23,929)
Disposal of property, plant and equipment	-	268
Proceeds from sales of investments	83	-
Repayment of granted loans	2,659	2,894
Non-current borrowings (granted)	(3,455)	(2,221)
Interest received	212	103
Net cash flows (to) investing activities	<u>(14,380)</u>	<u>(22,885)</u>

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

Cash flow statements (cont'd)

	2004	2003
Cash flows from (to) financing activities		
Dividends (paid)	(529)	-
Cash, (transferred) during reorganisation	(2,227)	-
Loans received	8,142	25,793
(Repayment) of loans	(9,238)	(18,259)
Grants received	-	7,122
Leasing (payments)	(1,624)	(1,792)
(Repayment) of non-current payables for shares	(385)	-
Interest (paid)	(2,006)	(1,785)
Net cash flows (to) from financial activities	(7,867)	11,079
Net (decrease) increase in cash and cash equivalents	(3,207)	8,255
Cash and cash equivalents at the beginning of the year	16,141	7,886
Cash and cash equivalents at the end of the year	12,934	16,141

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

<u>General Manager</u>	<u>Algirdas Pažemeckas</u>		<u>1 March 2005</u>
<u>Chief Accountant</u>	<u>Dalia Gecienė</u>		<u>1 March 2005</u>

AB ŽEMAITIJOS PIENAS

FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004

(all amounts are in LTL thousand unless otherwise stated)

Notes to the financial statements

1 General information

AB Žemaitijos pienas (hereinafter – “the Company”) is a joint stock company registered in the Republic of Lithuania. The address of its registered office is as follows:

Sedos Str. 35, Telšiai
Lithuania

The Company produces dairy products and sells them in Lithuanian and in foreign markets. The Company has established its own retail network with 110 outlets, it also has a number of wholesale departments with storage facilities and transport means in major Lithuanian towns. The Company started its operations in 1984. The Company’s shares are traded on the Official List of the National Stock Exchange.

As of 31 December 2004 the share capital of the Company was LTL 37,000 thousand. It consisted of 3,700,000 ordinary shares with a nominal value of LTL 10. All the shares of the Company are issued, signed and fully paid. The share capital did not change in 2004 and 2003. Subsidiaries did not hold any shares of the Company as of 31 December 2004 and 2003. As of 31 December 2003 the Company had its own shares, but during 2004 the Company sold them (Note 12).

The largest shareholder of AB Žemaitijos Pienas is the general director of the Company Mr. Algirdas Pažemeckas. As of 31 December 2004 Mr. Algirdas Pažemeckas owned 26.88% of the authorised share capital. There is no information available if there is any other single shareholder with the shareholding of 5% or more.

On 16 July 2004 reorganisation took place in the Company. By way of dividing during reorganisation a part of assets and liabilities of AB Žemaitijos Pienas were separated and transferred to a newly established company AB Žemaitijos Pieno Investicija. Upon reorganisation the investments to the subsidiaries of the Company AB Klaipėdos Pienas, ABF Šilutės Rambynas, UAB Baltijos Mineralinių Vandenių Kompanija, UAB Žemaitijos Prekyba and UAB Gimtinės Pienas were transferred to AB Žemaitijos Pieno Investicija. Upon reorganisation the value of net assets (assets less liabilities), which were transferred to AB Žemaitijos Pieno Investicija, was LTL 40,979 thousand. As a result of the reorganisation, the income of the Company did not decrease significantly as sales of the companies of AB Žemaitijos Pieno Investicija group were mostly to the Group, which is engaged in sales to the end consumers.

As of 31 December 2004 the Group consisted of AB Žemaitijos Pienas and the following subsidiaries (hereinafter referred to as „the Group”):

Company	Registration address	Ownership of the Group	Amount of investment	Profit (loss) for the year	Total equity holding	Main activities
AB Telšių Autoservisas	Mažeikių Str. 4, Telšiai	37.49%	393	4	(108)	Repair of vehicles
UAB Žemaitijos Pieno Žaliava	Sedos Str. 35, Telšiai	100%	1,000	(44)	740	Milk collection services
ŽŪK Tarpučių Pienas	Klaipėdos Str. 3, Šilutė	10.08%	50	(22)	430	Milk collection services
ŽŪK Sodžiaus Pienas	Šilalės Str. 35, Laukuva	15.09%	105	(29)	903	Milk collection services

AB ŽEMAITIJOS PIENAS

FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004

(all amounts are in LTL thousand unless otherwise stated)

1 General information (cont'd)

AB Telšių Autoservisas, ŽŪK Tarpučių Pienas ir ŽŪK Sodžiaus Pienas are considered subsidiaries, because AB Žemaitijos Pienas controls in the activities, although it owns less than 50% of the shares.

AB Telšių Autoservisas had no active operations in 2004 and 2003.

As of 31 December 2004, the number of employees of the Group was 2,272 (as of 31 December 2003 – 2,479).

2 Accounting principles

The principal accounting policies adopted in preparing the Group's financial statements for 2004 are as follows:

2.1. Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), which comprise standards and interpretations approved by the International Accounting Standards Board (IASB), and International Accounting Standards and Standing Interpretations Committee (SIC) interpretations approved by the International Accounting Standards Committee (IASC) that remain in effect.

2.2. Presentation currency

The amounts shown in these financial statements are presented in the local currency of the Republic of Lithuania, Litas (LTL).

Starting from 2 February 2002, Lithuanian Litas is pegged to EUR at the rate of 3.4528 Litas for 1 EUR, and the exchange rates in relation to other currencies are set daily by the Bank of Lithuania.

2.3. Consolidation principles

The consolidated financial statements of the Group include AB Žemaitijos Pienas and the companies under its control. This control is normally evidenced when the Group owns, either directly or indirectly, more than 50 percent of the voting rights of a company's share capital and/or is able to govern the financial and operating policies of an enterprise so as to benefit from its activities.

A part of equity and net profit, which depend on minority shareholders, are respectively separated in the caption of consolidated balances and consolidated income statements.

