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ENR

ENR EASTERN NATURAL RESOURCES SA

Letter to shareholders

Dear shareholders,

Over the course of last year, Russia experienced considerable political and economic upheaval. A crisis of confidence evolved on the back of converging negative factors, namely: plunging commodity prices, diminishing tax base, paralysis of government, overwhelming short-term debt burden and endemic corruption. As a result, Russian asset valuations declined dramatically. In 1998, ENR reported a net loss of CHF 137 million. This compares with a net profit of CHF 50.2 million and CHF 23.2 million in 1997 and 1996 respectively.

On March 23rd, Victor Chernomyrdin was replaced as Prime Minister by the young and relatively inexperienced Sergei Kiriyenko. Although the new administration was clearly reformist in character, its ability to address the deepening financial crisis was undermined by a combative Duma, uncooperative business "oligarchs" and the ailing health of the President. Events culminated with the de facto default and rouble devaluation last August 17 th. This brought the domestic banking system to the verge of insolvency. Restrictions on rouble trading and severe disruption to the country's payment, transfer and settlement system devastated Russia's capital markets which lost the characteristics of a normally functioning exchange. Consequently, ENR's Board of Directors was of the opinion that it was no longer possible to assess accurately the net asset value per share of the investment company and decided to suspend the calculation and publication until market conditions normalise (which is still not the case at the date of this letter).

In early September, Yevgeny Primakov, the foreign affairs minister and former head of the foreign intelligence service, replaced Sergei Kiriyenko, to become Russia's third Prime Minister in six months. To his credit M. Primakov has succeeded in calming political tension and building consensus in the midst of this economic turmoil. On the other hand, the new government has, so far, failed to formulate a credible economic programme and bilateral discussions with the creditors group to restructure the defaulted domestic debt have not gone well. Yet, as difficult as the present situation is, foreign investors have not entirely turned their backs on the potential of Russia's natural resource sector as exemplified by the year-end sale of 2.5% of Gazprom to Ruhrgas for USD 660 million.

Under the present circumstances, we are closely monitoring developments in Russia through established contacts with high-level policy makers and senior management of companies owned by ENR. We believe that these efforts will provide ENR with the capability to properly assess future opportunities as market conditions normalise.

February, 1999

Hans-Jörg Rudloff

THE PAST YEAR IN REVIEW

Russian political and economic overview

Despite the fact that on July 13th, the International Monetary Fund effectively pledged a USD 22.6 billion aid package and released a first tranche of USD 4.8 billion on July 21 st, on August 17th, the Russian government ordered a 90 day moratorium on repayments of loans and currency forwards and closed the rouble-denominated debt market.

Since then the economic environment in Russia has deteriorated substantially. A steep decline in domestic demand and the breakdown in the payment system has severely curtailed economic activity. Industrial production plummeted 8.9% YoY in the fourth quarter of 1998. Year-end inflation soared to 84.4% YoY, while, the rouble has sunk to one quarter of its value four months ago. Since his appointment as Prime Minister in September, Yevgeny Primakov has yet to put forward a credible economic policy to address the country's financial collapse.

In mid-November the government set out a broad economic plan calling for the normalisation of living conditions and the revitalisation of the real economy, but gave little detail on how these objectives would be achieved. The 1999 budget, widely viewed as unrealistic, assumes a steady rouble/USD rate, a 3% GDP contraction and 30% inflation. On the revenue side the budget projects a budget deficit of 2.5% of GDP, half of which to be financed by outside sources. Russia maybe hard pressed to achieve these targets given that the country has virtually cut itself off from international commercial funding. Although the government has continued to meet scheduled Eurobond interest payments, it is clear that Soviet-era debt payments will have to be restructured.

The Russian Central Bank, meanwhile, appears unwilling to accept the consequences of printing money (Sept.-Dec. money supply rose 21%) even in the face of a burgeoning budget deficit and sizable rouble liabilities in the economy. While the government may be able to fill gaps in the budget through privatisations, within the current environment the likelihood of extensive direct investment is limited.

Bilateral discussions between the foreign creditors group and the Finance Ministry, concerning the restructuring of the T-Bill market, have not gone well. The Finance Ministry unilaterally offered:

1 10% rouble cash settlement to be paid in installments.
2 20% converted into zero coupon convertible bonds (either exchangeable against government payables or bank shares)
3 70% to be rolled over into new 4-5 year rouble bonds with a 30% coupon

However, uncertainty with regard to the transferability of these new assets and the repatriation of proceeds means the present value of the proposal is difficult to assess. Trading in this newly issued paper has commenced with low trading volumes and no apparent foreign investor involvement. With regard to the Russian bank obligations there has been little headway in resolving the substantial amount of outstanding rouble forward contracts due to foreign holders.

On the other hand, Prime Minister Primakov has achieved a degree of political stability. This he has achieved through a conciliatory approach, maintaining the support of mainstream political forces and the population at large, on the back of his administration's "anti-monetarist" rhetoric and its public condemnation of the reform programme, the International Monetary Fund and the West in general.

ENR in 1998

As a consequence of the devastating impact of Russia's financial crisis on domestic asset valuations, ENR reported a net loss in 1998 of CHF 137 million. This compares with a net profit of CHF 50.2 million and CHF 23.2 million in 1997 and 1996 respectively.

The Russian equity markets lost all the characteristics of a normally functioning exchange place; total volume rarely exceeded USD 1 million per day and bid/ask spreads frequently exceeded 500%. This led ENR to suspend its daily NAV publication on August 24 th, as the market inefficiencies made it impossible to calculate a meaningful valuation to the portfolio.

