



More of Ferreyros

2006 Annual Report, approved by the Board of Directors in session held on February 28, 2007, for its presentation at the General Shareholders' Meeting on March 28, 2007.



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Lima, February 28 2007



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Report of the Board of Directors on the Company's Performance

General Information

2006 has been characterized by great accomplishments and good outcomes for our company. Record sales and profits and several other achievements enable us to consider this year as a benchmark for the future.

Firstly, we must mention a sustained increase of the company's sales volume, which amounted to over US\$ 403 million. And if we add the sales of the subsidiary Orvisa S.A. –which is in the same line of business as Ferreyros – in the Peruvian Forest, they total US\$ 426 million. If the sales of all other subsidiaries are considered, the total turnover amounts to US\$ 455 million. The company attained this turnover -which had never been reached before- without losing its leading position in any of the markets market where it has presence. Some of these positions have even improved in some cases.

An important factor in explaining these sales volumes has been market behavior, characterized by a growing demand from our customers in the construction sector –for earthmoving works particularly–, and by continuous mining activity encouraged by high ore prices in the international market. The implementation of major road and infrastructure projects and the investments made by mining companies in equipment maintenance and repair allowed us to introduce our machines, equipment and spare parts, and to provide our services which are highly regarded among our customers, who appreciate the added value in the company's operations.



Other sectors we serve also showed high levels of activity. In general, the positive scenario created by a steadily-growing economy, as shown in 2006, opens up great business opportunities for companies like ours with a clear leading position in almost all of its product lines, particularly in *Caterpillar*, which has a 61% market share in relation with the large number of brands it competes with in the different market sectors.

These achievements were further fostered by the timely adoption of decisions on equipment supply, which made it possible to have a large part of the required stock, in spite of the severe manufacturing restrictions caused by high worldwide demand.

In correlation with this significant sales volume, the company registered net profits for US\$ 30.5 million, approximately three times higher than profits earned the previous year. These profits represent a return on equity of approximately 32.4% and an added value of US\$ 16.6 million, understood as the earnings generated by the company for the shareholder, in addition to the expected return on capital.

It is important to stress that the levels of profitability attained by our company reveal not only exceptional market demand, but also careful management. It has been able to increase its profit margins and reduce operating expenses in percentage terms, resulting in significant operating profits, fostered by a positive financial outcome which had not been attained in many years. The arithmetic combination of these factors has allowed profits to grow in much greater proportion to sales.

Additionally, we have continued to strengthen our financial structure by having a conservative level of debt, reducing expenses and selling non-productive assets. Average financial ratios for liquidity, indebtedness and profitability attained throughout the year have allowed our company to show a strong financial situation and a solid cash flow position.

These measures have given rise to market recognition through an increase in market capitalization, which amounted to S/. 1,017,938,400 by the end of the fiscal year -160% higher than the percentage obtained in December 31, 2005.



On the other hand, our operational structure continued to improve, as well as our internal processes aimed at providing better services to our customers, taking into consideration our “value” concept which ultimately implies achieving excellence in satisfying the customer’s needs in the sale and post-sale services. For this purpose, we continue training our technical staff and insist on placing more emphasis on a matrix organization in order to make our management more customer-friendly and market-oriented. At the same time, we have continued to develop a continuous improvement process based, especially, on the *Six Sigma* quality management methodology, which has allowed us to save approximately US\$ 2.2 million during the 2003-2006 period.

The Company in the Peruvian Economy

The Peruvian Economy was characterized by the consolidation of sustained economic growth during 2006, with a GDP over 7% for the year. This was accompanied by an annual inflation of 1.2%, the lowest in the last three years.

Mining and construction, the main economic sectors of the country, are the driving forces of the growth of the capital goods market, where Ferreyros has an active participation.

Among the macroeconomic indicators that have reflected positive economic performance in 2006 are exports, which rose by 37% as compared to 2005 and reached a historical record amount of US\$ 23,750. On the other hand, imports amounted to US\$ 14,897 million, with a resulting trade surplus US\$ 8,853 million -68.3% higher than that obtained in 2005.