The purchase method of accounting is used for acquired businesses. The Group accounts for the acquired identifiable assets and liabilities of another company at their fair value at acquisition date. Difference between the acquisition cost and the fair value of the net assets at acquisition date is considered to be goodwill (negative goodwill). The goodwill (negative goodwill) is presented in the financial statements at cost less its amortisation and impairment. The goodwill (negative goodwill) is presented in separate financial statements of the Group in the same line as the investment into the acquired company. In the consolidated financial statements goodwill (negative goodwill) related to consolidated subsidiaries is presented in the intangible assets caption.

Companies acquired or sold during a year are included into the financial statements from the date of acquisition or until the date of sale.

Investments in associated companies where significant influence is exercised by AB Žemaitijos Pienas are accounted for using the equity method. An assessment of valuation of investments in associates is performed when there is an indication that the asset may be impaired or the impairment losses recognised in prior years no longer exist.

All other investments are accounted for in accordance with IAS 39 Financial Instruments: Recognition and Measurement as further disclosed in section 2.7.

Intercompany balances and transactions, including unrealised profits and losses, are eliminated on consolidation.

Consolidated financial statements are prepared by using uniform accounting policies for like transactions and other events in similar circumstances.

2 Accounting principles (cont'd)

2.4. Intangible assets

Intangible assets are measured initially at cost. Intangible assets are recognised if it is probable that future economic benefits that are attributable to the asset will flow to the Group and the cost of asset can be measured reliably. After initial recognition, intangible assets are measured at cost less accumulated amortisation and any accumulated impairment losses. Intangible assets are amortised on a straight-line basis over the best estimate of their useful lives.

Software

The costs of acquisition of new software are capitalised and treated as an intangible asset if these costs are not an integral part of the related hardware. Software is amortised over a period not exceeding 3 years.

Costs incurred in order to restore or maintain the future economic benefits that the Company expects from the originally assessed standard of performance of existing software systems are recognised as an expense when the restoration or maintenance work is carried out.

2.5. Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and estimated impairment losses.

When assets are sold or retired, their cost and accumulated depreciation are eliminated from the accounts and any gain or loss resulting from their disposal is included in the income statement.

The initial cost of property, plant and equipment comprises its purchase price, including non-refundable purchase taxes and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditures incurred after the property, plant and equipment have been put into operation, such as repair and maintenance costs, are normally charged to the income statement in the period the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard of performance and / or that they have resulted in an increase of the useful life of the asset, the expenditures are capitalised as an additional cost of property, plant and equipment. The Group capitalizes property, plant and equipment purchases with an estimated useful life exceeding one year and an acquisition cost above LTL 500.

Depreciation is computed on a straight-line basis over the following average estimated useful lives:

Buildings	20 - 40 years
Machinery and equipment	5 years
Vehicles and other equipment	4 - 10 years

The useful lives are reviewed periodically to ensure that the period of depreciation is consistent with the expected pattern of economic benefits from items in property, plant and equipment.

Construction-in-progress is stated at cost. This includes the cost of construction, plant and equipment and other directly attributable costs. Construction-in-progress is not depreciated until the relevant assets are completed and put into operation.

2.6. Investment property

Investment property of the Group consist of investments in land and buildings that are held to earn rentals, rather than for own use in the ordinary course of business. Investment property is stated at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is computed on a straight-line basis over the estimated useful live of 40 years.

Transfers to or from investment property are made when and only when there is an evidence of a change in use.

2 Accounting principles (cont'd)

2.7. Investments

Pursuant to IAS 39, Financial Instruments: Recognition and Measurement, investments are classified into the following categories: held-to-maturity, held-for-trading and available-for-sale. Investments with fixed or determinable payments and fixed maturity that the Company has the positive intent and ability to hold to maturity, other than loans and receivables originated by the Company, are classified as held-to-maturity investments. Investments acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as held-for-trading. All other investments, other than loans and receivables originated by the Company, are classified as available-for-sale.

Held-to-maturity investments are included in non-current assets unless they mature within twelve months of the balance sheet date. Investments held-for-trading are included in current assets. Available-for-sale investments are classified as current assets if management intends to realise them within twelve months of the balance sheet date.

All purchases and sales of investments are recognised on the trade date. Investments are initially measured at cost, which is the fair value of the consideration given for them, including transaction costs.

Available-for-sale and held-for-trading investments are subsequently carried at fair value by reference to their quoted market price at the balance sheet date, without any deduction for transaction costs that the Company may incur on their sale or other disposal. Gains or losses on measurement to fair value of available-for-sale investments are recognised directly in the fair value reserve in shareholders' equity, until the investment is sold or otherwise disposed off, or until it is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in net profit or loss for the period.

Changes in the fair values of held-for-trading investments are included in financial expenses or income.

Held-to-maturity investments are carried at amortised cost using the effective interest rate method.

2.8. Inventories

Inventories are valued at the lower of cost or net realisable value, after impairment evaluation for obsolete and slow moving items. Net realisable value is the selling price in the ordinary course of business, less the costs of completion, marketing and distribution. Cost is determined by the first-in, first-out (FIFO) method. The cost of finished goods and work in progress includes the applicable allocation of fixed and variable overhead costs based on a normal operating capacity. Unrealisable inventory is fully written-off.

2.9. Receivables and loans granted

Receivables are initially recorded at the fair value of the consideration given. Current receivables are subsequently carried at cost less impairment, and non-current receivables and loans granted – at amortised cost, less impairment.

2.10. Cash and cash equivalents

Cash includes cash on hand and cash with banks. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less and that are subject to an insignificant risk of change in value.

For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand, deposits held at call with banks, and other short-term highly liquid investments.

2 Accounting principles (cont'd)

2.11. Borrowings

Till 2004 borrowing costs were capitalised, if directly attributable to acquisition of assets, construction or production. In 2004 the Group changed the accounting principle for the borrowing costs, and borrowing costs are written-off to expenses as incurred, as described in detail in Note 3.

Borrowings are initially recognised at fair value of proceeds received, less the costs of transaction. They are subsequently carried at amortised cost, the difference between net proceeds and redemption value being recognised in the net profit or loss over the period of the borrowings. The borrowings are classified as non-current if the completion of a refinancing agreement before authorisation of the financial statements for issue provides evidence that the substance of the liability at the balance sheet date was long-term.

