AB ALYTAUS TEKSTILĖ

Independent Auditor’s Report,
Annual Report and
Financial Statements
for the year ended 31 December 2005

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INDEPENDENT AUDITOR'S REPORT

To the shareholders of AB Alytaus Tekstilė:

1. We have audited the accompanying financial statements (page 6 to 25) of AB Alytaus Tekstilė (thereafter – the Company), which comprise the balance sheet as of 31 December 2005, and the related statements of income, changes in equity and cash flow for the year then ended, and a summary of significant accounting policies and other explanatory notes. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit.

2. Except as discussed in the paragraph 3 and 4, we conducted our audit in accordance with the International Standards on Auditing issued by the International Federation of Accountants. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. 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. The historical cost of fixed assets acquired or constructed by the Company before 1996 has been indexed (revalued), to compensate for the changes in prices during the hyperinflationary period, by application of indices regulated and approved by the Government of the Republic of Lithuania. In our judgement, those indices did not ensure that the fixed assets were stated at fair value and no other reliable price indices were available to state the fixed assets at fair value. As the Company's assets are valued neither at cost nor at fair value, we do not express an opinion whether the Company's fixed assets as of 31 December 2005 and 2004 are fairly stated in accordance with International Financial Reporting Standards.

4. In our judgment, there are indications that the Company's fixed assets might be impaired, e.g. the Company has incurred significant operating losses during 2005 and during preceding years and the Company's utilization of certain production capacity is 50% or less. The Company has not made an estimate of the recoverable amount of the fixed assets, as required by International Financial Reporting Standards, when such indications exist. Accordingly, we were unable to satisfy ourselves whether the Company's fixed assets as of 31 December 2005 and 2004, carried at a value of LTL'000 66,414 and LTL'000 73,921 respectively, are properly stated in accordance with International Financial Reporting Standards.

5. In our opinion, except for the impact, if any, on the financial statements of the matters described in paragraphs 3 and 4, the financial statements present fairly, in all material respects, the financial position of the Company as of 31 December 2005 and the result of its operations, changes in equity and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

6. Without further qualifying our opinion, we draw attention to note 26 of the financial statements. For the years ended 31 December 2005 and 2004, the Company incurred a loss of LTL'000 15,994 and LTL'000 15,673, respectively, and as of 31 December 2005 and 2004 current liabilities exceeded current assets by LTL'000 23,527 and LTL'000 9,926, respectively. The Company's continued operations are significantly reliant upon sales of real estate and on a successful outcome of negotiations regarding the continued financing, as further described in note 26. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

7. We have reviewed the Annual Report (page 4 to 5) for the year ended 31 December 2005 and we have not identified any material discrepancies between the historical financial information presented in the Annual Report and the accompanying financial statements financial statements for the year ended 31 December 2005.

UAB Deloitte Lietuva
General Director Juozas Kabašinskas

Certified auditor Rima Kvietkauskaitė
Auditor's Certificate No. 0000369

Vilnius, Lithuania
10 April 2006

AB Alytaus Tekstilė proceeds further on implementing the program of renovation of production technology, optimizing management with the final goal to become a stable company of European level which could successfully compete in target markets by increasing the confidence of the clients and secure the expansion of the business. Unfortunately year 2005 was not a brake-through year for the company though much has been done in accommodation to the market changes and in restructuring of all activities of the company.

During 2005 **sales and production rates** has declined. In comparison with the year 2004 the sales of ready made fabrics have decreased by 1.241 mln. m, processing – by 0.1 mln. m. yarn sales – by 0.231 ton. Success has been achieved in ready made sewing sales which increased by 1.032 mln. m. The expansion of sewing production was in the level of 27%.

Main **sales countries** were the same: Lithuania (26%), Sweden (25%), Italy (15%), Finland, Germany, Estonia, England and Holland. Market sales have increased for Finland from 9.1% in 2004 till 12.4% in 2005 and for Germany from 6.2% in 2004 till 8.5% in 2005.

As production capacity has decreased in 2005 **531 employees were shelved**. With changes in work specialization part of the employees has changed their qualifications and were shifted to the new working places. Implementation of the new technologies gave a possibility to hire 113 employees. Withal the average salary level increased by 10% in 2005.

The financial rates for 2005 show the losses from the company's main activities. It has been planned in the budget of 2005 to reach the sales of LTL'000 83,891, that was by 10% more than in the year 2004 (LTL'000 76,277), but actual sales were in the volume of LTL'000 69,991. (LTL'000 13,900 less than budget). Annual loss for 2005 was in the amount of LTL'000 15,994.

Main causes of decrease of the sales volume:

- Weakening exchange rate of US dollar to EUR increase sales of competitors (China, Pakistan, Brazil) in EU;
- Some big clients have canceled there programs with AB "Alytaus Tekstilė" shifted their orders to China (LUCK - Germany, BOYD COOPER - UK);
- During second half of 2005 big sewing orders have not been fulfilled because of the lack of working capital.

