ABERDEEN EMERGING MARKETS SMALLER Co OPPORTUNITIES FUND, INC.
Form N-CSR
January 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number:	811-08076
Exact name of registrant as specified in charter:	Aberdeen Emerging Markets Smaller Company Opportunities Fund, Inc.
Address of principal executive offices:	1735 Market Street, 32nd Floor Philadelphia, PA 19103
Name and address of agent for service:	Ms. Andrea Melia Aberdeen Asset Management Inc. 1735 Market Street, 32nd Floor Philadelphia, PA 19103
Registrant s telephone number, including area code:	1-800-522-5465
Date of fiscal year end:	October 31
Date of reporting period:	October 30, 2017

Item 1. Reports to Shareholders.

Aberdeen s Investor Relations Services
We invite you to enroll today and stop the paper.

As part of our commitment to shareholders, we invite you to visit Aberdeen Closed-End Funds on the web at cef.aberdeen-asset.us/ where you can view monthly fact sheets, portfolio manager commentary, distribution and performance information, updated daily fact sheets courtesy of Morningstar®, portfolio charting, and other timely data.

To learn more about Aberdeen Closed-End Funds

Visit:

Aberdeen Closed-End Fund Center
cef.aberdeen-asset.us/

Watch:

Aberdeen Closed-End Fund TV
aberdeen-asset.us/aam.nsf/usclosed/aberdeentv

E-mail:

InvestorRelations@aberdeen-asset.com

Call:

Investor Relations: 800-522-5465
Open Monday to Friday 9am-5pm (ET)

Enroll today and receive shareholder reports electronically*

By enrolling in this convenient service, you will receive important Fund documents including annual reports, semi-annual reports, prospectuses, and proxy statements via e-mail.

There s never been a faster, simpler or more environmentally-friendly way to receive investment information.

To enroll, follow these simple steps:

1. Go to cef.aberdeen-asset.us/

2. Click on the link for Email Services
www.aberdeen-asset.us/aam.nsf/usclosed/email

3. Click Sign-up. You can expect to receive your electronic documents in 4-6 weeks.

* Please note that Aberdeen does not share our shareholder information with any other organizations. You can return to this site at any time to change your email address or edit your preferences.

Letter to Shareholders (unaudited)

Dear Shareholder,

We present this Annual Report, which covers the activities of Aberdeen Emerging Markets Smaller Company Opportunities Fund, Inc. (the Fund), for the fiscal year ended October 31, 2017. The Fund s principal investment objective is to seek long-term capital appreciation. The Fund seeks to achieve this investment objective by investing primarily in equity securities of emerging market smaller company issuers.

Total Investment Return

For the fiscal year ended October 31, 2017, the total return to shareholders of the Fund based on the net asset value (NAV) and market price of the Fund compared to the Fund s benchmark are as follows:

NAV*	10.2%
Market Price*	18.1%
MSCI Emerging Markets Small Cap Index[1]	21.1%

*assuming the reinvestment of dividends and distributions

The Fund s total return is based on the reported NAV on each financial reporting period end and may differ from what is reported on the Financial Highlights due to financial statement rounding or adjustments. For more information about Fund performance please see page 3 Report of the Investment Adviser.

NAV and Share Price

	NAV	Market Price	Discount
10/31/2016	$14.43	$12.23	14.6%
10/31/2017	$15.76	$14.43	8.4%

Open Market Repurchase Program

The Fund s policy is to consider buying back Fund shares on the open market when the Fund trades at certain discounts to NAV and management believes such repurchases may enhance shareholder value. During the fiscal year ended October 31, 2017, the Fund repurchased 159,122 shares. During the fiscal year ended October 31, 2016, the Fund repurchased 90,827 shares.

Fund Consolidation

In light of increasingly challenging conditions for smaller closed-end funds, the Fund s investment adviser presented a proposal to the Board in an effort to create a more sustainable fund with broader investment appeal, increased portfolio yield characteristics, a bigger fund with increased secondary market liquidity, and the potential for reduced overall expenses. In October 2017, the Fund s Board of Directors and the boards of directors of seven other closed-end funds announced that they had each approved the consolidation of their respective

funds into one fund, subject to the receipt of necessary approvals by stockholders of each fund. The combined fund would be managed by the Fund s investment adviser and otherwise serviced by the same service providers as currently serve the Fund. In the consolidation, the Fund would be reorganized into the Aberdeen Chile Fund, Inc. (the Acquiring Fund), which would, in connection with the consolidation, assuming requisite stockholder approvals are obtained, be renamed Aberdeen Emerging Markets Equity Income Fund, Inc. (the Combined Fund) and would invest in emerging market equity securities to seek to provide both current income and long term capital appreciation. The Combined Fund may use leverage to achieve its objective. It is anticipated that the Combined Fund s benchmark would be the MSCI Emerging Markets Index and that the Combined Fund would trade on the NYSE American (formerly, NYSE MKT) under a new ticker symbol, expected to be AEF. The Combined Fund s strategy will seek to capitalize on Aberdeen s global emerging market equity capability by investing in a global portfolio of emerging market securities. Following the consolidation, it is anticipated that the Board of Directors of the Combined Fund will consider the approval of a tender offer at 99% of NAV. The tender offer size, in combination with estimated capital gains to be distributed, will be up to a maximum distribution of 50%, and not less than 40%, of the net assets of the Combined Fund. The price, size and terms of the offer will be determined by the Combined Fund s board at a later date. The proposed consolidation is subject to several conditions, including approval by Fund stockholders of record on December 18, 2017, who will receive a prospectus/proxy statement describing the proposed consolidation and requesting their approval of the consolidation of the Fund into the Acquiring Fund. It is expected that a special meeting of the Fund s stockholders to consider the consolidation will be held on or about March 16, 2018. It is currently anticipated that the proposed consolidation will occur prior to the end of April 2018, subject to all requisite regulatory and stockholder approvals. The proposed tender offer would be conducted as soon as practicable following the consolidation.

Merger of Aberdeen Asset Management PLC with Standard Life plc

The Fund s investment adviser and administrator are each a subsidiary of Aberdeen Asset Management PLC (Aberdeen PLC). The merger of Standard Life plc and Aberdeen PLC was announced on March 6, 2017 and closed on August 14, 2017 (Merger). Aberdeen PLC became a direct subsidiary of Standard Life plc as a result of the Merger and the combined company changed its name to Standard Life Aberdeen plc. Shareholders of the Fund were not required to take any action as a result of the Merger. Following the Merger, the Fund s investment adviser and administrator each became an indirect subsidiary of

1 The MSCI Emerging Markets Small Cap Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of the small-cap segment of global emerging markets. As of October 31, 2017, the MSCI Emerging Markets Small Cap Index consists of the following 24 emerging market country indexes: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Pakistan, Peru, Philippines, Poland, Qatar, Russia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates. No fees or expenses are reflected. You cannot invest directly in an index.

Letter to Shareholders (unaudited) (concluded)

Standard Life Aberdeen plc, but otherwise did not change. The investment advisory and administration agreements for the Fund, the services provided under the agreements, and the fees charged for services did not change as a result of the Merger. The portfolio management team for the Fund also has remained the same following the Merger.