2.12. Financial and operating leases

Financial lease

The Group recognises financial leases as assets and liabilities in the balance sheet at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, to the present value of the minimum lease payments. The rate of discount used when calculating the present value of minimum payments of financial lease is the interest rate of financial lease payment, when it is possible to determine it, in other cases, Group's composite interest rate on borrowings applies. Directly attributable initial costs are included into the asset value. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

The depreciation is accounted for financial lease assets and it also gives rise to financial expenses in the Group's income statement for each accounting period. The depreciation policy for leased assets is consistent with that for depreciable assets that are owned. The leased assets can not be depreciated over the period longer than lease term, unless the Group, according by the lease contract, gets transferred their ownership after the lease term is over.

If the result of sales and lease back transactions is financial lease, any profit from sales exceeding the book value is not recognised as income immediately. It is postponed and amortised over the lease term.

Operating lease

Leases where the lessor retains all the risk and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

The gains from discounts provided by the lessor are recognised as a decrease in lease expenses over the period of the lease using the straight-line method.

If the result of sales and lease back transactions is operating lease and it is obvious that the transaction has been carried out at fair value, any profit or loss is recognised immediately. If the sales price is lower than the fair value, any profit or loss is recognised immediately, except for the cases when the loss is compensated by lower than market prices for lease payments in the future. The profit is then deferred and it is amortised in proportion to the lease payments over a period, during which the assets are expected to be operated. If the sales price exceeds the fair value, a deferral is made for the amount by which the fair value is exceeded and it is amortised over a period, during which the assets are expected to be operated.

2.13. Grants and subsidies

Grants and subsidies (hereafter - "grants") received in the form of non-current assets or intended for the purchase, construction or other acquisition of non-current assets are considered as asset-related grants. Assets received free of charge are also allocated to this group of grants. The amount of the grants related to assets is recognised in the financial statements as used in parts according to the depreciation of the assets associated with this grant. In the income statement, a relevant expense account is reduced by the amount of grant amortisation.

Grants received as a compensation for the expenses or unearned income of the current or previous reporting period, also, all the grants, which are not grants related to assets, are considered as grants related to income. The income-related grants are recognised as used in parts to the extent of the expenses incurred during the reporting period or unearned income to be compensated by that grant.

The balance of unutilised grants is shown in caption "Grants received" on the balance sheet.

2 Accounting principles (cont'd)

2.14. Income tax

Income tax charge is based on profit for the year and considers deferred taxation. Income tax is calculated based on the Lithuanian tax legislation.

The standard income tax rate in Lithuania is 15%. Tax losses can be carried forward for 5 consecutive years, except for the losses incurred as a result of disposal of securities and / or derivative financial instruments that can be carried forward for 3 consecutive years. The losses from disposal of securities and / or derivative financial instruments can be only used to reduce the taxable income earned from the transactions of the same nature.

Deferred taxes are calculated using the balance sheet liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets and liabilities are measured using the tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse based on tax rates enacted or substantially enacted at the balance sheet date.

Deferred tax assets have been recognised in the balance sheet to the extent the management believes it will be realised in the foreseeable future, based on taxable profit forecasts. If it is believed that part of the deferred tax asset is not going to be realised, this part of the deferred tax asset is not recognized in the financial statements.

2.15. Revenue recognition

Revenue is recognised when it is probable that the economic benefits associated with the transaction will flow to the enterprise and the amount of the revenue can be measured reliably. Sales are recognised net of VAT and discounts.

Revenue from sales of goods are recognised when delivery has taken place and transfer of risks and rewards has been completed.

Sales between the Group companies are eliminated in the consolidated income statement.

2.16. Expense recognition

Expenses are recognised on the basis of accrual and revenue and expense matching principles in the reporting period when the income related to these expenses was earned, irrespective of the time the money was spent. In those cases when the costs incurred cannot be directly attributed to the specific income and they will not bring income during the future periods, they are expensed as incurred.

The amount of expenses is usually accounted as the amount paid or due to be paid, excluding VAT. In those cases when long period of payment is established and the interest is not distinguished, the amount of expenses shall be estimated by discounting the amount of payment using the market interest rate.

2.17. Foreign currencies

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies on the balance sheet date are recognized in the income statement. Such balances are translated at period-end exchange rates.

2.18. Segments

In these financial statements a business segment means a constituent part of the Group participating in production of an individual product or provision of a service or a group of related products or services, the risk and returns whereof are different from other business segments.

In these financial statements a geographical segment means a constituent part of the Group participating in production of individual products or provision of services within certain economic environment the risk and returns whereof are different from other constituent parts operating in other economic environments.

Financial information about business and geographical segments is presented in Note 4 to these financial statements.

2 Accounting principles (cont'd)

2.19. Impairment of assets

Financial assets

Financial assets, as well as goodwill are reviewed for impairment at each balance sheet date.

For financial assets carried at amortised cost, whenever it is probable that the Group will not collect all amounts due according to the contractual terms of loans or receivables, an impairment or bad debt loss is recognised in the income statement. The reversal of impairment losses previously recognised is recorded when the decrease in impairment loss can be justified by an event occurring after the write-down. Such reversal is recorded in the income statement. However, the increased carrying amount is only recognised to the extent it does not exceed the amortised cost that would have been had the impairment not been recognised.

Other assets

Other assets are reviewed for impairment whenever events or changes in circumstances indicate that carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognised in the income statement. Reversal of impairment losses recognised in prior years is recorded when there is an indication that the impairment losses recognised for the asset no longer exist or have decreased. The reversal is accounted in the same caption of the income statement as the impairment loss.

2.20. Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with International Financial Reporting Standards, as published by the International Accounting Standards Board, requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingencies. The significant areas of estimation used in the preparation of these financial statements relate to depreciation and impairment evaluation. Future events may occur which may cause the assumptions used in arriving at the estimates to change. The effect of any changes in estimates will be recorded in the financial statements, when determinable.

2.21. Contingencies

Contingent liabilities are not recognised in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is not recognised in the financial statements but disclosed when an inflow or economic benefits is probable.

2.22. Subsequent events

Post-balance sheet events that provide additional information about the Group's position at the balance sheet date (adjusting events) are reflected in the financial statements. Post-balance sheet events that are not adjusting events are disclosed in the notes when material.