Main causes of annual loss:

- Decrease of the sales volume forced to pay employees for downtime and pay shelving compensations (compensation payment – LTL'000 2,334; minimum salary payment for downtime – LTL'000 1,762);
- Shortage of working capital forced cuts in ordered production volumes. Delays in salary payment and raised the volume of nonproductive expenditures (penalties for delayed salaries – LTL'000 640; economical sanctions – LTL'000 329);
- Increase of electricity and water supply tariffs – LTL'000 448;
- Formed provisions and write offs, also stocks evaluated to the market value – LTL'000 4,687 (stocks recalculated to the market value and additionally recalculated consumption of assets in usage – LTL'000 4,423; provisions formed to the bad debts – LTL'000 264).

Summarizing, the constant lack of working capital which determined the fitful work in production, not implemented planned investments in 2005, increase in raw material prices, decrease in sales volumes and high production costs struck the annual loss to LTL'000 15,994.

Looking forward, the company has drawn ambitious plans and will try to succeed

- Reach sales volume of mln LTL 87.8 i.e. 26% more than in 2005;
- Achieve mln LTL 2.3 of net profit;
- Increase by 29% in fabric sales;
- Increase by 25% in sewing sales;
- Increase by 22% in yarn sales ;
- Sustain increase of product quality;
- Increase the segment sales of expensive printed fabrics in the whole sales;
- Reorganize weaving production by achieving the bigger surplus value fabric output;
- Enhance management and accountancy by implementing informational technologies.

By implementation of these measures, producing expensive high quality home textile items, fabrics for work wear, uniforms, the company expects to increase sales volume. Further enhancements in management structure and accountancy system are planned.

The Company's administration wish to thank all employees for their work during last year and wish more optimism and effective work for 2006.

Nerijus Eidukevičius
Chairman of the Board

AB ALYTAUS TEKSTILĖ

BALANCE SHEET
AS OF 31 DECEMBER 2005

	Notes	2005 LTL'000	2004 LTL'000
ASSETS			
Non-current assets:			
Property, plant and equipment	**4**	66,414	73,921
Intangible assets	**5**	8	21
Total non-current assets		**66,422**	**73,942**
Current assets:			
Inventories	**6**	16,191	21,788
Accounts receivable and other current assets	**7**	4,649	5,627
Cash and cash equivalents	**8**	170	447
Total current assets		**21,010**	**27,862**
TOTAL ASSETS		**87,432**	**101,804**
EQUITY AND LIABILITIES			
Equity:			
Share capital	**9**	46,505	103,946
Revaluation reserve	**10**	45,587	45,587
Accumulated deficit		(53,954)	(95,401)
Total equity		**38,138**	**54,132**
Non-current liabilities:			
Long-term borrowings	**12**	1,196	3,116
Long-term trade payables		1,851	334
Other long-term liabilities	**13**	1,706	6,421
Obligations under finance lease	**14**	4	13
Total non-current liabilities		**4,757**	**9,884**
Current liabilities:			
Short-term borrowings	**15**	10,136	11,822
Current portion of long-term borrowings	**12**	2,300	1,975
Current portion of obligations under finance leases	**14**	9	8
Trade notes payable		1,167	1,913
Accounts payable and other current liabilities	**16**	30,925	22,070
Total current liabilities		**44,537**	**37,788**
TOTAL EQUITY AND LIABILITIES		**87,432**	**101,804**

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

These financial statements were approved on 10 April 2006 and signed by:

General Director Virginija Graudinienė	Chief Financial Officer Gražina Ludavičienė

STATEMENT OF INCOME
FOR THE YEAR ENDED 31 DECEMBER 2005

	Notes	2005 LTL'000	2004 LTL'000
Sales	**17**	69,991	76,277
Cost of sales	**17**	(74,995)	(78,663)
GROSS LOSS		**(5,004)**	**(2,386)**
Sales and distribution expenses	**18**	(4,884)	(4,480)
Operating expenses	**19**	(8,738)	(7,823)
Other operating income		5,793	2,761
Other operating expenses		(1,843)	(1,606)
OPERATING LOSS		**(14,676)**	**(13,534)**
Finance costs		(1,033)	(1,836)
Interest income		-	4
Net foreign currency exchange loss		(285)	(307)
Net loss before taxes		**(15,994)**	**(15,673)**
Income tax	**20**	-	-
NET LOSS		**(15,994)**	**(15,673)**
Basic and diluted loss per share (in LTL)		**(0.16)**	**(0.16)**

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

These financial statements were approved on 10 April 2006 and signed by:

General Director	Chief Financial Officer
Virginija Graudinienė	Gražina Ludavičienė