In particular, the rise in international ore demand and the development of new infrastructure in Peru resulted in a nearly 36% increase in capital goods imports in 2006 compared to 2005.

Business performance

The mining, construction and industrial market

In the **mining market**, the price of ore minerals continued to increase during 2006, with record prices for copper as well as for gold and zinc. By the end of the year, the upward trend stopped and even reversed slightly.

However, the upward trend, which prevailed throughout the year, encouraged our customers to strengthen their production plans and maximize the availability of their hauling equipment (off-highway



trucks) and auxiliary fleet, as well as to expedite the machine fleet replacement program.

Our sales of new *Caterpillar* machines – which revealed the acceleration of machine replacement programs – were 34% higher than predicted. Furthermore, the consistent effort of our customers to achieve challenging goals regarding the availability of key equipment led to the design of maintenance strategies, which also increased the sales of spare parts, services and repair work.

However, this increase in consumption has been promoted, in part, by the different process improvements we implemented in conjunction with Caterpillar, and sometimes, even with our own customers, for the purpose of increasing the useful life of components repaired by Ferreyros, and reducing their variability. The technological superiority of Caterpillar and the continuous improvement of our repair shops have made it possible to prolong the useful life of components.

In 2006, we incorporated in our customer portfolio the new copper and gold Project called *Cerro Corona*, located north of the city of Cajamarca, which started to operate in the first quarter of the year. In fact, this year, we have, again, demonstrated our commercial leadership by supplying hauling equipment and the auxiliary fleet for mining operations; in addition, we have started with *in situ* provision of spare parts and services.

As of the end of fiscal year 2006, we can ensure that underground mining is still the most important economic sub-sector for our company, not only due to its demand for goods and services, but also as an indirect source of sales to an important group of customers in the construction sector, which currently provides services to the mining sector.

Caterpillar products both for the mining market and, in general, for all markets in which we are present, accounted for 89% of our total sales in 2006, including income generated by the sale of spare parts and other services. As previously indicated, CAT equipment and machines still retain high market shares. According to Customs' statistics, the market share for units was 71% of the total number of machines for large-scale mining for units, representing 57% of import value.



In **mid-scale mining**, we still enjoy the trust and loyalty of our customers. We must mention the particular success we continue to enjoy with low-profile CAT loaders for underground mining, which were introduced into our market a few years ago, attain a market position as one of the leading brands with a 42% share in 2006.

It is worth mentioning that two larger loaders, manufactured by our supplier Caterpillar, were introduced into the country for a new mining underground operation in the south of Lima. This places us in a favorable position due to the implementation of modern, highly-productive mining methods in future underground mining projects.

In addition to supplying these machines for mining operations, Ferreyros sold a significant number of *Atlas Copco Drilling Solutions* (formerly *Ingersoll Rand*) drillers and had 100% of orders issued in 2006 approved; therefore, its share with regard to this type of equipment operating in the country stood at 78%.

As far as the **construction and industry markets** are concerned, the announcement of major road projects and the start-up of some preparatory work gave rise to a significant increase in the demand for machines and equipment. This led to a 50% increase in sales of machines for construction work compared to the previous year. It is especially important to mention that our company has supplied almost all the fleet bought or leased for the concession of the South Trans-Oceanic Highway, and that we sell machinery to individual subcontractors located in the areas where work is being carried out.

In addition to road and infrastructure works, water and sanitation works were also carried out in 2006, and we were able to sell a significant number of units of *Caterpillar* light construction equipment, both through direct sales and leasing of equipment.

It is also important to point out that contractors have purchased a significant number of pieces of equipment to renew their fleet of machines for use in irrigation projects such as the preliminary and complementary works for the First Stage of the Olmos Hydropower and Irrigation Project, and for other earthmoving works to be carried out by different mining companies.



Used machinery is another line of business where our company is doing well. While sales did not reach the significant levels reported the previous year, the market is showing an upward trend especially due demand from small and medium contractors who need machines to comply with medium-term contracts. Our company received the Top Ten Club recognition in 2006 from *Caterpillar Redistribution Center* for its sales of used equipment.