2.23. Offsetting and comparative figures

When preparing the financial statements, assets and liabilities, as well as revenue and expenses are not set off, except the cases when separate standard specifically require such set-off.

Where necessary, comparative figures have been adjusted to correspond to the presentation of the current year.

AB ŽEMAITIJOS PIENAS**FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004**

(all amounts are in LTL thousand unless otherwise stated)

3 Changes in accounting policies

Until 2004 borrowing costs were capitalised, if they were directly attributable to the acquisition, construction or production of certain assets. In 2004 the Group changed the accounting principle for the borrowing costs, and borrowing costs are charged to expenses as incurred. The change in accounting policy of borrowing costs is accounted using perspective method according to IAS 8 requirements. Because the capitalised interest and related depreciation was not accounted separately for units of assets, it is impossible to evaluate exactly the effect of change in accounting policies of borrowing costs for the specific prior periods. Therefore the new policy is applied only after the change in accounting policy for the borrowing costs, without evaluating the accrued effect for prior periods.

4 Segment information

For management purposes the activities of the Group are organised as one major segment – production and selling of the dairy products (primary segment). Financial information on geographical segments (secondary segment) is presented below:

	2004	2003
Sales		
Lithuania	194,610	170,110
The Baltic States and CIS countries	49,583	34,401
Other European countries	63,532	25,999
USA	27,290	22,003
Other	2,852	2,063
	337,867	254,576

The expenses of the Group, incurred by the acquisition of property, plant and equipment and intangible assets, accounted for LTL 15,606 thousand (LTL 24,618 thousand in 2003). As all assets of the Group are in Lithuania, all liabilities are related with the geographical segment of Lithuania.

AB ŽEMAITIJOS PIENAS**FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004**

(all amounts are in LTL thousand unless otherwise stated)

5 Intangible assets

	Negative goodwill	Other intangible assets	Total
Cost:			
Balance as of 31 December 2003	(5,115)	1,608	(3,507)
Additions	-	374	374
Transferred during reorganisation	5,115	(1,524)	3,591
Retirements	-	(156)	(156)
Balance as of 31 December 2004	-	302	302
Amortisation:			
Balance as of 31 December 2003	(4,785)	882	(3,903)
Charge for the year	(20)	144	124
Transferred during reorganisation	4,805	(838)	3,967
Retirements	-	(126)	(126)
Balance as of 31 December 2004	-	62	62
Net book value as of 31 December 2004	-	240	240
Net book value as of 31 December 2003	(330)	726	396

Amortization expenses of intangible assets are included within operating expenses in the income statement.

Negative goodwill

Upon acquisition of ABF Šilutės Rambynas shares in 1995, AB Žemaitijos Pienas recorded a negative goodwill amounting to LTL 4,715 thousand. In 2002 AB Žemaitijos Pienas has acquired additional shares of ABF Šilutės Rambynas. During the acquisition, additional negative goodwill of LTL 400 thousand was recorded. The negative goodwill is amortised on a straight-line basis over a 10-year period by the Group. The amortisation of the negative goodwill for the period 1 January 2004 to 16 July 2004, equal to LTL 20 thousand, is presented in the operating expenses in the income statement, by decreasing the depreciation expenses of property, plant and equipment.

As the shares of ABF Šilutės Rambynas were transferred to AB Žemaitijos Pieno Investicija upon reorganisation, the negative goodwill related to these shares was also transferred to AB Žemaitijos Pieno Investicija. The net book value of the negative goodwill at the transfer was equal to LTL 310 thousand.

AB ŽEMAITIJOS PIENAS
FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004

(all amounts are in LTL thousand unless otherwise stated)

6 Property, plant and equipment

	Land, buildings and construc- tions	Machinery and equipment	Vehicles	Other property, plant and equipment	Construction in progress	Total
Cost:						
Balance as of 31 December 2003	35,531	81,575	25,595	33,636	4,834	181,171
Additions	968	4,987	2,611	2,643	4,023	15,232
Disposed, transferred or written-off assets	(5,301)	(8,330)	(15,676)	(6,483)	(3,820)	(39,610)
Assets of subsidiaries, transferred upon reorganisation	(10,946)	(6,220)	(8,700)	(18,816)	(910)	(45,592)
Reclassification	536	2,962	72	557	(4,127)	-
Transfers to investment property	(6,491)	-	-	-	-	(6,491)
Balance as of 31 December 2004	14,297	74,974	3,902	11,537	-	104,710
Accumulated depreciation:						
Balance as of 31 December 2003	10,250	45,976	17,007	20,230	-	93,463
Charge for the year	919	9,672	1,504	2,905	-	15,000
Disposed, transferred or written-off assets	(1,789)	(2,695)	(9,174)	(3,471)	-	(17,129)
Assets of subsidiaries, transferred upon reorganisation	(3,721)	(4,504)	(6,899)	(13,864)	-	(28,988)
Transfers to investment property	(1,435)	-	-	-	-	(1,435)
Balance as of 31 December 2004	4,224	48,449	2,438	5,800	-	60,911
Impairment losses:						
Balance as of 31 December 2003	57	-	2	2,417	666	3,142
Charge for the year	-	-	-	122	35	157
Assets of subsidiaries, transferred during reorganisation	(57)	-	-	(2,464)	(701)	(3,222)
Balance as of 31 December 2004	-	-	2	75	-	77
Net book value as of 31 December 2004	10,073	26,525	1,462	5,662	-	43,722
Net book value as of 31 December 2003	25,224	35,599	8,586	13,592	1,565	84,566

As described in more detail in Note 1 of these financial statements, in 2004 the Company was reorganised, by transferring a part of assets and liabilities to a newly established company AB Žemaitijos Pieno Investicija, the transfer of the assets is presented in separate captions of the parts of the acquisition cost, accumulated depreciation and impairment losses in the table presented above. A part of property, plant and equipment of the Company was also transferred to AB Žemaitijos Pieno Investicija during reorganisation. The net book value of these assets was LTL 20,043 thousand at the moment of transfer. The Company can not distinguish acquisition cost and accumulated depreciation of transferred assets of AB Žemaitijos Pieno Investicija by the groups of assets, therefore these assets are presented in the same caption as other transferred, disposed or written-off assets.