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2005

	Share capital LTL'000	Revaluation reserve LTL'000	Legal reserve LTL'000	Accumulated deficit LTL'000	Total LTL'000
As of 31 December 2003	**85,744**	**45,587**	**1,365**	**(81,093)**	**51,603**
Shareholders' contribution in cash (note 9)	5,000	-	-	-	5,000
Shareholders' contribution by conversion of loan and accrued interest (note 9)	13,202	-	-	-	13,202
Use of legal reserve	-	-	(1,365)	1,365	-
Net loss	-	-	-	(15,673)	(15,673)
As of 31 December 2004	**103,946**	**45,587**	**-**	**(95,401)**	**54,132**
Reduction of share capital to cover accumulated deficit (note 9)	(57,441)	-	-	57,441	-
Net loss	-	-	-	(15,994)	(15,994)
As of 31 December 2005	**46,505**	**45,587**	**-**	**(53,954)**	**38,138**

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

These financial statements were approved 10 April 2006 and signed by:

General Director	Chief Financial Officer
Virginija Graudinienė	Gražina Ludavičienė

AB ALYTAUS TEKSTILĖ

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2005

	2005 LTL'000	2004 LTL'000
CASH FLOWS FROM (TO) OPERATING ACTIVITIES		
Net loss	**(15,994)**	**(15,673)**
Adjustments for:		
Depreciation and amortization	4,964	5,340
Gain on disposal of fixed assets	(4,139)	(1,261)
Provision for doubtful receivables	264	347
Write off of obsolete and slow moving inventory	4,423	2,623
Use of inventory previously written-off	(560)	(348)
Proceeds from accounts receivable previously provided for	(346)	(36)
Other non-cash items	380	-
Interest expense	1,033	1,836
Interest income	-	(4)
	(9,975)	**(7,176)**
Changes in operating assets and liabilities:		
Accounts receivable and other current assets	1,060	4,607
Inventory	1,734	(3,010)
Accounts payable and other current liabilities	488	4,919
Cash used in operating activities	**(6,693)**	**(660)**
Interest paid	(1,149)	(1,665)
Net cash used by operating activities	**(7,842)**	**(2,325)**
CASH FLOWS FROM (TO) INVESTING ACTIVITIES		
Purchase of tangible and intangible fixed assets	(210)	(2,595)
Proceeds from sales of tangible fixed assets	6,810	3,724
Interest received	-	4
Net cash from investing activities	**6,600**	**1,133**
CASH FLOWS FROM (TO) FINANCING ACTIVITIES		
Contribution to share capital in cash	5,000	5,000
Repayment of borrowings	(3,281)	(3,852)
(Repayment of) / proceeds from trade bills	(746)	521
Repayments of finance leases	(8)	(170)
Net cash from financing activities	**965**	**1,499**
Net (decrease) / increase in cash	**(277)**	**307**
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	**447**	**140**
CASH AND CASH EQUIVALENTS, END OF YEAR	**170**	**447**

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

These financial statements were approved 10 April 2006 and signed by:

General Director	Chief Financial Officer
Virginija Graudinienė	Gražina Ludavičienė

1. GENERAL INFORMATION

The Company was incorporated and commenced its' operations in 1968. The Company's main location is Pramonės str. 1, Alytaus, Lithuania. The Company's principal business activity is the production of yarn, textile fabrics and sewn goods.

2. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS

In the current year, the Company has adopted all of the new and revised Standards and Interpretations issued by the International Accounting Standards Board (the IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for accounting periods beginning on 1 January 2005. The adoption of these new and revised Standards and Interpretations has resulted in no significant impact to the Company's financial position and results of its operations.

At the date of authorization of these financial statements, the following Standards and Interpretations were issued but not yet effective:

New standard, interpretation, amendment	Issued	Effective for annual periods beginning on or after
Amendments to IAS 39 - Cash flow hedge of forecast intragroup transactions - Guarantee contracts (IFRS 4 amended accordingly) - Fair value option	2004	1 January 2006
Amendment to IAS 1 to add capital disclosures	2005	1 January 2007
Employee Benefits	2004	1 January 2006
Insurance Contracts Amendment for financial guarantee contracts	2005	1 January 2006
IFRS 6 Exploration for and evaluation of mineral resources (IFRS 1 amended accordingly)	2004	1 January 2006
IFRS 7 Financial Instruments: Disclosure (supersedes IAS 30)	2005	1 January 2007
IFRIC 4 – Determining whether an Agreement contains a Lease	2004	1 January 2006
IFRIC 5 Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds	2004	1 January 2006
IFRIC 6 Liabilities arising from Participation in a specific market – Waste electrical and electronic references	2005	1 December 2005
IFRIC 7 Applying the restatement approach under IAS 29 Financial reporting in hyperinflationary economies	2005	1 March 2006
IFRIC 8 Scope of IFRS 2	2006	1 May 2006
IFRIC 9 Reassessment of embedded derivatives	2006	1 June 2006

The management anticipates that the adoption of these Standards and Interpretations in future periods will have no significant impact on the financial statements of the Company.

3. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

The financial statements have been prepared on the historical cost basis, except for the revaluation of financial instruments and except for certain property, plant and equipment acquired before 1 January 1996, which are revalued in accordance with indexations set by the Lithuanian Government, and which does not correspond to cost or fair value. For details see Note 4.

The accompanying financial statements are presented in the national currency of Lithuania, the Litas (LTL).

The principle accounting policies adopted are set out below.

Critical judgments in applying the entity's accounting policies
Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Fixed assets depreciation rates
In making its judgment for the remaining useful life of property plant and equipment, management considered the conclusions from employees responsible for technical maintenance of assets.

Key sources of estimation uncertainty
The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Recoverability of property, plant and equipment
The management of the Company is confident that the Company is able to continue as a going concern and that the carrying amount of property, plant and equipment will be recovered in full. The recoverability of tangible assets depends upon satisfactory resolution of the going concern issues mentioned in note 26. The situation will be closely monitored, and adjustment made in the future if the Company is not able to continue as going concern.

Leasing
Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

The Company as lessee
Assets held under finance leases are recognized as assets of the Company at their fair value at the date of acquisition. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Finance costs, which represent the difference between the total leasing commitments and the fair value of the assets acquired, are charged to the income statement over the term of the relevant lease so as to produce a constant periodic rate of charge on the remaining balance of the obligations for each accounting period.

Rentals payable under operating leases are charged to expenses as incurred on a straight-line basis over the term of the relevant lease.

Foreign Currencies
The Company performs the majority of transactions in the national currency. Transactions denominated in foreign currency are translated into LTL at the official Bank of Lithuania exchange rate on the date of the transaction, which approximates the prevailing market rates. Monetary assets and liabilities are translated at the rate of exchange on the balance sheet date. The

applicable rates used for the principal currencies as of 31 December 2005 and 2004 were as follows:

	2005	2004
1 USD	2.9102 LTL	2.5345 LTL
1 EUR	3.4528 LTL	3.4528 LTL

All resulting gains and losses relating to cash settlement are recorded in the income statement in the period in which they arise. Gains and losses on translation are credited or charged to the income statement by application of the foreign exchange rates prevailing at the year-end.

Property, plant and equipment and intangible assets
Fixed assets including intangible and tangible fixed assets are stated at acquisition cost as adjusted for the indexation of certain fixed assets less accumulated depreciation or amortization, as further described in Note 4. Depreciation/amortization is charged so as to write-off the cost of fixed assets over their estimated useful lives, using the straight–line method, on the following basis:

Buildings and structures	40 - 100 years
Equipment, machinery tools, fixtures and fittings	5 - 33 years
Vehicles	7 - 8 years
IT equipment and software	1 - 5 years

All assets in excess of LTL 1,000 are capitalized. Gains and losses on disposal of fixed assets are recognized in the year of disposal.

Impairment
At each balance sheet date, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the greater of net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Inventories
Inventories are stated at the lower of cost or net realizable value. Cost is determined by the first-in, first-out method. Appropriate consideration is given to deterioration, obsolescence and other factors when evaluating net realizable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. The cost of work in progress and finished goods comprises of raw materials, direct labor, other direct costs and related production overheads.

Financial instruments
Financial assets and financial liabilities are recognised on the Company's balance sheet when the Company becomes a party to the contractual provisions of the instrument.

Trade receivables
Trade receivables are measured at initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest rate method. Appropriate allowances for estimated irrecoverable amounts are recognised in the statement of income when there is objective evidence that the asset is impaired as a result of one or more events that occurred after the initial recognition of the asset (a "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the asset that can be reliably estimated. The allowance recognised is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the effective interest rate computed at initial recognition.

Cash and cash equivalents
Cash and cash equivalents comprise cash on hand and in bank, demand deposits, and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Bank borrowings
Interest-bearing bank loans are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method. Any difference between the proceeds (net of transaction costs) and the settlement or redemption of borrowings is recognised over the term of the borrowings in the statement of income.

Trade payables
Trade payables are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method.

Segment reporting
A business segment is a distinguishable component of an entity that is engaged in providing products or services that are subject to risks and returns that are different from those of other business segments.

A geographical segment is a distinguishable component of an entity that is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of components operating in other economic environments.

Financial risk management
The principal financial risk management policies of the Company are set out below:

Credit risk
The Company's credit risk is primarily attributable to its trade receivables and loans granted. The amounts presented in the balance sheet are net of allowances for doubtful receivables and loans, estimated by the Company's management based on objective evidence of events occurred after the initial recognition of the amounts.

The credit risk on liquid funds is limited because the counter parties are banks with high credit ratings assigned by international credit-rating agencies.

The Company has no significant concentration of credit risk, with exposure spread over a number of counter parties and customers.

Foreign exchange risk
The Company's borrowings are in LTL. Major accounts receivable and payable are denominated at LTL or EUR. For these reasons, the Company's foreign exchange risk exposure is considered low.

