

A O A V T O V A Z
A N N U A L
R E P O R T

1999





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This annual report is a presentation version of the annual report of AO AVTOVAZ which was approved by the General Shareholders' Meeting on 27 May 2000. The AVTOVAZ Group mentioned hereinafter is the parent company (AO AVTOVAZ) and all of its subsidiaries. The references "we", "us", "AVTOVAZ", etc., may be applied to both the AVTOVAZ Group and AO AVTOVAZ depending on the context. All the figures used in reference to AO AVTOVAZ are shown in accordance with Russian statutory legislation, if not indicated otherwise. All the figures used in reference to the AVTOVAZ Group are shown in accordance with International Accounting Standards (IAS).



The Group's operating highlights for 1999



The Group's Operating Highlights for 1999

Indicators	1999	1998	Change
Vehicle unit sales	000's units	000's units	%
Domestic market	618	522	18.4
Export market	48	69	(30.4)
Total	666	591	12.7
	RR million	RR million	
Net sales	63,071	62,982	0.1
Operating income (loss)	25	(11,661)	100.2
	RR million	RR million	
Consolidated Statement of Operations	Year ended 31 December		
Net sales	63,071	62,982	0.1
Cost of sales	(52,376)	(57,929)	9.6
Gross profit	10,695	5,053	111.7
Operating and other income and expense	(2,591)	(5,916)	56.2
Financing income and expense	(7,254)	(5,931)	(22.3)
Net income (loss) for the year	850	(6,794)	112.5
Consolidated Balance Sheet	At 31 December		
Cash and cash equivalents	2,676	3,048	(12.2)
Other current assets	19,054	23,467	(18.8)
Non-current assets	63,139	63,155	0
Total liabilities	55,139	60,941	(9.5)
Minority interest	5,167	5,047	2.4
Total shareholders' equity	24,563	23,682	3.7

From 1 April 1999, AO AVTOVAZ has completely eliminated barter transactions.



Chairman's Address





The pace
of change in the
development of the
automotive industry
world-wide has never
been faster,
nor competition
more intense.



AVTOVAZ

in the 21st century

Address of V.V. Kadannikov, Chairman of the Board of Directors

In 2000, AVTOVAZ celebrates the thirtieth anniversary of the production of our first car. I am personally proud to have been associated with AVTOVAZ since those early years.

During that time I have had the privilege to work for the Company at every level, beginning as an engineer, and eventually being elected General Director in 1988. We have achieved great successes during these past thirty years and can take pride in our achievements. However, the challenges of the next years will be very different from what we have seen before.

The pace of change in the development of the automotive industry world-wide has never been faster, nor competition more intense.

«Globalisation» is affecting every aspect of the industry. Major manufacturers of cars and components are forming alliances with one another, and consolidating their businesses.

Each year, if not each month, our competitors are fewer, bigger and more efficient.

Just like our major competitors, the AVTOVAZ Group has had to restructure itself to meet the new challenges of this competitive environment. We will have to continually evolve to keep pace with the industry and ensure we make our next thirty years as successful as our first thirty years.



I am confident that AVTOVAZ will continue to be recognised in the future as the foremost automotive company in Russia – leading the way in producing high quality cars, best adapted for Russian conditions, for the majority of Russian citizens, at prices they can afford. To bring this vision about, AVTOVAZ will become more than ever before a consumer oriented company, under-



Ideas, traditions,

development

standing and responding to our customers' needs. We will continue to improve the quality, reliability, safety and environmental cleanliness of our cars. We will provide a high quality and wide range of after sales service to our customers.

We have already made great progress in designing our next generation of cars. Our immediate challenge is to raise the resources necessary to bring these cars into production.

To bring this about, we are actively pursuing every option open to us, including forming strategic alliances with a variety of leading foreign automotive partners.

As the leading manufacturing company in Russia, AVTOVAZ has a great responsibility to contribute to the revival of the nation's economy. I believe we have the ability to overcome the many difficulties we face, and build a prosperous Group for the future. I am committed to seeing this achieved.



3

President – General Director's Message





It is our mission to consolidate the AVTOVAZ Group's position as the market leader in the Russian automotive industry for the long term, providing quality cars to the Russian people at prices they can afford.

*Message of A.V. Nikolaev,
President – General Director*

1999 was a difficult year for AVTOVAZ and the overall AVTOVAZ Group and so I believe the results we achieved despite these difficulties reflect great credit on the efforts of our management and employees.

Today, AVTOVAZ is a leading Russian company, the seventh largest by turnover. We maintain leadership in the industry selling 70–80% of passenger cars in Russia. This year especially our Group has felt the impact of profound changes both in the world automotive industry and Russian economic environment.

International industry experts believe that annual world output will grow from 52 million cars today to 62 million cars in 2006. At the same time, world production capacity can produce more than 80 million cars in 1999 and is expected to be able to produce more than 83 million cars by 2006.

This situation in the automotive industry world-wide is driving the globalisation of production. Major car manufacturers are merging and consolidating their operations on a large scale, resulting in fewer, larger and more powerful companies. In the near future we expect the world-wide automotive market will be dominated by just 5–6 multinational vehicle manufacturers.

Objectives and tasks



These multinationals have a global sales strategy and aim to sell in all markets of the world. This will lead to tremendous economies of scale for them and the accumulation of resources required for the all-important work both of research and development and production modernisation to satisfy the ever increasing demand for improvements in quality and specification required by consumers.

In the process of globalisation:

- World class automobiles are ever more rapidly improving in quality, reliability, safety and ecological cleanliness;
- New models are introduced more rapidly, and tailored more closely to customer needs;
- At the same time, costs are driven down relentlessly .

These same giant multinational auto firms are actively looking to invest in developing economies as part of their globalisation strategies, and are seeking strategic partners within Russia just as they have already done outside of Russia. At a time when Russian manufacturers are short of resources, and particularly cash, to fund their new generation of cars, major multinationals have the cash, resources and know-how, and the strategic commitment to work with Russian producers to develop this market jointly. This is true not just for car but also for component manufacturers.



Therefore there will be significant opportunities for us to form strategic alliances with a variety of foreign partners.

The financial crisis of August 1998 not only reduced the real purchasing power of our customers, but it also dealt them a cruel psychological blow. Many of our potential customers lost their life savings in bank defaults, or lost their jobs. In circumstances like these people do not feel inclined to make a major purchase such as a new car. Thus, we have had to struggle with this weakening of demand in the market throughout 1999.

Not only was demand weakened, the crisis also led to a sharp increase in costs of imported components and

of main materials from domestic suppliers whose prices increased by significantly more than the general level of inflation. These factors combined to bring about persistent cash shortages at our company. The management of AVTOVAZ has had to spend a considerable amount of time and effort to overcome short-term difficulties resulting from the crisis in Russia often to the detriment of focussing on the implementation of our company's strategies.

The August 1998 crisis also led to a collapse of trust amongst investors in Russian banks and Russian business. As a result, lending from Western banks virtually dried up and foreign investments were cancelled or put on hold.

O B J E C T I V E S



We also have to deal with an unstable legal basis for foreign investments. This has led to extremely low levels of foreign investment in Russia in comparison for instance to Poland or Hungary. One main reason is fear of a lack of protection for shareholders in their investments.

At the same time as we are struggling to break even in difficult economic conditions, we have to pay high levels of tax. AVTOVAZ is one of the major taxpayers in Russia. In 1999, we succeeded in ensuring stable operations despite an onerous tax regime.



Speaking about the tax issue, I must emphasise the significant support AVTOVAZ received from the Russian government in helping to restructure our tax debts.

The examples below illustrate our difficulties in this regard:

– turnover taxes are charged whether or not the company makes a profit. This tax eats into the cash resources AVTOVAZ needs to develop its next generation of cars, delaying the introduction of better and more profitable cars;

A N D T A S K S



– taxable profits are often in excess of accounting profits because many legitimate business expenses remain non tax deductible;

– there are only limited tax incentives for capital investment. Most capital investments have to be made from that insignificant part of profit that remains once all taxes are paid. This is far from being enough for our needs to develop our production capacities.



AO AVTOVAZ is awarded the «Russian Car of the Century» certificate.





O B J E C T I V E S

It should be noted that the crisis had some positive impact on our business as the fall in the rouble/dollar rate in August 1998 temporarily priced foreign cars out of our market. This gave us some space to breathe.

The continued relative insulation of Russia from the world's division of labour and commerce is only temporary and partial, and in the medium term we will see foreign cars once again selling competitively in Russia.

Moreover, we believe in the short term there will be increasing competition for us to resist from second hand imported cars.

However, we do see some opportunities and those could be very significant for the AVTOVAZ Group going forward.



Firstly, we have a new President.

We believe the new government will be committed to proceeding with reforms of the tax system and legislation to tackle some of the problems we have outlined above.

A N D T A S K S

We hope the new government will also show a similar commitment to working to attract foreign investment and creating an environment to attract Russian investors into the manufacturing industry in Russia.

We do see and highly appreciate the new government's commitment to normalising relations with western financial institutions, including the restructuring of past debt, and have good reason to believe that business confidence in Russia will be restored.

Secondly, we have tremendous potential for growth in the automobile market in Russia. Car ownership per person in Russia is at one of the lowest levels in the world, let alone by comparison with Europe. If car ownership levels were to grow to even half of those elsewhere in Europe, we could see rapid growth in the annual market for new cars.

Potential for growth in the Russian market forecast over the next 10 years, even with fairly modest assumptions for growth in GDP, is in the order of 60%-100%. This is well in excess of growth possibilities in most western markets, because these markets are already at saturation level.



In 1999, AVTOVAZ has had to completely rethink its strategy in the light of the above combination of developments in the world automotive industry and the Russian economy. Before we could embark on developing any serious post-crisis strategy we have had to reshape the management system in the AVTOVAZ Group. We needed a management structure that enabled us to react more flexibly to the rapidly changing environment of the Russian economy. This internal restructuring has taken place over the past year and a half, and is continuing.



The most essential tasks of the current reforms have been to:

- establish within the AVTOVAZ Group a Corporate Centre which will develop a uniform strategy and provide strategic management;
- streamline the organisation of management of the parent company and its subsidiaries in the areas of production, investment, and financial management;
- re-organise the management of business entities comprising the AVTOVAZ Group;
- organise operational management of business entities by functional divisions of the Corporate Centre;
- ensure effective implementation in all the Group's business units of vertical management functions – marketing and sales, investment and finance management, personnel and quality management;
- ensure clear communication between functional divisions of the Corporate Centre and all business entities.

Business planning and control have been subject to significant restructuring, and the system of management of subsidiaries has started to undergo drastic changes.

We established a Corporate and Strategic Management Function to be run by the First Vice-president, V.A. Vilchik. All divisions involved in planning at the AVTOVAZ Group, from strategic planning to resource planning, have been consolidated. Principles of work with dealers and technical subsidiaries have been revised. We have begun to pay much more attention to advertising and promoting our goods in new markets.

We have also put significant efforts into improving our component supply system. Amongst our achievements in this area are:

- for each of over 80% of parts and components we have chosen just 2–4 suppliers
- continued efforts to substitute imported components with domestic production contributed significantly to a reduction of production costs at AVTOVAZ in 1999 by RR 316 million compared with 1998
- suppliers are implementing a new quality management system based on ISO 9000.

AVTOVAZ is actively establishing business entities within itself, which is crucial for the new system of cost management.

Our strategy has five clear elements which will combine to enable us to develop our next generation of cars and enable AVTOVAZ to secure its continued leadership of the Russian automotive industry for the long term.



A V T O V A Z ' S M I S S I O N

Strategic direction of AVTOVAZ for the long term is comprised of five elements as follows:

1 *Developing a modern management system of the AVTOVAZ Group*

We will establish within the AVTOVAZ Group a Corporate Centre which will provide strategic management for all the Group's business units. We will ensure maximum efficiency and communication between the Corporate Centre and the business units.

2 *Improving the financial condition of the Group and reducing costs while maintaining full employment*

AVTOVAZ inherited large debts from the Soviet era which have encumbered its balance sheet throughout the 1990s. In addition, large tax liabilities arose resulting from an excessively onerous tax regime in 1991–1993, which were then compounded by fines and penalties for non-payment. The combination of these liabilities and chronically low levels of profitability have been a serious threat to the financial viability of the Group.

We intend to make the AVTOVAZ Group attractive to investors. This will involve restructuring large tax and bank debts, increasing annual levels of profitability, and developing a prudent but consistent dividend policy.

The AVTOVAZ Group will focus on increasing returns to investors by increasing revenues through replacing older production with newer, higher value-added models, and by perpetually reducing costs.

We will rigorously assess capital expenditure proposals and prioritise projects by their expected returns. We will demonstrate our commitment to financial transparency and accountability by publishing our annual reports and audited IAS financial statements.

3 *Establishing a well-developed network of high quality dealers and corporate network of services*

In 1999, AVTOVAZ solved a very important task – the elimination of barter transactions. There was an acute need for this as barter transactions disturbed our sales by flooding the market with cut-price products sold by counterparties to barter deals. We still have to work closely with customs authorities to prevent the re-import of our cars at low prices into the domestic market. We have had to restructure the distribution network to gain greater control over sales. Our new dealership network is linked by one computer network to enable rapid «on-line» communication of information from across Russia.

We should improve the level of feedback from our customers about what kind of cars they want to spend their money on, because if we fail to do this any attempt to implement production to order is unlikely to be successful.

We will also improve the level of feedback on the quality of our after sales service. This will in turn enable us to produce cars more closely aligned with customer requirements.



A V T O V A Z ' S M I S S I O N

4 *Revival of export markets*

Our export markets shrank year by year up to the August 1998 crisis as a result of the overvaluation of the rouble pricing our products out of foreign markets. However, the crisis has once again opened up good possibilities for the Group to sell its products overseas.

We believe a healthy export business is vital to the development of the Group as a whole, because it enables us to maximise the level of production without saturating the domestic market, and it gives us access to much needed hard currency earnings to purchase the equipment needed for the next generation of our cars.

5 *Active pursuit of alliances with strategic partners in various areas of our activity*

AVTOVAZ is open for co-operation. We will pursue alliances with foreign component producers to upgrade the quality of all cars we produce. We will obtain maximum benefit from their know-how and research and development capabilities, together with the cash and equipment they bring to our business. In return, we will offer them the opportunity to establish themselves in one of the few remaining growth markets in the world.

The above elements of our strategy are designed to work together to deliver the resources required for our medium term programme of capital investment. This investment will, in turn, enable us to bring to production the next generation of AVTOVAZ cars. This generation of cars, and just as importantly the business processes across the AVTOVAZ Group by which they will have been realised, will establish a sound competitive basis for our future.

It is our mission to consolidate the AVTOVAZ Group's position as the market leader in the Russian automotive industry for the long term, providing quality cars to the Russian people at prices they can afford.



4

Background to the Company, Strategic Guidelines





In 2000, the year of the thirtieth anniversary of the first VAZ–2101 vehicle, this car was recognised as the Russian Car of the Century following a survey sponsored by the Russian automotive magazine «Za Rulyem» (Behind the Wheel).

1970
Thirtieth anniversary of the first vehicle produced

2000



HISTORY AND PRIVATISATION

On 19 April 1970, the first VAZ–2101 vehicles were assembled at the factory whilst construction of the factory was still in progress. This was the dawn of large-scale production of light vehicles in the USSR.

In 2000, the year of the thirtieth anniversary of the first VAZ–2101 vehicle, this car was recognised as the Russian Car of the Century following a survey sponsored by the Russian automotive magazine «Za Rulyem» (Behind the Wheel).

On 20 July 1966, the Government of the Soviet Union decided to build the Volga Automobile Works.

On 14 January 1967, the first shovel of earth was removed to lay the foundation for the first building of the factory, the Precision Tooling Division, and on 19 April 1970 the first VAZ produced vehicle was assembled. At that time, VAZ vehicles were named «Zhiguli» following a contest organised by the Sovetskaya Rossia newspaper called «Name the Car».

In June 1974, the «Volga Automobile Works», as it was then called, was awarded the internationally renowned prize «Intersoll–Rand» in recognition of its achievements in large-scale production. By the end of 1974, the factory reached projected capacity with three assembly lines in full operation, each producing 220,000 cars annually.

The factory's annual capacity is 660,000 cars. A new car leaves the assembly line every 22 seconds. 2,230 vehicles are produced at AVTOVAZ each day.

By 1985, the factory had established seven production divi-

sions located at one site– Foundry, Sub-assembly, Small Press, Final Assembly, Machine Building, and Precision Tooling.

In 1980 the in-house designed VAZ–2121 «Niva» was awarded gold medal at the 52nd International Fair in Poznan, Poland. To produce the «Niva» model, a separate assembly facility was built.

On 5 January 1993, an Open Joint Stock Company «AVTOVAZ» (AO AVTOVAZ) was established on the basis of the enterprises forming the Volga Associated Automobile Production Works. At that date, the Company's charter, privatisation plan, and Board of Directors were approved.

Vladimir Vasilyevich Kadannikov was appointed General Director and Chairman of the Board of Directors.

Among the largest manufacturing enterprises wholly owned by AO AVTOVAZ are OAO «AvtoVAZagregat», OAO «AvtoVAZtrans», OAO «Dimitrovgradski Avtoagregatny Zavod» (Dimitrovgrad, Ulyanovsk Region), OAO «Serpukhovskiy Avtomobilny Zavod» (Serpukhov, Moscow Region), OAO «Skopinski Avtoagregatny Zavod» (Skopin, Ryazan Region).

In total, AO AVTOVAZ owns 1,196 properties. AO AVTOVAZ owns shares in 238 subsidiaries and associated companies, and shares in another 27 companies where the Company's holding is less than 20%.



HISTORY AND PRIVATISATION

As at 31 March 2000, the statutory value of the Company's share capital is equal to RR 16,062,482 thousand. It is divided among 32,124,964 shares of equal nominal value and comprises of 27,194,624 ordinary shares, and 4,930,340 Type A preference shares. Nominal value of each of these shares is RR 500.

Information on share issues

Issue and year of issue	Number of state registration	Quantity and category of shares	Status of issue
First issue – 1993	42-1n-0164	5,354,161 preference type A 6,424,993 preference type A 9,637,489 ordinary	cancelled as a result of conversion
Second issue – 1994	МФ 42-1-0283	10 708 321 ordinary	cancelled as a result of conversion
Second issue – 1998	2-02-00002-A	4,930,340 preference type A	placed
Third issue – 1998	1-03-00002-A	27,194,624 ordinary	placed
Fourth issue – 1999	1-04-00002-A	32,124,965 ordinary for the restructuring of the debt to the budget	deemed non-existent, cancelled
Fifth issue – 2000	1-05-00002-A	32,124,965 ordinary for the restructuring of the debt to the budget	outstanding**

**– outstanding because shares of AO AVTOVAZ are subject to obligations under a contract for restructuring of debt to the federal budget in favour of the Russian Fund of Federal Property.

As at 31 March 2000, legal entities held 60.97% of the share capital of AO AVTOVAZ, individuals held 29.19%, nominal holders held 7.79%, federal government held 2.05%. During 1999, there have been no significant changes among the shareholders. The total number of shareholders increased from 192,866 registered entities to 200,310.

This increase is a result of the exchange of share depository certificates of OAO All-Russia Automobile Alliance (AVVA) for shares of AO AVTOVAZ. The percentage of individuals in the share capital of the Company has decreased from 30.63% to 29.19% as a result of shareholders selling the shares. The percentage of the Company's shares held by nominal holders has significantly increased, from 1% to 7.79%.

This fact, however, demonstrates an increasingly growing number of the Company's shares traded in the open market at the RTS Stock Exchange and the Moscow Inter-bank Currency Exchange (MICEX). During 1999, the Company's shares were amongst the most undervalued by the stock market. The total value of trading at the RTS Stock Exchange is US\$ 80,000, and US\$10,000 at the MICEX.