ENR liquidated the bulk of its GKO's in August before the moratorium and all the stock for which the market still gave us an orderly bid/ask spread. Since then ENR has also sold Surgut Holding. ENR bought back nominal CHF 46.8 million of its own convertible bonds of which it cancelled nominal CHF 42.5 million.

The portfolio, that we are holding coming into 1999, is concentrated in the oil and related industries and the paper and pulp sector. They are the two sectors which should show the most resilience in today's crisis. They are heavily export oriented and hence sheltered from further ruble devaluation and, most importantly, have a large proportion of their sales in cash. We believe that the core of our holdings have the strength to survive and, in some cases, could emerge as leaner and more focused entities, when Russia finally overcomes its crisis.

Looking to 1999

Political considerations and the macro economic developments that evolve from them are the only considerations uppermost on investors' minds and, until that picture brightens, we do not expect any new flows into this market. It will take action rather than words to resuscitate investor confidence. The Duma will have not only to pass budgets but will have to deliver the goods. It will no longer suffice to herald an International Monetary Fund coming but the check will have to be seen. All this will take time. Most importantly the deflationary cycle in commodities will have to be broken, so that Russia can be given the tools to set its house in order. Russia has an overall debt repayments burden this year of USD 18 billion which it cannot possibly meet without additional support from the International Monetary Fund (ie. rolling USD 4.8 billion of loans due this year) and other external debt restructuring such as Paris and London Club debts and forestalling more defaults. The World Bank forecasts Russian GDP to contract another 6-7% this coming year with inflation running no less than a 30-50% range.

Portfolio highlights

Seversky Pipe Works

Seversky, the second largest pipe producer in Russia, has a 19% market share. It is located in the Urals and has direct rail access to the major West Siberian oil producers. The company produces mainly seamless casing and line pipe for the oil industry. The seamless hot-rolled pipes are produced in a vertically integrated cycle from steel produced in-house. Sales to the oil sector represent about three-quarters of total revenues thus overall results are directly influenced by the price levels of crude oil.

This is one of the most transparent companies in Russia. Over 60% of shares are held by foreigners who also have a majority on the board. Seversky was the second company after Lukoil to issue ADRs. Cost-cutting and modernization programmes have been initiated. Social expenditures declined from USD 17 million in 1997 to an expected USD 11 million this year and should be eliminated for 1999.

The investment program covers the improvement of steel quality and efficiency and the installation of a coating facility. The steel project will enable Seversky to make high quality (and high margin) tubing suitable for severe climates such as northern Russia. Implementation of the program has commenced with Mannesman providing the machinery and supervision. To date this USD 21 million project has been financed entirely through internal cash flow. An USD 11 million project to build a coating shop for electro-welded pipe is also planned and negotiations have taken place with prospective joint venture partners.

Vyksunsky Pipe Works

This medium-sized pipe manufacturer has one of the most modern production facilities in Russia. Vyksunsky produces electro-welded casing and line pipe on Japanese machinery commissioned in 1986. Pipe production is just under 500'000 tons per year. In addition, Vyksunsky produces railway wheels utilizing its own steel production. Approximately 60% of sales are to the oil and gas sectors with Lukoil and Gazprom being the two main customers. Sales of railway wheels are almost entirely for cash on both domestic and export trades. As a consequence, the cash collection rate of 30% in 1997 was the highest in the industry, although the final 1998 figure will be lower. Management controls 60% of the shares and has to date been relatively closed. There is, however, a serious risk of dilution of the minority shareholders due to management's plan to issue new shares.

Kondopoga

Kondopoga, Russia's largest pulp and paper company, is a vertically integrated newsprint producer located just north of St. Petersburg in Karelia. The location is excellent both from the standpoint of wood supplies, proximity to domestic and, more importantly, export markets. Plant and equipment are relatively modern and in good condition. Over 80% of capacity has been rebuilt within the past six years. Rare for a Russian company, virtually all of Kondopoga's cash flow has been reinvested in machinery maintenance, pollution control and capital improvements. A new 180'000 ton per year paper machine is partially installed. The company has internally financed USD 90 million of the USD 180 million total cost, which includes a new 200'000 ton thermo-mechanical (TMP) pulp line, but may require external financing to complete the balance. Kondopoga currently has no long term debt.

In other developments, Kondopoga has acquired five local logging companies to ensure low-cost log inputs and the integrity of supply. Also planned is a gas turbine generating plant to provide an independent cheap power supply and eliminate reliance on Karelenergo, the regional utility.

In 1998 production is expected to exceed 500’000 tons. This is up from 488’000 tons in 1997 and 440’000 tons in 1996. Percentage of total output exported has risen from 65% in 1996 to approximately 75% in 1998.

Syktyvkar Forest Enterprises (SLPK)

Syktyvkar, along with Kondopoga, is one of the top two pulp and paper producers in Russia. The complex is both modern and fully integrated. Wood supply is obtained through fully owned or controlled logging companies. Ownership of a 436 MW gas-powered generation plant provides all heat and electricity requirements. In addition to being the country’s main producer of offset and printing papers, the company also produces newsprint, food packaging board, plywood, particleboard and tissue paper.

Frantschach AG, an Austrian pulp and paper producer, is a strategic investor in SLPK holding just under 20% of the common shares. It is a leading European producer and distributor of office communication paper and is working closely with the management of SLPK to improve both product quality and efficiency of operations. Frantschach is also assisting management in establishing a direct sales organization for both domestic and export markets.

The impact of ruble devaluation is quite positive as exports represent over 50% of sales whereas hard currency input costs represent about 10% of expenses. In spite of depressed international pulp and paper markets, paper production for the first half of this year is up 14% YoY and the company is maintaining its strong cash flow.