Furthermore, in order to increase our customers' loyalty, we have developed a policy on strategic commercial alliances, which, during its brief existence, has led to the adoption of six agreements with six companies.

Power and Fishing Markets

Our company maintained a significant presence in these markets, where *Caterpillar* engines held over 60% of the market share. In 2006, we occupied the first place among Latin American dealers in the "Power System Dealer Excellence Recognition Program".

In the **industrial fishing business**, we attracted a significant portion of the vessel-repowering market by introducing electronic engines which reduce operating costs due to lower fuel consumption, while maintaining an active presence in the provision of engines for small-scale fishing vessels.

In the **oil** and mining **market**, we continue to sell and rent mobile encased generating sets. In the oil market, particularly, five 6-MW generating sets as well as screw pumps were sold to recondition the *Oleoducto Norperuano* (Oil Pipeline in Northern Peru). This equipment will be delivered in 2007.

In the **energy market**, through our subsidiary Orvisa S.A., we signed a turnkey contract to install a 15-MW steam power plant, on which work will start in mid 2007.

In 2006, we signed a contract to build the plant and sell energy in Andoas through Pluspetrol. This project represents the first opportunity for our company to venture into direct power provision through our subsidiary Ferrenergy.

Finally, we increased our market share by selling over 18 generating sets to important customers for use in "El Platanal" project and in the South Trans-Oceanic Highway.

Agricultural and Automotive Markets

In the **agricultural sector**, especially the non-traditional sector, the country registered significant growth in 2006. Agricultural exports grew 33.5%, thus amounting to US\$ 1,790 million, and its structure shows increasing diversification of products and geographical location. In this



growing market, our company sold a significant number of *Massey Ferguson* farm tractors and achieved a 55% market share, thus confirming the long-standing leadership of this brand in the Peruvian market. The other product lines we represent showed a similar trend. For example, among forestry products, *Benecke* wood driers have achieved a 63% market share in two years, while *Zaccaria* rice mills achieved a 25% market share in 2006.

Regarding the **automotive business**, truck sales (categories P4 and P5 with a gross weight or more than 16 Tons) registered significant growth of 108% with respect to the previous year (while total market growth was 86%) because robustness, both in the transportation sector and in the mining and construction markets, continued in 2006. The *Kenworth* brand, represented by our company, maintained the good levels of sales reported the previous year and was consolidated as an elite product line in the truck market, with the high level of quality that characterizes its products.

Iveco, another important brand we have represented since the second quarter of 2005, took off in 2006, especially in the mining and construction markets. Over 100 units were sold, most of which were dump trucks, including the “heavy duty” version especially designed for highly-demanding tasks, such as underground mining. In connection with *Iveco* trucks, we introduced the first units of the *Stralis* model, which is a high-performance unit.

In short, the automotive business turned over US\$ 21.6 million, representing a 73% increase with respect to 2005.



Sales of Spare Parts and Services

Sales in this line of business continued growing during 2006, not only in terms of volume, but also in terms of coverage. The size of the machinery and equipment fleet introduced in the market by Ferreyros has generated an increasing demand for spare parts over time, which has been adequately covered by the company, and this is a positive trend in this business. Furthermore, we have maintained our policy of differentiating mining customers from non-mining customers when it comes to commercial management of spare parts and services. In the latter case, where the potential for increasing market share exists, sales of spare parts have risen by 26% as compared to 2005, while for spare parts supplied through service provision, sales increased in 78%. In order to better reach our non-mining customers, we signed 230 Customer Service Agreements (CSA) this year, which involved 326 machines and engines, aimed at improving availability of equipment, decreasing maintenance costs (by reducing emergencies) and increasing our customers' loyalty.