Unclaimed Share Accounts

Please be advised that abandoned or unclaimed property laws for certain states require financial organizations to transfer (escheat) unclaimed property (including Fund shares) to the state. Each state has its own definition of unclaimed property, and Fund shares could be considered unclaimed property due to account inactivity (e.g., no owner-generated activity for a certain period), returned mail (e.g., when mail sent to a shareholder is returned to the Fund s transfer agent as undeliverable), or a combination of both. If your Fund shares are categorized as unclaimed, your financial advisor or the Fund s transfer agent will follow the applicable state s statutory requirements to contact you, but if unsuccessful, laws may require that the shares be escheated to the appropriate state. If this happens, you will have to contact the state to recover your property, which may involve time and expense. For more information on unclaimed property and how to maintain an active account, please contact your financial adviser or the Fund s transfer agent.

Portfolio Holdings Disclosure

The Fund s complete schedule of portfolio holdings for the second and fourth quarters of each fiscal year are included in the Fund s semi-annual and annual reports to shareholders. The Fund files its complete schedule of portfolio holdings with the Securities and Exchange Commission (the SEC) for the first and third quarters of each fiscal year on Form N-Q. The Fund s Form N-Q filings are available on the SEC s website at http://www.sec.gov and may be reviewed and copied at the SEC s Public Reference Room in Washington, D.C. Information about the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330. The Fund makes the information on Form N-Q available to shareholders on the Fund s website or upon request and without charge by calling Investor Relations toll-free at 1-800-522-5465.

Proxy Voting

A description of the policies and procedures that the Fund uses to determine how to vote proxies relating to portfolio securities, and information regarding how the Fund voted proxies relating to portfolio securities during the most recent twelve months ended June 30 is available by August 31 of the relevant year: (i) upon request and without charge by calling Investor Relations toll-free at 1-800-522-5465; and (ii) on the SEC s website at http://www.sec.gov.

Investor Relations Information

As part of Aberdeen s commitment to shareholders, we invite you to visit the Fund on the web at www.aberdeenabe.com. Here, you can view monthly fact sheets, quarterly commentary, distribution and performance information, updated daily fact sheets courtesy of Morningstar®, portfolio charting and other Fund literature.

Enroll in Aberdeen s email services today and be among the first to receive the latest closed-end fund news, announcements, videos and information. In addition, you can receive electronic versions of important Fund documents including annual reports, semi-annual reports, prospectuses, and proxy statements. Sign up today at cef.aberdeen-asset.us/en/cefinvestorcenter/contact-us/email.

Contact Us:

- Visit: cef.aberdeen-asset.us;
- Watch: www.aberdeen-asset.us/aam.nsf/usclosed/aberdeentv;
- Email: InvestorRelations@aberdeenstandard.com; or
- Call: 1-800-522-5465 (toll-free in the U.S.).

Yours sincerely,

/s/ Christian Pittard

Christian Pittard
President

Important Information

This letter is not intended to, and does not, constitute an offer to sell, or solicitation of an offer to buy, any securities, nor is this letter intended to solicit any vote from any stockholder in connection with the proposed transaction described under Fund Consolidation . Such solicitations will only be made by a final, effective registration statement, which includes a definitive proxy statement/prospectus (the Registration Statement), after the Registration Statement is declared effective by the SEC.

STOCKHOLDERS OF THE FUND ARE URGED TO READ THE REGISTRATION STATEMENT AND OTHER DOCUMENTS TO BE FILED WITH THE SEC CAREFULLY AND IN THEIR ENTIRETY WHEN THEY BECOME AVAILABLE BECAUSE THESE DOCUMENTS WILL CONTAIN IMPORTANT INFORMATION ABOUT THE PROPOSED CONSOLIDATION AND RELATED MATTERS.

The Registration Statement will not constitute an offer to sell securities, nor will it constitute a solicitation of an offer to buy securities, in any state where such offer or sale is not permitted.

Security holders may obtain free copies of the Registration Statement and other documents filed with the SEC (when they become available) at the SEC s web site at www.sec.gov. In addition, free copies of the Registration Statement and other documents filed with the SEC may also be obtained after effectiveness of the Registration Statement by calling 1-800-522-5465.

Dividend Reinvestment and Direct Stock Purchase Plan (unaudited)

Computershare Trust Company, N.A. (Computershare), the Fund s transfer agent, sponsors and administers a Dividend Reinvestment and Direct Stock Purchase Plan (the Plan), which is available to shareholders.

The Plan allows registered stockholders and first-time investors to buy and sell shares and automatically reinvest dividends and capital gains through the transfer agent. This is a cost-effective way to invest in the Fund.

Please note that for both purchase and reinvestment purposes, shares will be purchased in the open market at the current share price and cannot be issued directly by the Fund.

For more information about the Plan and a brochure that includes the terms and conditions of the Plan, please call Computershare at 1-800-647-0584 or visit www.computershare.com/buyaberdeen.

All amounts are U.S. Dollar unless otherwise stated.

Report of the Investment Adviser (unaudited)

Market/economic review

Shares of smaller companies in emerging stock markets, as measured by the MSCI Emerging Markets Small Cap Index, rose over the 12-month period ended October 31, 2017, rebounding from a lull early in the period in the wake of Donald Trump s unexpected U.S. presidential election victory in November 2016. While geopolitical tensions and a series of natural disasters threatened global risk appetite at times, higher-yielding assets remained in favor largely across the board. Investors were generally encouraged by signs of improvement in corporate earnings, buoyant economic signals across both developed and emerging markets and stabilizing oil prices.

European markets performed particularly well on growing optimism over the region s economic resilience, with Poland, the Czech Republic and Romania all reporting healthy growth. Russia returned to favor initially on hopes of a thaw in relations with the U.S. under the Trump presidency. While that did not materialize, investor sentiment remained supported by the oil price recovery and a return to economic growth in Russia for the first time in two years. Brazilian equities garnered notable gains due to positive economic signals, the central bank s significant cut in interest rates and the government s plan to privatize state assets. However, the Brazilian market relinquished some gains late in the period when President Michel Temer was briefly hospitalized. In Asia, Chinese equities performed well on broadly positive corporate earnings reports, surprisingly robust economic growth and the rise of large domestic internet service companies.

Amid this environment, investors largely shrugged off the downgrade of China s credit rating by Standard & Poor s[1] on increased risk from prolonged credit growth. Conversely, Indonesian stocks saw weak performance, while the Philippine market also came under pressure.

Fund performance review

The Fund underperformed its benchmark, the MSCI Emerging Markets Small Cap Index, on a net asset value basis over the reporting period. The Fund s overall positioning in Turkey was a key detractor from performance as the deteriorating lira weighed on U.S. dollar returns, with shares of soft-drink bottler Coca-Cola Icecek coming under particular pressure as its balance sheet is largely U.S.-dollar funded. Stock selection and underweight allocation to Taiwan also weighed on Fund performance as the performance of the country s smaller companies, which are heavily slanted towards the technology sector, rose in anticipation of increased demand for their products that are used in the new iPhones.