Interest rate risk
The Company's borrowings are arranged at the fixed interest rates.

Revenue recognition and related expenses
Revenue is measured at the fair value of the consideration received or receivable and represents amounts received or receivable for goods and services provided net of value-added tax, rebates and discounts. Revenues from sale of goods are recognised when goods are delivered and title has passed. Revenue from rendering of services is recognised on performance of the services.

Interest income is recognized on an accrual basis, by reference to the principal outstanding and at the effective interest rate applicable.

Expenses are charged to operations as incurred.

Taxation
Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill (or negative goodwill) or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Related parties
Related parties are defined as shareholders, employees, members of the management board, their close relatives and companies that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting entity, provided the listed relationship empowers one of the parties to exercise the control or significant influence over the other party in making financial and operating decisions.

4. PROPERTY, PLANT AND EQUIPMENT

At 31 December property, plant and equipment consisted of the following:

	Buildings LTL'000	Machinery and equipment LTL'000	Vehicles LTL'000	Other assets LTL'000	Construc-tion in progress LTL'000	Total LTL'000
Modified historical cost						
31 December 2004	100,350	152,707	3,970	4,785	1,078	262,890
Additions	42	144	-	22	-	208
Disposals	(5,366)	(11,412)	(442)	(963)	-	(18,183)
Transfers	-	164	-	-	(164)	-
31 December 2005	95,026	141,603	3,528	3,844	914	244,915
Accumulated depreciation						
31 December 2004	42,383	139,391	3,198	3,997	-	188,969
Charge for the year	1,092	3,289	371	197	-	4,949
Disposals	(2,711)	(11,366)	(439)	(901)	-	(15,417)
31 December 2005	40,764	131,314	3,130	3,293	-	178,501
Net book value						
31 December 2004	**57,967**	**13,316**	**772**	**788**	**1,078**	**73,921**
31 December 2005	**54,262**	**10,289**	**398**	**551**	**914**	**66,414**

As of 31 December 2005 property, plant and equipment with the net book value of LTL'000 39,264 (2004: LTL'000 38,152) have been pledged as security against outstanding borrowings (see notes 12, 15 and 16).

As of 31 December 2005 property, plant and equipment include assets with a net book value of LTL'000 32 (2004: LTL'000 36) that were acquired under finance lease.

Also, fixed assets with a net book value of LTL'000 2,800 as of 31 December 2005 have been arrested in connection with legal disputes (note 24).

According to Lithuanian Government Regulations four revaluations (indexations) of property, plant and equipment were performed prior to 31 December 1995.

The indexations of property, plant and equipment were performed in the following stages:

The first indexation was performed on 1 July 1991 increasing the value of property, plant and equipment acquired up to that date by 2.2 times.

The second indexation was performed on 1 May 1992 and the indexation rates stated by Lithuanian Government were from 2 to 5 times.

The third indexation was performed on 1 May 1994 and the indexation rates were different for buildings (1-14) and for machinery and equipment (1-10).

The fourth indexation was performed at 31 December 1995 and again the indexation rates were different for buildings (1-1.68) and for machinery and equipment (1-1.593).

During the second, the third, and the fourth indexations the indexation was performed for the property, plant and equipment that had been revalued during the previous indexations.

As of 31 December 2005 property, plant and equipment include assets acquired before 1996 and which were revaluated (indexed) in accordance with regulations mentioned above with a net book value of LTL'000 55,434 million (2004: LTL'000 72,777).

5. INTANGIBLE ASSETS

At 31 December intangible assets consisted of the following:

	Software LTL'000
Historical cost	
31 December 2004	105
Additions	2
Disposals	(1)
31 December 2005	106
Accumulated amortization	
31 December 2004	84
Charge for year	15
Disposals	(1)
31 December 2005	98
Net book value	
31 December 2004	**21**
31 December 2005	**8**

6. INVENTORIES

As of 31 December inventories consisted of the following:

	2005 LTL'000	**2004 LTL'000**
Work in progress	13,993	13,609
Finished goods	5,473	7,897
Raw material and consumables	3,433	4,096
Less: net realizable value provision for inventory	(6,708)	(3,814)
Total	**16,191**	**21,788**

As of 31 December 2005 the inventories in the amount of LTL'000 20,000 (2004: LTL'000 20,000) have been pledged as security against borrowings outstanding (see note 15).