AO AVTOVAZ's short-term strategy for developing a market for its shares is:

- optimise shareholder relations;
- improve securities market infrastructure;
- proactively work with professional securities market participants.



VEHICLES

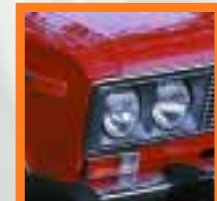
Since 1968 the Company's designers have been developing a new generation of cars for the Russian market with its harsh weather and road conditions.

In 1971, the fastest Russian vehicle VAZ-2103 was produced. It was subsequently replaced by the famous «Six» model. Notwithstanding its outdated design the demand for this model remains stable.

In 1977, a new four-wheel drive car VAZ-2121 entered the market. This innovative car was fully developed by AO «AVTOVAZ». An off-road vehicle with outstanding cross-country ability, VAZ-2121 was recognised world-wide after it had proved its ability to run in any climatic zone, from the Karakumy Desert to the Arctic. In Australia, for instance, there is still a «Niva» fan club which periodically organises cross-country races. In 1989, the crew comprising Ickx and Pock, Jr., participating in the Rally of Pharaohs won the third place with a VAZ-2121 «Niva». In 1989, AVTOVAZ was the fourth in the overall ranking of automobile companies participating in car races.

In 1984, full-scale production of the front-wheel drive VAZ-2108, the first car of the «Samara» family, commenced. This vehicle was also developed in-house. ZAZ and

FOR RUSSIAN ROADS



AZLK also made attempts at developing a front-wheel drive car but they failed to outperform AVTOVAZ. Within three years, the «Eight» model was enhanced with a five-door modification, VAZ-2109, and in the early 1990s the family was expanded with the sedan VAZ-21099.

AVTOVAZ is currently approaching the projected capacity of VAZ-2110 (220,000 cars per year). The vehicles from this family represent a break-through in the domestic automotive industry in areas such as safety and ecology which are vital factors in the automotive market throughout the world.

These vehicles are equipped with a new range of in-house produced 16-valve electronically controlled engines. They are also fitted with a ventilated braking system. It is planned to equip certain modifications with safety bags and ABS. These cars comply with contemporary requirements of comfort and fuel efficiency.

According to the results of a survey carried out by the «Za rulyom» magazine, VAZ-2110 ranked third as a Russian car of the century.



Rally marathon

Paris – Moscow – Beijing – 1996.

Silver medallists of the super marathon
A. Nikonenko and S. Talantsev
driving the LADA SAMARA T3.

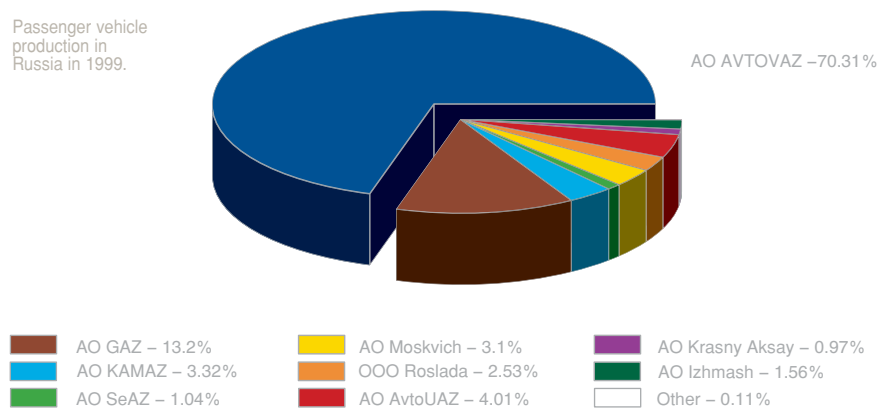


AVTOVAZ WITHIN THE RUSSIAN AUTO MARKET

Production of LADA cars is developing on the basis of technological innovation. From the birth of the concept of a future car designers, stylists and manufacturing engineers are striving not only to make it attractive but also to make it comfortable to drive, simple to manufacture and fuel efficient.

The Russian automotive market is one of the most promising markets in the world. Expert estimates indicate that its capacity, despite current economic difficulties, is considered to be in the range of 1.5–2.0 million vehicles a year. The worst period for Russian automakers was 1998. At that time the country was flooded by second-hand foreign makes as a result of the artificially low Rouble/Dollar rate.

Whilst AVTOVAZ was forced to reduce export levels from 300,000 vehicles a year to less than 100,000, it continually increased output to a 30-year record of 740,000 in 1997. In 1999 the Russian auto industry accounted for 960,000 cars with AVTOVAZ's share being more than 70%.



The competitive strengths of AVTOVAZ which underpin its domination in the industry are:

- Well established price/quality ratio optimal for the Russian market;
- Well developed service network;
- Mass production best practices;
- Availability of pilot production facilities used as a testing ground for pilot projects;
- High concentration of necessary resources for car assembly operations.

Despite many difficulties, AVTOVAZ has retained its dominance of the market and is the unrivalled leader in terms of the price/quality ratio which is the key factor in the domestic market. Owing to its professional approach to managing this ratio, AVTOVAZ has carved out a major share of its home market.



FOR RUSSIA AND SAMARA REGION

According to the rating prepared by the Russian rating agency «Expert RA» published in the «Expert» magazine issue 36 for 1999, AO AVTOVAZ is the seventh largest in Russia by turnover and the second among companies most undervalued by investors.

More than 110,000 employees currently work at the main production facilities of AO AVTOVAZ and total Group's workforce is 204,000.

In addition, AO AVTOVAZ buys components from more than 700 domestic suppliers. Some of these companies are fully dependent on orders from AO AVTOVAZ. In various ways, we estimate 15 million Russian people are associated with goods produced by AO AVTOVAZ.

AVTOVAZ is a key company for Togliatti and its 750,000 population. In 1999 alone, AO AVTOVAZ paid in taxes RR 10,052 million to various state agencies.

In all the above ratings, AO AVTOVAZ is outperformed only by companies of the energy industry, leaving other manufacturing companies far behind.



First trademark of VAZ vehicles.

Our first vehicle, the VAZ 2101, of the AVTOVAZ family.



In the economy of the Samara region the automotive industry, and its leading company AO AVTOVAZ, play a key role by providing 40% of total production of the machine-building industry in the region. It also promotes the development of automotive-related industries, boosts the implementation of advances in science and technology, assists in the development of the regional transport infrastructure and technical services.

In 1999, about 190 suppliers of AO AVTOVAZ were located in the Samara region. The companies located in the Samara region supply about 40% of all purchases of components and raw materials made by AVTOVAZ.

The automotive industry is a vital part of the economy of many countries helping to overcome economic crises. Nations leading in car production are also leaders by gross domestic product and production output.

As world practice shows, one job in machine building provides 7–8 jobs in related industries, and, combined with the services industry (trade, technical service, and repair), – up to 10 jobs.

The management of AVTOVAZ are fully aware of how important is the contribution of AVTOVAZ to the Russian economy. Hundreds of thousands of jobs throughout Russian industry depend on AVTOVAZ's success in maintaining stable production and growing its business.



M I S S I O N , S T R A T E G Y



The AVTOVAZ Group's mission is to:

Consolidate the AVTOVAZ Group's position as the market leader in the Russian automotive industry for the long term, providing quality cars to the Russian people at prices they can afford.

To achieve this mission, we have set ourselves a number of strategic tasks as follows:

- establish within the AVTOVAZ Group a Corporate Centre which will develop a uniform strategy and provide strategic management;
- establish an efficient system for the management of the Group's property by establishing business units and ensure effective implementation in all its business entities of integrated functions of marketing and sales, investment and finance management, personnel and quality management;
- ensure that changing consumer preferences are addressed in a timely manner in the development of new models, and reduce the time required to replace and modernise the model range;
- actively look for opportunities to form strategic alliances with large investors in a variety of areas of our activity;
- rigorously pursue improvements in the quality of our products;
- ensure that our products comply with the latest requirements of environmental safety;
- improve the financial condition of the Company and reduce costs while maintaining full employment;
- restructure our dealership network;
- revive the export market.

In 1998, we launched a process aimed at restructuring our operations, which has resulted in a revised philosophy of how the AVTOVAZ Group does business.

The whole management system of AVTOVAZ has been changed to be more responsive to the specific requirements of our consumers.

We have created a strong function of marketing and market research, monitoring macroeconomic trends in the market.

We have established prompt feedback from our customers through our dealers and service companies.

This provides the basis for a flexible plan of operations which is then transformed into production programmes and model upgrade strategy.



A N D R E F O R M



Nikolai Vasilyevich LYACHENKOV,
First Vice-president - First
Deputy General Director.

We have established a Corporate Centre to develop long term strategy. To ensure this strategy is executed in practice, we have completely reorganised the structure of our management to streamline and integrate the core functions of our business: marketing and sales, production and quality control, finance, personnel and investment. Building the long term success of our business is the key objective of everybody at AVTOVAZ.



AVTOVAZ's team
of mountaineers
on the Everest summit



To achieve the objectives of its new business philosophy, the AVTOVAZ Group has changed its production planning system together with the system of materials and components supplies.

In particular, we are establishing component and material suppliers' consignment warehouses in the vicinity of the production site, which will enable the reduction of stock levels. This will assist the AVTOVAZ Group to use its working capital more efficiently and respond more promptly to changing consumer requirements.

In addition, we have begun to substitute imported components with domestic ones, and are providing comprehensive support to Russian suppliers to enable them to produce these components. We are working towards implementing a system of larger sub-assembly supplies.





5

Overview of the Year



IMPACT OF THE FINANCIAL CRISIS AND RESTRUCTURING OF DEBTS

The efficient operations of our company have been affected by the fluctuating demand for our cars, which was largely driven by external factors. At the end of 1998 and in the first quarter of 1999, the dramatic growth of the Rouble/US dollar exchange rate made our cars more competitive and allowed us and our dealers to reduce the build-up of stock, increase prices (by 33% between January and May 1999), reduce costs of materials and increase overall profitability.

In 1999, AVTOVAZ fully settled its liabilities for restructured and current payments to the budget on a timely basis. These liabilities will continue to be settled on a timely basis in the future.



Mikhail Valeryevich
Moskaiev
Vice-president Finance.

The Company used the resulting cash to eliminate barter from April 1999 onwards.

However, the rise of the US dollar exchange rate led to a significant increase in petrol prices (which grew approximately 3 times), which severely undermined the retail business and reversed the results of our efforts to improve AVTOVAZ's post-crisis financial situation. Dealers, who suffered losses on bank debt, were forced to lower retail prices significantly and reduce wholesale purchases of cars made from the factory from mid-July 1999. This resulted in a further build-up of stock, reduction in cash collections and cash flow problems for the Company. In response, the Company developed and promptly implemented new methods of debt finance using bills of exchange, which helped to raise about RR 3,000 million. This allowed the Company to mitigate the effect of the dramatic rise in petrol prices.

Long term and short term taxes payable to the budget by AO AVTOVAZ amounted to RR 16,706 million at 31 December 1999, (RR 19,810 million at 31 December 1998).

In accordance with Decree No. 254 of 5 March 1997 and Decree No. 1316 of 15 October 1997, in the reporting year AO AVTOVAZ made contracts on restructuring of tax liabilities to the budget and non-budget authorities.

As disclosed in Note 12 to the consolidated financial statements long term taxes payable comprise various taxes that have been deferred up to ten years.

As part of the condition of restructuring the federal taxes, the Company was required to register an issue of additional shares of AO AVTOVAZ covering 50% plus one vote at a general shareholders' meeting and transfer them to the Russian Federal Property Fund («RFPF»). These shares will be auctioned by the government in the event that the Company makes no payment on these restructured taxes within two months after the due date of its payable or if the Company has more than two late payments within a period of 12 months (see Note 14 to the consolidated financial statements).

To optimise its taxation, AVTOVAZ submitted its proposals to the State Duma (lower house of Russian parliament). These proposals include the conversion of the restructured debts into production development investment. To support its case, AVTOVAZ prepared feasibility studies and identified areas for investment. In addition, the Company proposed to include R&D expenses in tax-deductible vehicle production cost, abolish turnover taxes, extend the terms for foreign currency revenue repatriation under export foreign currency denominated contracts up to one year.



PRODUCTION AND DISPATCH

In 1999, 677,687 cars were produced, which represented 103.1% of planned output and was an increase of 83,165 units (14%) over 1998. The Company produced 116,876 VAZ-2110 cars (including a balance of incomplete cars from 1998), a 184.4% increase compared to 1998.

51,572 vehicles were assembled for export markets as opposed to the planned 65,000 units, which is 17,260 cars lower (25.1%) compared to 1998. In 1999, 47,906 vehicles were shipped to export markets.

The rate of production at main assembly lines in 1999 was 166.35 cars per hour as compared with 158.42 cars per hour in 1998, an increase of 6% on 1998.

Car assembly at main assembly lines of AO AVTOVAZ in 1999:

Model	Plan (units)	Actual (units)	Variance (%)
Total Cars	657,043	667,735	1.6
Including cars with electronic engine control system	200,798	118,174	-41.1
VAZ-2110	120,152	116,699	-2.9

In addition to the vehicles produced at the main assembly lines of the factory, the Pilot Production Division of the Research and Development Centre of AO AVTOVAZ assembled 5,717 units of the long-base five-door «Niva» VAZ-2131 model and its modifications.

AO AVTOVAZ produced spare parts with a value of RR 1,588 million (in accordance with IAS) and 26,264 automotive assembly kits with a value of RR 2,678 million (in accordance with IAS).

Shipment of cars produced at main assembly lines during the year was as follows:

Model	Domestic market	Export	Total
21043	49,471	3,618	53,089
21053	54,381	1,714	56,095
2106	78,158	4,524	82,682
2107	87,972	4,111	92,083
2108	18,051	290	18,341
2109	82,112	3,426	85,538
21099	91,698	5,432	97,130
2110	84,765	16,266	101,031
2111	13,601	1,615	15,216
21213	58,064	6,910	64,974
TOTAL	618,273	47,906	666,179

In 1999, the Pilot Production Division of the Research and Development Centre of AO AVTOVAZ re-equipped and re-adjusted 6,355 vehicles which had been produced at the main assembly lines of the factory. These included 254 units of the Diesel engine VAZ-21045 model, 5,091 units of the Samara-2 family VAZ-2115, and 984 vehicles of the VAZ-2111 model and 26 units of the VAZ-2112 model which are part of the VAZ-2110 model family.



OF FINISHED GOODS



Mikhail Nikolaevich
DOBYNDO
Vice-president Production.

The main objectives for the production facilities of the AVTOVAZ Group in year 2000 are to retain production output at the level already reached in 1999 while improving product quality, perpetually upgrading production know-how, promptly responding to ever changing consumer demand, and reducing time needed for replacement and modernisation of the model range.

Cars output by model

Model	Percentage of total deliveries in 1998, %	Percentage of total deliveries in 1999, %	Change (+/-)
21043	8.7	8.0	-0.7
21053	8.6	8.8	0.2
2106	18.9	12.6	-6.3
2107	13.3	14.2	0.9
2108	3.5	2.9	-0.6
2109	12.1	13.3	1.2
21099	14.3	14.8	0.5
2110	10.7	13.7	3.0
2111	0.0	2.2	2.2
21213	9.9	9.4	-0.5



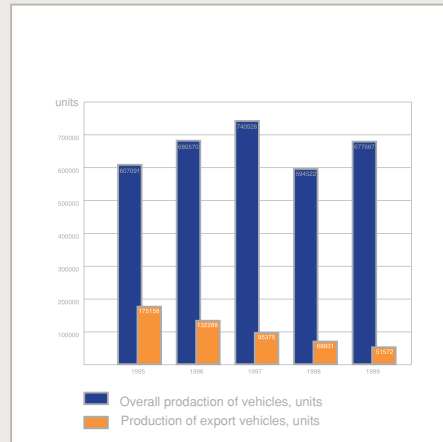
PRODUCTION, ECONOMICS,

Annual car production capacity in 1999 of 730,000 units remained unchanged from that of 1998. The commissioning of VAZ-2110 facilities for 160,000 cars was completed in parallel to the disposal of an equivalent quantity of VAZ-2106 production capacity.

1999 saw an increase in the utilisation of car production capacity to 93%. The percentage of capacity utilisation for metal machining equipment and production fittings increased to 92% compared to 1998. Special production equipment utilisation was reduced to 60%.

Production equipment utilisation of main production divisions was equal to 1.64 shifts. Equipment employed in the production of tools and fittings was utilised during 1.34 shifts (1998:1.12), equipment used in the production of equipment was utilised during 1.18 shifts (1998: 0.92).

Production of vehicles



Production of spare parts (AVTOVAZ)



In 1999, net sales of the Group amounted to RR 63,071 million. In 1999, the volume of goods produced by AO AVTOVAZ amounted to RR 47,462.2 million (historical roubles from production records).

Actual cost of goods produced by the Company was RR 0.7891 to RR 1 as compared to the planned RR 0.7931.

Gross margin increased during 1999 by comparison with 1998 almost completely due to cost savings achieved by the AVTOVAZ Group, since the total turnover remained at the same level as 1998.

Cost of materials and components were reduced by RR 770 million, including RR 316 million as a result of the Company's success in substituting locally supplied components for expensive imported components. Production overheads were also reduced by RR 145 million thanks to efficiencies achieved during 1999. The wages paid by the Company per average pre-assembled vehicle in 1999 increased to RR 4,030 in nominal terms. However, the wages paid by the Company per RR 1 of goods produced reduced to RR 0.0848 compared to RR 0.1147 in 1998, also in nominal terms. Labour costs of the Group were also reduced largely as a result of keeping wage rises below the general level of inflation.

Social expenditures were reduced by RR 738 million.

In summary the above figures show the tremendous efforts made by AVTOVAZ during 1999 to control costs and improve efficiency in order to increase gross margin. These cost reduction efforts are continuing on a permanent basis to improve the profitability of the Group.

The economic crisis following 17 August 1998 significantly affected the Company's pricing. From November 1995 until September 1998 the increase in the average selling price of cars was largely caused by changes in the mix of models and their modifications. However, the past year has been characterised by an overall increase in prices for cars and related spare parts.



COSTS AND PRICES



The average rise in prices of LADA cars in the domestic market since 17 August 1998 was 74.5%, whilst inflation since that date was 133%, demonstrating how much AVTOVAZ absorbed the impact of inflation without passing this on to its customers.



Vitali Andreevich
VILCHIK
First Vice-president
Strategy and Corporate
Governance.

In 1999, the share of the AVTOVAZ Group in the gross domestic product of the Russian Federation amounted to 1.39% including 1.04% that of AO AVTOVAZ.

In 1999, we accrued a total of RR 11,650.4 million in tax payments to all levels of the budget and non-budget funds. The share of AO AVTOVAZ in overall revenues of the Russian budget amounted to 1.16%.

In 1999, the operations of the AVTOVAZ Group were break-even.

Unfortunately, AO AVTOVAZ continues to make losses. However, the Company demonstrates steady and rapid progress to the break-even level.

Domestic price changes by car model:

Model	Price at 1 August 1998, RR	Price at 1 January 2000, RR	Change RR	Change %
VAZ 21043	43,187	66,820	23,633	54.7
VAZ 21053	37,456	58,060	20,604	55.0
VAZ 21061	38,498	67,911	29,413	76.4
VAZ 21070	41,387	66,356	24,969	60.3
VAZ 21083	49,476	91,450	41,974	84.8
VAZ 21093	51,444	93,650	42,206	82.0
VAZ 21093-20	56,602	94,494	37,892	66.9
VAZ 21099	56,088	105,172	49,084	87.5
VAZ 21099-20	60,909	109,745	48,836	80.2
VAZ 2110	62,243	122,720	60,477	97.2
VAZ 21102	66,343	130,752	64,409	97.1
VAZ 21103	71,843	154,820	82,977	115.5
VAZ 21110	*94,285	139,868	45,583	48.3
VAZ 21111	*89,473	133,400	43,927	49.1
VAZ 2115	58,900	120,960	62,060	105.4
VAZ 21213	43,762	76,220	32,458	74.2

* Prices as at 1 January 1999 because these models were not produced in August 1998.