The Fund s holding in Indonesian confectionary producer Delfi hindered performance as the company experienced lackluster sales growth and profitability in an environment of subdued consumer demand, while Jordanian drug-maker Hikma Pharmaceuticals stock price declined after management cut its revenue forecasts due to the delayed launch of a new high-profile generic drug, as well as increased pricing pressure in the U.S. In China, traditional medicine manufacturer Tong Ren Tang Technologies results over the reporting period generally

1 Standard & Poor s credit ratings express the agency s opinion about the ability and willingness of an issuer, such as a corporation or state or city government, to meet its financial obligations in full and on time. Typically, ratings are expressed as letter grades that range, for example, from AAA to D to communicate the agency s opinion of relative level of credit risk. Ratings from AA to CCC may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

Report of the Investment Adviser (unaudited) (concluded)

did not meet expectations, attributable to subdued sales of core products amid heightened competition. In addition, Peruvian infrastructure firm Grana Y Montero s shares fell sharply after it became embroiled in a corruption scandal. However, Grana Y Montero s stock price began to recover later in the period on investors increased confidence in its ability to surmount the allegations.

Conversely, the Fund s underweight allocation to Korea relative to the benchmark mitigated losses as the market corrected amid growing concerns over the political brinkmanship of neighboring North Korea as well as the continued sell-off in shares of biotechnology companies, which were a key driver of the Korean small-cap market performance in 2016. Fund performance also benefited from an overweight allocation to Brazil, as the market was supported by an improving outlook for corporate earnings as well as the broader economy. Footwear retailer Arezzo was a top contributor to Fund performance following its robust results for the second quarter of its 2017 fiscal year.

Additionally, the Fund s holding in Chinese industrial gas company Yingde Gases contributed to performance after it became a takeover target. We sold the Fund s shares in Yingde Gases to private equity firm PAG Capital at HK$6 (roughly US$0.77) per share. In India, the positon in conglomerate Piramal Enterprises bolstered Fund performance as its share price rose sharply on the back of an improving outlook for its financing business, given the company s willingness to raise capital to support growth.

During the period, we initiated a position in Medy-Tox, a Korean maker of botulinum toxin, when its valuation turned more reasonable following broader weakness in the Korean healthcare sector. The company has a 40% share of the Korean market and is one of only eight makers of botulinum toxin globally. We also initiated holdings in: Taiwanese retail chain Poya, which is taking market share from smaller rivals with its large stores and diverse products; leading South Korean home-furnishing franchise Hanssem, which has an asset-light business model, reputable brand and solid track record, in our view; airport operator Shenzen Airport, which we believe to be of high quality; Chinese car dealership franchise Zhongsheng Group, as we believe it has an attractive valuation, healthy operations and a decent

business outlook; leading Polish supermarket chain Dino Polksa; and large African financial institution Guaranty Trust Bank. Separately, we participated in Pilipinas Shell Petroleum s initial public offering, as well as Maple Leaf Cement s rights issue.2

Conversely, in addition to selling the Fund s shares of Yingde Gases as previously noted, we exited the Fund s positions in Dah Sing Banking Group, IT services provider Sonda and Hong Kong Aircraft Engineering Co. to fund what we viewed as better opportunities elsewhere. We also sold the Fund s shares in BNK Financial Group as we believed that it had deteriorating prospects.

Outlook

In our opinion, the synchronized global economic recovery should continue to underpin further gains in the emerging markets, which outperformed their developed-market counterparts for the first 10 months of 2017. We think that Chinese economic growth may moderate, given the government s focus on regulatory tightening and supply-side reform, but a sharp downturn seems unlikely as economic drivers appear resilient and both fiscal and monetary policy remain accommodative. However, political risks remain, including Kurdish separatism exacerbating Middle Eastern tensions, and unresolved domestic political crises in South Africa and Brazil. Elections in various developing countries over 2018 could add further uncertainty, in our view. Nevertheless, most emerging-market economies are benefiting from an improved global macroenvironment, with recovering growth supported by moderate inflation and healthy trade flows. While we believe that major global central banks monetary policy normalization and tighter liquidity could cause some concerns, we believe that the banks well-telegraphed changes should ensure stability. Emerging-market companies also have sustained earnings improvement due to stronger corporate fundamentals and consumers rising spending capacity. We think that the expansion of long-term trends such as the semiconductor super-cycle and rise of e-commerce provides an additional boost for several Fund holdings. We are cautiously optimistic, and will remain disciplined in our approach and diligent in engaging the management teams of the Fund s holdings in an effort to maintain the quality of the Fund s portfolio.

Aberdeen Asset Managers Limited

2 A rights issue provides a company s existing shareholders with the opportunity to buy additional shares directly from the company in proportion to their existing holdings, within a fixed time period.

Total Investment Return (unaudited)

The following table summarizes the average annual Fund total investment return compared to the MSCI Emerging Markets (EM) Small Cap Index, the Fund s benchmark, for the 1-year, 3-year, 5-year and 10-year periods as of October 31, 2017.(1)

	1 Year	3 Years	5 Years	10 Years
Net Asset Value (NAV)	10.2%	1.2%	1.1%	-1.1%
Market Price	18.1%	1.8%	1.5%	-1.4%
MSCI EM Small Cap Index	21.1%	5.2%	5.9%	1.7%

Aberdeen Asset Managers Limited, the Fund s investment adviser, has entered into a written contract with the Fund to waive certain fees without which total return performance would be lower. See Note 3 in the Notes to Financial Statements. This contract aligns with the term of the advisory agreement and may not be terminated prior to the end of the current term of the advisory agreement. Returns represent past performance. Total investment return at NAV is based on changes in the NAV of Fund shares and assumes reinvestment of dividends and distributions, if any, at market prices pursuant to the dividend reinvestment program sponsored by the Fund s transfer agent. All return data at NAV includes fees charged to the Fund, which are listed in the Fund s Statement of Operations under Expenses. Total investment return at market value is based on changes in the market price at which the Fund s shares traded on the NYSE American (formerly, NYSE MKT) during the period and assumes reinvestment of dividends and distributions, if any, at market prices pursuant to the dividend reinvestment program sponsored by the Fund s transfer agent. The Fund s total investment return is based on the reported NAV on the financial reporting period ended October 31, 2017. Because the Fund s shares trade in the stock market based on investor demand, the Fund may trade at a price higher or lower than its NAV. Therefore, returns are calculated based on both market price and NAV. ***Past performance is no guarantee of future results.*** *The performance information provided does not reflect the deduction of taxes that a shareholder would pay on distributions received from the Fund. The current performance of the Fund may be lower or higher than the figures shown. The Fund s yield, return, market price and NAV will fluctuate. Performance information current to the most recent month-end is available at www.aberdeenabe.com or by calling 800-522-5465.*

The total expense ratio, excluding fee waivers, based on the fiscal year ended October 31, 2017 was 1.57%. The total expense ratio, net of fee waivers, based on the fiscal year ended October 31, 2017 was 1.52%.

(1) Effective March 15, 2013, the Fund s investment strategy changed from an infrastructure focus to a global emerging markets smaller company issuer focus. In connection with the strategy change, the Fund s benchmark changed from the MSCI Emerging Markets Infrastructure Index to the MSCI EM Small Cap Index. The Fund s performance information for periods that include performance prior to March 15, 2013, such as, five- and ten-year performance information, includes periods when the Fund was managed with an infrastructure focus. In light of this, a comparison of that performance to the MSCI EM Small Cap Index may not provide useful information to investors evaluating long-term Fund performance.

Portfolio Summary (unaudited)

The following table summarizes the sector composition of the Fund s portfolio by geographic classification expressed as a percentage of net assets as of October 31, 2017.