7. ACCOUNTS RECEIVABLE AND OTHER CURRENT ASSETS

As of 31 December accounts receivable and other current assets consisted of the following:

	2005 LTL'000	2004 LTL'000
Trade accounts receivable	5,764	7,153
Other accounts receivable	529	268
Prepayments and deferred expenses	353	285
	6,646	**7,706**
Less: provision for doubtful accounts receivable	(1,997)	(2,079)
Total	**4,649**	**5,627**

For the years ended 31 December movements in provision for doubtful accounts receivable were as follow:

	2005 LTL'000	2004 LTL'000
Opening balance	2,079	2,873
Repayment of accounts receivable previously provided for	(346)	(36)
Charge for the year	264	347
Written off accounts receivable previously provided for	-	(1,105)
Closing balance	**1,997**	**2,079**

8. CASH AND CASH EQUIVALENTS

As of 31 December cash and cash equivalents consisted of the following:

	2005 LTL'000	2004 LTL'000
Cash at bank	109	343
Cash on hand	61	23
Payment cheque	-	81
Total	**170**	**447**

As of 31 December 2005 cash inflows into the Company's current accounts at bank up to LTL'000 14,000 (2004: LTL'000 14,000) have been pledged as security against outstanding borrowings (see note 15).

9. SHARE CAPITAL

At 31 December 2005 and 2004 authorized share capital consisted of 46,504,972 and 103,945,811 common shares respectively at par value of LTL 1.

All shares are outstanding and fully paid.

During the year ended 31 December 2004 the share capital of the Company was increased up to LTL‘000 103,946. The share capital was increased by issuing 18,201,668 shares with a par value of LTL 1 each.

On 21 December 2005 the share capital of the Company was decreased by LTL’000 57,441 to LTL’000 46,505. 57,440,839 common shares at a par value of LTL 1 each were canceled.

As of 31 December 2005 the shareholders of the Company are as follows:

	Number	%
Government of the Republic of Lithuania	30,828,133	66.29
Tolaram Investments AS, Estonia	7,885,401	16.96
Other	7,791,438	16.75
Total	**46,504,972**	**100.00**

On 22 December 2005 a share issue agreement was signed with the major shareholder Government of the Republic of Lithuania. According to the agreement the shareholder acquired 5,000,000 common shares with par value of LTL 1 each. The shareholder paid in cash (note 16). For subsequent registration of the share issue see note 25.

10. RESERVES

The revaluation reserve represents the increase in the value of property, plant and equipment created through revaluation performed based on government indexation rates (see note 4).

Legal reserve is a compulsory reserve under Lithuanian legislation. Annual transfers of 5% of net profit calculated in accordance with Lithuanian regulatory legislation are compulsory until the reserve reaches 10% of the share capital. Legal reserve cannot be distributed and is formed to cover future losses.

11. EARNINGS PER SHARE

For the purpose of calculating earnings per share the weighted average number of common shares outstanding during 2005 and 2004 was 102,087,306 and 96,914,482 respectively. The Company had no dilutive share options outstanding during 2005 and 2004 and as of 31 December 2005 and 2004.

12. LONG-TERM BORROWINGS

As of 31 December long-term borrowings consisted of the following:

	2005 LTL'000	2004 LTL'000
Loan granted by AB Bankas Snoras denominated in LTL, with maturity in 2007 (the loan was reclassified from short term borrowings)	3,496	5,036
Loan granted by NEFCO denominated in EUR, with maturity in 2005 (the loan granted in 2002 was renewed, the maturity was changed from 2003 to 2005, the loan being reclassified to long-term borrowings)	-	55
	3,496	**5,091**
Less: amount due for settlement within 12 months	(2,300)	(1,975)
Total long-term borrowings	**1,196**	**3,116**

In the year 2005 the interest rate for the loans ranged from 3% to 5.5% (2004: from 3% to 5.5%)

As of 31 December 2005 the Company has pledged property, plant and equipment with the net book value of LTL'000 13,486 (2004: LTL'000 14,773) to secure the loans received.

The future aggregate loan repayments are as follows:

	LTL'000
2006	2,300
2007	1,196
Total	**3,496**

13. OTHER LONG-TERM LIABILITIES

As of 31 December other long-term liabilities consisted of the following:

	2005 LTL'000	2004 LTL'000
Deferred social insurance tax	3,273	4,910
Deferred personal income tax	2,872	4,308
AB Rytų Skirstomieji Tinklai	246	-
UAB Dzūkijos Vandenys	-	1,066
Tolaram Investeeiringute AS	-	556
	6,391	**10,840**
Less: amount due for settlement within 12 months	(4,685)	(4,419)
Total long-term borrowings	**1,706**	**6,421**

14. OBLIGATIONS UNDER FINANCE LEASE

As of 31 December 2005 the Company has outstanding obligations of LTL'000 13 (2004: LTL'000 21) for acquired fixed assets under finance lease.

Net book value of fixed assets under finance lease was LTL'000 32 as of 31 December 2005 (2004: LTL'000 36).