In 1999, overall gross margin of the AVTOVAZ Group was 17%.

Gross margin of vehicles produced was 26.7% at AO AVTOVAZ (representing average cost of production divided by average value of cars at factory prices in historical roubles).

For the first time since 1995, the export of cars became profitable.

This was only achieved thanks to the balanced and diligent effort of the whole team of the AVTOVAZ Group aimed at the reduction of costs. In following this route, AO AVTOVAZ has eliminated all barter transactions since early 1999, which, however, resulted in temporary disruptions in production and sales of goods.

Our target for the coming year is to continue the recovery of the financial position of our company by reducing costs while retaining full employment of the workforce.



NEW GENERATION

The main task for the technical development of AVTOVAZ is to preserve its dominance in the Russian market in the future through the launch of the VAZ-2110 family, and the replenishment of the model range with VAZ-1118 and VAZ-2123. This will enable us to meet both the needs of our potential customers and the requirements of environmental safety.



*Konstantin Grigoryevich
SAKHAROV
Vice-president
Research and Development.*

OF VEHICLES

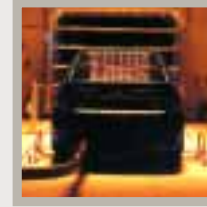
Ever increasing competition requires acceleration of the process of development and launch of production of new models. In February 1997, in recognition of these needs, the Board of Directors approved a schedule of model replacements until the year 2015. The model mix is based on requirements and preferences of various target groups of potential consumers as well as common trends of the automotive industry world-wide. Today, the Company is actively pursuing the implementation of this schedule.



Development of new vehicles at AO AVTOVAZ is guided by the following principles:

- 1 focus first of all on the home market;
- 2 maximum replacement of those production facilities which do not require high technologies or the transfer of such production facilities to other enterprises, thus preparing AVTOVAZ facilities for high technology production;
- 3 establishing common platforms as far as possible whilst at the same time including the maximum possible number of component assembly variations;
- 4 maximum improvement of the quality of goods produced.

READY FOR PRODUCTION



Project VAZ-2110

The output of VAZ-2110 is being continuously increased. There are plans to purchase and build production equipment to support a production capacity of 220,000 cars a year. It is expected that the Company will attain the projected output level for the VAZ-2110/11/12 family in 2002. During 1999, the project was supported by necessary research and development work to enable production at the main assembly line. The Company identified opportunities to produce and found suppliers for new components. The VAZ-2111 model was launched into mass-production. Performance compliance of the VAZ-2111 model was tested for different exhaust systems. Additional component assembly variants were developed.

The Company completed certification and performance compliance testing of the VAZ-2112 model, and adjusted design documentation for design and technology tuning programmes.

In 2000, the factory is expected to start mass-production of the VAZ-2112 model.

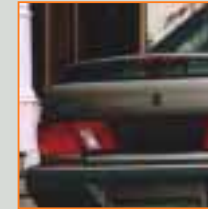


During 1999,
116,876
vehicles of the
VAZ 2110
model were
produced.



Project VAZ-2115

Modernisation
of the
LADA Samara
family



The Company has substantially completed, to the pre-production stage, preparation of the VAZ-2115. This model will replace the VAZ-21099 model. Performance parameters for the VAZ-2113 and 2114 models (other models of the family) were finalised. Active work was done to test prototypes for compliance with safety standards R-35 and R-95. Pre-performance tests were completed and a specimen VAZ-2115 vehicle was prepared for UTAC certification tests. The first commercial batch of vehicles was assembled and technical documents were adjusted for the results of the assembly of five component assembly variants.

The Company carried out research into new materials to be used in the production of the VAZ-2115 model. It is planned to produce 25,000 cars of this model at the main production facilities of the Company during 2000.





Project VAZ-1118

During 1999, the Company developed and issued design documentation for the VAZ-1118, and 1119 vehicles for subsequent improvement testing of the models. The Company developed and issued design documentation to start preparation of production facilities for engine and body systems, electric equipment, body frame, switchboard and sub-assembly components of VAZ-1118 in five component assembly variants.



The concept of a pilot production batch was developed. This batch will be assembled in the Pilot Production Division of AVTOVAZ Research and Development Centre.

The Company is considering options for locating production equipment in order to rationalise logistics, and the use of production capacity and assets.

Suppliers of original components are being identified.

The launch of the VAZ-1118 family represents the key strategic objective of AVTOVAZ in the area of technological development. This family of vehicles should replace the production of the VAZ 2104/05/07 by the year 2004.

Planned output is 220,000 cars a year.

To implement this project the required level of investment is approximately US\$ 1.2 billion.



Project VAZ-2123



In 1999, design work was particularly focussed on finalising pre-production development for the VAZ-2123 family. Key design documentation for the base VAZ-2123 vehicle was adjusted to enable the production of commercial vehicles in the Pilot Production Division of AVTOVAZ Research and Development Centre. Production equipment requirements were identified, and a detailed plan of in-house production of equipment was prepared.

A number of economic estimates were prepared to determine a budget level of costs of production of components both in-house and at suppliers' locations to ensure that the budgeted level of profitability is maintained strictly during the launch of the model. The Company carried out an evaluation of the competitive advantages of the VAZ-2123 vehicle equipped with a two-litre engine.

The Company entered into contacts with a number of suppliers for the preparation of component production. This model is expected to replace the VAZ-2121 vehicle.

Planned output is 70,000 vehicles a year.

To implement this project, the required level of investment is US\$ 500 million.



Project VAZ-2120



In 1999, the Pilot Production Division assembled a pilot batch of the VAZ-2120 «Nadezhda» minivans. The VAZ-2120 is a base model in the family of four-wheel drive minivans designed by AVTOVAZ. This model uses mass-produced components and systems. Thanks to the all-metal carrying body, the original spacious salon can comfortably seat seven passengers. One of the four doors slides to make it comfortable for passengers to get into and out of the vehicle. This also enables easy transportation of relatively sizeable items.

The VAZ-2120 model is suitable for active family recreation and long-distance tourism.

The VAZ-2120 family of vehicles is expected to be comprised of the following variants:

«Furgon» (truck) – a cargo transportation vehicle with a tall roof for transportation of various sizeable cargoes;

«Service» – mobile service station;

«Manager» – special vehicle for business journeys of corporate executives.

The vehicle is equipped with a 4x4 transmission with permanent differential gear to all wheels using components of the VAZ-21213 model.



The «Golf-2» electric car project



Paying much attention to the protection of the environment, the Company is developing a family of electric powered vehicles. The future of electric cars is also being investigated.

To date the Company has finalised revising an overall layout and design project for the «Golf» electric vehicle. The Company assembled a pilot batch of 3 units. The car is designed for use in golf clubs, tourist and resort areas, shopping and exhibition areas, airports, sports events, etc.

Project VAZ-21XX



The Company continued to work on the VAZ-21XX project. According to the results of marketing research, a potential consumer is more inclined to buy vehicles of a bigger class than contemporary LADA models. The planned family of vehicles includes a sedan and a hatchback (bigger by size than VAZ-2110), a minivan, and a sports coupe.

In the near future, LADA models will be represented in all mass sectors and price segments of the Russian automotive market: small urban cars, elegant and economical family hatchbacks, sedans and station-wagons, multipurpose vehicles, off-road vehicles, commercial vehicles, and sports cars for young people.



TECHNOLOGICAL DEVELOPMENT

The Company is in process of shifting its focus to domestic suppliers of components, providing them with assistance to launch new high technology products.

AO AVTOVAZ continues to improve the ecological aspects of its production in the following ways:

- 1 materials and production processes are chosen after considering their environmental impact from an analysis of the vehicle life cycle. Preference is given to materials for which cost effective recycling technologies exist;
- 2 utilisation of hazardous materials and substances such as cadmium, barium, lead, asbestos, fluochlorine hydrocarbon is being eliminated or reduced;
- 3 for convenience of identification of materials in the process of recovery, polymer parts of vehicles have a special marking which meets the German standard VDA-260 generally accepted in Europe;
- 4 design of vehicles enables convenient disassembly of the vehicle, full discharge of all liquids, and sorting of parts by type of material. AO AVTOVAZ is actively involved in designing innovative engines for LADA models. The Company has developed the concept for a family of engines and a schedule for engine model replacement up until the year 2010.

At every stage of the life cycle of research great importance is placed by AO AVTOVAZ on the protection of intellectual property. Unique patents are provided for all innovations and legal protection of the Company's interests with regard to research carried out under contracts made.

Patents defend all the main areas of activity and research of the Technical Development Directorate. In 1999 alone, applications were filed for 70 innovations, 41 models, and 13 prototypes. 23 innovations, 11 models, and 2 prototypes were put into production. Trademarks of AO AVTOVAZ (LADA, NIVA, SAMARA) are registered in Russia and in those countries to which AVTOVAZ makes direct exports.



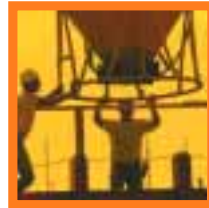
C A P I T A L C O N S T R U C T I O N

In 1999, the Group's capital expenditures on new construction for production and non-production assets amounted to RR 4,556 million.

The total value of assets completed during the year and transferred to production was RR 7,545 million (1998: RR 6,829 million). The bulk of this amount is represented by a production facility for VAZ-2110 with a capacity of 40,000 cars.

The net value of assets under construction is RR 10,479 million as at 31 December 1999. This represents a reduction of RR 2,991 million over the period.

Construction of the testing ground of the R&D Centre of AO AVTOVAZ



In 1999, AO AVTOVAZ transferred to production the following assets (numbers are presented in accordance with IAS):

- start-up facility for VAZ-2110 RR 4,584 million
- R&D assets RR 295 million
- technology modernisation RR 97 million
- assets covered by the employee collective agreement RR 30 million
- other assets RR 1,916 million

All major tasks in the capital construction area were completed in accordance with allocated budgets.



C O - O P E R A T I O N W I T H C I S C O U N T R I E S

It is believed that it takes between five and ten years to conquer a new automotive market. The auto market of the CIS countries is a historically established market for our cars. From the Baltic countries to the Far East, from the Caspian Sea to the White Sea – there is no region where our partners do not work selling and servicing LADA vehicles.

AO AVTOVAZ continues to co-operate with CIS countries where LADA vehicles are widely represented. For instance, notwithstanding a protectionist policy of Ukraine in favour of their own joint venture «AvtoZAZ-Daewoo» in the form of high customs duties and limitations related to import of used foreign vehicles in 1999, 50% of all sales were LADA vehicles.

To maintain our dominant position on the CIS markets, and be a responsible partner for our consumers and suppliers from the CIS countries, is one of the top priority tasks of the AVTOVAZ Group.



Aleksandr Grigoryevich ZIBAREV, Vice-president Co-operation with the CIS countries.



Moreover, having currently considerable idle capacity, JV «AvtoZAZ-Daewoo» is ready to consider proposals regarding the assembly of LADA vehicles by their company.

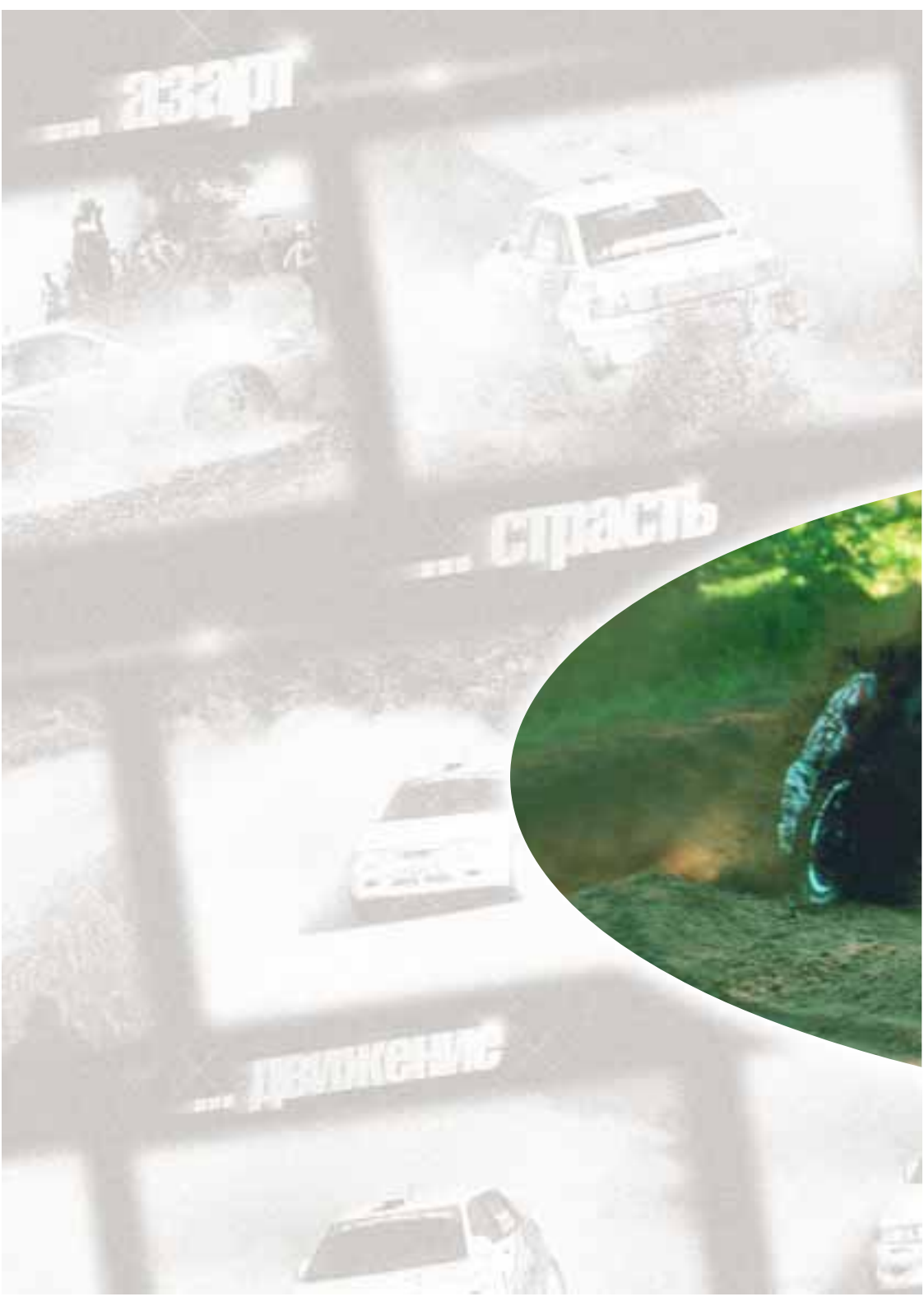
According to preliminary estimates, vehicles assembled in Ukraine will be by more than US\$ 1,000 cheaper than vehicles imported into the Ukraine by AO AVTOVAZ.

With the help of this alliance or the alliance with Lutsk Automotive Company, AO AVTOVAZ plans to secure a

niche in the Ukrainian automotive market. The Asian automotive market of CIS is in a similar situation: the UzDaewoo project did not see any further progress and did not provide serious competition for the more adapted LADA vehicles either in the Asian or Russian market.

To date, AO AVTOVAZ has established working relations with 160 dealers in CIS countries. In 1999, 11,500 LADA vehicles were sold in CIS countries.





ANNUAL REPORT OF AO AVTOVAZ

M A R K E T I N G

In 1999, AO AVTOVAZ completed the reorganisation of the domestic distribution network. This new distribution network is outlined below.

40 regional sales centres have been set up in all large towns across Russia. It is planned to increase the number of sales centres to 50 in the near future.

Each centre has its own network of distributors. Each distributor establishes a network of dealers. 430 dealers have gone through a newly developed standard certification procedure. Of this number, 150 dealers are part of AO AVTOVAZtechobsluzhivaniye and are subsidiaries of AO AVTOVAZ. Regional sales centres accumulate orders from their regional dealers. Based on these orders and the economic forecast for the automotive market, AO AVTOVAZ develops a consolidated car production programme and makes regular corrections to this programme.

AO AVTOVAZ is currently implementing in each of the companies of this dealers' network business planning principles in the form of budgets and estimates of expenses, and control and appraisal of budget execution.

By holding promotion campaigns as part of AO AVTOVAZ's advertising activity, AVTOVAZ will implement a coherent corporate image, and corporate standards of trade and provision of services to customers.

Improvements have also been made in the area of export sales. Geographical coverage of AVTOVAZ's sales is widespread. AVTOVAZ sells to countries of Central and Eastern Europe, as well as Norway, Finland, Sweden, Germany, Switzerland, the Netherlands, France, Italy, Spain, Portugal and Turkey. AVTOVAZ vehicles are also supplied to the Middle East and Latin America.

In Turkey in 1999, VAZ-2110 was named as the fifth most popular car with consumers.

Once the VAZ-2123 and vehicles from the VAZ-1118 family are launched export sales of AO AVTOVAZ are anticipated to grow.

By improving and developing the marketing and sales system AVTOVAZ continues to strive to satisfy all customers' needs whilst appealing to the broadest cross section of the market.



Vladimir Nikolaevich KUCHAI, Vice-president Marketing.



Konela, Representative of AO AVTOVAZ in Finland.

A press conference of senior managers of AO AVTOVAZ at a motor show in Nizhny Novgorod.



A N D S A L E S

The major obstacle to the increase of export sales is the current legislation that requires the payment of foreign currency proceeds to the Company's account within 90 days from the shipment of the first vehicle made under the contract. Unfortunately, it is impossible to meet this requirement given the practical reali-

Together with Sberbank, the company ROSAVTO-Credit was set up. On the basis of the current maintenance network of AO AVTOVAZ, the all-Russia network of branches involved in sales on credit was established. To date this network spans 15 regions in Russia.



It should be noted that the range of emerging services rendered to customers is wide: credit, lease, and special-purpose saving schemes. Sales on credit are designed first of all for those customers who can pay from RR 600 to RR 2,000 each month, i.e. a very broad layer of customer segment. Credit terms vary from several months to five years.

Some other non-traditional methods of sales are being developed, for example, lotteries.

World-wide conference of importers of LADA vehicles.



ties of transportation of vehicles and existing world-wide contractual payment terms.

The total world-wide fleet of LADA vehicles is 12 million units including 8 million vehicles in Russia. 4.5 million of these vehicles have been used for 8 years.

AO AVTOVAZ is actively implementing sales on credit.

The greatest competitive advantage of AO AVTOVAZ in Russia is its extensive maintenance network.



C O R P O R A T E N E T W O R K O F S E R V I C E S



The corporate network of technical maintenance provides warranty, repair and technical maintenance to high professional standards. It liaises with the factory through regular updates about the condition of the car fleet in operation.

The corporate network of car technical maintenance and repair (including certified independent dealers) comprises 8,200 service enterprises.

The corporate network of technical maintenance and repair comprises 196 technical subsidiaries and 675 technical centres that are branches of these subsidiaries in Russia and CIS. They represent 7,039 enterprises with 40,000 employees.

This corporate network can provide maintenance for 6 million LADA vehicles each year.

The number of enterprises dealing with warranties is 148. To date the companies of the technical maintenance network also provide technical maintenance and repair of VAZ-2110, 2111 with the Bosch-Saratov and GM fuel injection systems.