Region	As a Percentage of Net Assets
Asia	54.4%
Latin America	15.0%
Europe	14.3%
Africa	8.2%
North America	4.7%
Middle East	2.2%
Short-Term Investment	0.9%
Global	0.7%
Liabilities in Excess of Other Assets	(0.4)%
	100.0%

The following table summarizes the composition of the Fund s portfolio, in Standard & Poor s Global Industry Classification Standard (GICS) sectors, expressed as a percentage of net assets. The GICS structure consists of 11 sectors, 24 industry groups, 68 industries and 157 subindustries. As of October 31, 2017, the Fund did not have more than 25% of its assets invested in any industry. The sectors, as classified by GICS, are comprised of several industries.

Sectors	As a Percentage of Net Assets
Industrials	18.4%
Consumer Staples	17.3%
Consumer Discretionary	15.6%
Materials	11.5%
Information Technology	10.2%
Real Estate	9.9%
Health Care	7.9%
Financials	6.4%
Energy	1.3%
Private Equity	1.0%
Short-Term Investment	0.9%
Liabilities in Excess of Other Assets	(0.4)%
	100.0%

Top Ten Equity Holdings (unaudited)

The following were the Fund s top ten holdings as of October 31, 2017:

Name of Security	As a Percentage of Net Assets
Parque Arauco SA	3.5%
Godrej Consumer Products Ltd.	3.5%
Jollibee Foods Corp.	3.0%
Ace Hardware Indonesia Tbk PT	2.8%
Pacific Basin Shipping Ltd.	2.7%
AKR Corporindo Tbk PT	2.7%
Grupo Aeroportuario del Centro Norte SAB de CV, ADR	2.7%
ASM International NV	2.6%
Container Corp. of India Ltd.	2.6%
Ramco Cements Ltd. (The)	2.5%

Portfolio of Investments

As of October 31, 2017

Shares	Description	Industry and Percentage of Net Assets	Value (US$)
LONG-TERM EQUITY SECURITIES IN EMERGING MARKET COUNTRIES 92.1%			
COMMON STOCKS 91.0%			
BRAZIL 10.6%			
166,961	Arezzo Industria e Comercio SA	Textiles, Apparel & Luxury Goods 1.7%	$ 2,579,977
267,155	Iguatemi Empresa de Shopping Centers SA	Real Estate Management & Development 2.1%	3,142,519
104,272	Localiza Rent a Car SA	Road & Rail 1.2%	1,844,594
481,595	Odontoprev SA	Health Care Providers & Services 1.6%	2,317,215
193,845	TOTVS SA	Software 1.3%	1,930,569
165,537	Valid Solucoes e Servicos de Seguranca em Meios de Pagamento e Identificacao SA	Commercial Services & Supplies 0.6%	927,044
239,471	Wilson Sons Ltd., BDR	Transportation Infrastructure 2.1%	3,074,552
			15,816,470
CHILE 3.5%			
1,791,700	Parque Arauco SA	Real Estate Management & Development 3.5%	5,177,054
CHINA 4.4%			
1,085,092	Shenzhen Airport Co. Ltd., A Shares (Stock Connect)(a)(b)	Transportation Infrastructure 1.0%	1,444,776
1,172,000	Tong Ren Tang Technologies Co. Ltd., H Shares(b)	Pharmaceuticals 1.1%	1,647,188
2,119,100	Yanlord Land Group Ltd.(b)	Real Estate Management & Development 1.8%	2,784,610
342,000	Zhongsheng Group Holdings Ltd.(b)	Specialty Retail 0.5%	702,960
			6,579,534
EGYPT 1.1%			
133,914	Edita Food Industries SAE, GDR	Food Products 0.4%	535,656
2,247,692	Juhayna Food Industries(b)	Food Products 0.7%	1,123,363
			1,659,019
INDIA 15.7%			
235,000	Castrol (India) Ltd.(b)	Chemicals 1.0%	1,451,951
180,000	Container Corp. of India Ltd.(b)	Road & Rail 2.6%	3,837,860
358,744	Godrej Consumer Products Ltd.(b)	Personal Products 3.5%	5,173,097
450,000	Kansai Nerolac Paints Ltd.(b)	Chemicals 2.4%	3,592,841
204,185	Mphasis Ltd.(b)	Information Technology Services 1.4%	2,175,192

82,500	Piramal Enterprises Ltd.(b)	Pharmaceuticals 2.3%	3,490,044
341,000	Ramco Cements Ltd. (The)(b)	Construction Materials 2.5%	3,783,438
			23,504,423
INDONESIA 8.5%			
45,278,000	Ace Hardware Indonesia Tbk PT	Specialty Retail 2.8%	4,189,780
7,286,300	AKR Corporindo Tbk PT	Trading Companies & Distributors 2.7%	4,002,428
22,277,147	Bank Permata Tbk PT(b)(c)	Banks 0.7%	1,067,381
2,170,000	Delfi Ltd.	Food Products 1.6%	2,356,100
17,142,800	Holcim Indonesia Tbk PT(b)(c)	Construction Materials 0.7%	1,043,396
			12,659,085
JORDAN 0.8%			
75,317	Hikma Pharmaceuticals PLC(b)	Pharmaceuticals 0.8%	1,164,175
KENYA 1.1%			
701,800	East African Breweries Ltd.	Beverages 1.1%	1,657,263

Portfolio of Investments (continued)

As of October 31, 2017

Shares	Description	Industry and Percentage of Net Assets	Value (US$)
MALAYSIA 4.9%			
4,537,900	Aeon Co. (M) Bhd(b)	Multiline Retail 1.5%	$ 2,219,370
170,000	Heineken Malaysia Bhd	Beverages 0.5%	762,159
790,200	Oriental Holdings Bhd(b)	Automobiles 0.8%	1,222,314
2,064,065	SP Setia Bhd Group	Real Estate Management & Development 1.1%	1,594,306
240,000	United Plantations Bhd	Food Products 1.0%	1,554,458
			7,352,607
MEXICO 2.7%			
98,676	Grupo Aeroportuario del Centro Norte SAB de CV, ADR	Transportation Infrastructure 2.7%	3,986,510
NIGERIA 1.8%			
4,370,209	Guaranty Trust Bank PLC	Banks 0.3%	509,858
3,090,909	Guinness Nigeria PLC	Beverages 0.6%	862,278
19,437,011	Zenith Bank PLC	Banks 0.9%	1,375,708
			2,747,844
PAKISTAN 0.8%			
1,951,937	Maple Leaf Cement Factory Ltd.	Construction Materials 0.8%	1,242,487
PERU 0.9%			
303,354	Grana y Montero SAA, ADR(c)	Construction & Engineering 0.9%	1,365,093
PHILIPPINES 4.3%			
915,080	Jollibee Foods Corp.(b)	Hotels, Restaurants & Leisure 3.0%	4,418,797
1,650,000	Pilipinas Shell Petroleum Corp.	Oil, Gas & Consumable Fuels 1.3%	1,989,588
			6,408,385
POLAND 1.9%			
99,589	Dino Polska SA(b)(c)(d)	Food & Staples Retailing 1.3%	1,872,061
96,115	Eurocash SA	Food & Staples Retailing 0.6%	971,990
			2,844,051
REPUBLIC OF SOUTH KOREA 3.3%			
11,000	Hanssem Co. Ltd.	Household Durables 1.1%	1,674,030
5,200	Medy-Tox, Inc.(b)	Biotechnology 1.3%	1,968,358
6,000	Shinsegae, Inc.	Multiline Retail 0.9%	1,226,403
			4,868,791
ROMANIA 1.7%			
807,000	BRD-Groupe Societe Generale SA	Banks 1.7%	2,540,253
RUSSIA 1.0%			
133,150	Beluga Group PJSC(c)	Beverages 1.0%	1,440,106
SOUTH AFRICA 5.3%			
893,654	African Oxygen Ltd.	Chemicals 1.0%	1,548,547
106,384	City Lodge Hotels Ltd.	Hotels, Restaurants & Leisure 0.6%	947,985
204,900	Clicks Group Ltd.(b)	Food & Staples Retailing 1.5%	2,294,980
181,276	JSE Ltd.	Capital Markets 1.2%	1,718,941
121,735	SPAR Group Ltd. (The)	Food & Staples Retailing 1.0%	1,432,364
			7,942,817
SRI LANKA 1.9%			