In the case of mining customers, the high volume of spare parts sales is largely explained by repairs made in the Component Repair Center (CRC). This line of business had significant performance in 2006 since 1,152 major components for large-scale mining were repaired, which included engines, transmissions and final drives, thus representing 12% growth as compared to 2005. 329 components for the "construction and medium mining" market have been repaired in the CRC since 2006, representing a 53% increase. Minor components repaired in the CRC added up to 3,398. Regarding turnover, the large-scale mining market experienced a 25% increase while the "construction and medium mining market" grew by 73%.

To meet quality standards concerning customer services, we maintained our policy of investing in equipping repair shops, which included the construction of hydraulics and rebuilding shop at the Cajamarca branch office.

Contamination control is another quality standard we must adhere to, and for this purpose, we have invested significant amounts of money in reconditioning our branch offices' repair shops. In 2006, *Caterpillar* granted the five-star contamination control certification to repair shops in Lima and to the branch offices of Arequipa, Cajamarca and Piura, and a three-star certification to the repair shop of Trujillo branch office. With these certifications, Ferreyros has become a dealer with the greatest number of certified repair shops in Latin America.

Furthermore, the Component Repair Center (CRC) once again obtained the *World Class* certification granted by *Caterpillar*.

Logistic Processes



On the other hand, we have continued to improve processes in spare parts and machine warehouses. The Operational Excellence Project was carried out with the support of external consultants, and the implementation of *Six Sigma* quality management projects continued. Improvements made were aimed at reducing cargo handling times both in the receipt and delivery of goods, ensuring accuracy in inventories and deliveries, and increasing productivity. As part of the above, new applications are still being developed with bar codes at the Spare Parts Distribution Center (CDR, Spanish acronym) located in Lima, and are already being used at the Yanacocha mine warehouse.

These measures must ensure adequate stock rotation and a high level of service in spite of the increase in the number of parts for new construction and mining operations, the sale of new machines, engines and equipment, and the growth of other markets.

Both indicators have improved as compared to 2005 and are within the best standards of similar companies in the region. 95% of our customers' demands are immediately covered from said stock while the remainder is covered with emergency orders which are processed through a very flexible system in which all chain suppliers are integrated?

Regarding **imports**, it is worth stressing that we are number one in the ranking for capital goods imports, having registered 68% growth with respect to 2005, according to reports from Comexperú prepared with information from the Sunat. We maintain the flexibility achieved in import processes, both for spare parts and capital goods. For these processes, 90% of dispatches are carried out through Anticipated Dispatch and Direct Unloading, with an average cargo release time of 4 hours for spare parts and 24 hours for machinery.

Training Programs

Given the growing demand for qualified technicians, **training programs** have been intensified through focused, specialized training. Our company places great emphasis on this aspect which has turned into a great distinctive value for our customers.



At the core of our training program for technicians is *Service Pro*, a career program for technical staff, based on the certification of representative work skills. The first stage of this program consists of migrating to new categories and careers through the certification process, and 75% of this stage is completed.

Currently, 378 technicians working in mining projects, branch offices and repair shops are enrolled in *Service Pro*.

In order to meet the expectations of our mining customers, we are training our most qualified technicians, who will be trained to obtain the Caterpillar Technical Certification for Mining (granted in Tucson, Arizona) and Heavy Equipment. In 2006, 14 technicians participated, achieving 27 technical certifications.

On the other hand, the number of technical instructors certified by Caterpillar has risen to four and they will contribute to the continuous improvement of training quality. The Supervisor Training Program, conducted by *Universidad del Pacífico*, has continued, with 360 hours of class provided to 30 participants.

In order to cover the present and future demand for qualified technicians, the *Think Big* Project (two-year professional training), launched in 2002 in collaboration with Tecsup and Caterpillar, turned out its third graduating class with 19 students, who have been incorporated in our company.

For new technicians, we have implemented the ABC program (Caterpillar Basic Training), based on a four-month training course, including theory courses and technical activities.

Branch Offices

Ferreyros S.A.A. has 10 branch offices located in the country's major cities and a subsidiary, Orvisa S.A., with 4 branch offices in the jungle. These operational units are very important to our company, since they provide wide product and service coverage throughout Peru and ensure the operating capacity of the equipment sold to our customers by conducting business nationwide.