As of 31 December the future annual minimum obligations under finance leases of fixed assets were as follows:

	2005		2004	
	Minimum lease payments LTL'000	**Present value of minimum lease payments LTL'000**	**Minimum lease payments LTL'000**	**Present value of minimum lease payments LTL'000**
Amounts payable under finance leases in:				
2005	-	-	9	8
2006	10	9	10	9
2007	4	4	4	4
Minimum lease payments	**14**	**13**	**23**	**21**
Less: future finance charges	(1)	-	(2)	-
Present value of lease obligations	**13**	**13**	**21**	**21**

15. SHORT-TERM BORROWINGS

At 31 December short-term borrowings consisted of the following:

	2005 LTL'000	**2004 LTL'000**
Loan granted by AB SEB Vilniaus Bankas denominated in LTL, with maturity in 2006 (the loan granted in 2000 was renewed)	10,136	10,865
Loan granted by AB SEB Vilniaus Bankas denominated in LTL, with maturity in 2005 (the loan granted in 2001 was renewed reducing the limit)	-	957
Total	**10,136**	**11,822**

As of 31 December 2005 the Company has pledged cash inflows into current accounts up to LTL'000 14,000 (2004: LTL'000 14,000), finished goods and other inventories in the amount of LTL'000 20,000 (2004: LTL'000 20,000), and property, plant and equipment with the net book value of LTL'000 24,181 (2004: LTL'000 23,379) to secure loans received.

As of 31 December 2005 the weighted average interest rate was 5% (2004: 5%).

16. ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES

At 31 December accounts payable and other current liabilities consisted of the following:

	2005 LTL'000	2004 LTL'000
Trade payable	9,765	9,324
Other taxes payable	5,912	3,727
Shareholder's contribution (note 9)	5,000	-
Salaries payable	4,002	4,069
Social insurance payable	2,984	2,362
Vacation reserve	1,487	725
Accrued expenses	444	429
Other accounts payable	1,331	1,434
Total	**30,925**	**22,070**

As of 31 December 2005 the Company has pledged fixed assets with the net book value of LTL'000 1,597 to secure accounts payable to UAB Litesko (2004: None).

17. BUSINESS AND GEOGRAPHICAL SEGMENTS

Business segments

For management purposes, the Company has divided its business into four main groups – yarn, fabrics, sewing goods, services and spare parts. These groups are the basis on which the Company reports its primary segment information. Segment information about these groups is presented below.

	2005 LTL'000			2004 LTL'000		
	Sales	**Cost of sales**	**Segment result**	**Sales**	**Cost of sales**	**Segment result**
Yarn	3,736	(3,671)	65	5,707	(5,663)	44
Fabrics	39,437	(43,152)	(3,715)	47,652	(49,497)	(1,845)
Sewing Goods	25,684	(27,148)	(1,464)	20,983	(21,501)	(518)
Other Services and spare parts	1,134	(1,024)	110	1,935	(2,002)	(67)
Total	**69,991**	**(74,995)**	**(5,004)**	**76,277**	**(78,663)**	**(2,386)**

All business segments use most of the Company's assets and liabilities and no reasonable basis exists to allocate the Company's assets, capital expenditure and liabilities to different segments.

Geographic segments

For the years ended 31 December sales by geographical segments consisted of the following:

	2005 LTL'000	%	2004 LTL'000	%
Lithuania	18,544	26.49	25,430	33.34
Sweden	17,545	25.07	14,380	18.85
Italy	10,468	14.96	12,268	16.08
Finland	8,676	12.40	6,974	9.14
Germany	5,949	8.50	4,757	6.24
Estonia	1,872	2.67	1,635	2.14
England	929	1.32	3,391	4.45
Holland	617	0.89	702	0.92
Other countries	5,391	7.70	6,740	8.84
Total	**69,991**	**100.00**	**76,277**	**100.00**

All geographic segments use most of the Company's assets and liabilities and no reasonable basis exists to allocate the Company's assets, capital expenditure and liabilities to different segments.

18. SALES AND DISTRIBUTION EXPENSES

For the years ended 31 December sales and distribution expenses consisted of the following:

	2005 LTL'000	2004 LTL'000
Commissions	2,283	2,179
Salaries and related taxes	843	788
Transportation and railway services	667	891
Representation and fairs expenses	351	185
Production shipment expenses	149	148
Business trips	109	151
Other distribution expenses	482	138
Total	**4,884**	**4,480**

19. OPERATING EXPENSES

For the years ended 31 December operating expenses consisted of the following:

	2005 LTL'000	2004 LTL'000
Write off of obsolete and slow moving inventory	4,294	2,623
Salaries and social security	2,041	2,085
Penalties	1,154	488
Taxes other than income tax	934	1,039
Use of inventory previously written off	(560)	(348)
Repayment of accounts receivable previously provided for	(346)	(36)
Provision for doubtful trade receivables	264	347
Depreciation and amortization	108	242
Insurance expenses	181	174
Bank charges	145	173
Professional services	66	133
Transportation expenses	84	114
Other expenses	373	789
Total	**8,738**	**7,823**

As of 31 December 2005 the Company employed 1,668 people (2004: 2,248).