The preparation of maintenance facilities for VAZ-2123, 21045 with domestic diesel engine, and VAZ-21215 with Peugeot diesel engine and climate control systems is in process.

Detailed requirements regarding certification of companies engaged in technical maintenance and production of spare parts for LADA vehicles are being currently developed. The development of standard requirements regarding warranties is also in process.

AO AVTOVAZ arranges training for employees involved in technical maintenance, and provides information about all design and technological changes in the goods produced.



S O U R C I N G O F S U P P L I E S



*Pavel Nikolaevich
SKRINSKY,
Vice-president
Purchasing.*



*AVTOVAZ's suppliers
are part of a very
large team of auto makers.
We will strengthen long-term
co-operation with our suppliers
based on partnership, respect
and justice.*

In 1999, AO AVTOVAZ paid great attention to cost control. With the proportion of materials and components in excess of 60% of the total cost of vehicles, improvements in the Company's profitability depend first and foremost on revising its relations with suppliers.

Between August 1998 and early 2000, cars have become 1.98 times more expensive (including the sharp rise in prices for export vehicles in Rouble equivalent) and components 2.34 times more expensive. AO AVTOVAZ cannot keep pace with its suppliers in increasing prices. Consequently, AO AVTOVAZ has developed and implemented a number of measures aimed at mitigating this problem. In particular, suppliers are being required to reduce the percentage of foreign purchased materials and parts in their goods.

As mentioned earlier, the substitution of imports with domestically produced materials and components in 1999 provided AO AVTOVAZ an economic benefit of RR 316 million. Moreover, as a result of this replacement, up to 50% of all raw materials and components are currently produced in the Volga region.

One of the ways of solving the problems of AO AVTOVAZ could be the National Association of Automotive Components Producers.

It is expected that this association will represent the interests of the automotive industry in general by raising legislative initiatives, and developing unified quality and documentation standards. In addition, this association will aim to attract foreign investment.

The system of multi-tier supplies will continue to develop. This will ensure that whole units and subassemblies will be supplied to AO AVTOVAZ.

Another stage of purchasing system reform will be consignment warehouses in Togliatti where suppliers will store their goods. To reduce the number of monopoly suppliers AO AVTOVAZ is setting up alternative suppliers, and providing them with technological and financial support.



With assistance from AO AVTOVAZ the work related to certification of suppliers has been continued. By the end of 1999, 45 companies that supply metal, materials and components had obtained certificates of compliance with ISO 9000. From this number Volgograd Ball-bearing Factory No. 23 obtained an international certificate of compliance with a more rigid American standard, QS 9000.

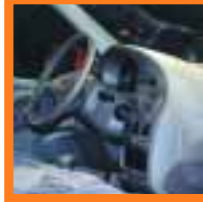
Based on the results of suppliers' assessment and quality forecast work has been started to identify suppliers that do not meet quality requirements. To do this, a committee headed by the Vice-President of Purchasing was established. In accordance with contracts, suppliers are strictly required to obtain certification of their quality system for compliance with ISO.



S Y S T E M O F Q U A L I T Y

One of the most important areas of AO AVTOVAZ activity is improvement of product quality. The Company is taking steps to obtain certification of its quality system to meet ISO 9000 standards. This work is carried out together with UTAC, a well-known international organisation specialised in the audit of quality systems of automotive companies. Preparation for the certification is accompanied by training of personnel and implementation of properly structured documentation, modern information technologies and related computer-aided management systems.

This certification has already been completed in two main divisions, Final Assembly and Sub-Assembly. The main task of certification in our view is not to obtain a mere certificate but to change our underlying way of thinking and acting.



C O N T R O L



Valeri Yakovlevich
KOKOTOV,
Director Quality.

Improvement of the quality of goods produced will continue to be one of the key goals of AO AVTOVAZ in the future, and this is reflected in the mission of our company.



In 1999, the Company formulated and started the implementation of a quality policy whose key tenets are as follows:

- production of quality cars is the key goal of all employees and a vital part of increasing sales;
- vehicles produced should precisely meet the customers' requirements;
- each employee is responsible for the quality of their work. An employee should not decide or act in such a way as to violate our obligations to the consumer;
- relations with suppliers are built upon mutual understanding and co-operation;
- AVTOVAZ provides all possible assistance to its suppliers in order to continue to improve the quality of materials and components.



AO AVTOVAZ uses a system of financial rewards for high-quality work, which is constantly improved.

The development of relations with suppliers on the basis of general quality ideology is a high priority area. Suppliers are assessed on a regular basis.

AO AVTOVAZ continued to help its suppliers to obtain necessary quality certificates.

In 1999, there were no suppliers remaining that received unsatisfactory appraisal, and losses incurred from rejects were consequently reduced. It was noted that quality of cars during the warranty period improved.

The Group's total warranty provision as at 31 December 1999 was RR 1,058 million. During the year, the Group saw a significant decrease in the provision by RR 1,057 million from the previous year. Improvements in the quality of cars and components produced have played a major role in this reduction.

Furthermore, we have introduced a system where defective products with valid warranty are returned to suppliers from the sales network. In 1999, suppliers of AO AVTOVAZ reimbursed RR 18.9 million, or 81% of the total value of the warranty claims presented.



S O C I A L A N D P E R S O N N E L P O L I C Y



Yuri Borisovich
STEPANOV
Vice-president
Personnel.

The main aim in the area of social development of AO AVTOVAZ is to form a new type of employee who understands the tasks and objectives of the Company, and who understand that their company takes care of them in spite of the difficult times of today's Russia.

AO AVTOVAZ is pursuing a co-ordinated policy in the area of remuneration and social protection of its employees. It has a uniform minimum wage rate, minimum social benefits and guarantees.

Moreover, depending on resources available and given the existing level of wages and benefits, each subsidiary adopts additional agreements which are recorded in the subsidiaries' collective agreements with their workers. At the end of 1999, the average monthly salary per employee was equal to RR 4,030.

Consistent with prior years, the proportion of employees wages which is dependent upon work performed has increased, while there has been a decrease in the proportion of the social benefit component which is provided irrespective of employees' contribution to the Company's business. This has improved motivation.

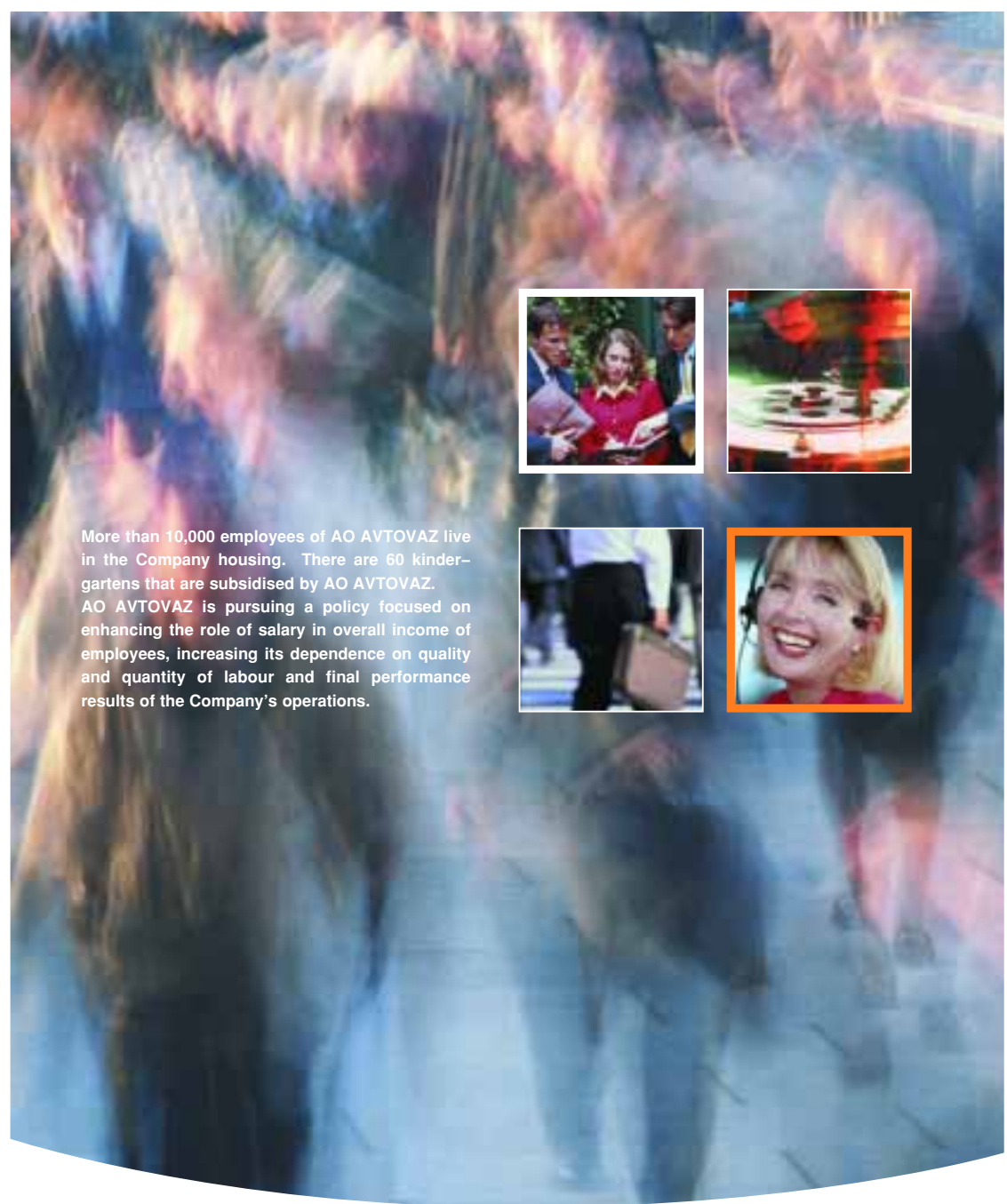
In spite of additional monthly payments resulting from the restructured debts to the federal authorities amounting to RR 23.8 million per month and the urgent need to finance new models, AO AVTOVAZ spends a significant amount on social benefits and guarantees in accordance with the Collective Agreement.

These social allowances include: annual leave payment, maternity leave payment (for women taking care



of children under age 3), termination payments (due to retirement age or disability), and financial aid to former employees.

AO AVTOVAZ has a Labour Medicine Centre which provides extra medical services to the employees. In addition, the Company is involved in a housing programme and pays housing subsidies.

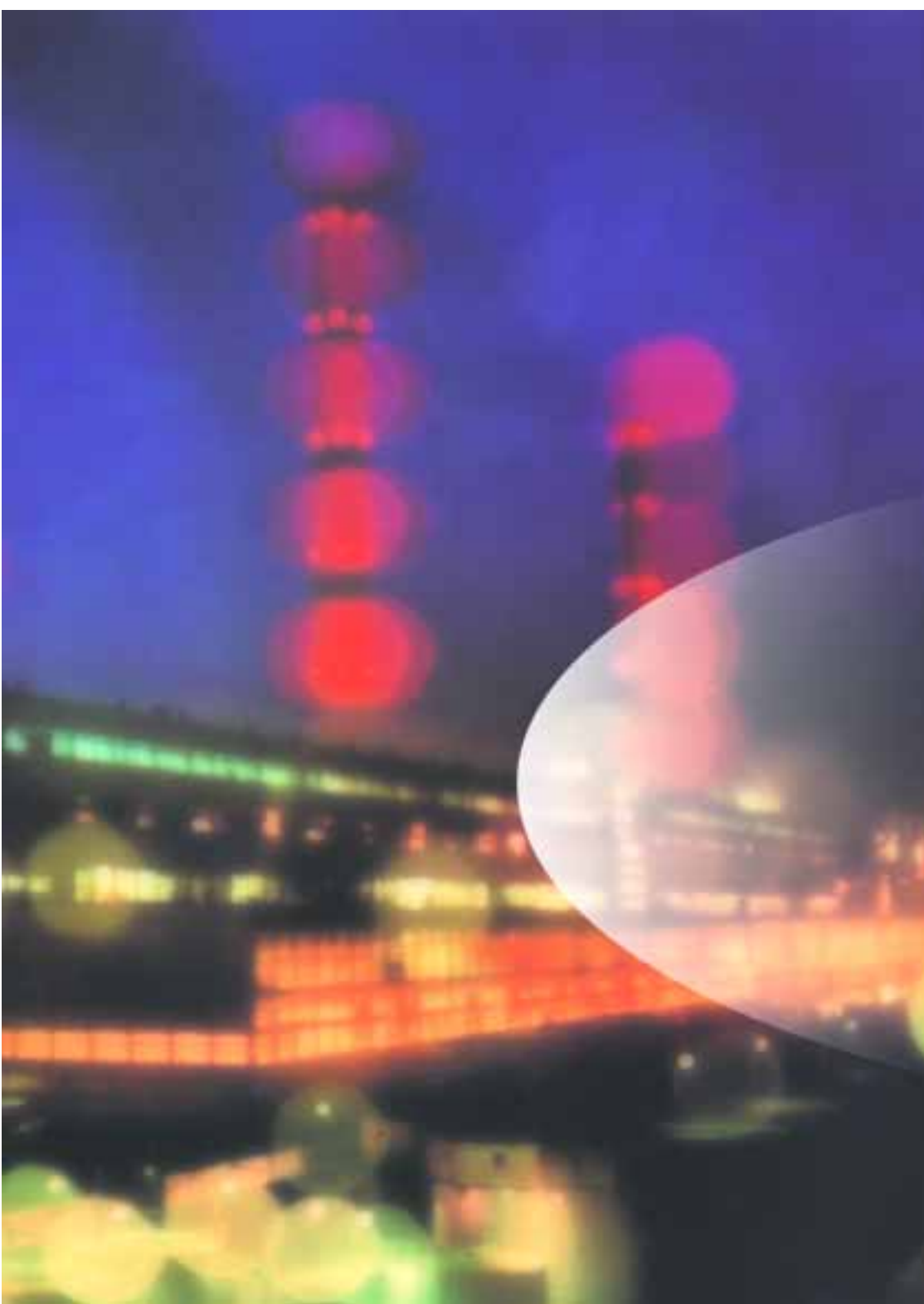


More than 10,000 employees of AO AVTOVAZ live in the Company housing. There are 60 kindergartens that are subsidised by AO AVTOVAZ. AO AVTOVAZ is pursuing a policy focused on enhancing the role of salary in overall income of employees, increasing its dependence on quality and quantity of labour and final performance results of the Company's operations.





It is our mission to consolidate the AVTOVAZ Group's position as the market leader in the Russian automotive industry for the long term, providing quality cars to Russian people at prices they can afford.



6

Management of the Company





WORKING FOR THE WELFARE OF RUSSIANS AND FOR THE GLORY OF THE
COUNTRY



BOARD OF DIRECTORS

(elected at the Annual Shareholders' Meeting on 29 May 1999)



Chairman of the Board of Directors

Vladimir Vasilyevich KADANNIKOV.

Members of the Board of Directors:

Ivan Antonovich BARYSHNIKOV,
President of the Labour Council, AO AVTOVAZ;

Aleksandr Petrovich BYCHKOV,
General Director, OAO «IK RUSS-INVEST»;

Vitali Andreevich VILCHIK,
First Vice-President, Strategy and Corporate Governance,
AO AVTOVAZ;

Nikolai Nikolaevich KOSOV,
First Deputy Chairman, Vnesheconombank;

Yuri Mikhailovich LOGOIDO,
First Deputy Governor, Samara Region;

Nikolai Vasilyevich LYACHENKOV,
First Vice-President, First Deputy General Director, AO
AVTOVAZ;

Aleksei Vasilyevich NIKOLAEV,
President-General Director, AO AVTOVAZ;

Aleksandr Alekseevich PUGACH,
Head of Personnel Department of Sub-Assembly Division
– Deputy President of the Labour Council,
AO AVTOVAZ;

Konstantin Grigoryevich SAKHAROV,
Vice-President, Research and Development,
AO AVTOVAZ;

Yuri Borisovich STEPANOV,
Vice-President, Personnel, AO AVTOVAZ;

Roman Lvovich SHEININ,
General Director, ZAO Central Branch of Automobile
Finance Corporation.



Individual Executive Body

President–General Director of AO AVTOVAZ
Aleksei Vasilyevich Nikolaev.

Collective Executive Body

BOARD OF MANAGEMENT OF AO AVTOVAZ

Chairman of the Board of Management of AO AVTOVAZ

Aleksei Vasilyevich NIKOLAEV,
 President – General Director, AO AVTOVAZ.

Members of the Board of Management:

Vladimir Ivanovich BELYAKOV,
 General Director, AO AvtoVAZtrans.

Vitali Andreevich VILCHIK,
 First Vice–President, Strategy and Corporate Governance,
 AO AVTOVAZ.

Rudolf Sergeevich VSHIVTSEV,
 Director, AO AvtoVAZagregat.

Nikolai Aleksandrovich GUINTS,
 Director, Car Technical Maintenance, AO AVTOVAZ.

Nikolai Maksimovich GOLOVKO,
 Director, Development, AO AVTOVAZ.

Aleksandr Ivanovich GRECHUKHIN,
 Director, Manufacturing Logistics – Chief Engineer,
 AO AVTOVAZ.

Viktor Alekseevich DAVYDOV,
 Director, Press Stamping Division, AO AVTOVAZ.

Mikhail Nikolaevich DOBYNDO,
 Vice–President, Production, AO AVTOVAZ.

Yevgeni Alekseevich DOKUTOVICH,
 Director, Production, AO AVTOVAZ.

Nikolai Petrovich DYBIN,
 First Deputy Commercial Director, AO AVTOVAZ.

Yuri Petrovich YEDUNOV,
 Director, Sales Operations, AO AVTOVAZ.

Valeri Petrovich YELISEYEV,
 Director, Plastic Production, AO AVTOVAZ.

Konstantin Petrovich YEROSLAYEV,
 Director, Small Press Shop, AO AVTOVAZ.

Yuri Samoilovich ZEKTSER,
 General Director, AO AVVA.

Aleksandr Grigoryevich ZIBAREV,
 Vice–President, Co–operation with CIS,
 AO AVTOVAZ.

Vladimir Ivanovich ISAYENKO,
 Deputy General Director, AO TZTO.

Galina Ivanovna KAZAKOVA,
 Finance Director – Head of Treasury, AO AVTOVAZ.

Vladimir Vasilyevich KARMAZIN,
 Director, GlavAVTO, AO AVTOVAZ.

Valeri Yakovlevich KOKOTOV,
 Director, Quality, AO AVTOVAZ.

Vladimir Kuzmich KOTENEV,
 Director, Sub–Assembly, AO AVTOVAZ.

Igor Aleksandrovich KROPACHEV,
 Director, AO SeAZ.

Boris Antonovich KRUPENKOV,
 Director, Economics, AO AVTOVAZ.

Nikolai Aleksandrovich KUZNETSOV,
 Director, Property Department, AO AVTOVAZ.

Vladimir Nikolaevich KUCHAI,
 Vice–President, Marketing, AO AVTOVAZ.

Nikolai Vasilyevich LYACHENKOV,
 First Vice–President, First Deputy General Director,
 AO AVTOVAZ.

Aleksandr Konstantinovich MAMONTOV,
 Director, AO SAAZ.

Dmitri Vladimirovich MARKUSHEV,
 Director, Final Assembly, AO AVTOVAZ.

Yuri Ivanovich MERZLYAKOV,
 Director, Precision Tooling, AO AVTOVAZ.

Mikhail Valeryevich MOSKALYOV,
 Vice–President, Finance, AO AVTOVAZ.

Pyotr Abramovich NAKHMANOVICH,
 Director, Corporate Governance, AO AVTOVAZ.

Vladimir Aleksandrovich NESTEROV,
 Director, Security, AO AVTOVAZ.