Chelyabinsk Trubny Zavod (Chelyabinsk Pipe-Rolling Works)

The fortunes of the pipe manufacturing industry in Russia are closely aligned to energy prices and activity. A slowdown in drilling and the lack of available funds to replace an increasing porous pipeline system have had an adverse impact on Russia’s pipe manufacturers. In this difficult operating environment, Chelyabinsk has maintained net margins above the level of its competitors.

Chelyabinsk Pipe is the largest pipe producer in Russia and accounts for 20% of total Russian production. It produces both seamless and welded pipe primarily for the oil and gas sector and is the monopoly producer of large diameter line pipe within Russia. This sector accounts for approximately 80% of total sales. The seamless line is supplied by the plant’s own steel production which has a capacity of 400’000 tons per year.

Work has commenced on the rebuilding of shop No. 1 to improve the quality and increase production of seamless hot rolled pipes. Plans have also been drawn up to produce 1'420 mm pipe for the largest gas pipelines and to set up a coating facility.

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Consolidated results

As of December 31, 1998, the Company recorded a net consolidated loss on investment of CHF 139 million. That amount includes realised gain and losses on investments as well as the valuation of the portfolio at fair value at the closing date. The other revenues are in excess of other expenses of CHF 0.2 million, reversal of income taxes amounts to CHF 1.7 million which gives a net consolidated loss for the year of CHF 137.1 million.

The Company's portfolio of investment is valued at the year end on a consolidated basis at CHF 12.2 million which, together with other assets and liabilities, amounted to a consolidated shareholders' equity of CHF 17.8 million. Total assets at this date were CHF 33.9 million.

Parent Company

As of December 31, 1998 the Parent Company recorded shareholders' equity of CHF 17.7 million compared to CHF 80.7 million at December 31, 1997. Total assets represents CHF 19.3 million. During the period, provisions totalling CHF 62.8 million were required against the declining value of investments which, at the parent holding company level, resulted in a loss for the year of CHF 62.9 million and the net loss for the year amounts to CHF 0.2 million. The board of directors proposes to carry forward the accumulated deficit as of December 31, 1998 of CHF 19'763'216.

Consolidated Balance Sheet as of December 31, 1998

	Notes	1998	1997
Assets		CHF	CHF
Cash and cash equivalents		14'069'571	53'308'739
Investment portfolio at cost	4	67'163'080	101'894'511
(Value impairment)/fair value adjustment		(55'000'000)	52'183'641
Investment portfolio - net		12'163'080	154'078'152
Other assets		500'543	4'183
Current assets		*26'733'194*	*207'391'074*
Own convertible bonds	6	4'252'930	–
Treasury stock and warrants	6	35'124	5'618'371
Capitalised expenditure - net	5	2'870'860	3'720'001
Total assets		33'892'108	216'729'446
Liabilities and Shareholders' Equity			
Short-term loan		–	2'847'798
Accounts payable and accrued expenses		1'171'241	1'468'115
Provision for income and deferred taxes	7	320'093	2'062'720
Other liabilities		–	598'857
Convertible bonds	6	14'629'046	48'111'562
Liabilities		*16'120'380*	*55'089'052*
Share capital	6	37'500'000	37'500'000
Capital paid in excess of par value (share premium)		1'586'564	39'774'670
Reserve for treasury stock	6	–	2'725'330
Equity component of convertible bonds	6	3'571'573	12'252'400
(Accumulated deficit)/Retained earnings		(24'886'409)	69'387'994
Shareholders' Equity		*17'771'728*	*161'640'394*
Total Liabilities and Shareholders' Equity		33'892'108	216'729'446

Consolidated Statement of Income and Retained Earnings for the year ended December 31, 1998

	Notes	1998	1997
Operating Income		CHF	CHF
Interest income		743'156	353'600
Dividends		262'660	213'782
Gain on sale and net fair value adjustment of investments		17'907'004	61'446'182
Net gain on cancellation of convertible bonds		7'406'400	–
Exchange (loss)/gain, net		(2'394'428)	1'072'308
Total operating income		23'924'792	63'085'872
Operating expenses			
Loss on sale of investments and value impairment adjustment		156'957'757	375'520
Management and performance fees		1'079'220	6'526'368
Administrative fees		124'281	285'555
Professional and directors' fees		578'158	627'499
Amortisation of capitalised expenditure		849'141	346'731
Bank charges and interest expenses		2'445'147	2'416'238
Accrued finance cost of convertible bonds	6	346'658	363'961
Other expenses		191'858	231'455
Taxes other than on income		178'039	118'995
Total operating expenses		162'750'259	11'292'322
Net (loss) income before income taxes		(138'825'467)	51'793'550
Income taxes	7	1'737'090	(1'607'636)
Net (loss) income for the year		(137'088'377)	50'185'914
Retained earnings at the beginning of the year		69'387'994	19'202'080
Reversal of share premium		42'813'974	–
(Accumulated loss)/retained earnings at the end of the year		(24'886'409)	69'387'994