20. INCOME TAX

The charge for the year can be reconciled to the profit per the income statement as follows:

	2005 LTL'000	%	2004 LTL'000	%
Loss before taxes	(15,994)		(15,673)	
Tax at the statutory income tax rate	(2,399)	(15)	(2,351)	(15)
Tax effect of expenses that are not deductible in determining taxable profit	209	1	120	1
Decrease in unrealised tax loss carry forward	272	2	6,899	44
Change in deferred tax valuation allowance	1,918	12	(4,668)	(30)
Income tax expense	**-**	**-**	**-**	**-**

In accordance with IAS 12, the Company recognizes a deferred tax liability or asset for temporary differences where amounts of income taxes are probable for payment or recovery in future periods. At each balance sheet date the Company re-assesses all unrecognized deferred tax assets and recognizes the previously unrecognized portion to the extent that it has become probable that future taxable profit will allow the deferred tax assets to be recovered.

21. DEFERRED TAX

The management has recorded a valuation allowance in the amount it believes is necessary to reduce the deferred tax asset to the amount that will most likely be realized. The components of deferred income tax assets are summarized as follows:

	2005 LTL'000	2004 LTL'000
Deferred tax asset:		
Provisions and accrued expenses	523	312
Provision for inventory	1,006	572
Tax loss carry forward	6,231	4,958
Total deferred tax asset	**7,760**	**5,842**
Less: valuation allowance	(7,760)	(5,842)
Net position at 31 December	**-**	**-**

22. RELATED PARTY TRANSACTIONS

As of 31 December 2005 and for the year then ended related party transactions were as follows:

Related parties	Payable to related party LTL'000	Receivable from related party LTL'000	Purchases from related party LTL'000	Sales to related party LTL'000
Toloram Investeeringute AS	275	-	-	-
State controlled entities	7,246	-	7,559	-

The transactions with related parties were concluded on an arm's length basis.

Toloram Investeeringute AS is a related party of Tolaram Investments AS (one of the Company's shareholders).

The average number of management in 2005 was 3 (2004: 6). The management remuneration for 2005 amounted to LTL 212,036 (2004: LTL 229,952).

23. FAIR VALUE OF FINANCIAL INSTRUMENTS

At 31 December the estimated fair values of financial instruments that do not approximate the carrying values in the financial statements are as follows:

	2005		2004	
	Carrying Amount LTL'000	Estimated Fair Value LTL'000	Carrying Amount LTL'000	Estimated Fair Value LTL'000
Short-term borrowings	10,136	10,071	11,822	11,746
Long-term borrowings	3,496	3,469	5,091	5,038
Long-term trade payables	1,851	1,762	334	318
Trade notes	1,167	1,091	1,913	1,788

The fair value of debt was based on discounting the future payments at prevailing market rates.

24. COMMITMENTS AND CONTINGENCIES

As of 31 December 2005 the Company is involved in 3 legal disputes:

- AB Rytų Skirstomieji Tinklai claims for debts in the amount of LTL'000 802 and fines in the amount of LTL'000 40;
- UAB Dzūkijos Vandenys claims for debts in the amount of LTL'000 559;
- UAB Dzūtra claims for debts in the amount of LTL'000 11.

All the liabilities related with the legal disputes mentioned above are provided for in the financial statements.

As of 31 December 2005 due to the legal disputes some of the fixed assets of the Company are arrested:

Groups of fixed assets	Net Book value LTL'000
Buildings	917
Machinery and equipment	1,766
Vehicles	117
Total	**2,800**

25. EVENTS AFTER THE BALANCE SHEET DATE

As of 24 January 2006 the new share emission was registered and the share capital of the Company was increased by LTL'000 5,004 (Government of the Republic of Lithuania in the amount of LTL'000 5,000; other shareholders in the amount of LTL'000 4) up to LTL'000 51,509.

26. GOING CONCERN

For the years ended 31 December 2005 and 2004, the Company incurred loss of LTL'000 15,994 and LTL'000 15,673, respectively, and as of 31 December 2005 and 2004 net current liabilities exceeded current assets by LTL'000 23,527 and LTL'000 9,926, respectively.

The working capital of the Company is insufficient. During the months subsequent to year-end the Company has increased share capital and sold a portion of unused real estate with the profit in the amount more than LTL'000 4,000. However during the months subsequent to the year-end the Company incurred gross loss and continued to generate negative cash flows from operating activities.

The Company's going concern depends on additional financing. The Company is negotiating with a potential buyer regarding sale and lease back of certain real estate in the approximate amount of LTL'000 12,000. At the date of financial statements the management of the Company does not have any formal arrangements.

Also the Company is planning to sell real estate to the providers of utility services in order to settle debts and to assure supply of utility services necessary to continue manufacturing.

The financial statements are prepared assuming that the Company will continue as going concern. No adjustments have been made to these financial statements that may be deemed necessary if the Company would not continue as going concern.

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