Valeri Ivanovich OVCHARENKO,
 Director, Foundry, AO AVTOVAZ.

Vladimir Petrovich PERESYPKINSKI,
 Chief Manufacturing Engineer, AO AVTOVAZ.

Victor Pavlovich POTEKIN,
 General Director, AO DAAZ.

Pyotr Mikhailovich PRUSOV,
 Chief Designer, AO AVTOVAZ.

Anatoli Nikolaevich PUSHKOV,
 Director, Large Press Shop, AO AVTOVAZ.

Konstantin Grigoryevich SAKHAROV,
 Vice–President, R&D, AO AVTOVAZ.

Pyotr Romanovich SENKOV,
 Director, Machine Production, AO AVTOVAZ.

Pavel Nikolaevich SKRINSKY,
 Vice–President, Purchasing, AO AVTOVAZ.

Valeri Ivanovich SOKOLOV,
 Director, Power Supply, AO AVTOVAZ.

Yuri Borisovich STEPANOV,
 Vice–President, Personnel, AO AVTOVAZ.

Vladimir Ivanovich TIKHONOV,
 Director, Information Systems, AO AVTOVAZ.

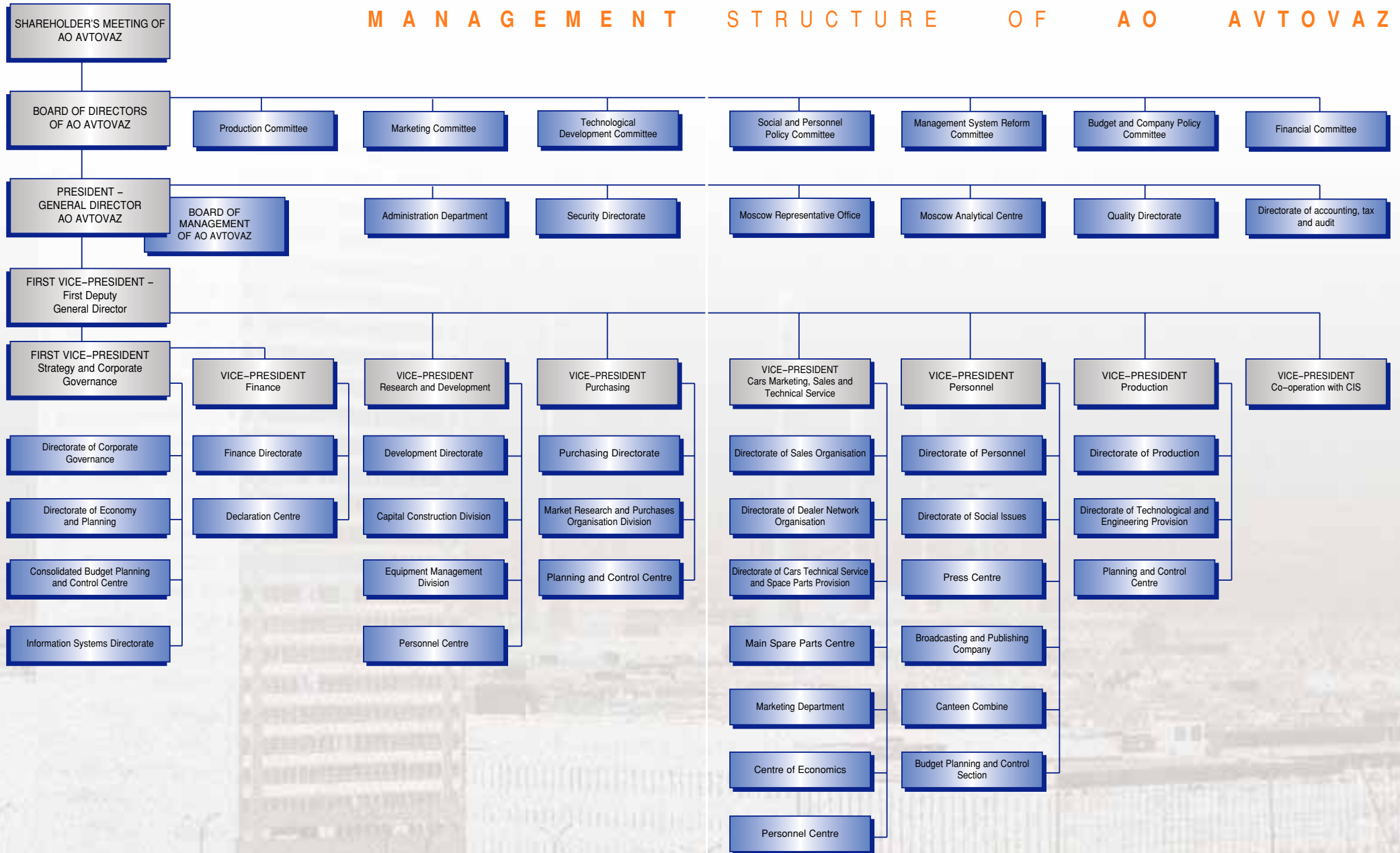
Nikolai Petrovich KHATUNTSOV,
 Chief Accountant – Director of Accounting, Taxes
 and Audit, AO AVTOVAZ.

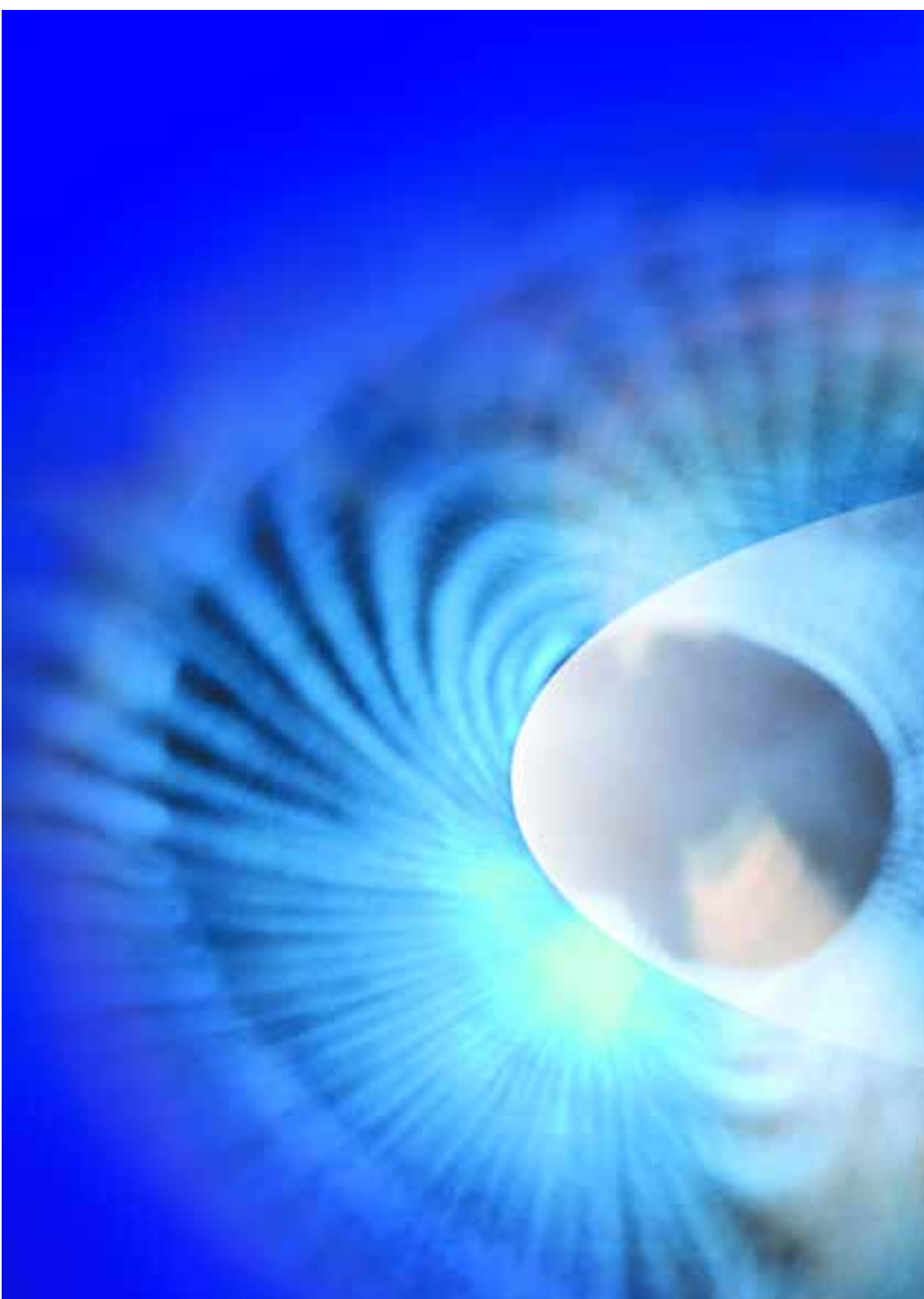
Anatoli Semyonovich CHERYOMUKHIN,
 Director, Spare Parts Production and Sales –
 Director of Main Spare Parts Centre, AO AVTOVAZ.

Viktor Borisovich ENS,
 Director, Social Infrastructure, AO AVTOVAZ.



M A N A G E M E N T S T R U C T U R E O F A O A V T O V A Z





7

Financial Condition and Results of Operations





The following management's discussion and analysis of financial condition and results of operations (MD&A) should be read in conjunction with the IAS consolidated financial statements presented on pages 82 to 95 of this annual report.

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



O V E R V I E W

The financial crisis (the «crisis») in August 1998 contributed to a decline in margins on vehicle sales as the cost of imported components rose significantly more than domestic selling prices. The crisis also triggered a severe devaluation of the Russian Rouble, which in turn led to the realisation of significant exchange losses in connection with the Group's US dollar denominated debt. The crisis, however, gave the Group a competitive advantage as imported vehicles became financially restrictive for most Russians.

In view of the above, the most significant initiatives undertaken by management include:

- successful negotiations with tax authorities to restructure overdue tax liabilities and related interest;
- extinguishing during 1999 and the first months of the year 2000 US\$ 378 million of debt inherited from the Russian government upon privatisation by way of a settlement of approximately US\$ 75 million;
- significantly eliminating the purchase of foreign components and replacing them with less costly domestically produced components in order to increase margins;
- cost reductions in non-core divisions; and
- reorganisation of the Group structure which led to re-establishing an effective distribution system.

For 1999, the Group's consolidated net income amounted to RR 850 million or RR 56.14 per share, as compared with the Group's consolidated net loss of RR 6,794 million or RR 677.95 per share in 1998. The 1999 financial results were significantly impacted by:

- increase in the number of vehicles sold over that of 1998;
- gross margins have recovered as a result of replacing costly foreign purchased components with domestically produced components, cost of domestic purchases increasing less than inflation, and a change in the product mix towards higher margin vehicles;
- gain on further restructuring of tax liabilities and other long term debt.



R E S U L T S O F O P E R A T I O N S

Increase in sales volume

The Russian economy has displayed a significant improvement since the crisis of 1998. In 1999, number of vehicles sold increased by 12% over 1998 levels. However, this yielded a Rouble increase in car sales in real terms of only 7.8% highlighting that selling prices had not recovered to pre-crisis levels.

1998 was a year of strong competition from foreign imports. However, as a result of the crisis, Russian produced cars regained their competitive price advantage following the severe devaluation of the Rouble which followed the crisis. This contributed to the overall increase in vehicles sold for the year. Management recognised that this competitive advantage is likely to be short term and has thus focussed on increasing its production of newer, more attractive, models and significantly reducing the focus on the traditional older 2106 models.

Exports continued to decrease both in absolute numbers (from 69 thousand in 1998 to 48 thousand in 1999) and in percentage of cars sold (from 12% of cars sold in 1998 to 7% in 1999). Management is in the process of assessing the viability of its existing foreign markets and is performing market studies to identify potential for developing other foreign markets.

	1999	1998
Vehicles sold domestically, thousand units	618	522
Vehicles sold to foreign markets, thousand units	48	69
Total vehicles sold, thousand units	666	591
Revenue from domestic vehicle sales, RR million	42,928	38,636
Revenue from foreign vehicle sales, RR million	3,695	5,056
Revenue from sales of other manufacturers' vehicles by subsidiaries of AO AVTOVAZ	6,170	5,333
Total revenue from vehicle sales, RR million	52,793	49,025
Other revenue, RR million	10,278	13,957

Other revenue, which comprises sales of automotive components and assembly kits as well as repair services, has decreased in real rouble terms as the volumes sold remained flat while selling prices did not keep up with inflation.

Gross profit margins have recovered.

1998 domestic gross margins from sales saw a sharp drop of 14% (i.e. from 21.4% to 7.4%) during the year as a result of the crisis because the price of foreign produced components in Rouble terms rose significantly more than the increase in vehicle selling prices. 1999 overall gross margin has increased to 17% as a result of:

- foreign produced components being substantially replaced with Russian produced components;
- the Group negotiating price increases with suppliers of components at amounts less than inflation; and
- produce mix changing from less profitable older models to the higher margin 2110 family.

Because foreign sales contracts are concluded in foreign currency, the foreign market margins increased significantly post crisis in Rouble terms. However, these increased margins were offset by a decline in vehicles sold to the export markets. This drop in vehicles sold arose because a large portion of exports were sold to companies who sell to markets affected by the Russian economic crisis, such as Ukraine or other CIS countries.

Foreign subsidiaries whose customers sell to markets affected by the Russian economic crisis suffered significant losses which in some instances are resulting in the liquidation of the subsidiary. However, the severe devaluation of the Rouble created a competitive advantage in other markets.

Selling, general and administrative expenses.

Selling, general and administrative expenses have decreased from 1998 levels by RR 3,238 million as the Group reversed a write-off on doubtful debts which were recovered and, while sales based costs, such as turnover taxes, have increased as a result of higher sales, most other costs, such as labour and transportation, have not increased with the level of inflation.



AND EFFECT ON FINANCIAL POSITION OF THE AVTOVAZ GROUP

Provision for impairment of property, plant and equipment.

Management regularly assesses the carrying value of its property, plant and equipment and if the recoverable amount is less than the carrying amount the asset is reduced to its recoverable amount. The recoverable value of the assets is estimated based on the estimated future cash flows discounted to present values using the Group's weighted average cost of capital (the discount rate).

The 1998 provision arose because the Group's cost of capital increased significantly after the crisis to a point where the estimated discounted cash flows were lower than the assets' carrying value. No additional provision was considered necessary in 1999 as the economic situation has improved along with the prospects of the Group.

Operating income (loss).

In 1999, the Group's operating income is at a level of break-even (1998: loss of RR 11,661 million). This is evidence of the Group coping with the effects of the crisis. However, management continues to focus on financial and operational restructuring in order to stimulate more favourable operating results.

Finance expenses.

Finance expenses have increased by RR 1,325 million as a result of the higher cost of US dollar denominated debt in Rouble terms. While interest rates remain unchanged, the actual Rouble costs to service the debt have increased.

Foreign exchange differences.

The crisis caused a severe devaluation of the Rouble in 1998. The devaluation of the Rouble to the US dollar was 38% in 1999 as compared to 300% in 1998, which explains the decrease in this expense by over RR 8,269 million or 65%.

The reported foreign exchange loss is primarily related to the US dollar denominated loan which is further discussed in the «Gains on extinguishment and forgiveness of tax debts and other liabilities» section below. As noted in this section, management has made significant progress in eliminating the exposure caused by this debt.

Inflation and Monetary gain.

As discussed in Note 3 to the consolidated financial statements, in an inflationary environment the general purchasing power of money declines as the general level of prices of goods and services rises. The general purchasing power of money and the general price level are interdependent. The effect of the decline in the purchasing power related to an enterprise's monetary position will create a monetary gain or loss. In a period of inflation, an enterprise holding net monetary assets loses purchasing power, and an enterprise holding net monetary liabilities gains purchasing power.

International Accounting Standards (IAS) require that the financial statements of an enterprise that reports in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date.

The Group's monetary gain as reported in the IAS consolidated accounts decreased from RR 26,146 million in 1998 to RR 10,650 million in 1999 because:

- The Group's net monetary liabilities decreased during 1999, primarily as a result of the restructuring of its liabilities;
- Inflation decreased from 86% in 1998 to 36% in 1999.

Gains on extinguishment and forgiveness of tax debts and other liabilities.

Government taxes.

In the years subsequent to privatisation, the Group was not able to find suitable financing to maintain its research and development expenditures or capital investments required to modernise production processes for models produced. However, expenditures were essential in order for the Group to be in a position to compete with foreign manufacturers that were showing interest in the Russian marketplace. These expenditures resulted in the development of the new Niva and improved production capacity of the 2110 family. However, the Group was not able both to maintain these levels of expenditure and remain current with its payments to tax authorities. Thus prior to 1998 an overdue balance of unpaid taxes of RR 8,000 million accrued. Interest was charged on these unpaid taxes at an average rate of 70% per year, which resulted in interest accruing on the overdue balance of RR 16,400 million.



Nikolai Petrovich
KHATUNTISOV
Chief Accountant – Director
of Accounting,
Taxes and Audit.



R E S U L T S O F O P E R A T I O N S

In order to compensate Russian companies for these excessive interest rates, the Government forgave 80% of interest accumulated on unpaid tax liabilities for all Russian companies. This amounted to a RR 10,000 million reduction of tax liabilities in 1997 and 1998.

Management initiated negotiations with the Russian government to restructure its remaining tax liabilities to be made over the subsequent 10 to 15 years at zero or preferential interest rates. Management's successful efforts resulted in the restructuring of taxes with various tax authorities during 1997, 1998 and 1999. The total amount of taxes restructured during this period was RR 15,352 million (1999: RR 6,733 million, 1998: 4,521 million).

The difference between the present value of these restructured tax obligations and the nominal amount was recorded as a gain in the IAS financial statements. A discount rate of 12% was used to calculate the present value which, for long term Rouble liabilities, is a modest estimate of the economic benefit received from this restructuring. The resulting gains recorded in 1999 and 1998 were RR 2,116 million and RR 1,463 million, respectively. For a further understanding of the terms of this restructuring initiative, Note 12 of the consolidated IAS financial statements should be reviewed.

Other debt.

The Group had a loan of approximately US\$ 400 million for past investments made by the Russian government which it inherited upon privatisation. Although the US dollar interest rate ranged from 3.8% to 8.6%, the severe devaluation of the Rouble following the crisis caused the Group to suffer significant exchange losses in 1998, as noted in the «foreign exchange» section above. Recognising the need to reduce the Group's foreign currency exposure, in 1999 management extinguished US\$ 118 million of current debt through consideration of RR 575 million of cash and RR 2,355 million of non-interest bearing Rouble denominated bills of exchange payable between 18 and 20 years. The present value of these bills of exchange, using a 12% discount rate, is RR 317 million. The resulting gain of RR 2,038 million has been recognised in the statement of operations as an extinguishment of debt. Subsequent to year end, management has settled another US\$ 260 million through consideration of RR 925 million of cash, RR 580 million of non-interest bearing Rouble denominated bills of exchange payable within 1 year, and RR 5,731 million of non-interest bearing Rouble denominated bills of exchange payable between 26 and 30 years.

Taxation.

Current taxation.

The Group accrued RR 1,242 million of profit tax in 1999 and has remained current with payments to tax authorities with respect to these amounts: as well as the restructured portion of prior year tax liabilities (see gain on extinguishment of tax debts discussed above).

The Group's taxes as a percentage of revenue was 13% in 1999 as compared to 3%–5% for other international automotive makers.

Deferred taxation.