2,689,150	John Keells Holdings PLC	Industrial Conglomerates 1.9%	2,783,237
TAIWAN 1.8%			
209,070	Poya International Co. Ltd.(b)	Multiline Retail 1.8%	2,681,272

Portfolio of Investments (continued)

As of October 31, 2017

Shares	Description	Industry and Percentage of Net Assets		Value (US$)
THAILAND 6.0%				
2,600,100	BEC World PCL, Foreign Shares(b)	Media 0.9%	$	1,361,883
190,000	Bumrungrad Hospital PCL, Foreign Shares(b)	Health Care Providers & Services 0.8%		1,258,278
800,000	Central Pattana PCL, Foreign Shares(b)	Real Estate Management & Development 1.3%		1,914,509
1,679,000	Hana Microelectronics PCL, Foreign Shares(b)	Electronic Equipment Instruments & Components 1.7%		2,463,915
238,399	Siam City Cement PCL, Foreign Shares(b)	Construction Materials 1.3%		2,002,811
				9,001,396
TURKEY 7.1%				
1,537,000	Aksigorta AS(b)(c)	Insurance 0.8%		1,269,442
240,745	AvivaSA Emeklilik ve Hayat AS	Insurance 0.8%		1,189,272
703,784	Cimsa Cimento Sanayi VE Ticaret AS(b)	Construction Materials 1.8%		2,660,880
359,391	Coca-Cola Icecek AS(b)	Beverages 2.5%		3,663,610
114,491	Logo Yazilim Sanayi Ve Ticaret AS(c)	Software 1.2%		1,810,826
				10,594,030
				136,015,902
PRIVATE EQUITY 1.0%				
GLOBAL 0.7%*				
7,248,829(e)	Emerging Markets Ventures I, L.P.(b)(c)(f)(g)(h)(i)	Private Equity 0.1%		112,067
2,400,000(e)	Telesoft Partners II QP, L.P.(b)(c)(f)(g)(j)	Private Equity 0.6%		918,336
				1,030,403
ISRAEL 0.3%				
1,674,587(e)	BPA Israel Ventures, LLC(b)(c)(f)(g)(h)(i)	Private Equity 0.1%		153,375
72,640	Exent Technologies Ltd. Preferred A1 Shares(b)(c)(f)(g)(j)(k)	Private Equity %		

62,304	Exent Technologies Ltd. Preferred C Shares(b)(c)(f)(g)(j)(k)	Private Equity	%

Disclosure and reporting requirements, as well as anti-fraud legislation, have o
Russia. Most Russian companies and managers are not accustomed to restricti
from these requirements. The concept of fiduciary duties of management or di
shareholders is also relatively new and is not well developed. Violations of dis
requirements or breaches of fiduciary duties to us and our subsidiaries or to ou
adversely affect the value of your investment in our ADSs.

While the Joint Stock Companies Law provides that shareholders owning not l
stock may bring an action for damages on behalf of the company, Russian cou
experience with respect to such lawsuits. Russian law does not contemplate cla
Accordingly, your ability to pursue legal redress against us may be limited, red
to you as a holder of ADSs.

Shareholder rights provisions under Russian law may impose add could cause our financial results to suffer.

Russian law provides that shareholders, including holders of our ADSs, that vo
participate in voting on certain matters have the right to sell their shares to the
determined in accordance with Russian law. The decisions that trigger this righ

- decisions with respect to reorganization;
- approval by shareholders of a major transaction, which, in general te property worth more than 25% of the book value of our assets calculate accounting standards; and
- amendment of our charter that restricts the shareholder s rights.

Our obligation to purchase the shares in these instances is limited to 10% of ou
according to Russian accounting standards, at the time the matter at issue is vo
subsidiaries obligation to purchase shares in these circumstances could have
flows and our business.

The lack of a central and rigorously regulated share registration sy in improper record ownership of our shares, including the shares

Ownership of Russian joint stock company shares (or, if the shares are held th
then the holding of such nominee or custodian) is determined by entries in a sh
extracts from that register. Currently, there is no central registration system in
maintained by the companies themselves or, if a company has more than 50 sh
licensed registrars located throughout Russia. Regulations have been issued re
for such registrars, as well as the procedures to be followed by both companies
registers and licensed registrars when performing the functions of registrar. In
regulations have not been strictly enforced, and registrars generally have relati
and inadequate insurance coverage. Moreover, registrars are not necessarily su
supervision. Due to the lack of a central and rigorously regulated share registra
transactions in respect of a company s shares could be

Table of Contents

Risk factors

improperly or inaccurately recorded, and share registration could be lost throu
and unofficial governmental actions or oversight by registrars incapable of co
their misconduct. This creates risks of loss not normally associated with inves
markets. Further, the depositary, under the terms of the agreement governing t
liable for the unavailability of shares or for the failure to make any distributio
respect thereto due to the unavailability of the shares. See Description of Ca
Requirements of Russian Legislation Description of Capital Stock Registrati
Description of American Depositary Shares Registrar for more discussion
registrars in the Russian Federation.

**Weaknesses and changes in the Russian tax system could materi
business and the value of our ADSs.**

Generally, taxes payable by Russian companies are substantial and numerous.
others:

- income taxes;
- value-added tax, or VAT;
- excise taxes;
- unified social tax; and
- property tax.

The tax environment in Russia has historically been complicated by the fact th
often issued contradictory pieces of tax legislation. Because of the political ch
Russia over the past several years, there have recently been significant change
system.

Global tax reform commenced in 1999 with the introduction of Part One of th
taxation guidelines. Since then, Russia has been in the process of replacing leg
application of major taxes such as corporate income tax, VAT and property ta
Code. For instance, new chapters of the Tax Code on VAT, unified social tax
into force on January 1, 2001; the profits tax and mineral extraction tax chapte
2002; and the newly introduced corporate property tax chapter of the Tax Cod
2004.

In practice, the Russian tax authorities often have their own interpretation of t
taxpayers, who often have to resort to court proceedings to defend their positi
Differing interpretations of tax regulations exist both among and within gover
organizations at the federal, regional and local levels, creating uncertainties an
Tax declarations, together with related documentation such as customs declar
investigation by a number of authorities, each of which may impose fines, pen

Generally, taxpayers are subject to inspection for a period of three calendar ye
immediately preceded the year in which the audit is carried out. As previous a
claims relating to the audited period, the statute of limitations is not entirely ef
instances, new tax regulations have been given retroactive effect. Recently, th
Russian Federation ruled that VAT paid on a commercial enterprise s purchas
offset against VAT collected from sales to the extent that the input VAT was i
with borrowed funds.