Consolidated Cash Flow Statement for the year ended December 31, 1998

	Notes	1998	1997
Cash flow from operating activities		CHF	CHF
Net (loss)/income for the year		(137'088'377)	50'185'914
Adjustments for:			
Amortisation of capitalised expenditure		849'141	346'731
Accrued finance cost of convertible bonds		346'659	363'962
Net gain on cancellation of convertible bonds		(7'406'400)	–
Fair value adjustment on treasury stock and warrants		(15'137)	1'898'878
Fair value adjustment on convertible bonds		(46'134)	–
Impairment loss on investment portfolio	4	107'182'967	(34'189'033)
Operating (loss)/income before working capital changes		(36'177'281)	18'606'452
Movement in working capital:			
Net sale/(purchase) of investments	4	34'732'101	(49'209'558)
Net sale/(purchase) of treasury stock and warrants		5'598'384	(7'517'249)
Purchase of convertible bonds		(4'206'796)	–
Short-term loan		(2'847'798)	(2'548'202)
Accounts payable and accrued expenses		(296'874)	729'492
Other assets		(496'360)	32'151
Provision for income and deferred taxes	7	(1'742'627)	1'607'635
Other liabilities		(598'857)	469'009
Net cash flow used in operating activities		(6'036'108)	(37'830'270)
Cash flow from financing activities			
Proceeds from issue of share capital		–	30'000'000
Proceeds from issue of convertible bonds		–	60'000'000
Purchase of convertible bonds for cancellation		(33'203'060)	–
Capitalised expenditure		–	(3'719'248)
Net cash flow (used in)/from financing activities		(33'203'060)	86'280'752
Net cash flow		(39'239'168)	48'450'482
Cash and cash equivalents at beginning of the year		53'308'739	4'858'257
Cash and cash equivalents at end of the year		14'069'571	53'308'739

Determination of the Shareholders' economic interest as of December 31, 1998

	Notes	1998 Following IAS presentation	1998 Representing the existing shareholders' economic interest
Total assets		33'892'108	33'892'108
Liabilities			
Convertible bonds	6	14'629'046	17'490'000
Other liabilities		1'491'334	1'491'334
Total liabilities		16'120'380	18'981'334
Shareholders' equity			
Share-capital		37'500'000	37'500'000
Capital paid in excess of par value (share premium)		1'586'564	1'586'564
Equity component of convertible bonds	6	3'571'573	0
Retained earnings		(24'886'409)	(24'175'790)
Total shareholders' equity		17'771'728	14'910'774
Total liabilities and shareholders' equity		33'892'108	33'892'108
Shareholders' economic interest			19.88

The conversion rights relating to the convertible bonds and the exercise of the warrants have a non dilutive effect on the shareholders' economic interest at December 31, 1998.

IMPORTANT NOTICE

As a result of the crisis in Russia, the Board of Directors decided to suspend calculation and publication of the Company's Net Asset Value as from August 24, 1998 until market conditions normalise. The terms "shareholders' equity" and "shareholders' economic interest" used in the present financial statements should not be construed as Net Asset Value (as defined in the listing memorandum dated December 12, 1995).

Notes to the Consolidated Financial Statements as of December 31, 1998

1 Incorporation and activity

ENR Eastern Natural Resources SA, Geneva (hereinafter, the "Company") is an investment holding company incorporated as a limited company under the laws of Switzerland.
The Company invests, through its wholly-owned subsidiaries (hereinafter, together, the "Group"), in a diversified portfolio composed primarily of equity and equity-related securities of companies with substantial activities in the natural resources industry in the Commonwealth of Independent States (CIS) and the Baltic States.

2 Basis for the presentation of the consolidated financial statements

The consolidated financial statements of the Group, which include the accounts of ENR Eastern Natural Resources SA and its subsidiaries at December 31, 1998, are prepared in accordance with International Accounting Standards (IAS) as issued by the International Accounting Standards Committee. Financial instruments held for dealing purposes are measured on a fair value basis, as described in note 3.5, all other assets/liabilities are measured on an historical cost basis.

3 Significant accounting policies

3.1. Consolidation

Full consolidation is applied to subsidiaries, all of which are wholly owned. The accounts of the Company's subsidiaries are appropriately reclassified and adjusted for consolidation purposes to conform to the Group's accounting policies. All significant intra-group balances and operations are eliminated.

3.2. Fully consolidated companies

At December 31, 1998, the ENR Group was composed of ENR Eastern Natural Resources SA and the following wholly-owned subsidiaries:

	Share capital*			
Company		1998		1997
ENR Overseas Ltd, Nicosia	C£	1'833.0	C£	1'833.0
ENR Holdings Ltd, Nicosia	C£	3'310.0	C£	3'310.0
ENR Treasury Ltd, Nicosia	C£	370.0	C£	370.0
ENR Investment Ltd, Nicosia	C£	3'846.0	C£	3'846.0
ENR Securities Ltd, Grand Cayman	USD	0.1	USD	0.1
ENR Finance Ltd, Grand Cayman	USD	0.1	USD	0.1

3.3. Recognition of revenues and costs

Revenues and costs are recognised as they are earned or incurred and recorded in the financial statements of the periods to which they relate.

3.3.1 Interest

Interest is recognised on a time proportion basis that reflects the effective yield on the asset or liability.

3.3.2 Gain/(Loss) on investments

The gains or losses arising from the disposal of investments are recognised in the statement of income as they arise.

3.3.3 Dividends

Dividends are recognised when the Company's right to receive payment is established.

3.3.4 Other revenue

Other revenue is measured at the fair value of the consideration received or receivable.

3.4. Foreign currency translation

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Assets and liabilities denominated in foreign currencies are translated into Swiss francs at exchange rates ruling on the balance sheet date. Foreign exchange profits and losses are included in the income statement of the year in which the profits and losses arise. The financial statements of the subsidiaries are prepared in Swiss Francs as subsidiaries are integral to the operations of the parent. Their operations in foreign currencies are translated according to the above mentioned principles.

3.5. Investment portfolio

The investment portfolio is composed of listed shares and other investments and is recorded in the balance sheet at fair value. Fair value is determined on the basis of bid price for actively-traded investments and at cost for other investments if no significant transactions have taken place. If a significant transaction has taken place, the directors of the company may revalue the holding. If negative developments occur in any company, a write down will be made immediately. Changes in value are charged or credited in the statement of income.
Due to the significant adverse changes in Russia, the country in which the Group invests, the listed shares are no longer considered as being actively traded investments. As a consequence, they are held at cost as for other investments less a value impairment adjustment made on an aggregate portfolio basis, as determined by the board of directors, as an active market no longer exists. These changes were brought to the attention of the shareholders at the extraordinary general meeting held on October 12, 1998.