Sales through branch offices have registered sustained growth in recent years. In 2006, they grew by 33% with respect to the previous year as a result of traditional medium-scale mining, the construction of highways and infrastructure, and sales to large-scale mining contractors. Key achievements in terms of security and service processes in repair shops came along with this trend.



Financial management

Our main objective for 2006 in this line of business has been to maintain adequate stocks to keep up with our company's sustained sales growth in spite of the difficulties faced in equipment supply.

For this purpose, and in order to optimize costs, increase efficiency and capitalize on the synergies of the traditional commercial areas, Logistics Management was created to take charge of integral logistics, which involves the entire process from the placement of orders for equipment and spare parts to delivery and the issuance of invoices.

Stocks grew by 40%, on average, due to a larger purchase of machinery, equipment and spare parts to avoid a potential shortage of machines.

Regarding spare parts, there was a 22% increase in stock levels; however, in spite of this, the adjusted rotation was 4.0 versus 3.8 registered in the previous year. This was the result of the implementation of administration measures and stock control which allowed us to remain within the highest standards of similar companies in the region.

Regarding machinery, equipment and vehicles, our company dealt with supply restrictions from different factories abroad by placing purchase orders in advance based on accurate sales predictions.

This increase in stock was basically financed with the company's own resources. Cash flow levels were maintained during 2006 primarily with income resulting from cash payments made by our customers. The good cash flow and prompt payments made to Caterpillar generated additional financial income which was 37% higher as compared to 2005, due to prompt payment discounts given by foreign suppliers.

Our financial debt went from US\$ 108.5 million in December 2005 to US\$ 113 million in December 31, 2006, essentially due to the purchase of equipment shipped from the factory at the end of 2006, invoiced by Caterpillar and payable during the first quarter of 2007, after its delivery.

In order to obtain the lowest interest rates and reduce the risk that they increase, a financial strategy was developed, which consisted of securing loans with fixed interest rates. This avoided variable rate costs associated with the Libor rate, which maintained an upward trend for the greater part of the year.

The strategy also considered the use of foreign currency in financing transactions in order to pay the resulting obligations with income expressed in the same currency, thus avoiding exchange risk.



Financial expenses in 2006 amounted to S/. 28.6 million -an amount lower than that recorded in 2005 (S/. 30.7 million) - due to the reasons abovementioned, and to negotiations with suppliers to obtain longer time limits and with financial agencies to improve rates and commissions, as well as a reduction in our company's debts as a result of profits accumulated throughout the year.

In the **capital market**, the last issue of the First Corporate Bond Program was successfully placed, allowing placements for as much as US\$ 50 million. In previous years, we placed bonds for up to US\$ 40 million; therefore, this bond issue was for the difference, i.e. US\$ 10 million. Conditions for this placement were favorable and the interest rate was 6.06%.

We placed commercial paper for US\$ 30 million in the short-term capital market, which is the maximum limit permitted in the Second Short-Term Instrument Program. Issues were made at 180, 270 and 360 days respectively according to predicted flows and the company's capital requirements at a Libor cost + 0.1, on average. This financing method enabled us to match the short-term due dates of collectibles from mining customers.

The four issues of the First Debt Instrument Program, approved at the general shareholders' meeting in March 2006 are registered with Conasev. In this new program, the possibility that corporate bonds or commercial papers could be issued for up to US\$ 90 million is considered.

In 2006, *Apoyo y Asociados Internacionales S.A.C.* and *PCR Clasificadora de Riesgo S.A.C.* (risk raters) improved their rating on Ferreyros' corporate bonds and commercial papers.

At the end of the year, the balance of cash in banks amounted to US\$ 10.8 million, which was used to pay debts and cover operating expenses in national currency during the first days of 2007. For the payment of debts in dollars, we carried out exchange transactions on the spot market.

At the end of the year, our company showed a 1.49 debt ratio which was lower than that attained at the end of 2005 (1.65).