Every asset or liability has a tax base. The tax base is the amount that will be deductible for tax purposes against future earnings when the carrying amount of the asset is recovered or liability settled. Differences between the carrying amount of an asset or liability and its tax base are called temporary differences. These differences are temporary because an enterprise will realise its assets and settle its liabilities continually over time, at which point any tax consequences will crystallise.

The Group has a net deferred tax liability of RR 4,437 million which has arisen primarily because the carrying value of property, plant and equipment exceeds the tax base of these assets. The liability represents the amount which will not be deductible for tax purposes when the assets are depreciated or sold.

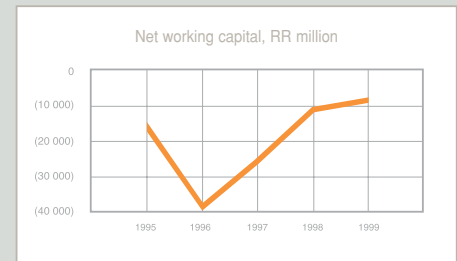
The increase in the deferred tax liability in 1999 resulted because the carrying value of the property, plant and equipment was restated for inflation by 36% in the consolidated IAS financial statements and, while the tax base of the asset was increased, the increase in tax base did not offset the increase in the carrying value. This increase in the deferred tax liability resulted in a deferred tax charge of RR 1,901 million in the statement of operations.



D I S C U S S I O N O F T H E P A S T F I V E Y E A R S R E S U L T S

Liquidity and capital resources.

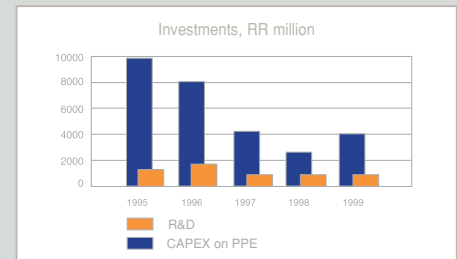
Because of the elimination and restructuring of the majority of the Group's debt, the working capital ratio is 0.74 at 31 December 1999 (31 December 1998: 0.71) which is an improvement over prior years financial position. An analysis of the Group's working capital ratio shows a solid trend of continuous improvement over the past four years.



Investments in research and development and capital expenditures.

Management recognised the need to improve existing production facilities and invest in new generation models. The management's commitment to the Company's survival is demonstrated through the resources allocated to its development.

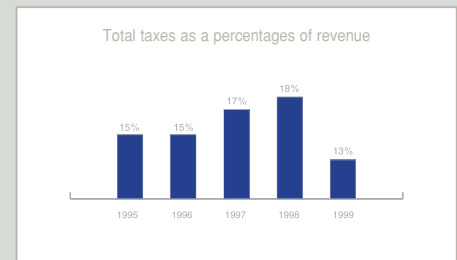
Despite an increased tax burden, the Company continues to finance the development and launch of its new models. Over the past five years the Company's research and development (R&D) expenses amounted to RR 6,726 million and its capital expenditures on property, plant and equipment amounted RR 28,810 million. These are analysed in the graph opposite.



Tax burden.

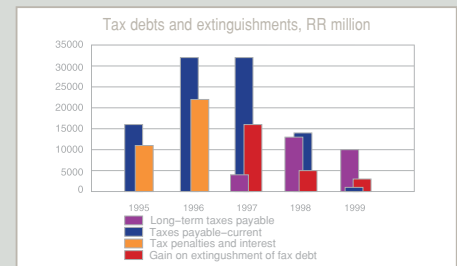
The Group has a significant annual obligation to pay various taxes. The chart provides insight as to the total taxes accrued (net of fines and interest) as a percentage of revenue.

In prior years, the Company was not able to remain current with these payments and fund the required level of research and development and capital expenditures as noted above.



Tax debts.

The accumulation of the tax debts and related gain on extinguishment and restructuring over the past five years is as follows.



**AUDIT FIRM'S OPINION**

on the 1999 statutory accounting reports
of Open Joint Stock Company "AVTOVAZ"

ZAO PricewaterhouseCoopers Audit

Kosmodamianskaya Nab. 52, Bld.5

113054 Moscow

Russia

Telephone +7 (095) 967 6000

Facsimile +7 (095) 967 6001

To the shareholders of Open Joint Stock Company "AVTOVAZ":

1. We have audited the attached 1999 statutory accounting reports of Open Joint Stock Company "AVTOVAZ" (hereinafter – Company). These statutory accounting reports were prepared by the management of the Company in accordance with the Federal Law on Accounting and Regulation on Accounting and Reporting in the Russian Federation adopted by the decree of the Ministry of Finance of the Russian Federation dated 29 July 1998 №34H(n). Such statutory accounting reports differ to a significant extent from those prepared in accordance with International Accounting Standards.

2. Preparation of the statutory accounting reports is the responsibility of management of the Company. Our responsibility as auditors is to express our opinion on these statutory accounting reports based on our audit.

3. We conducted our audit in accordance with the Temporary Rules of Audit Activity in the Russian Federation adopted by Decree of the President of the Russian Federation of 22 December 1993 № 2263, in accordance with Russian Auditing Standards issued by the Presidential Audit Committee and in accordance with International Standards on Auditing. Russian Auditing Standards and International Standards on Auditing require that we plan and perform the audit to obtain reasonable assurance about whether the statutory accounting reports are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the statutory accounting reports. An audit also includes assessing the accounting principles used and significant estimates made by management of the Company, as well as evaluating the overall statutory accounting reports presentation in order to assess compliance with laws and regulations of the Russian Federation. We believe that our audit provides a reasonable basis for our opinion.

4. In our opinion, the statutory accounting reports attached to this report have been properly prepared to present in all material respects the assets and liabilities of the Company as of 31 December 1999 and financial results of its operations for the year ended 31 December 1999 in accordance with the Federal Law on Accounting and Regulation on Accounting and Reporting in the Russian Federation adopted by the decree of the Ministry of Finance of the Russian Federation dated 29 July 1998 № 34H(n).

5. Without qualifying our opinion, we draw your attention to the following matters:

5.1) The operations of the Company, and those of similar organisations in the Russian Federation, have been affected and may be affected for the foreseeable future by the economic instability in the country.

5.2) The Company's balance sheet carries a significant amount of receivables, including those which were not collected when due as stated in the contract and which were not accordingly guaranteed. The Company's accounting policy does not require these receivables to be provided for.

5.3) In preparing the statutory accounting reports attached to this Report, the management of the Company assumed that the Company's operations would continue for the foreseeable future and that there is no need to liquidate or significantly reduce its activities, and, accordingly, liabilities, including liabilities to the Budget, would be settled in the normal course of business. However, at 31 December 1999, the Company had obligations to make mandatory payments which had not been settled within three months of the due date. The amount of these obligations is in excess of 500 minimum monthly wages. In accordance with Federal Law of the Russian Federation "On insolvency (bankruptcy)", the Company may be deemed eligible for bankruptcy. We noted that financial position of the Company has significantly improved over the reporting year as a result of the restructuring of the Company's obligations and other initiatives undertaken by management to ensure the Company continues as a going concern in the foreseeable future.

Director of ZAO PricewaterhouseCoopers Audit

J.S. Root

Statutory auditor

Y.P. Ilushkin

30 March 2000



Full name of the audit company is ZAO PricewaterhouseCoopers Audit. General audit licence № 016153 issued by the Central Attesting and Licensing Audit Committee of the Ministry of Finance of the Russian Federation on 23 November 1999. The licence is valid until 24 June 2002. State registration certificate № 008.890, issued by Moscow Registration Bureau on 28 February 1992.

The firm is an authorized licensee of the tradename and logo of PricewaterhouseCoopers.



Condensed Russian Statutory Balance Sheet and Profit and Loss Account

Balance Sheet at 31 December 1999 (in millions of roubles):	Condensed form	
	At 31 December 1999	At 31 December 1998
ASSETS		
<i>Non-current assets</i>		
Intangible assets	63	60
Fixed assets	35,575	24,331
Long-term financial investments	3,190	2,189
Other non-current assets	162	20
<i>Current assets</i>		
Inventories	8,016	5,019
Input VAT	1,186	684
Long-term receivables	829	8,941
Short-term receivables	13,467	9,189
Short-term financial investments	5,820	1,510
Monetary assets	696	222
<i>Losses</i>		
Outstanding losses of previous years	10,726	10,726
Utilisation of profit of the reporting year	5,679	X
Losses of the reporting year	1,016	X
Total	86,425	62,891
EQUITY AND LIABILITIES		
<i>Equity and reserves</i>		
Charter capital	16,062	16,062
Additional capital	13,912	4,758
Legal reserve	2	2
Other reserves	4,687	3,031
<i>Long-term liabilities</i>		
Borrowings	10,451	8,655
Other long-term liabilities	14,940	-
<i>Short-term liabilities</i>		
Borrowings	5,257	5,536
Accounts payable	21,086	24,818
Income of future periods	28	6
Other short-term liabilities	-	23
Total	86,425	62,891
Profit and Loss Account for the year ended 31 December 1999 (in millions of roubles):		
	Condensed form	
	For 1999	For 1998
Sales of goods, products, work, services (less: value added tax, excises, and other similar compulsory payments)	47,999	26,255
Cost of goods, products, work, services sold (net of sales expenses)	37,549	21,931
Sales expenses	921	497
Gross profit from sales	9,529	3,827
Interest receivable	2	2
Participation in other companies	28	3
Other operating income	63,892	23,052
Other operating losses	66,795	21,719
Income from operations	6,656	5,165
Other non-sale income	1,408	370
Other non-sale losses	5,480	1,033
Pre-tax profit of the reporting period	2,584	4,502
Profit tax	898	1,167
Profit used in the reporting year and reserved for different purposes	2,702	7,069
Retained earnings (loss) of the reporting year	(1,016)	(3,734)

A. Nikolaev
President-General Director



A. Nikolaev

N. Khatuntsov
Chief Accountant

N. Khatuntsov



ZAO PricewaterhouseCoopers Audit

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AUDITORS' REPORT

To the Board of Directors of AO AvtoVAZ:

1. We have audited the accompanying consolidated balance sheet of AO AvtoVAZ and its subsidiaries («the Group») as of 31 December 1999 and the related consolidated statements of operations, of cash flows and of changes in shareholders' equity for the year then ended, as expressed in the equivalent purchasing power of the Russian Rouble (RR) at 31 December 1999. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.

2. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform our 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 management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

3. In our opinion, the accompanying consolidated financial statements, expressed in the equivalent purchasing power of the Russian Rouble at 31 December 1999, present fairly, in all material respects, the financial position of the Group as of 31 December 1999, and the results of its operations and its cash flows for the year then ended in accordance with International Accounting Standards.

4. Without qualifying our opinion, we draw your attention to the following:

4.1. As discussed further in Note 2 to the financial statements, the operations of the Group, and those of similar companies having operations in the Russian Federation, have been affected, and may continue to be affected for the foreseeable future by the continuing regulatory, political and economic uncertainties existing for enterprises operating in the Russian Federation.

4.2. In addition, Note 2 to the financial statements sets out a number of matters that raise substantial doubt that the Group will be able to continue as a going concern as well as management's plans regarding the strengthening of the financial condition and performance of the Group. The accompanying financial statements have been prepared assuming that the Group will continue as a going concern and, consequently, do not include any adjustments that might be required if the Group proves not to be a going concern.

5. As explained in Note 3, US dollar (US\$) amounts presented in the financial statements are translated from RR as a matter of arithmetic computation only, at the official rate of the Central Bank of the Russian Federation at 31 December 1999 of RR 27 to US\$1. The US\$ amounts are presented solely for the convenience of the reader and should not be construed as a representation that the RR amounts have been or could have been converted to US\$ at this rate, nor that the US\$ amounts present fairly the financial position of the Group or its results of operations or cash flows in accordance with International Accounting Standards.

PricewaterhouseCoopers

Moscow, Russia
19 July 2000



AVTOVAZ GROUP

Consolidated Balance Sheet at 31 December 1999

(In thousands of Russian Roubles in terms of purchasing power of the Rouble as of 31 December 1999, Note 3)
(Amounts translated into US dollars for convenience purposes, Note 3)

	RR thousand		US\$ thousand
	At 31 December		Unaudited
	1999	1998	1999
ASSETS			
Current assets:			
Cash and cash equivalents (Notes 5 and 6)	2,676,186	3,048,399	99,118
Trade receivables, net (Notes 5 and 7)	6,316,840	9,452,909	233,957
Prepaid expenses, advances and other receivables (Note 5)	3,932,218	4,077,567	145,638
Inventories (Note 8)	8,804,837	9,936,102	326,105
Total current assets	21,730,081	26,514,977	804,818
Property, plant and equipment (Note 9)	61,680,225	62,064,810	2,284,453
Investments (Note 10)	1,159,301	978,204	42,937
Other assets	299,625	112,256	11,097
Total assets	84,869,232	89,670,247	3,143,305
LIABILITIES & SHAREHOLDERS' EQUITY			
Current liabilities:			
Trade payables current	9,522,057	8,794,044	352,669
Other payables and accrued expenses	6,736,017	6,761,899	249,482
Taxes payable-current (Note 12)	6,771,792	12,679,906	250,807
Warranties and other provisions	1,058,417	2,133,618	39,201
Short-term debt (Note 11)	3,840,220	4,242,151	142,230
Advances from customers	1,502,083	2,435,315	55,633
Total current liabilities	29,430,586	37,046,933	1,090,022
Long-term debt (Note 11)	11,336,986	14,226,664	419,888
Long-term taxes payable (Note 12)	9,933,949	7,130,100	367,924
Deferred tax liability (Note 20)	4,437,900	2,537,111	164,367
Total liabilities	55,139,421	60,940,808	2,042,201
Minority interest	5,167,154	5,047,866	191,376
Shareholders' equity:			
Share capital (Note 14)	18,429,820	18,197,611	682,586
Currency translation adjustment	676,021	701,713	25,038
Retained earnings	5,456,816	4,782,249	202,104
Total shareholders' equity	24,562,657	23,681,573	909,728
Total liabilities and shareholders' equity	84,869,232	89,670,247	3,143,305

Approved on behalf of Management, 19 July 2000.

A. Nikolaev
President-General Director



N. Khatuntsov
Chief Accountant



The accompanying notes 1 to 22 are an integral part of the financial statements.



AVTOVAZ GROUP

Consolidated Statement of Operations for the year ended 31 December 1999

(In thousands of Russian Roubles in terms of purchasing power of the Rouble as of 31 December 1999, Note 3, except for earnings per share)
(Amounts translated into US dollars for convenience purposes, Note 3)

	RR thousand		US\$ thousand
	Year ended 31 December		Unaudited
	1999	1998	1999
Net sales (Notes 4C and 15)	63,071,148	62,981,754	2,335,968
Cost of sales (Note 16)	(52,376,074)	(57,929,409)	(1,939,854)
Gross profit	10,695,074	5,052,345	396,114
Selling, general and administrative expenses (Note 17)	(6,265,387)	(9,502,718)	(232,051)
Provision for impairment of property, plant and equipment to estimated recoverable value (Note 9)	-	(3,225,128)	-
Research and development expenses (Note 18)	(1,050,538)	(1,161,617)	(38,909)
Other operating expenses (Note 19)	(3,354,440)	(2,823,574)	(124,239)
Operating income (loss)	24,709	(11,660,692)	915
Financing expense	(7,254,539)	(5,930,104)	(268,686)
Foreign exchange loss (Note 4I)	(4,375,752)	(12,644,953)	(162,065)
Monetary gain (Note 3A)	10,649,819	26,146,386	394,437
Gains on extinguishment and forgiveness of tax debts and other borrowings (Note 13)	5,131,264	5,224,587	190,047
Profit before taxation	4,175,501	1,135,224	154,648
Income tax expense (Note 20)	(3,142,437)	(7,581,618)	(116,387)
Net profit (loss)	1,033,064	(6,446,394)	38,261
Minority interest	(183,005)	(347,318)	(6,778)
Net income (loss) attributable to shareholders of AVTOVAZ Group	850,059	(6,793,712)	31,483
Weighted average number of ordinary shares outstanding during the year ('000's)	15,142	10,021	15,142
Earnings (loss) per share (in RR and US \$) (Note 4P)	56.14	(677.95)	2.08

The accompanying notes 1 to 22 are an integral part of the financial statements.



AVTOVAZ GROUP

Consolidated Statement of Cash Flows for the year ended 31 December 1999

(In thousands of Russian Roubles in terms of purchasing power of the Rouble as of 31 December 1999, Note 3)
(Amounts translated into US dollars for convenience purposes, Note 3)

	RR thousand		US\$ thousand
	Year ended 31 December		Unaudited
	1999	1998	1999
Cash flows from operating activities (Note 4F):			
Profit before taxation	4,175,501	1,135,224	154,648
Adjustments for:			
Depreciation	3,604,331	3,814,117	133,494
Provision for bad debts	(296,214)	1,172,669	(10,971)
Write-down of assets to recoverable value	-	3,225,127	-
Loss on disposal of property, plant and equipment	549,090	1,238,811	20,337
Gains on extinguishment and forgiveness of tax debts and other borrowings	(5,131,264)	(5,224,587)	(190,047)
Finance expense	7,254,539	5,930,104	268,686
Provision for impairment of investments	24,843	310,059	920
Warranties' reserves	(1,075,201)	(22,440)	(39,822)
Unrealised foreign exchange effect on non-operating balances	4,694,784	16,111,124	173,881
Monetary effect on non-operating balances	(6,328,992)	(8,590,969)	(234,407)
Adjustment for non-cash investing activities	-	(1,144,433)	-
Operating cash flows before working capital changes	7,471,417	17,954,806	276,719
Decrease in gross trade receivables	3,432,282	1,821,898	127,122
Decrease in prepaid expenses, advances and other receivables	46,756	277,335	1,732
Decrease in inventories	1,131,265	2,223,095	41,899
Increase (decrease) in trade payables and other payables and accrued expenses	(285,869)	(4,561,700)	(10,588)
Increase (decrease) in other taxes payable	(3,863,663)	(8,855,542)	(143,099)
Increase (decrease) in advances from customers	(933,232)	2,255,871	(34,564)
Cash provided from operations	6,998,956	11,115,763	259,221
Income taxes paid	(861,073)	(7,291,386)	(31,892)
Interest paid	(2,001,423)	(658,122)	(74,127)
Net cash provided from operating activities	4,136,460	3,166,255	153,202
Cash flows from investing activities:			
Purchase of property, plant and equipment	(4,556,002)	(1,413,808)	(168,741)
Proceeds from the sale of property, plant and equipment	787,166	1,040,985	29,154
Proceeds from the sale of investments	-	11,016	-
Purchase of investments	(205,940)	(946,466)	(7,627)
Net cash used in investing activities:	(3,974,776)	(1,308,273)	(147,214)
Cash flows from financing activities:			
Proceeds from borrowings	1,007,343	1,104,329	37,309
Reduction of loans and long-term taxes payable	(8,486,340)	(12,026,006)	(314,309)
Sale (purchase) of treasury shares	306	(490)	11
Inflation effect on financing activities	7,226,905	11,825,868	267,663
Net cash (used in) provided from financing activities	(251,786)	903,701	(9,326)
Effect of inflation on cash	(897,914)	(3,234,899)	(33,256)
Effect of exchange rate changes	615,803	1,630,252	22,808
Net (decrease) increase in cash and cash equivalents	(372,213)	1,157,036	(13,786)
Cash and cash equivalents at the beginning of the period	3,048,399	1,891,363	112,904
Cash and cash equivalents at the end of the period (Note 6)	2,676,186	3,048,399	99,118

The accompanying notes 1 to 22 are an integral part of the financial statements.