* *in thousands*

3.6. Taxation

The Company provides for taxes when profits are earned. A provision is made in the consolidated accounts for deferred taxation arising from timing differences. Deferred taxation is provided for under the liability method.

3.7. Capitalised expenditure

These comprise of preliminary expenses and ancillary costs incurred in relation to borrowing and are amortised over 5 years on a straight line basis.

4 Investment portfolio

	Equities CHF *	Other financial instruments CHF *	1998 Total CHF *	1997 Total CHF *
Fair value of portfolio brought forward	127'792	26'286	154'078	70'680
Purchase of investments	40'759	236'421	277'180	141'486
Sale of investments	(49'931)	(240'763)	(290'694)	(122'620)
Net (loss)/gain on disposal of investments	(7'558)	(13'661)	(21'219)	30'343
Net investment movements for the year	(16'730)	(18'003)	(34'733)	49'209
Fair value adjustment	(98'899)	(8'283)	(107'182)	34'189
Fair value of portfolio	12'163	–	12'163	154'078

At December 31, 1998 the investment portfolio consisted of the following:

	1998 CHF *	1997 CHF *
Listed shares	43'203	59'763
Special situations and illiquid shares	18'200	18'368
Fixed income instruments	5'760	23'763
Total at cost	**67'163**	**101'894**
(Value impairment)/fair value adjustment	(55'000)	52'184
Investment portfolio - net	**12'163**	**154'078**

Special situation and illiquid shares include investments where the Company holds a significant stake, either on its own or in agreement with other shareholders, in the investment and/or where the shares are not readily tradable. 13

The investments in listed shares consist of the following positions:

Companies	Number of shares 31.12.1998	Changes since 31.12.1997	Local currency	Total cost 31.12.1998 (CHF *)	in % of portfolio
Listed shares					
Chelyabinsky Trubny Zadov	18'347'616	(1'500'000)	USD	10'519	15.66%
Irkutsk Energo - ADR	–	(274'000)	USD	–	0.00%
Lenenergo Common	–	(1'379'000)	USD	–	0.00%
Lenenergo Preferred	1'000'000	–	USD	411	0.61%
LUKoil Holding - ADR	–	(120'988)	USD	–	0.00%
LUKoil Holding Preferred	–	(10'000)	USD	–	0.00%
Megionneftegaz	–	(160'000)	USD	–	0.00%
Nishnovenergo	–	(4'250)	USD	–	0.00%
Nizhnetagilsky Metal	29'143'990	(11'050'000)	USD	6'406	9.54%
Noyabrskneftegaz	532'980	–	USD	3'537	5.27%
Oskol Steel	12'500	–	USD	698	1.04%
Purneftegaz Preferred	120'000	–	USD	527	0.78%
Sakhalinenergo	2'200'000	–	USD	1'319	1.96%
Sakhalinmorneftegaz Preferred	135'000	–	USD	675	1.01%
Sakhalinmorneftegaz Common	1'656'710	600'000	USD	7'304	10.88%
Samara Energo	4'150'000	(250'000)	USD	2'052	3.06%
Seversky Tube - ADR	58'250	(5'000)	USD	2'682	3.99%
Severstal	–	(6'000)	USD	–	0.00%
Sinarsky Trubny Zadov	156'631	–	USD	2'386	3.55%
Surgut Holding	–	(45'825)	USD	–	0.00%
Surgutneftegaz - ADR	–	(105'000)	USD	–	0.00%
Surgutneftegaz Preferred	–	(5'000'000)	USD	–	0.00%
Sverdlovenergo Preferred	650'000	–	USD	249	0.37%
United Energy System Common	–	(6'000'000)	USD	–	0.00%
United Energy System Preferred	–	(6'700'000)	USD	–	0.00%
Yuganskeneftegaz Common	250'000	–	USD	4'102	6.11%
Yuganskeneftegaz Preferred	25'000	–	USD	336	0.50%
Sub-total				**43'203**	**64.33%**

** in thousands*

Special situations and illiquid shares					
Akron	10	–	USD	183	0.27%
BAM Resources PLC	200'000	–	USD	–	0.00%
Buryatzoloto	28'580	–	USD	839	1.25%
Kondopoga	162'314	–	USD	3'232	4.81%
Moscow Refinery Common	81'463	(5'000)	USD	2'750	4.10%
Moscow Refinery Preferred	12'500	–	USD	337	0.50%
Nosta (Orsko-Khalilovsk Met C)	45'000	–	USD	214	0.32%
Slavneft	5'159'314	–	USD	3'046	4.53%
Syktyvkarsky Common	40'083	–	USD	3'639	5.42%
Syktyvkarsky Prefered	7'000	–	USD	57	0.08%
Vyksunsky Plant	19'000	–	USD	3'903	5.81%
Sub-total				**18'200**	**27.09%**
Fixed income instruments					
The Red Square Debt Fund	400'000	–	USD	5'760	8.58%
GKOs - 21098	–	(10'000)	RUR	–	0.00%
GKOs - 21104	–	(71'629)	RUR	–	0.00%
GKOs - 23006	–	(10'000)	RUR	–	0.00%
Sub-total				**5'760**	**8.58%**
Total cost value				**67'163**	**100.00%**
Value impairment				(55'000)	
Total investment portfolio				12'163	

Derivative instruments

In addition, the Group has the following call contracts outstanding which have been fully written-off:

Instrument	Nominal value USD*	Maturity date	Strike price	Market value
Call Min Fin 10% June 2007	5'000	27.01.99	70.125	–
Call Min Fin 10% June 2007	9'000	30.07.99	70.500	–

5 Capitalised expenditure

At December 31, 1998, total expenditure carried forward and related amortisation were as follows:

	1998 CHF *	1997 CHF *
Capitalised expenditure	5'281	5'281
Accumulated amortisation	(2'410)	(1'561)
Net	2'871	3'720

6 Share capital

At December 31, 1998, the issued ordinary share capital of the Company was CHF 37.5 million, divided into 750'000 bearer shares of par value CHF 50 each.