In 2004 the Group changed the classification of property, plant and equipment into groups. The change in grouping is presented in the movement of property, plant and equipment above by adjusting opening – as of 31 December 2003 – balances .

AB ŽEMAITIJOS PIENAS**FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004**

(all amounts are in LTL thousand unless otherwise stated)

6 Property, plant and equipment (cont'd)

The depreciation charge of the Group's property, plant and equipment for 2004 amounts to LTL 15,000 thousand (LTL 16,891 thousand in the year 2003). Amount of LTL 3,913 thousand for 2004 (LTL 3,221 thousand in 2003) was included into operating expenses in the Group's income statement. The remaining amounts were included into cost of sales for the period.

Property, plant and equipment of the Group with a net book value of LTL 28,913 thousand as of 31 December 2004 (LTL 43,543 thousand as of 31 December 2003) was pledged as a collateral for the loans. The related parties AB Klaipėdos Pienas and ABF Šilutės Rambynas also pledged their property, plant and equipment with a net book value of LTL 3,714 thousand and LTL 154 thousand respectively as of 31 December 2004 (Note 14).

Property, plant and equipment of the Group with acquisition cost amounts of LTL 31,084 thousand were fully depreciated as of 31 December 2004 (LTL 45,517 thousand as of 31 December 2003) but were still in active use.

7 Investment property**Cost:**

Transfers from property, plant and equipment	6,491
Balance as of 31 December 2004	<u>6,491</u>

Accumulated depreciation:

Transfers from property, plant and equipment	1,435
Charge for the year	<u>132</u>
Balance as of 31 December 2004	<u>1,567</u>

Net book value as of 31 December 2004 **4,924**

All investment property is rented out to related party ABF Šilutės Rambynas. ABF Šilutės Rambynas was a subsidiary of the Company till the reorganisation (Note 1) and was included into consolidated financial statements of the Group. The Group's rental income from the investment property for the year 2004 amounted to LTL 132 thousand.

There were no restrictions on the realisation of investment property or the transfer of income and proceeds from disposals as of 31 December 2004. No material contractual obligations to purchase, construct, repair or enhance investment property existed at year-end. The Group has not incurred any material operating expenses directly related to the investment property.

The fair value of the investment property as of 31 December 2004 approximates the net book value.

AB ŽEMAITIJOS PIENAS**FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004**

(all amounts are in LTL thousand unless otherwise stated)

8 Non-current receivables

		<u>2004</u>	<u>2003</u>
Held to maturity investments	a)	109	163
Non-current loans issued	b)	2,079	2,501
		<u>2,188</u>	<u>2,664</u>

a) Held to maturity investments of the Group comprise Government bonds held to maturity, which will be repurchased by the Government of Lithuania on a preset schedule during the period of 2004 – 2007.

b) Non-current loans issued balance represents loans issued to the suppliers of raw materials and employees of the Group. Current portion of non-current loans issued amounting to LTL 2,668 thousand as of 31 December 2004 (LTL 1,783 thousand as of 31 December 2003) is included in accounts receivable balance in these financial statements.

Part of these loans is non-interest bearing. The fair value of non-interest bearing loans issued is assessed using the effective interest rate for similar borrowings (5% in 2004 and 2003) and are stated at amortised cost.

9 Inventories

	<u>2004</u>	<u>2003</u>
Raw materials	12,971	15,938
Finished goods and work in process	38,245	41,009
Goods for resale	1,594	1,919
	<u>52,810</u>	<u>58,866</u>
Less: value allowance	(30)	(2,354)
	<u>52,780</u>	<u>56,512</u>

The acquisition cost of the Group's inventories accounted for at net realisable value as of 31 December 2004 amounted to LTL 30 thousand (LTL 33,045 thousand as of 31 December 2003). Changes in the allowance for inventories for 2004 and 2003 have been included into cost of sales in the Company's income statement.

As described in Note 14, in order to insure the repayment of the issued loan, the Group pledged inventories with total value of LTL 32,000 thousand as of 31 December 2004 (LTL 34,343 thousand as of 31 December 2003), of which LTL 28,500 thousand accounted for the inventories of the Company, and the remaining part accounted for the inventories of ABF Šilutės Rambynas, according to the conditions of the loan agreement. In 2004 ABF Šilutės Rambynas changed the nature of its activities, and started to supply production services to the Company. Due to this reason, all produced goods were sold to the Company, and the inventories of ABF Šilutės Rambynas amounted to LTL 302 thousand as of 31 December 2004. The Company regularly informs the bank about the amount of inventories on stock and their value, however, since the inventories of the Company exceed the total value of the pledged inventories, the bank did not inform the Company about any sanctions in relation with insufficient inventories of ABF Šilutės Rambynas.

10 Trade receivables

	<u>2004</u>	<u>2003</u>
Trade receivables, gross	13,128	11,295
Less: allowance for doubtful trade receivables	(206)	(1,226)
	<u>12,922</u>	<u>10,069</u>

Changes in allowance for doubtful trade receivables for 2004 and 2003 have been included into operating expenses in the Company's income statement.

AB ŽEMAITIJOS PIENAS**FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004**

(all amounts are in LTL thousand unless otherwise stated)

11 Cash and cash equivalents

	<u>2004</u>	<u>2003</u>
Cash at bank	10,669	14,740
Cash on hand	2,265	1,401
	<u>12,934</u>	<u>16,141</u>

12 Shareholders' equityShare surplus

Share surplus is accounted, when the shares are sold at higher than nominal value. According to Lithuanian legislation, the above mentioned reserve can not be distributed, but only transferred to the share capital.

Legal reserve

A legal reserve is a compulsory reserve under Lithuanian legislation. Annual transfers of not less than 5% of net profit calculated in accordance with Lithuanian Business Accounting Standards are compulsory until the reserve reaches 10% of the share capital. Because the legal reserve was reached 10% of share capital, the Company has no duty to transfer a part of net profit of the year 2004 to this reserve.