AVTOVAZ GROUP

Consolidated Statement of Changes in Shareholders' Equity

For the year ended 31 December 1999

(In thousands of Russian Roubles in terms of purchasing power of the Rouble as of 31 December 1999, Note 3)
(Amounts translated into US dollars for convenience purposes, Note 3)

	In RR thousand				
	Share capital	Treasury shares (Notes 5C and 3)	Currency translation adjustment	Retained earnings	Total Shareholders' Equity
Balances as of 31 December 1997	21,510,863	(11,492,577)	240,654	19,755,777	30,014,717
Purchase of treasury shares	-	(12,959)	-	12,469	(490)
Currency translation adjustment	-	-	461,059	-	461,059
Loss for the year	-	-	-	(6,793,713)	(6,793,713)
Capitalisation of reserves	17,590,150	(9,397,866)	-	(8,192,284)	-
Balances as of 31 December 1998	39,101,013	(20,903,402)	701,713	4,782,249	23,681,573
Sale of treasury shares	-	232,209	-	(175,492)	56,717
Currency translation adjustment	-	-	(25,692)	-	(25,692)
Profit for the year	-	-	-	850,059	850,059
Balances as of 31 December 1999	39,101,013	(20,671,193)	676,021	5,456,816	24,562,657
	In US\$ thousand (Unaudited)				Total Shareholders' Equity
	Share capital	Treasury shares	Currency translation adjustment	Retained earnings	Total Shareholders' Equity
Balances as of 31 December 1999	1,448,186	(765,600)	25,038	202,104	909,728

Profits and reserves available for distribution to shareholders are only those as stated in the Russian statutory financial statements prepared in accordance with rules of the Russian Federation, which are not included herewith. As at 31 December 1999, the Company had no profits or reserves available for distribution to shareholders.

The accompanying notes 1 to 22 are an integral part of the financial statements.

AVTOVAZ GROUP

Notes to the Consolidated Financial Statements at 31 December 1999

(In thousands of Russian Roubles in terms of purchasing power of the Rouble as of 31 December 1999, Note 3)

1. The AvtoVAZ Group

AO AvtoVAZ and its subsidiaries ("the Group") principal activities include the manufacture, sales, and technical service of passenger automobiles. The Group's manufacturing facilities are primarily based in the Samara Oblast of Russia. The Group has a sales and service network spanning the former Soviet Union and a number of other countries. The parent company, AO AvtoVAZ ("the Company" or "AvtoVAZ") was incorporated as an open joint stock company in the Russian Federation on 5 January 1993. On that date the majority of assets and liabilities previously managed by the state conglomerate Volga Automobile Associated Works ("VAZ") were transferred to the Company. The transfer of assets and liabilities was made in accordance with Decree No. 721 on the privatisation of state companies approved on 1 July 1992. The Order approving the privatisation plan was issued on 5 January 1993 ("the privatisation date"). The Company was given control of the majority of its subsidiaries under the privatisation decree referred to above. At 31 December 1999 the Group employed approximately 135,000 employees. The registered office of AO AvtoVAZ is Yuzhnoye Shosse, 36, Togliatti, 445633, Russian Federation.

2. Going concern and effect of economic conditions in the Russian Federation

A. Going concern

Although there have been considerable improvements in the financial position and results of operations from that of prior years, the Group's current liabilities exceeded its current assets as at 31 December 1999 by RR 7,700,505 (1998: RR 10,531,956) and the Group's operating income is at a level of break-even (1998: loss of RR 11,660,692) and as such raises doubt as to whether the Group is able to continue as a going concern.

Despite the conditions described above, management believes that its strategy as outlined below will enable the Group to continue as a going concern for the foreseeable future. Therefore, the financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that would be necessary if the Group is unable to continue as a going concern.



AVTOVAZ GROUP

Notes to the Consolidated Financial Statements at 31 December 1999

(In thousands of Russian Roubles in terms of purchasing power of the Rouble as of 31 December 1999, Note 3)

2. Going concern and effect of economic conditions in the Russian Federation (continued)

A. Going concern (continued)

Management's strategies to address these issues during the year ended 31 December 1999 and subsequently include:

- Further restructuring of current liabilities (See Note 13);
- Continued negotiations with a possible strategic partner;
- Continued reorganisation of the sales and distribution system which will enhance sales and margins, reduce the incidence of bad debts and further reduce barter transactions; and
- Continuing cost reduction programmes including obtaining improved conditions from suppliers of materials used in production.

B. The effect of the economic condition in the Russian Federation

The Russian Federation continues to experience economic difficulties following the financial crisis of August 1998. Consequently, the Country's currency continues to devalue, there is continued volatility in the debt and equity market, hyperinflation persists, confidence in the banking sector has yet to be restored and there continues to be general lack of liquidity in the economy. In addition, laws and regulations affecting businesses operating within the Russian Federation continue to evolve.

The Russian Federation's return to economic stability is dependent to a large extent on the effectiveness of the measures taken by the government, decisions of international lending organisations, and other actions, including regulatory and political developments, which are beyond the Group's control.

The Group's assets and operations could be at risk if there are any further significant adverse changes in the political and business environment. Management is unable to predict what effect those uncertainties might have on the future financial position of the Group. No adjustments related to these uncertainties have been included in the accompanying financial statements.

3. Basis of presentation of the financial statements

A. Rouble consolidated financial statements

Group companies maintain their books of accounts and prepare their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation or of the country in which the particular subsidiary is resident. In the case of the companies resident in the Russian Federation, which account for approximately 90% of assets and liabilities of the Group, the financial statements are based on the statutory records, with adjustments and reclassifications recorded in the financial statements for the purpose of fair presentation in accordance with IAS. Similarly, adjustments to conform with IAS are recorded in the financial statements of companies not resident in Russia.

The adjustments and reclassifications made to the statutory records for the purpose of IAS presentation include the restatement for the changes in the general purchasing power of the RR in accordance with IAS 29 ("Financial Reporting in Hyperinflationary Economies"). IAS 29 requires that the financial statements prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the balance sheet date. Corresponding figures, for the year ended 31 December 1998, have also been restated for the changes in the general purchasing power of the RR at 31 December 1999.

The restatement was calculated using the conversion factors derived from the Russian Federation Consumer Price Index ("CPI"), published by the Russian State Committee on Statistics ("Goscomstat"), and from indices obtained from other sources for years prior to 1992. The indices used to restate the financial statements, based on 1988 prices (1988 = 100) for the five years ended 31 December 1999, and the respective conversion factors, are:

Year	Indices	Conversion Factor
1995	487,575	3.4
1996	594,110	2.8
1997	659,403	2.5
1998	1,216,400	1.4
1999	1,661,481	1.0

The main guidelines followed in restating the financial statements are:

- All amounts, including corresponding figures, are stated in terms of the measuring unit current at 31 December 1999;
- Monetary assets and liabilities are not restated because they are already expressed in terms of the monetary unit current at 31 December 1999;
- Non-monetary assets and liabilities which are not expressed in terms of the monetary unit current at 31 December 1999 and components of shareholders' equity are restated by applying the relevant conversion factors;
- The effect of restating the balance sheet at the date of privatisation was credited to retained earnings;
- All items in the statement of operations and cash flows are restated by applying the relevant conversion factors;
- The effect of inflation on the Group's net monetary position for the period is included in the statement of operations as a monetary gain or loss.

B. U.S. Dollar Translation

U.S. dollar ("US\$") amounts shown in the accompanying financial statements are translated from the RR as a matter of arithmetic computation only, at the official rate of the Central Bank of the Russian Federation at 31 December 1999 of RR 27 = US\$1. The US\$ amounts are presented solely for the convenience of the reader, and should not be construed as a representation that RR amounts have been or could have been converted to US\$ at this rate, nor that the US\$ amounts present fairly the financial position and results of operations and cash flows of the Group in accordance with IAS.

Since 1 January 2000 the devaluation of the RR against the US\$ has continued. As of 30 April 2000, the official exchange rate was RR 28.4 = US\$ 1 and the CPI 1,744,555 (1988 = 100), representing devaluation and inflation rates of approximately 5% for this period.



AVTOVAZ GROUP

Notes to the Consolidated Financial Statements at 31 December 1999

(In thousands of Russian Roubles in terms of purchasing power of the Rouble as of 31 December 1999, Note 3)

3. Basis of presentation of the financial statements (continued)

C. Change in presentation of corresponding figures

For comparative purposes, certain prior year amounts have been reclassified to conform to the current year's presentation. Significant changes in presentation are noted below.

The Group currently presents interest on late or non-payment of taxes within financing costs in the statement of operations. This resulted in the reclassification of RR 4,788,724 of interest expense as previously presented in tax penalties and interest in the prior year to financing expenses.

The Group currently presents expenses previously classified as other expenses in the statement of operations as other operating expenses. This resulted in the reclassification of RR 2,823,574 of other expenses as previously presented in the prior year to other operating expenses.

Management believes these changes provide a more appropriate presentation.

4. Summary of significant accounting policies

A. Consolidation

Subsidiary undertakings, being those companies in which the Company, directly or indirectly, has the ability to exercise control over the operations, have been consolidated. Separate disclosure is made of minority interests.

B. Investments

Investments, including immaterial subsidiaries and associates, are accounted for at restated cost. Provision is made where, in the opinion of the Group's management, there is a permanent decline in value.

C. Revenue recognition

Revenues on sales of cars, parts and miscellaneous production are recognised when items are dispatched to customers. Value-added and excise taxes are deducted to obtain the value of revenue.

D. Trade receivables and payables

Accounts receivable and payable are recorded at nominal value. Accounts receivable include value-added and excise taxes. Accounts receivable are written down to estimated realisable value by recording an allowance for doubtful accounts as considered appropriate by management.

E. Inventories

Inventories are recorded at the lower of restated cost and net realisable value. Cost of inventory is determined on the weighted average basis, and includes material, labour and the appropriate indirect manufacturing costs. Provision is made for potential losses on obsolete or slow-moving inventories taking into account their expected use and future realisable value.

F. Cash and cash equivalents

Cash comprises cash on hand and demand deposits. Cash equivalents comprise short-term investments which are readily converted to cash, are not subject to significant risk of changes in value and mature within three months of the balance sheet date.

G. Property, plant and equipment

Property, plant and equipment are recorded at purchase or construction cost restated to the equivalent purchasing power of the RR at 31 December 1999. However, when the amount the Company expects to recover from the future use of an asset declines below the carrying amount, the carrying amount is reduced to the recoverable amount and the difference is recognised as an expense in the statement of operations.

Depreciation is calculated on the restated amounts of property, plant and equipment on a straight line basis. The depreciation periods, which approximate to the estimated useful economic lives of the respective assets, are as follows:

	Number of years
Buildings	40 to 50
Foundry equipment	25
Plant, machinery and equipment	10 to 20
Other	5 to 10

Repair and maintenance expenditure is expensed as incurred. Short-term assets, which include moulds, dies and tools are expensed in the period acquired.

H. Deferred income taxes

Deferred tax assets and liabilities are calculated in respect of temporary differences using the balance sheet liability method for financial reporting and accounting for deferred income taxes. Deferred income taxes are provided for all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

I. Foreign currency transactions and translation

Balance sheet items denominated in foreign currencies have been translated at the exchange rate at the balance sheet date. Exchange gains or losses arising from the settlements are taken to income for the year. Foreign subsidiary balance sheets and statements of operations have been translated into RR at the year end and average rates of exchange, respectively. Differences arising from translation of foreign subsidiaries' balances are included in shareholders' equity as currency translation adjustments.



AVTOVAZ GROUP

Notes to the Consolidated Financial Statements at 31 December 1999

(In thousands of Russian Roubles in terms of purchasing power of the Rouble as of 31 December 1999, Note 3)

4. Summary of significant accounting policies (continued)

J. Product warranty costs

Estimated costs of future product warranties are fully provided for at the time of the sale of products.

K. Research and development costs

Research and development costs on developing new models and production processes are expensed to the consolidated statement of operations in the year in which they are incurred.

L. Social costs

The Group incurs significant costs on social activities, principally within the City of Togliatti. These costs include the provision of health services, kindergartens, and the subsidy of worker holidays. These amounts represent an implicit cost of employing principally production workers and, accordingly have been charged to cost of sales in the Group's IAS financial statements.

M. Taxation charges

The profits' tax expense for the year within the statement of operations includes current profits' tax payable for the year and the movement in the deferred tax account. Provisions and settlements of claims and similar charges, in accordance with IAS, includes provision for all claims submitted by the tax, customs, hard currency control and other government authorities where management believe claims are substantiated (Note 19). Interest accrued on overdue tax liabilities has been included in interest expense.

N. Finance expense and interest income

Interest income and expenses are recognised on the accrual basis, as earned or incurred.

O. Barter transactions

Approximately 10% of sales and purchases are settled by barter. These are included in the accompanying financial statements on the same basis as cash transactions. Barter transactions are generally either in the form of direct settlement by goods or services, or through a chain of non-cash transactions involving several companies. In such cases, both sales and purchases are recorded as a result of the barter transaction. Barter transactions related solely to operating activity are considered to be cash flows for the purpose of presenting the cash flow statement. Other barter transactions are excluded from the cash flow statement. The receivables and payables recorded in this balance sheet that are expected to be settled by mutual offsets reflect management's estimate of the value to be received or given up in non-cash settlements.

P. Earnings (loss) per share

Earnings per share are calculated by dividing the net profit for the period attributable to shareholders participating in earnings by the weighted average number of ordinary shares in issue during the year, excluding the number of shares held by entities within the Group. Losses are not allocated to preference shares, and thus loss per share is calculated by dividing the loss for the period by the weighted average number of ordinary shares.

Q. Environmental matters

Liabilities for environmental remediation are recognised when it is probable that an obligation exists and the amounts can be reasonably estimated.

R. Financial instruments

The carrying value of cash, cash equivalents, accounts receivable, and accounts payable and accrued liabilities approximate their fair values because of the short maturity of these instruments.

The carrying value of the Group's long-term debt approximates fair value based upon the present value of future cash flows for which inflation adjusted discount rates are used.

S. Pension costs

The Company contributes to the Russian Federation state pension scheme in respect of its employees. The Company's pension scheme contribution amounts to 28% of employees' gross salaries, and is expensed as incurred.

T. Treasury shares

The par value of treasury shares acquired by the Company or by its subsidiaries is deducted from share capital. The difference between the par value and the acquisition price is charged or credited to retained earnings.

5. Balances and transactions with related parties

The transactions with related parties noted below are made in the ordinary course of business on normal commercial terms. The volume of transactions with these related parties is not significant in the context of the Group's overall activities. Balances and transactions with related parties of the Group as at and for the years ended 31 December 1999 and 1998 consist of the following:

A. Balances with related parties:

Balance sheet caption	Relationship	1999	1998
Cash and short-term deposits:	Associate	-	135,527
Trade receivables, gross:	Associate	315,452	569,990
Bad debt provision:	Associate	(183,087)	(138,893)
Prepaid expenses, advances and other receivables:	Associate	-	208,570



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Notes to the Consolidated Financial Statements at 31 December 1999

(In thousands of Russian Roubles in terms of purchasing power of the Rouble as of 31 December 1999, Note 3)

5. Balances and transactions with related parties (continued)

B. Transactions with related parties:

Profit and loss statement caption	Relationship	1999	1998
Net sales:	Associate	359,814	490,857
Purchases:	Associate	277,152	1,031,860
Interest, commissions and other expenses:	Associate	-	73,854

Cash flow statement caption

Cash flow statement caption	Relationship	1999	1998
Net cash provided from (used in) operating activities:	Associate	337,200	(610,225)

C. Cross shareholding:

At 31 December 1999 AVVA, an 81% owned subsidiary of AvtoVAZ, owned 38% of the ordinary shares of the Company. Automobile Financial Corporation, a company in which AvtoVAZ has a 50% interest and AVVA has a 10% interest, in turn owns 23% of the ordinary shares of AvtoVAZ. As approximately 61% of the ordinary share capital of AvtoVAZ is held by entities within the Group, management of AvtoVAZ have effective control of the Group.

6. Cash and cash equivalents

Cash and cash equivalents comprise the following:

	1999	1998
RR denominated cash on hand and balances with banks	957,690	1,176,682
Foreign currency denominated balances with bank	1,718,496	1,871,717
	2,676,186	3,048,399

7. Trade receivables

	1999	1998
Trade receivables		
Rouble denominated	5,255,160	6,731,096
Foreign currency denominated	2,793,587	4,678,778
	8,048,747	11,409,874
Less Provision for doubtful debts		
Rouble denominated	(963,181)	(1,039,611)
Foreign currency denominated	(768,726)	(917,354)
	(1,731,907)	(1,956,965)
Net receivable		
Rouble denominated	4,291,979	5,691,485
Foreign currency denominated	2,024,861	3,761,424
	6,316,840	9,452,909

8. Inventories

Inventories consist of the following:

	1999	1998
Raw materials	3,475,802	5,250,159
Work in progress	1,678,203	1,572,685
Finished products	3,650,832	3,113,258
	8,804,837	9,936,102

9. Property, plant and equipment

Property, plant and equipment and related accumulated depreciation consist of the following:

	Buildings	Plant and equipment	Other	Assets under construction	Total
Cost					
Balance at 31 December 1997	43,485,829	50,134,432	7,365,862	21,863,117	122,849,240
Additions / Transfers in	1,980,784	4,796,751	53,344	2,710,950	9,541,829
Disposals / Transfers out	(1,872,708)	(1,475,013)	(860,280)	(7,336,263)	(11,544,264)
Balance at 31 December 1998	43,593,905	53,456,170	6,558,926	17,237,804	120,846,805
Additions / Transfers in	1,177,671	6,328,437	40,366	4,058,289	11,604,763
Disposals / Transfers out	(919,045)	(1,712,240)	(338,512)	(7,048,761)	(10,018,558)
Balance at 31 December 1999	43,852,531	58,072,367	6,260,780	14,247,332	122,433,010
Accumulated Depreciation					
Balance at 31 December 1997	(15,249,765)	(31,079,478)	(4,029,477)	(3,312,235)	(53,670,955)
Depreciation expense for 1998	(1,106,609)	(2,469,397)	(238,111)	-	(3,814,117)
Disposals	408,273	1,210,763	309,169	-	1,928,205
Provision for impairment of assets	(2,076,948)	-	(692,334)	(455,846)	(3,225,128)
Balance at 31 December 1998	(18,025,049)	(32,338,112)	(4,650,753)	(3,768,081)	(58,781,995)
Depreciation expense for 1999	(1,017,291)	(2,377,651)	(209,389)	-	(3,604,331)
Disposals	202,064	1,309,822	121,655	-	1,633,541
Balance at 31 December 1999	(18,840,276)	(33,405,941)	(4,738,487)	(3,768,081)	(60,752,785)



AVTOVAZ GROUP

Notes to the Consolidated Financial Statement sat 31 December 1999

(In thousands of Russian Roubles in terms of purchasing power of the Rouble as of 31 December 1999, Note 3)

9. Property, plant and equipment (continued)

	Buildings	Plant and equipment	Other	Assets under construction	Total
Net Book Value					
Balance at 31 December 1998	25,568,856	21,118,058	1,908,173	13,469,723	62,064,810
Balance at 31 December 1999	25,012,255	24,666,426	1,522,293	10,479,251	61,680,225

Assets Under Construction (AUC) includes the cost of fixed assets which have yet to be put into production. The majority of the transfers out from AUC were placed in service and transferred into Buildings and Plant and Equipment. The Company presently does not have funds available to finance the completion of the remaining projects in AUC. However, management believes that the completion of these assets will be financed through operations and additional financing.

The accumulated depreciation within assets under construction of RR 3,768,081 at 31 December 1999 and 1998 represents the cumulative impairment provision on assets under construction. The cumulative impairment provision included within the accumulated depreciation of the remaining property, plant and equipment is RR 2,769,282.