6.1. Movements in shareholders' equity

	Share capital CHF*	Share premium CHF*	Reserve for Treasury Stock CHF*	Retained Earnings/ (accumulated deficit) CHF*	Equity component of convertible bonds CHF*	Total CHF*
Balance at January 1, 1998	37'500	39'775	2'725	69'388	12'252	161'640
Repurchase of convertible bonds		1'901			(8'681)	(6'780)
Purchase of treasury stock		(2'045)	2'045			
Sale of treasury stock		4'770	(4'770)			
Reversal of share premium		(42'814)		42'814		
Net loss for the year				(137'088)		(137'088)
Balance at December 31, 1998	**37'500**	**1'587**	**–**	**(24'886)**	**3'571**	**17'772**

At the extraordinary shareholders meeting of October 12, 1998 it was decided to use the consolidated share premium existing as of September 30, 1998 to compensate the losses suffered by the Group.

6.2 Treasury stock and warrants

At December 31, treasury stock and warrants consisted of the following:

	1998	1997
Number of shares	–	13'706
Number of warrants	117'080	292'380

* *in thousands*

The Company had the following movements on its own shares during the year:

Date	Purchase/(Sale)	Price
June	12'500	140.12
April	2'250	130.36
October	(11'570)	17.94
November	(16'886)	19.72

6.3. Conditional capital and authorised capital

The Company may increase its share capital by the exercise of option or conversion rights by up to a maximum amount of CHF 18'750'000 through the issue of a maximum of 375'000 bearer shares of par value of CHF 50 each. These shares are reserved for the exercise of option and conversion rights issued by the Company (see notes 6.4 and 6.5).

The Board of Directors is authorised until March 16, 2000 to increase the Company's share capital by up to CHF 18'750'000 through the issue of a maximum of 375'000 bearer shares of par value of CHF 50 each.

	1998 CHF *	1997CHF *
Conditional capital	18'750	18'750
Authorised capital	18'750	18'750

6.4. Warrants

The Company has issued a total of 1'900'000 option rights in the form of warrants, entitling warrant holders to subscribe for one share for every ten warrants up to May 31, 2000. Following the June 1997 capital increase, the exercise price of the warrants was reduced from CHF 100 to CHF 83.10.

6.5. Convertible bonds

On October 28, 1997, ENR Finance Ltd issued, at par value, 3 3/4% convertible bonds for CHF 60'000'000, October 28, 2002. Each bond of CHF 5'000 nominal is convertible into 20 bearer shares of ENR Eastern Natural Resources SA of CHF 50 nominal each. In the consolidated financial statements, the loan is divided into a liability and an equity component. The fair value of the liability component is calculated using a discount rate of 9%, as if the bonds have no embedded conversion rights and the market rate of interest applied.

As the amount payable on redemption will normally exceed the amount allocated to the debt at the time of issue, a finance cost, additional to the coupon actually paid, will be accrued in each accounting period. The interest expense on the effective yield basis comprises of the coupon and the finance cost.

At the date of issue, the detail of the liability and equity components was as follows:

	CHF *
Present value of the principal (CHF 60 million payable at the end of five years)	38'996
Present value of the interest (CHF 2.25 million payable annually in arrears for five years)	8'752
Total liability component	47'748
Equity component	12'252
Proceeds of the bonds issue	60'000

As of December 31, 1998, the Company had bought, on the open market, CHF 46'865'000 nominal value of its own bonds of which CHF 42'510'000 was cancelled. Non cancelled bonds are valued at market in the balance sheet. The purchase of bonds cancelled resulted in a total gain of CHF 9'306'939 of which CHF 1'900'539 representing the gain on the equity component of the cancelled bonds, has been credited to the share premium account and the CHF 7'406'400 gain the liability component has been taken to the statement of income and retained earnings.

At December 31, 1998 the liability and the equity component of the convertible bonds consist of the following:

	Liability component	Equity component	Nominal value
At October 28, 1997 (date of issue)	47'748	12'252	60'000
Accrued finance cost 1997	364		
Sub-total all bonds	48'112	12'252	60'000
Less: cancelled bonds	(33'829)	(8'681)	(42'510)
Less: accrued finance cost at December 31, 1998 of outstanding bonds	346	–	–
Outstanding convertible bonds	14'629	3'571	17'490

At the year-end, the group held CHF 4'355'000 nominal value of its own bonds valued at market price.

7. Provision for income taxes

In 1998, the provision for deferred taxes was reduced by an amount of CHF 1.7 million.

* *in thousands*

ATAG ERNST & YOUNG

Report of the Group Auditors to the General Meeting of ENR Eastern Natural Resources SA, Geneva

As auditors of the group, we have audited the consolidated financial statements (consolidated balance sheet, consolidated statement of retained earnings, consolidated cash flow statement and notes) on pages 10 to 15 of ENR Eastern Natural Resources SA for the year ended December 31, 1998.

These consolidated financial statements are the responsibility of the board of directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with auditing standards, promulgated by the profession and with International Standards on Auditing issued by the International Federation of Accountants (IFAC), which require that an audit be planned and performed to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the consolidated financial statements. We have also assessed the accounting principles used, significant estimates made and the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the consolidated financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with International Accounting Standards (IAS) and comply with the law and the accounting provisions as contained in the Listing Rules of the Swiss Exchange.