Non-restricted (distributable) reserves

Non-restricted (distributable) reserves are formed based on the decision of the General Shareholders' Meeting on appropriation of distributable profit. These reserves can be used only for the purposes approved by the General Shareholders' Meeting. According to the Law of Stock Companies and Business Accounting Standards, the reserves formed by the Company other than legal reserve should be restored to retained earnings and redistributed.

Own shares

In the financial statements for 2003, the own shares acquired by the Company were accounted at acquisition cost. In 2001 the Company purchased 173,301 shares (4.68% of the authorised capital) for LTL 1,137 thousand. In 2004 the Company sold its shares to AB Klaipėdos Pienas at the market value valid at that time. AB Klaipėdos Pienas was transferred to a newly established company AB Žemaitijos Pieno Investicija upon the reorganisation. The proceeds from this sale in the amount of LTL 3,542 thousand is accounted as the income of financial and investment activities of the Group in the income statement for the year 2004.

AB ŽEMAITIJOS PIENAS**FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004**

(all amounts are in LTL thousand unless otherwise stated)

13 Grants received**Grants received:**

Balance as of 31 December 2003	9,338
Additions	-
Balance as of 31 December 2004	<u>9,338</u>

Accumulated amortisation:

Balance as of 31 December 2003	1,661
Charge for the year	<u>1,843</u>
Balance as of 31 December 2004	<u>3,504</u>

Net book value as of 31 December 2004	<u>5,834</u>
Net book value as of 31 December 2003	<u>7,677</u>

On 11 April 2002 the Company signed a financing agreement with the National Payment Agency at the Ministry of Agriculture (the "NMA") in relation to the Company's Modernisation Project (the "Project"). The financing is provided from the European Commission (EC) Aid and National Budget in accordance with SAPARD financing stream Agriculture and Fishery Manufacturing and Marketing Modernisation. The NMA obliged to provide the Company with total financing of LTL 7,723 thousand for the implementation of the Project, approved by the NMA on 29 March 2002. 75% of the support was provided by EC and the remaining 25% - by the National Budget. The net book value of the grant was LTL 4,831 thousand as of 31 December 2004 (LTL 6,384 thousand as of 31 December 2003).

Additionally, in 2003 subsidiaries ŽŪK Tarpučių Pienas and ŽŪK Sodžiaus Pienas received financing amounting to LTL 611 thousand and LTL 1,005 thousand, respectively, from the National Payment Agency at the Ministry of Agriculture for the acquisition of milk refrigeration equipment. The financing was provided from the European Commission (EC) Aid and the National Budget in accordance with SAPARD financing stream Agriculture and Fishery Manufacturing and Marketing Modernisation. The net book value of the grants received by ŽŪK Tarpučių Pienas and ŽŪK Sodžiaus Pienas was equal to LTL 367 thousand and LTL 636 thousand respectively as of 31 December 2004 (LTL 489 thousand and LTL 804 thousand respectively as of 31 December 2003).

The amortised part of the financing was offset against depreciation and accounted under depreciation and amortisation caption under cost of sales in the statement of income for 2004 and 2003. The grant financing is amortised in equal parts over the depreciation period of the assets acquired using the financing received.

AB ŽEMAITIJOS PIENAS**FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004**

(all amounts are in LTL thousand unless otherwise stated)

14 Borrowings

	<u>2004</u>	<u>2003</u>
Non-current borrowings		
Bank borrowings secured by Group's and related parties assets	46,550	27,889
	<u>46,550</u>	<u>27,889</u>
Current borrowings		
Current portion of non-current borrowings	2,196	21,953
	<u>2,196</u>	<u>21,953</u>
	<u>48,746</u>	<u>49,842</u>

Terms of repayment of non-current debts are as follows:

	As of 31 December 2004	
	<u>Fixed interest rate</u>	<u>Variable interest rate</u>
2005	-	2,196
2006	16,000	7,444
2007	17,609	2,196
2008	-	2,196
2009	-	1,105
	<u>33,609</u>	<u>15,137</u>

Parts of borrowings at the end of the year in national and foreign currencies:

	<u>2004</u>	<u>2003</u>
Borrowings denominated in:		
EUR	32,746	17,333
USD	-	14,156
LTL	16,000	18,353
	<u>48,746</u>	<u>49,842</u>

As of 31 December 2004 weighted average effective interest rates of borrowings outstanding was 4.07% (3.97% as of 31 December 2003).

For granted loans the Group has pledged inventories for LTL 32,000 thousand (Note 9) and property, plant and equipment with the net book value of LTL 28,913 thousand (Note 6) as of 31 December 2004. The related parties AB Klaipėdos Pienas and ABF Šilutės Rambynas also pledged the property, plant and equipment with the net book value of LTL 3,714 thousand and LTL 154 thousand respectively as of 31 December 2004.

AB ŽEMAITIJOS PIENAS**FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004**

(all amounts are in LTL thousand unless otherwise stated)

15 Financial lease

The assets leased by the Group under financial lease contracts consist of vehicles, refrigerators and curd production line. Apart from the lease payments, the most significant liabilities under lease contracts are property maintenance and insurance. The terms of financial lease are up to 5 years. The distribution of the net book value of the assets acquired under financial lease are as follows:

	<u>2004</u>	<u>2003</u>
Equipment	2,169	1
Vehicles	-	2,184
	<u>2,169</u>	<u>2,185</u>

As of 31 December 2004 the net book value of the assets of AB Žemaitijos Pienas acquired by financial lease consisted only of equipment, because vehicles with net book value of LTL 1,641 thousand as of 31 December 2004 were transferred to AB Žemaitijos Pieno Investicija upon reorganisation, though liabilities of the financial lease, which are equal to LTL 974 thousand as of 31 December 2004, are accounted in the Group's financial statements.

Principal amounts of financial lease payables at year-end denominated in national and foreign currencies are as follows:

	<u>2004</u>	<u>2003</u>
EUR	1,571	952
LTL	974	1,498
	<u>2,545</u>	<u>2,450</u>

As of 31 December 2004 the interest rate of the balance of financial lease liability, which is equal to LTL 1,530 thousand, varies depending on the 12-month EUR LIBOR plus 1.1%. The interest rate for the remaining portion of the financial lease liability in LTL outstanding as of 31 December 2004, is fixed, i. e. from 5.75% to 5.85%.