On the other hand, the current ratio deteriorated in the last month of the year and dropped to 1.47 due to higher debt related to short-term credits secured in December to pay for significant purchases of equipment, which will be sold and made payable in the first months of 2007. The positive trend in the interest coverage ratio (7.7 times) in recent months was maintained as a result of stable financial expenses and the increase in financial income and EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization).



Bank financing decreased from US\$ 41 million in 2005 to US\$ 24 million in 2006. It mainly came from local sources, which maintain very competitive interest rates in spite of the upward trend in the Libor rate. Foreign funding is affected by the increase in international rates as compared to local rates and the incorporation of the country risk.

Short-term financing has been mainly aimed at matching receivables from our customers.

Concerning sales financing, we maintained the policy of cutting down on medium-term credit transactions, which accounted for 12% of sales - very well below the 25% limit established as part of the company's objectives. This was possible due to the active participation of *Caterpillar Financial Services*, which provided significant credit to our customers and to financing transactions through local financial institutions with financial credits and leasing. In addition, we have decided to meet our customers' demand for equipment through our own or third-party operational leasing.

The receivable portfolio increased by 16%, but it is mainly made up of short-term debts resulting, basically, from invoices with 30- and 60-day commercial credit.

The turnover of receivables for the sale of spare parts, services and leasing decreased from 47 to 43 days on average, and the default rate of the current portfolio over 30 days was 0.21% as compared to 1.9% in 2005. The allowance for receivables decreased from US\$ 1.8 million in 2005 to US\$ 1.0 million in 2006.

The consolidation of the financial situation and the good results of the year were perceived by the market as a positive sign; our stock closed at S/. 3.94 per share, and the market capitalization was 160% higher than that of 2005. The profit rate for 2006 was 167.41%.

Subsidiaries

Throughout the year, most subsidiaries showed a positive performance which complemented Ferreyros S.A.A.'s operations, and helped capitalize on the synergies generated for the company. Subsidiaries achieved a total turnover of US\$ 52 million and added US\$ 2.1 million to the company's profits.

Orvisa S.A. reported consolidated sales of US\$ 23.5 million (including the turnover of its subsidiary *Orvisa Servicios Técnicos S.A.C.*) for 2006, 17% higher than for the previous year. Its operations are oriented toward the oil, energy, forestry, agricultural, river transportation, government and medium-scale mining sectors in the Peruvian jungle. These outcomes are the result of the growing demand for generating sets in the oil and energy sector; marine engines in the river transportation sector; machinery, wood exploitation and woodworking tools and equipment as well as heavy machinery in



the government sector; and used equipment and spare parts in the medium and small-scale mining sector. The development of turnkey projects, the discovery of new oil fields, and improvement in the forestry sector enable us to forecast continuity of the demand for the products we sell.

Orvisa Servicios Técnicos S.A.C. was conceived to provide services for the reconstruction and maintenance of generating sets and production plants. The company achieved a sales turnover of US\$ 2.06 million, an amount similar to that registered in the previous year.

Orvisa's total net profits amounted to US\$ 1.9 million, 5% higher than net profits for 2005.

Unimaq S.A. increased its sales by 41% with respect to the previous year and turned over US\$ 23.3 million. This growth was consistent throughout the 25 lines of light equipment, sanitation products and inputs it represents to serve the mining, construction, fishing and industrial markets. As a result of the increase in sales, the company's net profits grew by 60% as compared to 2005 (from US\$ 504 thousand in 2005 to US\$ 834 thousand in 2006).

In order to attain better market coverage, the Board of Directors agreed to integrate Unimaq's sales operations with the leasing operations of Ferreyros' business unit through *Rentando Cat Rental Store*. This merger will be very convenient for the organization, given the synergies between the two companies since they work with the same product line and target the same market segments. Assets such as properties and equipment will be transferred from Ferreyros to Unimaq in 2007.

Depósitos Efe S.A. achieved a total turnover of US\$ 600 thousand, 13% lower than the turnover registered in 2005. This reduction was mainly due to the expiration of one of the company's major customer's contract in the middle of the year. Net profits amounted to US\$ 100 thousand, 45% lower than last year's net profits. By the end of 2006, some diversification projects had been started in the logistics area.