Moreover, financial statements of Russian companies are not consolidated for
of our Russian entities pays its own Russian taxes and may not offset its profit
of another entity in our group. In addition, pursuant to legislation that entered

---

38

Table of Contents

Risk factors

on January 1, 2002, payments of intercompany dividends between two Russian withholding tax of 6% at the time they are paid out of profits, though this tax c they have already been taxed.

The foregoing conditions create tax risks in Russia that are more significant th with more developed tax systems, imposing additional burdens and costs on ou management resources. In addition to our substantial tax burden, these risks ar tax planning and related business decisions, potentially exposing us to signific enforcement measures despite our best efforts at compliance, and could advers value of our ADSs. For a discussion of certain tax-related contingencies, see

RISKS RELATING TO OTHER JURISDICTIONS

We also face risks associated with conducting business in the cou Union and former Soviet-bloc countries in Eastern and Central Eu

We currently have two steel mills in Romania, a hardware plant in Lithuania a Kazakhstan. We may acquire additional operations in the countries of the form Soviet-bloc countries in Eastern and Central Europe. As with Russia, these cou subject to greater political, economic, social and legal risks than more develop the risks inherent in transacting business in these countries are similar to those risks set out above in Risks Relating to the Economic Environment in Russ Environment in Russia and Risks Relating to Russian Legislation and the

Moreover, these countries are new operating environments for us, which are lo great distance from our Russian operations and across multiple international b less control over their activities and these businesses may face more uncertain operational needs. These factors may hurt the profitability of our current and f countries.

Table of Contents

Cautionary note regarding forward-loo statements

Matters discussed in this prospectus may constitute forward-looking statement include statements concerning plans, objectives, goals, strategies, future event underlying assumptions and other statements, which are other than statements believe, expect, anticipate, intend, estimate, forecast, proje identify forward-looking statements. Forward-looking statements appear in a n without limitation, Risk Factors, Business and Management s Discuss and Results of Operations, and include statements regarding:

- strategies, outlook and growth prospects;
- future plans and potential for future growth;
- liquidity, capital resources and capital expenditures;
- growth in demand for our products;
- economic outlook and industry trends;
- developments of our markets;
- the impact of regulatory initiatives; and
- the strength of our competitors.

The forward-looking statements in this prospectus are based upon various assu based, in turn, upon further assumptions, including without limitation, manage operating trends, data contained in our records and other data available from th believe that these assumptions were reasonable when made, these assumptions significant uncertainties and contingencies which are difficult or impossible to control and we may not achieve or accomplish these expectations, beliefs or pr important factors and matters discussed elsewhere herein, important factors th actual results to differ materially from those discussed in the forward-looking achievement of the anticipated levels of profitability, growth, cost and synergy timely development and acceptance of new products, the impact of competitiv necessary regulatory approvals, the condition of the Russian economy, politica of general business and global economic conditions and other important factor time to time in the reports to be filed by us with the Securities and Exchange C

Except to the extent required by law, neither we, nor any of our agents, emplo any duty or obligation to supplement, amend, update or revise any of the forw contained in this prospectus.

Table of Contents

Escrow of proceeds and registration o
report

Under Russian law, placement of the shares underlying the ADSs we offer pur
subject to our registration of a placement report with the Federal Service for th
placement report may not be filed with the Federal Service for the Financial M
this offering. We intend to file the placement report as soon as practicable foll
offering. The Federal Service for the Financial Markets is statutorily required
weeks after we file the placement report but the current practice is that registra
between 30 and 44 days after filing.

Accordingly, prior to the registration of the placement report by the Federal Se
all sums paid for the ADSs will be held in escrow and escrow-type accounts. T
agreements governing these accounts will provide that, pending the registratio
Federal Service for the Financial Markets, the proceeds of this offering will be

- the net proceeds to us will be converted into rubles and deposited in rub accounts at Raiffeisenbank Austria ZAO, a Russian subsidiary of Raiffe Österreich AG; and
- the underwriters commission and the net proceeds to the selling sharel U.S. dollar-denominated escrow account at UBS AG.

As Russian law does not allow for escrow accounts of the nature commonly se
have entered into a series of agreements with Raiffeisenbank Austria ZAO to r
functions of an escrow account. We refer to the accounts established under the
accounts.

In the event that the placement report is not registered by the Federal Service f
60 days after the closing date (or such later date to which we and the selling sh
underwriters), we will be required to issue a press release and to notify the dep
escrow and escrow-type accounts, the underwriters and the NYSE of the termi
close of business on the termination date. In this instance, all funds received in
escrow-type and escrow accounts will be released to the depositary, together w
upon those funds from the closing date to the termination date and any additio
funds being released to the depositary would be equal (after conversion of all r
the original U.S. dollar proceeds of the offering. The depositary will promptly
through DTC the funds it receives to the holders of the ADSs on the terminatio
**circumstances, the amount returned to the holders of the ADSs as of the t
offer price for the ADSs, including interest, if any, regardless of the then-p
the ADSs. The return of funds may be delayed due to Russian currency co
prevented if there is a change in such regulations.**

Until the registration of the placement report by the Federal Service for the Fi
entitled to instruct the depositary to exercise any voting rights on your behalf a
depositary and its nominee will not be entitled to exercise any voting rights as
withdraw our shares or other property with the depositary in respect of the AD
the registration of the placement report with the Federal Service for the Financ
Factors Risks Related to our ADSs and the Trading Market The holder of an
underlying the ADS prior to the registration of a placement report for these sh
this placement report could result in the offering being held invalid and being

---

Table of Contents

Use of proceeds

The net proceeds to us from the offering will be approximately $213.4 million
rubles. This amount represents net proceeds after deducting estimated underwr
expenses incurred in connection with the offering. We expect to use the net pr
following purposes:

- $106.7 million for capital expenditures, including the purchase of equip
facilities; and
- $106.7 million for acquisitions of additional operations and subsoil lice

We are not currently engaged in any discussions or negotiations with any acqu
completion of an acquisition has reached the probable stage.

We will not receive any of the proceeds from the sale of ADSs representing co
selling shareholders.

Until the registration of a placement report regarding the placement of shares u
Federal Service for the Financial Markets, the proceeds from this offering will
escrow-type accounts at UBS AG and Raiffeisenbank Austria ZAO, a Russian
Zentralbank Österreich AG. The terms of the deposit of funds into these accou
proceeds will be released to us, and that the sums due to the selling shareholde
released to them, only upon the registration of the placement report. Although
placement report should be registered within two weeks after the report is filed
Service for the Financial Markets, the registration may take longer or may not
Proceeds and Registration of Placement Report and Risk Factors Risks Re
Market The holder of an ADS cannot withdraw the shares underlying the AD
placement report for these shares, and the failure to register this placement rep
being held invalid and being withdrawn for more detail.

Table of Contents

Dividend policy

Mechel Steel Group declared a dividend of 149 million rubles (or approximate 2004, which was paid in October 2004. Other than this dividend, Mechel Steel any dividends on its common shares since its incorporation on March 19, 2003 group paid dividends to our controlling shareholders in amounts of $26.3 milli million in the years ended December 31, 2003, 2002 and 2001, respectively. C respect to the year ended December 31, 2004, we expect to declare and pay an least 15% of our annual net income, as determined under U.S. GAAP, subject restrictions. See Description of Capital Stock and Certain Requirements of R Capital Stock Dividends.