Minimal future lease payments under the above mentioned lease contracts as of 31 December 2004 are as follows:

Within one year	849
From one to five years	<u>1,881</u>
Total financial lease liabilities	2,730
Interest	<u>(185)</u>
Present value of financial lease liabilities	<u>2,545</u>

Financial lease liabilities are accounted as:

- current	758
- non-current	1,787

AB ŽEMAITIJOS PIENAS**FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004**

(all amounts are in LTL thousand unless otherwise stated)

16 Operating lease

The Group concluded several contracts of operating lease. The terms of lease do not include restrictions of the activities of the Group in connection with the dividends, additional borrowings or additional lease agreements. In 2004, the lease expenses of the Group amounted to LTL 4,005 thousand (LTL 1,849 thousand in 2003, accordingly).

Minimal future lease payments according to the signed lease contracts are as follows:

Within one year	6,537
From one to five years	20,156
After five years	17
	<hr/>
	26,710
	<hr/>

The currency of the payment of operating lease is Litas.

17 Other current liabilities

	2004	2003
Taxes, other than income tax	756	1,688
Social security payable	726	737
Advances received	725	916
Accrued expenses	544	842
Remuneration and social security payable	66	1,556
Other current liabilities	492	841
	<hr/>	<hr/>
	3,309	6,580
	<hr/>	<hr/>

AB ŽEMAITIJOS PIENAS**FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004**

(all amounts are in LTL thousand unless otherwise stated)

18 Operating expenses

	<u>2004</u>	<u>2003</u>
Wages, salaries and social security*	22,560	17,219
Services	21,044	18,877
Fuel and spare parts	5,176	1,005
Depreciation and amortisation	4,037	2,742
Taxes	2,954	2,798
Materials	1,745	-
Marketing	167	1,631
Impairment allowance for property, plant and equipment	157	(638)
Allowance for net realisable value of current assets	(38)	2,404
Other	2,594	3,976
	<u>60,396</u>	<u>50,014</u>

* In 2004 the Group's wages, salaries and social security expenses amounted to LTL 34,457 thousand (LTL 34,819 thousand in 2003). LTL 22,560 thousand of this amount is accounted in operating expenses (LTL 17,219 thousand in 2003), the remaining – LTL 8,645 thousand is accounted in production cost (LTL 17,600 thousand in 2003).

19 Other operating income (expenses)

In 2004 other operating income of the Group mostly consist of income of the canteen (LTL 1,006 thousand), sales of material valuables (LTL 755 thousand) and rental income (LTL 676 thousand). Other operating expenses of the Group mostly consist of wages and salaries (LTL 3,252 thousand), expenses of sales of material valuables (LTL 971 thousand) and expenses for various services (LTL 1,707 thousand).

20 Income (expenses) from financial and investment activities, net

	<u>2004</u>	<u>2003</u>
Profit from the sale of own shares (Note 12)	3,542	-
Foreign currency exchange gain	2,411	7,381
Interest income	225	306
Foreign currency exchange loss	(4,292)	(4,862)
Interest (expenses)	(2,130)	(1,785)
Other financial income, net	213	71
	<u>(31)</u>	<u>1,111</u>

AB ŽEMAITIJOS PIENAS

FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004

(all amounts are in LTL thousand unless otherwise stated)

21 Income tax

	<u>2004</u>	<u>2003</u>
Components of the income tax expense (income)		
Current income tax for the reporting period	2,385	2,114
The correction of income tax of prior periods	27	130
Deferred income tax expenses	270	9
Change in realisable value of deferred income tax	36	-
Income tax expenses recorded in the income statement	<u>2,718</u>	<u>2,253</u>

	<u>2004</u>	<u>2003</u>
Deferred income tax asset		
Calculation of inventories at net realisable value	-	243
Accrued taxable loss	109	128
Accrued liabilities	69	116
Other	35	52
Deferred income tax asset before valuation allowance	<u>213</u>	<u>539</u>
Less: valuation allowance	(109)	(73)
Deferred income tax asset, net	<u>104</u>	<u>466</u>

Deferred income tax asset with net value of LTL 56 thousand was transferred to AB Žemaitijos Pieno Investicija upon reorganisation.

Deferred income tax asset and liability were accounted at 15% rate. The changes of temporary differences before the tax effect in the Group were as follows:

	<u>Balance as of 31 December 2003</u>	<u>Transferred upon reorganisation</u>	<u>Recognised in income statement</u>	<u>Balance as of 31 December 2004</u>
Taxable loss	850	(151)	30	729
Inventories	1,619	-	(1,619)	-
Accrued	777	(47)	(272)	458
Other	350	(173)	58	235
Total temporary differences	<u>3,596</u>	<u>(371)</u>	<u>(1,803)</u>	<u>1,422</u>
Deferred income tax, net	539	(56)	(270)	213

AB ŽEMAITIJOS PIENAS**FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004**

(all amounts are in LTL thousand unless otherwise stated)

21 Income tax (cont'd)

The reported amount of income tax expenses attributable to the period can be reconciled to the theoretical amount of income tax expenses that would arise from applying statutory income tax rate to pre-tax income as follows:

	<u>2004</u>	<u>2003</u>
Profit before tax and minority interest	14,149	9,536
Income tax expenses computed using the statutory tax rate	2,122	1,431
Non-deductible differences	533	690
Change in evaluation of realisation	36	2
Adjustments of income tax for the prior periods	27	130
	<u>2,718</u>	<u>2,253</u>

22 Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to the shareholders by the weighted average number of ordinary shares issued and paid during the year.

	<u>2004</u>	<u>2003</u>
Net profit attributable to the shareholders	11,190	7,092
Weighted net average number of shares (in thousand)	3,642	3,527
Basic earnings per share (LTL)	<u>3.07</u>	<u>2.01</u>

Weighted net average number of shares is calculated as follows:

	<u>2004</u>	<u>2003</u>
Shares outstanding 1 January – 31 December (in thousand)	3,700	3,700
Weighted net average number of own shares (in thousand)*	(58)	(173)
Weighted net average number of shares (in thousand)	<u>3,642</u>	<u>3,527</u>

* Because the Company sold own shares at the end of April 2004, weighted net average number of shares in 2004 was calculated as follows: $173 \times 4/12 = 58$.