In addition, as required under article 20 of the listing rules for investment companies, in our opinion the board of directors has used reasonable methods and estimates to determine the fair value of the investment portfolio.

We recommend that the consolidated financial statements submitted to you be approved.

Geneva, February 22, 1999

ATAG Ernst & Young SA

Pascal Gisiger
Certified Accountant
(Auditor in charge)

Prof. Dr Claude Bourqui
Certified Accountant

ATAG ERNST & YOUNG

Report of the Statutory Auditors to the General Meeting of ENR Eastern Natural Resources SA, Geneva

As statutory auditors, we have audited the accounting records and the financial statements on pages 18 to 19 of ENR Eastern Natural Resources SA for the year ended December 31, 1998.

These financial statements are the responsibility of the board of directors. Our responsibility is to express an opinion on these financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with auditing standards promulgated by the profession, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the accounting records and the financial statements comply with the law and the company's articles of incorporation as well as the listing rules of the Swiss Exchange.

In addition, as required under article 20 of the listing rules for investment companies, in our opinion the board of directors has used reasonable methods and estimates to determine the fair value of the investment portfolio.

We recommend that the financial statements submitted to you be approved.

In conformity with the prescriptions of Article 725 paragraph 1 of the Swiss Code of Obligations, the Board of Directors convoked an extraordinary general meeting on October 12, 1998 to inform the shareholders of the financial situation of the company following the crisis in Russia, based on interim financial statements as at September 30, 1998. During this extraordinary general meeting, the shareholders agreed to allocate the share premium against the accumulated loss, and to continue the activity of the Company. The financial situation of the company at December 31, 1998 has not changed significantly since the above mentioned meeting.

Geneva, February 22, 1999

ATAG Ernst & Young SA

Pascal Gisiger
Certified Accountant
(Auditor in charge)

Prof. Dr Claude Bourqui
Certified Accountant

Parent Company Balance Sheet as of December 31, 1998

	Notes	1998	1997
Assets		CHF	CHF
Cash and cash equivalents		16'590	13'525
Receivables from subsidiaries (net of a provision of, CHF 30'756'362)		–	29'869'213
Other assets		544	4'183
Current assets		*17'134*	*29'886'921*
Investments (net of a provision of CHF 32'000'000)	1	18'000'000	50'000'000
Capitalised expenditure – net		1'284'075	1'680'753
Total assets		19'301'209	81'567'674
Liabilities and Shareholders' Equity			
Accounts payable		35'642	2'350
Accrued expenses		159'408	197'220
Payables to subsidiaries		1'369'375	682'316
Liabilities		*1'564'425*	*881'886*
Share capital	2	37'500'000	37'500'000
Capital paid in excess of par value (share premium)		–	39'774'670
Reserve for treasury stock		–	2'725'330
(Accumulated deficit)/retained earnings		(19'763'216)	685'788
Shareholders' Equity		*17'736'784*	*80'685'788*
Total Liabilities and Shareholders' Equity		19'301'209	81'567'674

Parent Company Statement of Income and Retained Earnings for the year ended December 31, 1998

	1998	1997
Income	CHF	CHF
Net exchange gain	–	12'566
Service fees from subsidiaries	–	986'000
Interest income	893'855	603'772
Total income	893'855	1'602'338
Expenses		
Provision on receivables from subsidiaries	30'756'362	–
Provision on investments	32'000'000	–
Administrative fees	34'421	29'288
Professional and directors' fees	294'040	274'692
Amortisation of capitalised expenditure	396'678	221'476
Bank charges and interest	67'067	169'794
Other expenses	121'903	147'299
Taxes	172'388	96'644
Total expenses	63'842'859	939'193
Net (loss)/income for the year	(62'949'004)	663'145
Retained earnings at the beginning of the year	685'788	22'643
Reversal of share premium	42'500'000	–
(Accumulated deficit)/retained earnings at the end of the year	(19'763'216)	685'788

Notes to the Financial Statements as of December 31, 1998

1 **Significant investments**

At December 31, 1998, the ENR Group was composed of ENR Eastern Natural Resources SA and the following wholly-owned subsidiaries:

Company	Share capital* 1998		1997	
ENR Overseas Ltd, Nicosia	C£	1'833.0	C£	1'833.0
ENR Holdings Ltd, Nicosia	C£	3'310.0	C£	3'310.0
ENR Treasury Ltd, Nicosia	C£	370.0	C£	370.0
ENR Investment Ltd, Nicosia	C£	3'846.0	C£	3'846.0
ENR Securities Ltd, Grand Cayman	USD	0.1	USD	0.1
ENR Finance Ltd, Grand Cayman	USD	0.1	USD	0.1

2 **Share capital**

At December 31, 1998, the issued ordinary share capital of the Company was CHF 37.5 million, divided into 750'000 bearer shares of par value CHF 50 each.

2.1. Movements in shareholders' equity

	Share capital CHF *	Share premium CHF *	Reserve for Treasury Stock CHF *	Retained earnings/ (accumulated deficit) CHF *	Total CHF *
Balance at January 1, 1998	37'500	39'775	2'725	686	80'686
Purchase of treasury stock	–	(2'045)	2'045	–	–
Sale of treasury stock	–	4'770	(4'770)	–	–
Reversal of share premium	–	(42'500)	–	42'500	–
Net loss for the year	–	–	–	(62'949)	(62'949)
Balance at December 31, 1998	37'500	–	–	(19'763)	17'737

2.2 Treasury stock and warrants

At December 31, treasury stock and warrants held by a subsidiary consisted of the following:

	1998	1997
Number of shares	–	13'706
Number of warrants	117'080	292'380

The Group had the following movements on its own shares during the year:

Date	Purchase/(Sale)	Price
June	12'500	140.12
April	2'250	130.36
October	(11'570)	17.94
November	(16'886)	19.72

2.3. Conditional capital and authorised capital

The Company may increase its share capital by the exercise of option or conversion rights by up to a maximum amount of CHF 18'750'000 through the issue of a maximum of 375'000 bearer shares of par value of CHF 50 each. These shares are reserved for the exercise of option and conversion rights issued by the Company.