Dividend payments, if any, must be recommended by our board of directors an shareholders. In particular, dividends may be declared only out of net profits c accounting standards and as long as the following conditions have been met:

- our charter capital has been paid in full;
- the value of our net assets, calculated under Russian accounting standar would not become less as a result of the proposed dividend payment) th charter capital, our reserve fund and the difference between the liquidat value of our issued and outstanding preferred shares;
- we have repurchased all shares from shareholders having the right to de
- we are not, and would not become as the result of the proposed dividen

For a further description, please refer to Description of Capital Stock and Ce Legislation Description of Capital Stock Dividends.

We anticipate that any dividends we may pay in the future on the common sha will be declared and paid to the depositary in rubles and will be converted into and distributed to holders of ADSs, net of the depositary s fees and expenses. dividends received by holders of ADSs will be subject to fluctuations in the ex and the U.S. dollar.

Table of Contents

Capitalization

The following table sets forth our short-term debt and capitalization at June 30
as adjusted to give effect to the issue and sale of 33,301,659 common shares in
application of the net proceeds of the offering as described under Use of Proc
together with the information under Management s Discussion and Analysis
Results of Operations and our consolidated financial statements included else

Short-term debt (including current portion of long-term debt)[1]
Long-term debt, net of current portion[1]
Shareholders equity:
Common shares
Treasury shares
Additional paid-in capital
Retained earnings
Accumulated other comprehensive income
Total shareholders equity
Total capitalization

(1) Of our total indebtedness at June 30, 2004, $436.2 million was secured and $101.8

There has been no material change in our capitalization since June 30, 2004.

44

Table of Contents

Dilution

Our net tangible book value as of June 30, 2004, was $508.5 million, or $4.14
value per ADS represents the amount of our total tangible assets less total liab
divided by the product of the number of shares outstanding and the ratio of on

Dilution in net tangible book value per ADS represents the difference betwee
purchasers of ADSs in this offering and the net tangible book value per ADS i
completion of this offering. After giving effect to the sale by us of 33,301,659
the offering at the offering price of $21.00 per ADS and after deducting the u
estimated offering expenses payable by us, our net tangible book value as of J
would have been $721.9 million, or $5.39 per ADS. This represents an immed
book value of $1.25 per ADS to existing shareholders and an immediate diluti
investors purchasing ADSs in the offering.

The following table illustrates the per-ADS dilution.

Public offering price per ADS
Net tangible book value per ADS before the offering
Increase in net tangible book value per ADS attributable to new investors
Pro forma net tangible book value per ADS after the offering
Dilution to new investors

Table of Contents

Selected consolidated financial data

The financial data set forth below as of December 31, 2003, 2002 and 2001, ar
been derived from our audited consolidated financial statements. The financial
30, 2004 and 2003, and for the six-month periods then ended have been derive
consolidated financial statements. Our reporting currency is the U.S. dollar and
financial statements in accordance with U.S. GAAP.[1] The unaudited interim c
statements reflect all normal and recurring adjustments that are necessary for a
financial position and results of operations for the interim periods presented. R
six-month period ended June 30, 2004, are not necessarily indicative of results
December 31, 2004, for any other interim period or for any future fiscal year. T
2000 are not presented, as financial statements for these years are not available
and expense.

Our results of operations for the periods presented are significantly affected by
operations of these acquired businesses are included in our consolidated financ
after their respective dates of acquisition. The financial data below should be r
qualified in their entirety by reference to, our consolidated financial statement
elsewhere in this prospectus and in Management s Discussion and Analysis
of Operations.

	Six months ended June 30,		Ye
	2004	2003	2003
	(in thousands of U.S. dollars,		
Consolidated income statement data			
Revenue, net	1,630,063	930,595	2,050,0
Cost of goods sold	(985,370)	(647,809)	(1,440,0
Gross margin	644,693	282,786	610,0
Selling, distribution and operating expenses	(295,587)	(193,430)	(417,2
Operating income	349,106	89,356	192,7
Other income and expense, net	(12,630)	(5,866)	(20,0
Income before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principle	336,476	83,490	172,7
Income tax expense	(74,100)	(23,135)	(47,7
Minority interest in loss (income) of subsidiaries	(7,920)	6,632	18,9
Income from continuing operations	254,456	66,987	143,9
Loss from discontinued operations, net of tax		(1,317)	(2,4

Extraordinary gain, net of tax		5,740	5,7
Changes in accounting principle, net of tax		(3,670)	(3,7
Net income	254,456	67,740	143,5
Earnings per share from continuing operations	0.69	0.18	0.
Loss per share effect of discontinued operations			(0.
Earnings per share effect of extraordinary gain		0.02	0.
Earnings per share effect of a changes in accounting principle		(0.01)	(0.
Net income per share	0.69	0.18	0.
Cash dividends paid per share(2)	0.00		0.
Weighted average number of shares outstanding	367,150,968	366,178,815	366,178,8

46

Table of Contents

Selected consolidated financial data

	Six months ended June 30,		Y
	2004	2003	2003
	(in thousands of U.S. dollars		
Steel segment income statement data			
Revenue, net[3]	1,307,903	778,846	1,678,
Cost of goods sold[3]	(964,118)	(572,817)	(1,247,
Gross margin	343,785	206,029	431,
Selling, distribution and operating expenses	(180,071)	(145,147)	(301,
Operating income	163,714	60,882	129,
Mining segment income statement data			
Revenue, net[3]	522,594	251,027	599,
Cost of goods sold[3]	(221,686)	(174,270)	(420,
Gross margin	300,908	76,757	179,
Selling, distribution and operating expenses	(115,516)	(48,283)	(115,
Operating income	185,392	28,474	63,
Consolidated balance sheet data (at period end)			
Total assets	2,336,233	n/a	1,834,
Shareholders equity	705,903	n/a	448,
Long-term debt, net of current portion	152,583	n/a	122,
Consolidated cash flows data			
Net cash provided by operating activities	207,960	43,535	119,
Net cash used in investing activities	(207,805)	(49,963)	(209,
Net cash provided by financing activities	43,843	19,162	103,
Non-U.S. GAAP measures[4]			
Consolidated EBITDA	420,818	157,307	341,
Steel segment EBITDA	206,739	116,420	245,
Mining segment EBITDA	214,080	40,887	95,

(1) The value of property, plant and equipment pertaining to non-controlling shareholde
minority interests resulting from acquisitions of various subsidiaries has been recor
rather than at historical cost as required by U.S. GAAP.

(2) Mechel Steel Group declared a dividend of 149 million rubles (or approximately $5
was paid in October 2004. Certain companies in our group paid dividends to our co
$26.3 million, $13.4 million and $8.8 million in the years ended December 31, 200

(3) Segment revenues and cost of goods sold include intersegment sales.

(4) EBITDA represents net income before interest expense, income taxes and deprecia
present EBITDA because we consider it an important supplemental measure of our
it is frequently used by securities analysts, investors and other interested parties in t
industry. We also present EBITDA by segment because our overall performance is
results of each segment.