The assets transferred to the Company upon privatisation do not include the land on which the Company's factories and buildings, comprising the Group's principal manufacturing facilities, are situated. The Company has the option to purchase this land upon application to the Property Fund of the Samara Oblast or to continue occupying this land under a rental agreement. Russian legislation does not specify an expiry date to this option. At 31 December 1999 the Company has not filed any application to exercise the purchase option.

At 31 December 1999 and 31 December 1998, the gross carrying value of fully depreciated property, plant and equipment was RR 20,775,601 and RR 20,077,773, respectively.

10. Investments

Principal investments accounted for at restated cost comprise:

Entity	Country	Activity	1999 % share	1998 % share	1999	1998
AO AvtoVAZbank	Russian Federation	Banking	4.2%	35%	1,103,961	1,103,961
Other investments					1,241,134	1,035,194
Total investments					2,345,095	2,139,155
Provision for write down to estimated recoverable value					(1,185,794)	(1,160,951)
Total investments net of provision					1,159,301	978,204

As a result of a capital increase in 1999 by AvtoVAZbank, the Company's interest was diluted from a 35% interest to a 4.2% interest. The Company no longer considers this investment to be an associate, however, this has no effect on these financial statements as this investment was, and continues to be, accounted for at cost.

The provision relates to 100% of the investment in AO AvtoVAZbank as well as to amounts that have been recorded to write certain other investments down to realisable values.

11. Short-term and long-term debt due after one year

Short-term and long-term debt by principal lender may be analysed as follows:

	1999	1998
Short-term debt (including current portion of long-term debt)		
Vnesheconombank	2,277,342	2,030,461
Ministry of Finance	447,861	337,268
Sberbank	150,000	54,687
Standard Chartered Bank (UK) and Sudwest Deutsche Landesbank (Germany)	-	1,441,675
Various financial institutions	965,017	378,060
	3,840,220	4,242,151

Short-term debt comprises a total of foreign currency denominated loans in USS/DM of RR 2,866,901 (1998: RR 3,841,657) and RR denominated loans of RR 973,319 (1998: RR 400,494) at fixed interest rates ranging from 3.8% to 15% and 43% to 74% respectively.

	1999	1998
Long-term debt		
Vnesheconombank	9,825,017	12,250,857
Ministry of Finance	626,400	927,487
Other	885,569	1,048,320
	11,336,986	14,226,664

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(In thousands of Russian Roubles in terms of purchasing power of the Rouble as of 31 December 1999, Note 3)

11. Short-term and long-term debt due after one year (continued)

Long-term debt by category of loan consists of the following:

Currency	Interest Rate	1999	1998
US\$/DM	3.8%–8.6%	10,955,528	13,990,744
RR	43%–74%	381,458	235,920
Total loans from financial institutions		11,336,986	14,226,664

Long-term debt is repayable as follows:

	1999	1998
1 to 2 years	2,219,438	2,850,401
2 to 3 years	1,650,741	1,802,081
3 to 4 years	1,650,741	1,802,081
4 to 5 years	1,650,741	1,802,081
Over 5 years	4,165,325	5,970,020
	11,336,986	14,226,664

As at 31 December 1999 and 1998 loans for RR 2,152,500 and RR 1,217,490, respectively, inclusive of short-term borrowings, are guaranteed by collateral of receivables and inventories.

The Group has not entered into any hedging arrangements in respect of its foreign currency obligations or interest rate exposures.

12. Taxation

Taxes payable—current

Taxes payable—current are comprised of the following:

	1999	1998
Value-added tax	219,115	1,828,427
Profit tax	-	449,325
Penalties and interest on profit tax	62,009	1,908,787
Other taxes	2,863,591	1,605,966
Penalties and interest on other taxes	3,073,788	6,474,315
Excise tax	167,471	109,654
Current portion of taxes restructured to long-term	385,818	303,432
	6,771,792	12,679,906

The principal tax liabilities past due accrue interest each day at one three hundredth of the current refinancing rate of the Central Bank of Russia which, at 31 December 1999 was equal to an effective rate of 67% (1998: 73%). The principal tax liabilities past due at 31 December 1999 and 1998 was approximately RR 900 million and RR 1,360 million, respectively.

Long-term taxes payable

Long-term taxes payable comprise various taxes payable to the Russian Government which were previously past due and which have been restructured to be repaid over a period of up to 10 years following the application of Government Resolutions 254 and 1316 as described below.

The net present value of this debt and its maturity profile is as follows:

	1999			1998		
	Federal	Regional taxes and other state funds	Total	Federal	Regional taxes and other state funds	Total
Current	285,600	100,218	385,818	195,051	108,381	303,432
1 to 2 years	285,600	4,534,669	4,820,269	390,101	97,609	487,710
2 to 3 years	285,600	156,695	442,295	390,101	326,200	716,301
3 to 4 years	285,600	587,027	872,627	390,101	291,249	681,350
4 to 5 years	285,600	124,236	409,836	390,101	259,268	649,369
Thereafter	2,358,070	1,030,852	3,388,922	2,144,463	2,450,907	4,595,370
Total restructured	3,786,070	6,533,697	10,319,767	3,899,918	3,533,614	7,433,532
Less: portion of taxes payable – current	(285,600)	(100,218)	(385,818)	(195,051)	(108,381)	(303,432)
Long-term portion of restructured taxes	3,500,470	6,433,479	9,933,949	3,704,867	3,425,233	7,130,100

Restructured taxes and other state funds includes RR 3,466,104 and RR 3,899,918 at 31 December 1999 and 1998, respectively, which accrue interest at the official rate of financing of the Central Bank of Russia (31 December 1999: 55%, 31 December 1998: 60%).



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Notes to the Consolidated Financial Statements at 31 December 1999

(In thousands of Russian Roubles in terms of purchasing power of the Rouble as of 31 December 1999, Note 3)

12. Taxation (continued)

Long-term taxes payable (continued)

As part of the condition of restructuring the federal taxes, the Company was required to register 50% plus one share of the authorised statutory share capital with the Russian Federal Property Fund ("RFPF"). These shares will be auctioned by the government in the event that the Company makes no payment on these restructured taxes within two months after the due date of its payable or if the Company has more than two late payments within a period of 12 months (Note 14).

Other principal conditions related to restructuring the federal taxes include:

- the Company is not able to perform a securities issue of voting shares;
- the Company should inform the Ministry of Taxes and Duties of its intentions to dispose of shares of its subsidiaries or main production assets exceeding 10% of the total value of these assets.

The Company is in compliance with the terms of restructuring the federal tax debts at 31 December 1999.

13. Gains on extinguishment and forgiveness of debt

Gains on forgiveness and extinguishment of debt credited to the statement of operations comprise:

	1999	1998
Gain on forgiveness of tax debts	977,268	3,761,094
Gain on extinguishment of tax debts	2,116,125	1,463,493
Gain on extinguishment of other borrowings	2,037,871	—
	5,131,264	5,224,587

During 1998, the gain on the forgiveness of debt arises from the application of certain government resolutions which resulted in an eighty per cent reduction of penalties and interest accrued on the late or non-payment of taxes which accrued in 1998. During 1999 interest was forgiven in accordance with the Tax Code which came into effect in 1999. The Tax Code provides that the amount of accrued interest cannot be in excess of the principal debt, and as such, a gain was realised on the previously recorded interest in excess of the principal balance.

The net gain on extinguishment of tax debt arises from the application of Resolutions 254 and 1316 which restructures current tax debts by deferring payment of liabilities to the federal and regional tax authorities and pension and road funds to between 8 and 10 years free of interest. This restructuring constituted a substantial modification in terms of the difference between the recorded value of the tax liabilities prior to restructuring and the present value of the future cash flows of the restructured liabilities. The difference between the recorded and net present value of the restructured liabilities, using a discount rate of 12%, is accounted for as an extinguishment of debt and, accordingly, a gain of RR 3,745,797 (1998: RR 1,463,493) was included in the net gain on extinguishment of tax debts. The gain recorded in 1999 is net of a reversal of a prior year gain on the restructuring of pension fund liabilities in the amount of RR 1,629,672. Although all payments have been made in relation to the pension fund restructuring agreement for 1999, this prior year gain has been reversed because the restructuring agreement was terminated in January 2000. Despite having confirmation from the pension authorities in 1998 that the restructuring agreement was still in effect, the agreement was subsequently terminated as a result of not paying amounts due to the pension fund for two months in 1998. Management is in the process of negotiating the restructuring of these amounts with the pension fund authorities including the amounts not paid in relation to the pension fund liability in 1998.

Management negotiated the settlement of US\$ 118 million of the Group's current portion of long-term debt, as discussed in Note 11, through consideration of RR 575,340 of cash and RR 2,354,743 of non-interest bearing rouble denominated bills of exchange payable between 18 and 20 years. The present value of these bills of exchange using a 12% discount rate is RR 316,872. The resulting gain of RR 2,037,871 has been credited to the statement of operations as an extinguishment of debt. Subsequent to year end Management has settled another US\$ 260 million through consideration of RR 925,288 of cash, RR 580,000 of non-interest bearing rouble denominated bills of exchange payable within 1 year, and RR 5,731,133 of non-interest bearing rouble denominated bills of exchange payable between 26 and 30 years.

14. Share capital

The carrying value of share capital, as restated in terms of the purchasing power of the Rouble as of 31 December 1999, and the legal share capital value subscribed, issued and fully paid up, consists of the following classes of shares:

	1999			1998		
	No. of shares	Legal statutory value	Carrying amount	No. of shares	Legal statutory value	Carrying amount
Class A preference	4,930,340	2,465,170	6,000,981	4,930,340	2,465,170	6,000,981
Ordinary	27,194,624	13,597,312	33,100,032	27,194,624	13,597,312	33,100,032
Total share capital	32,124,964	16,062,482	39,101,013	32,124,964	16,062,482	39,101,013
Less: Treasury share capital	(16,983,226)	(8,491,613)	(20,671,193)	(17,174,005)	(8,587,003)	(20,903,402)
Total outstanding share capital	15,141,738	7,570,869	18,429,820	14,950,959	7,475,479	18,197,611



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14. Share capital (continued)

Class A preference shares, which were issued to employees free of charge at the privatisation date (see Note 1), give the holders the right to participate in general shareholders' meetings without voting rights except in instances where decisions are made in relation to re-organisation and liquidation of the Company, and making changes and amendments to the Company's charter which restrict the rights of preference shareholders. The preferred shares have no rights of redemption or conversion but carry guaranteed dividends per share of 10% of net profits for the year as defined by Russian accounting legislation divided by the number of preference shares outstanding at privatisation (5,354,161). If the Company fails to pay dividends, or has no profits in any year, the preferred shareholders have the right to vote in the general shareholders' meeting. As a result, the preferred shares have carried voting rights since 1996. These voting rights will continue until the year when the guaranteed dividend for that year is paid.

Dividends declared for a single common share cannot exceed the dividend declared for a single preference share for any period. As such, the preference holders share in earnings along with ordinary holders and thus the preference shares are considered participating securities.

Treasury shares mainly represent ordinary shares of the Company held within the other Group members. All Russia Automobile Alliance (AVVA) and ZAO Automobile Finance Corporation (AFC), subsidiaries of the Company, own approximately 38% and 23% of the ordinary share capital, respectively. As set out in Note 5, this results in the management of AvtoVAZ having effective control of the Group.

During 1998, 10,646 shares were repurchased by the Company for RR 490 and placed into treasury. The difference between the consideration given and the inflation adjusted par value resulted in a credit to retained earnings of RR 12,469. During 1999, the Group sold 190,779 shares previously held in treasury for a value of RR 56,717. The difference between the consideration received and the inflation adjusted par value resulted in a credit to retained earnings of RR 175,492.

No dividends were proposed at the 1999 and 1998 Annual General Shareholders' Meeting. This was approved by the shareholders.

During 1999, the Company increased the authorised shares by 32,124,965 to bring the total authorised shares to 64,249,929. These shares will be auctioned by the Russian government in the event of defaults in the tax restructuring agreements as described in Note 12 under the heading "Long-term taxes payable".

15. Net sales revenue

The components of net sales were as follows:

	1999	1998
Finished vehicles	52,792,960	49,024,580
Automotive components and assembly kits	4,983,338	6,703,195
Repair services	4,324,175	5,926,501
Other sales	970,675	1,327,478
	63,071,148	62,981,754

Other sales are represented by transportation and utilities services.

16. Cost of sales

The components of cost of sales were as follows:

	1999	1998
Changes in inventories of finished goods and work in progress	(643,092)	942,852
Materials and components used	32,383,935	34,778,581
Labour costs	4,471,332	5,241,882
Depreciation	3,604,331	3,814,117
Production overheads	11,260,300	11,114,877
Social expenditure	1,299,268	2,037,100
	52,376,074	57,929,409

17. Selling, general and administrative expenses

Selling, general and administrative expenses comprise:

	1999	1998
Labour	1,488,693	2,184,868
Taxes (property, dwelling)	1,456,814	1,592,639
Road user tax	1,301,273	1,275,751
Transportation	814,477	1,224,511
Repairs and improvements to fixed assets	584,240	778,866
Bad debt expense	(296,214)	1,172,669
Advertising	120,183	122,931
Discounts and commissions to dealers	107,156	144,201
Materials	86,381	203,228
Other	602,384	803,054
	6,265,387	9,502,718

18. Research and development expenses

Research and development expenses comprise:

	1999	1998
Materials	532,097	704,537
Labour and other costs	518,441	457,080
	1,050,538	1,161,617



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19. Other operating expenses

The components of other operating expenses were as follows:

	1999	1998
Write-off or loss on disposal of fixed assets	(549,090)	(1,238,811)
Provision for impairment of investments	(24,843)	(310,059)
Provisions and settlements of claims and similar charges	(2,628,862)	(795,885)
Write-off of non-recoverable promissory notes	(56,902)	(55,300)
Other	(94,743)	(423,519)
	(3,354,440)	(2,823,574)

20. Income tax expense

	1999	1998
Current profits' tax	1,241,648	2,617,522
Movement in deferred tax account	1,900,789	4,964,096
	3,142,437	7,581,618

The tax charge of the Group may be reconciled as follows:

	1999	1998

IAS profit before taxation in AO AvtoVAZ's consolidated financial statements 4,175,501 1,135,224

Theoretical tax charge at statutory rate of 30% (1998: 35%) thereon 1,252,650 397,328

Tax effect of items which are not deductible or assessable for taxation purposes:

Non-taxable foreign exchange gain	-	(1,030,949)
Tax penalties and interest	625,317	359,670
Qualifying capital expenditure	(387,612)	(744,969)
Non-temporary elements of monetary gain	2,308,830	4,810,376
Other non-deductible expenses	2,855,248	5,507,503

Inflation effect on deferred tax balance at beginning of the year	(679,646)	1,111,332
Effect of reduction in tax rate	(362,444)	-
Temporary difference on statutory revaluation of tax base	(2,469,906)	(2,828,673)

Consolidated tax charge 3,142,437 7,581,618

In general the companies in the Group are subject to tax rates of 30% (before 1 April 1999: 35%) on taxable profits. In the context of the Group's current structure, tax losses in different companies may not be applied against taxable profits of other companies and accordingly taxes may accrue even where there is a net consolidated tax or accounting loss.

	31 December 1998	Change in tax rate	Movement in year	31 December 1999
Tax effects of future deductible items (temporary differences):				
Trade receivables	5,092,281	(727,469)	(1,926,395)	2,438,417
Inventories	80,535	(11,505)	373,332	442,362
Property, plant and equipment	(8,688,489)	1,241,213	472,357	(6,974,919)
Accounts payable and provisions	1,133,177	(161,882)	(860,104)	111,191
Other temporary differences	(154,615)	22,087	(322,423)	(454,951)
Deferred tax liability	(2,537,111)	362,444	(2,263,233)	(4,437,900)

21. Contingencies, commitments and guarantees

A. Contractual commitments

As at 31 December 1999 the Group had contractual commitments for the purchase of plant, property and equipment from third parties for RR 369,900 (1998: RR 590,093). At the same date the Group had given no guarantees in favour of third parties or related companies.

B. Taxation

Russian tax legislation is subject to varying interpretations and changes occurring frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group's entities may not coincide with that of management. As a result, transactions may be challenged by tax authorities and the Group's entities may be assessed additional taxes, penalties and interest, which can be significant. The periods remain open to review by the tax and customs authorities with respect to tax liabilities for three years. In addition, the Company is subject to several claims from tax authorities for additional taxes and related fines and penalties. In the opinion of management, the ultimate outcome of these claims should not have a material adverse effect on the result of operations or financial position of the Company.



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Notes to the Consolidated Financial Statements at 31 December 1999

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21. Contingencies, commitments and guarantees (continued)

C. Insurance policies

The Group holds no insurance policies in relation to its assets, operations, or in respect of public liability or other insurable risks, with the exception of insurance policies covering export shipments, and no provisions for self-insurance are included in the accompanying balance sheet.

D. Environmental matters

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

E. Credit risk

Financial assets which potentially subject the Group to concentrations of credit risk consist principally of cash and trade receivables. Cash and trade receivables are presented net of the provision for credit risk. Credit risk with respect to individual trade receivables is limited due to the large number of customers comprising the Group's customer base. The Group has no significant concentration of credit risk.

F. Legal proceedings

The Company is a party to certain legal proceedings arising in the ordinary course of business. Also, the Company is subject to various environmental laws regarding handling, storage, and disposal of certain products and is subject to regulation by various governmental authorities. In the opinion of management, there are no current legal proceedings or other claims outstanding which could have a material adverse effect on the result of operations or financial position of the Company.

22. Principal subsidiaries and associates

The principal subsidiaries consolidated within the Group and the degree of control exercised by AO AvtoVAZ are as follows:

Entity	Country of Incorporation	Activity	1999 % share	1998 % share
AO AVVA	Russia	Investments	81	81
AO DAAZ	Russia	Car components	100	100
AO AvtoVAZagregat	Russia	Car components	100	100
AO SAAZ	Russia	Car components	100	100
AO AvtoVAZtrans	Russia	Transport	100	100
AO Tevis	Russia	Utilities	100	100
AO SeAZ	Russia	Car assembly	100	100
ZAO AFC	Russia	Financial	58	58
Lada International Ltd.	Cyprus	Car distribution	100	100
Lada Car Trading SpA	Italy	Car distribution	60	60
Oy Konela Ab	Finland	Car distribution	70	70
113 Technical Service Centres	Russia	Car service centres	50.1-100	50.1-100

In addition to the above there are a further two subsidiaries which have not been consolidated within the Group as they are insignificant in total. These non-consolidated subsidiaries accounted for at restated cost comprise:

Entity	Country of Incorporation	Activity	1999 % of share	1998 % of share
Lada Hellas S.A.	Greece	Car distribution	50	50
Lada Parts Hellas S.A.	Greece	Spare parts distribution	50	50

A number of subsidiaries located in the republics of the Former Soviet Union (excluding the Russian Federation) were not consolidated, since AvtoVAZ lost effective control of these subsidiaries when the republics gained independence and is in the process of trying to regain control.

All associated companies are immaterial to the Group and are included in investments at restated cost (Note 10). The principal associated companies and degree of ownership by the Group are as follows:

Entity	Country of Incorporation	Activity	1999 % share	1998 % share
FerroVAZ GmbH	Germany	Metal production	50	50



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Date of the Company's state registration	5 January 1993, registration number – 2925
Shareholder relations:	Property Department of AO AVTOVAZ Telephone: (8482) 34 96 66 Facsimile: (8482) 37 81 61 e-mail: vla@vaz.ru epm@tlt.volga.ru
Keeper of the shareholders' register:	OAO "Tsentralny Moskovskiy Depositariy" 107066, Moscow, ul. Olkhovskaya, 22 Telephone: (095) 263 81 53 Facsimile: (095) 263 80 69 www.mcd.ru

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