Diluted earnings per share equals to basic earnings per share as there were no potential shares issued as of 31 December 2004.

AB ŽEMAITIJOS PIENAS

FINANCIAL STATEMENTS OF THE GROUP FOR THE YEAR ENDED 31 DECEMBER 2004

(all amounts are in LTL thousand unless otherwise stated)

23 Financial assets and liabilities and risk management

Credit risk

The Group has no significant concentration of trading counterparties, which is related with one partner or group of partners with similar characteristics. Customers risk, or the risk, that the partners will not keep to their obligations, is managed by approving credit terms and procedures of control. The Group's procedures are in force to ensure on a permanent basis that sales are made to customers with an appropriate credit history and do not exceed an acceptable credit exposure limit.

Interest rate risk

The major part of the Group's borrowings is with variable rates, related to LIBOR, which creates an interest rate risk. There are no financial instruments designated to manage its exposure to fluctuation in interest rates outstanding as of 31 December 2004 and 2003.

Liquidity risk

The Group's policy is to maintain sufficient cash and cash equivalents or have available funding through an adequate amount of committed credit facilities to meet its commitments at a given date in accordance with its strategic plans. The Group's liquidity and quick ratios as of 31 December 2004 were 3.31 and 1.28 (1.72 and 0.62 as of 31 December 2003).

Foreign exchange risk

Major currency risks of the Group occur due to the fact that the Group borrows foreign currency denominated funds as well as is being involved in imports and exports. The Group's policy is to match cash flows arising from highly probable future sales and purchases in each foreign currency. The Group does not use any financial instruments to manage its exposure to foreign exchange risk other than aiming to borrow in EUR, to which LTL is pegged. Monetary assets and liabilities stated in various currencies as of 31 December 2004 were as follows:

	<u>Assets</u>	<u>Liabilities</u>
LTL	25,041	39,501
EUR	3,122	37,125
USD	7,252	46
LVL	-	43
Total	<u>35,415</u>	<u>76,715</u>

Fair value of financial instruments

The Group's principal financial instruments not carried at fair value are trade and other receivables, trade and other payables, long-term and short-term borrowings.

Fair value is defined as the amount at which the instrument could be exchanged between knowledgeable willing parties in an arm's length transaction, other than in forced or liquidation sale. Fair values are obtained from quoted market prices, discounted cash flow models and option pricing models as appropriate.

The following methods and assumptions are used to estimate the fair value of each class of financial instruments:

- (a) The carrying amount of current trade accounts receivable, current accounts payable and short-term borrowings approximates fair value.
- (b) The fair value of non-current debt is based on the quoted market price for the same or similar issues or on the current rates available for debt with the same maturity profile. The fair value of non-current borrowings with variable interest rates approximates their carrying amounts.

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24 Commitments and contingencies

During reorganisation, AB Žemaitijos Pienas transferred the financial lease agreement with Nordea Finance to a newly established company AB Žemaitijos Pieno Investicija. Assets and related liabilities were transferred according to tripartite agreement between the Company, AB Žemaitijos Pieno Investicija and Nordea finance dated on 14 November 2004. On the same day the Company signed a guarantee agreement with Nordea Finance, and guaranteed for liabilities of AB Žemaitijos Pieno Investicija, according to the transferred agreement. The liability of AB Žemaitijos Pieno Investicija according to this agreement was LTL 4,287 thousand as of 31 December 2004.

25 Related party transactions

The parties are considered related when one party has the possibility to control the other one or have significant influence over the other party in making financial and operating decisions. The related parties of the Group are as follows:

- AB Žemaitijos Pieno Investicija (same controlling shareholder);
- ABF Šilutės Rambynas (same ultimate controlling shareholder);
- UAB Baltijos Mineralinių Vandenių Kompanija (same ultimate controlling shareholder);
- AB Klaipėdos Pienas (same ultimate controlling shareholder);
- UAB Žemaitijos Prekyba (same ultimate controlling shareholder);
- UAB Gimtinės Pienas (same ultimate controlling shareholder).

The related party transactions and the balances at the end of the year were as follows:

i) Sales

2004

AB Žemaitijos Pieno Investicija	157
ABF Šilutės Rambynas	477
AB Klaipėdos Pienas	830
UAB Gimtinės Pienas	40
	<u>1,504</u>

ii) Purchases

2004

AB Žemaitijos Pieno Investicija	2,496
ABF Šilutės Rambynas	3,428
UAB Baltijos Mineralinių Vandenių Kompanija	60
AB Klaipėdos Pienas	2,940
UAB Žemaitijos Prekyba	177
UAB Gimtinės Pienas	3,547
	<u>12,648</u>

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25 Susijusių šalių sandoriai (tęsinys)**iii) Year-end balances of accounts receivables**

	<u>2004</u>
ABF Šilutės Rambynas	2,727
UAB Gimtinės Pienas	<u>80</u>
	<u>2,807</u>

iv) Year-end balances of payables

	<u>2004</u>
AB Žemaitijos Pieno Investicija	1,270
AB Klaipėdos Pienas*	3,533
UAB Baltijos Mineralinių Vandenių Kompanija	8
UAB Žemaitijos Prekyba	34
UAB Gimtinės Pienas	<u>330</u>
	<u>5,175</u>

* AB Klaipėdos Pienas has granted non-current interest-free loans to ŽŪK Sodžiaus Pienas and ŽŪK Tarpučių Pienas. The loans should be repaid till 31 December 2006. As of 31 December 2004 the loan to ŽŪK Sodžiaus Pienas amounted to LTL 1,340 thousand, and the loan to ŽŪK Tarpučių Pienas amounted to LTL 700 thousand. These loans are accounted in the non-current payables caption in the Group's financial statements.

Remuneration of the management and other payments

The Group's management remuneration amounted to LTL 1,436 thousand in 2004 (LTL 1,388 thousand in 2003). In 2004 and 2003, the management of the Company did not receive any loans, guarantees; no other payments or property transfers were made or accrued.

26 Subsequent events

After 1 April 2005 UAB Baltijos Mineralinių Vandenių Kompanija will start selling mineral water (currently these sales are conducted by AB Žemaitijos Pienas).