Fiansa S.A. has made progress in its business reorientation process which started in 2005, and has consequently earned US\$ 7.6 million in revenues. However, in 2006, it had to assume the losses generated by the implementation of projects undertaken in 2005 and make adjustments to restructure its assets, which resulted in losses of US\$ 600 thousand. The capitalization of obligations to Ferreyros, the restructuring of debts with banks, the preparation of short and medium-term strategies to make the company an instrument for implementing the organization's integral projects, the turnover of senior staff, and the economic perspectives of the construction, metalworking and electrical markets, are paving the way for reaching profit levels consistent with the market starting in 2007.



Domingo Rodas S.A. In 2006, **Domingo Rodas S.A.** produced 851 tons of prawns for export, 19% more than in the previous year. However, its sales decreased by 14.6% compared to 2005 and amounted to US\$ 2.8 million. The result for the year was nearly even. The main factors affecting sales and outcomes were: a) A drop in international prices starting in the second quarter; b) variation in the exchange rate; c) an increase in input costs in the second semester, especially food, due to an increase in fishmeal prices, and d) a delay in the harvest of a significant lot of prawns, which was not exported until January 2007.

In order to tackle the external variables that may affect its outcomes, the company decided to diversify its operations by creating a new business unit that will be in charge of the extraction, processing and exportation of hydrobiological products. A total amount of US\$1,350,000 will be used to buy fishing vessels -which are currently owned by the organization - with a 30-ton warehouse capacity.

Ferrenergy S.A.C. is a company resulting from the association of Ferreyros and Energy International. It signed a contract to supply 3.5 MW power to a project conducted by Pluspetrol in the Peruvian jungle. This contract, executed in January 2006, envisaged the construction of the plant in Lot 1-AB in Shivyacu-Andoas in seven and a half months, and the start up of electrical power production by the end of that same year. Despite the fact that the execution of the contract was initiated on schedule, the work had to be stopped due to discrepancies between the client and ministry authorities regarding environmental permits, problems that appear to be nearing a solution. Given that in 2006, 100% of the investment was made for the purchase of equipment and construction works without the possibility of starting up operations, with the ensuing generation of financial expenses, which are currently being contested, the company's net results evidenced a loss amounting to S/.1 million. It is expected that construction will be resumed in March and that the Project will be completed by the end of May 2007, so as to recover the expenses incurred during this first investment year through energy sales starting in the second half of 2007.

Corporate governance

At Ferreyros we have long understood the importance of implementing good corporate governance practices. While the company, which will celebrate its 85th anniversary in 2007, has not always used the recently-coined term "corporate governance", throughout its company life it has certainly guided its actions in the light of ethical principles, many of which are included in the current concept of corporate governance. Fair treatment of shareholders and respect for their rights, clear establishment of the roles of the board of directors and management, and the timely, transparent presentation of information relevant to the market are practices that we adopted long ago which



have enabled us to align the interests of the shareholders with the different management levels.

Thus, we promptly adhered to the declaration of principles of good governance for Peruvian business companies published by the Securities and Exchange Commission (CONASEV) in 2002, in which the company actively participated through Procapitales. Since then, we have focused our efforts on achieving greater compliance with these principles. In this Annual Report, for the third consecutive year we submit an Annex with our self-assessment on compliance with the 26 principles and an explanation of the score achieved in each case.



The high compliance level achieved in almost all principles reflects the continuous improvement process adopted by the company. Changes in the bylaws have recently been approved in relation with the representation of shareholders in the Shareholders' Meeting so as to enable a broader delegation, as well as the requirements for being a director, making it possible to appoint independent directors. Furthermore, two new board committees were created in addition to the one already in existence; we published a set of rules for the shareholders, the board of directors, and the board's self-assessment of its management performance, among others. The high level of compliance with the principles has led to different forms of recognition of the company's efforts throughout 2006:

1. *Market recognition*, evidenced by the increased number of investors that have purchased our shares, making us grow from 746 to 988 shareholders in one year, as well as by the good reception of our corporate bonds and commercial paper placed in 2006 for an amount of US\$40 million through the capital market.
2. *The recognition of local institutions* that promote the implementation of good practices, materialized in the first-place award obtained in the category of Best Treatment of Shareholders, granted by Procapitales and the University of Applied Sciences as part of the First Competition on Good Corporate Governance.
3. *The recognition of international institutions*, with the company having been distinguished as a finalist in the Good Corporate Governance competition among Latin American companies, organized by Garrigues Affinitas in Madrid, Spain.