The Board of Directors is authorised until March 16, 2000 to increase the Company's share capital by up to CHF 18'750'000 through the issue of a maximum of 375'000 bearer shares of par value of CHF 50 each.

	1998 CHF *	1997 CHF *
Conditional capital	18'750	18'750
Authorised capital	18'750	18'750

2.4. Warrants

The Company has issued a total of 1'900'000 option rights in the form of warrants, entitling warrant holders to subscribe for one share for every ten warrants up to May 31, 2000. Following the June 1997 capital increase, the exercise price of the warrants was reduced from CHF 100 to CHF 83.10.

3 **Guarantees for the convertible bonds**

On October 28, 1997, ENR Finance Ltd issued, at par value, 3 3/4% convertible bonds for CHF 60'000'000, October 28, 2002. Each bond of CHF 5'000 nominal is convertible into 20 bearer shares of ENR Eastern Natural Resources SA of CHF 50 nominal each. As of December 31, 1998, ENR Finance Ltd had bought, on the open market, CHF 46'865'000 nominal value of its own bonds of which CHF 42'510'000 was cancelled. These bonds have been unconditionally and irrevocably indemnified by the Company.

4 **Significant events**

Due to the significant adverse changes in Russia, the country in which the Group invests, the listed shares held by the Group are no longer considered as being actively traded investments. As a consequence, they are held at cost less a value impairment adjustment made on a aggregate portfolio basis, as determined by the board of directors, as an active market no longer exists. A provision has therefore been made against the amount receivable from the group companies in which these investments are held as well as against the carrying value of the group companies.

* *in thousands*

Price information

Date	Net Assets CHF (in thousand)	NAV per share CHF (adjusted)	NAV per share Fully diluted * (adjusted) CHF	Share price CHF (adjusted)	Warrant price CHF
31.03.95	50'210	82.28	82.50	89.14	4.00
31.12.95	45'958	75.31	77.46	88.69	3.90
31.03.96	45'170	74.02	74.02	78.44	2.05
30.06.96	70'260	115.13	106.31	118.55	7.00
30.09.96	59'083	100.85	95.96	106.97	4.90
31.12.96	69'202	113.39	105.05	109.64	4.90
31.03.97	102'510	167.98	144.60	151.54	10.30
30.06.97 [1)]	162'998	217.33	190.20	154.00	11.80
30.09.97	190'937	254.58	219.92	192.50	13.50
31.12.97	149'752	199.67	176.11	155.00	11.95
31.03.98	129'303	172.40	154.35	134.75	8.20
30.06.98	65'003	86.67	85.95	91.00	4.80
30.09.98 [2)]	n/a	n/a	n/a	17.00	0.11
31.10.98 [2)]	n/a	n/a	n/a	19.50	0.39
30.11.98 [2)]	n/a	n/a	n/a	31.00	0.59
31.12.98 [2)]	n/a	n/a	n/a	25.85	0.30

* Fully diluted to reflect the exercise of the warrants
[1)] Capital increase of 250'000 shares, par value CHF 50, subscription price CHF 120 on June 30, 1997
[2)] NAV calculation suspended as from August 24, 1998

Warrants

The Company has issued a total of 1,9 million option rights in the form of Warrants, entitling Warrant holders to subscribe for one Share for every ten Warrants held at a price of CHF 83.10 per share up to May 31, 2000.

Summary

Organisation

Board of directors	Hans-Jörg Rudloff	*Chairman*
	Robert Pennone	*Vice-Chairman*
	Jean-Paul Aeschimann	*Secretary*
	Martin Pestalozzi	*Member*
Investment Manager	NRM Natural Resources Management Ltd	
Investment Advisors	MC Trustco Axiom Advisory Services SA Vulcan Petroleum Ltd	
Custodian	ING Bank Eurasia A/O	
Administrator	Fidutec Fiduciaire SA	
Auditors	Atag Ernst & Young	
Management Fee *	2% per annum of the average total stock market capitalisation	
Performance Fee *	15% of the amount by which the share price increase exceeds an annual return of 10% and 20% of the amount in excess of an annual return of 20%	

Publication Listing

NAV Publication	Finanz & Wirtschaft (twice a week) The Financial Times (once a week) Reuters : MCSY (daily)
Interim Report	Available upon request at the Company
Listing	Swiss Exchange
Ticker symbol	Bloomberg : ENR SW • Reuters : ENRZ.S
Security number	Bearer Shares 347.166 • Warrants 347.167

Investment policy

The investment objective of the Company is to maximise the long term returns to shareholders. The Investment Manager intends to achieve this by investing the Company's assets in a diversified portfolio of securities of companies with substantial activities in the natural resources industry in Russia and in other Newly Independant States (NIS), and within certain limits, in debt instruments, physical commodities and privatisation vouchers.

* The Company informed at the Extraordinary General Meeting of Shareholders of 12 October 1998, that the Investment Manager renounces to the management fees as of 1 August 1998 until the net asset value per share reaches CHF 56.18 (being the net asset value of 14 August 1998, the day before the Russian debt moratorium was announced). Once this level is reached, the management fees will be paid to the Investment Manager retroactively. The hurdle rate for the calculation of the performance fee has been lowered to CHF 100.-