In 2006, our company once again shared its experiences in the local market by participating in different events, where it contributed its testimony in order to motivate other companies to continue working on the application of these principles.

Within this context, joining the "Companies Circle of the Latin American Corporate Governance Roundtable" in 2006 has been of great value. This venue was launched in 2005 by the Organization for Economic Cooperation and Development (OECD) and the International Finance Corporation (IFC) together with its eight founding members. Ferreyros joined this circle in 2006. The Companies Circle is formed by 13 Latin American companies, leaders in the implementation of good corporate governance principles in the region, seeking to:

- Be a forum of discussion of challenges and achievements obtained in the improvement of their corporate governance



- Share with the Latin American community of business companies the practical solutions found to good corporate governance challenges and,
- Contribute to the work of the “Latin American Corporate Governance Roundtable” with the vision and experience of companies that have already undergone a high level of reforms.

In 2006, we participated in meetings of the circle and it has been enhanced by the exchange of experiences and positions with respect to good governance issues included on the agendas.

2007 Challenges

All projections point to the fact that the growth level of the national economy should increase or remain stable in 2007, driven mostly by the good levels achieved during the previous year.

The existence of important mining, hydrocarbon and road construction projects that are scheduled to take place throughout the year and sound management of the major macroeconomic variables, lead to a reasonable expectation of good performance by our company, which, having a consolidated financial structure and an articulated organization, is increasing the efficiency of its processes and strengthening its ties with its clients. Therefore, its leading position must be emphasized.

Nevertheless, as our company progresses, new and renewed challenges emerge.

In the first place, the exceptional level of sales and profits accomplished in 2006 has set the bar very high and surmounting it constitutes a gigantic challenge.

Hand in hand with this challenge is our pursuit of excellence in meeting the needs of our clients in our sales and post-sales service, placing emphasis on the value of what we offer.

The need to grow forces us to define, actively but carefully, the new areas where we must be present in order to use our synergies efficiently through new business forms.



The varied and aggressive competition present in all the markets in which we operate, presents on-going challenges as the competition typically tries to overtake the market leader. Modestly, yet firmly, we have successfully faced these challenges without losing our share of the market; on the contrary, we have increased it. Everything seems to indicate that in 2007 we will witness renewed competition for which we will be prepared. We trust the quality of the brands we represent, the incomparable strength of our organization and the professional service-oriented level of our personnel.

Our personnel, who have identified themselves with our company and its goals in a harmonious, motivating organizational environment, constitute our greatest comparative advantage in facing the challenges of 2007.

Our performance has obtained good approval levels among our clients. It is our obligation to offer them **more** quality, **more** service, **more** identification with their needs, **more** comprehensive solutions, **more** dedication in the processes, **more** of Ferreyros.

With optimism and without arrogance, the board believes that 2007, the year of our 85th anniversary, our company will continue growing and thriving, with integrity, social responsibility and good corporate governance, to the benefit of our shareholders and our workers. Our 2006 achievements enable us to assert that we are more prepared than ever for success.

Before ending this introduction to the Annual Report for its second year, the board wishes to express its gratitude to the shareholders for their trust, to the clients for having honored our company with their preference and to our suppliers and personnel for the support received during this time.

We are pleased to submit to the shareholders general information on the company and detailed information on the operations, as well as an analysis and discussion of our financial statements, pursuant to Conasev Resolution 141.98.EF/94.10, issued by the National Securities and Exchange Commission (Conasev) on the presentation of annual reports. The mandatory liability statement is also included.