EBITDA has limitations as an analytical tool, and you should not consider it in isolation
our operating results as reported under U.S. GAAP. Some of these limitations are as foll

- EBITDA does not reflect the impact of financing costs, which are significant and more debt, on our operating performance.
- EBITDA does not reflect the impact of income taxes on our operating performar
- EBITDA does not reflect the impact of depreciation, depletion and amortization assets of our businesses which are being depreciated, depleted and/or amortized reserves) will have to be replaced in the future and such depreciation, depletion a approximate the cost to replace these assets in the future. By excluding such exp not reflect our future cash requirements for such replacements.
- Other companies in our industry may calculate EBITDA differently or may use i limiting its usefulness as a comparative measure.

We compensate for these limitations by relying primarily on our U.S. GAAP operating supplementally. See our consolidated income statements and consolidated statements of this prospectus.

EBITDA is a measure of our operating performance that is not required by, or presented EBITDA is not a measurement of our operating performance under U.S. GAAP and sho alternative to net income, operating income or any other performance measures derived as an alternative to cash flow from operating activities or as a measure of our liquidity. I considered as a measure of discretionary cash available to us to invest in the growth of c

Table of Contents

Selected consolidated financial data

Reconciliation of EBITDA to net income is as follows for the periods indicated:

	Six months ended June 30, 2004	2003 (in thousa
Consolidated EBITDA reconciliation		
Net income	254,456	67,740
Add:		
Depreciation, depletion and amortization	62,240	46,185
Interest expense	30,022	20,247
Income taxes	74,100	23,135
Consolidated EBITDA	420,818	157,307
Steel segment EBITDA reconciliation		
Net income	91,542	53,551
Add:		
Depreciation, depletion and amortization	36,574	32,490
Interest expense	23,460	17,638
Income taxes	55,163	12,741
Steel segment EBITDA	206,739	116,420
Mining segment EBITDA reconciliation		
Net income	162,915	14,189
Add:		
Depreciation, depletion and amortization	25,666	13,695
Interest expense	6,562	2,609
Income taxes	18,937	10,394
Mining segment EBITDA	214,080	40,887

Exchange Rates

The following tables show, for the periods indicated, certain information regar
the ruble and the U.S. dollar, based on data published by the Central Bank of R

These rates may differ from the actual rates used in preparation of our financia
information provided herein.

	Rub	
	High	**Low**
Year ended December 31,		
2003	31.88	29.25
2002	31.86	30.14
2001	30.30	28.16
2000	28.87	26.90
1999	27.00	20.65

(1) The average of the exchange rates on the last business day of each full month durin

Table of Contents

Selected consolidated financial data

September 2004
August 2004
July 2004
June 2004
May 2004
April 2004

The exchange rate between the ruble and the U.S. dollar on October 28, 2004,
dollar.

No representation is made that the ruble or U.S. dollar amounts in this prospec
converted into U.S. dollars or rubles, as the case may be, at any particular rate
not convertible outside Russia. A market exists within Russia for the conversio
currencies, but the limited availability of other currencies may inflate their val

Table of Contents

Unaudited condensed pro forma cons
income statements

The following unaudited condensed pro forma consolidated income statement
31, 2003, and the six months ended June 30, 2004, are presented to give effect
Korshunov Mining Plant OAO, or KMP, effected on October 16, 2003, as if it
January 1, 2003; and (2) the acquisition of Izhstal OAO, or Izhstal, effected on
consummated on January 1, 2003.

We have prepared the unaudited condensed pro forma consolidated income sta
December 31, 2003, based on our audited consolidated financial statements fo
2003, which include the results of operations of KMP from the date of acquisi
December 31, 2003, and the audited consolidated financial statements of Izhst
31, 2003.

We have prepared the unaudited condensed pro forma consolidated income sta
ended June 30, 2004, based on our unaudited consolidated financial statement
30, 2004, which include the results of operations of Izhstal from the date of ac
June 30, 2004, and Izhstal unaudited historical financial data.

The following unaudited condensed pro forma consolidated income statement
illustrate the effects of the acquisition of KMP and Izhstal by us accounted for
accounting. We believe the assumptions used to prepare the unaudited conden
income statements provide a reasonable basis for presenting the significant eff
acquisitions of KMP and Izhstal. The unaudited condensed pro forma consolid
purport to represent what our results of operations would actually have been if
Izhstal had in fact occurred on January 1, 2003, or to project our results of ope
date.

The unaudited condensed pro forma consolidated income statements, includin
read in conjunction with Management s Discussion and Analysis of Financi
Operations, our audited consolidated financial statements, our unaudited inte
statements for the six months ended June 30, 2004, and the audited consolidat
and Izhstal, with the related notes thereto included elsewhere in this prospectu

Table of Contents

Unaudited condensed pro forma consolidated income statements

UNAUDITED CONDENSED PRO FORMA CONSOLIDATED INCOME

For the year ended December 31, 2003

	Mechel (A)	KMP (B)	Izhstal (C)	Pro adju
	(in thousands of U.S. dollars, except per share amour			
Revenue, net (including related party amounts of $211,943, $45,323 and $138, in Mechel, KMP and Izhstal, respectively)	2,050,088	45,728	140,650	
Cost of goods sold (including related party amounts of $212,492, $39,418 and $121, in Mechel, KMP and Izhstal, respectively)	(1,440,053)	(39,445)	(132,679)	
Gross margin	610,035	6,283	7,971	
Selling, distribution and operating expenses:				
Selling and distribution expenses	(214,519)	(633)	(3,316)	
General, administrative and other operating expenses	(202,740)	(7,165)	(18,748)	
Total selling, distribution and operating expenses	(417,259)	(7,798)	(22,064)	
Operating income (loss)	192,776	(1,515)	(14,093)	
Other income and (expense):				
Interest income	2,292		8	
Interest expense	(48,528)	(621)	(1,125)	
Other income (expense), net	27,940	(153)	117	
Foreign exchange gain	(1,722)	49	273	
Total other income and (expense), net	(20,018)	(725)	(727)	
Income (loss) before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principles	172,758	(2,240)	(14,820)	
Income tax (expense) benefit	(47,759)	1,111	2,267	
Minority interest in loss (income) of subsidiaries	18,979			
Income (loss) from continuing operations	143,978	(1,129)	(12,553)	
Basic and diluted income from continuing operations per common share				
Shares used in computing basic and diluted income from continuing operations per common share				

Unaudited condensed pro forma consolidated income statements

UNAUDITED CONDENSED PRO FORMA CONSOLIDATED INCOME

For the six months ended June 30, 2004

	Mechel (A)	Izhstal (C)	Pro adjus (
	(in thousands of U.S. dollar		
Revenue, net (including related party amounts of $33,950 and $25 in Mechel and Izhstal, respectively)	1,630,063	64,005	
Cost of goods sold (including related party amounts of $6,279 and $25 in Mechel and Izhstal, respectively)	(985,370)	(57,117)	
Gross margin	644,693	6,888	
Selling, distribution and operating expenses:			
Selling and distribution expenses	(173,571)	(656)	
General, administrative and other operating expenses	(122,016)	(5,783)	
Total selling, distribution and operating expenses	(295,587)	(6,439)	
Operating income (loss)	349,106	449	
Other income and (expense):			
Interest income	1,125	11	
Interest expense	(30,022)	(604)	
Other income (expense), net	13,230	(2,249)	
Foreign exchange gain	3,037	34	
Total other income and (expense), net	(12,630)	(2,808)	
Income (loss) before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principles	336,476	(2,359)	
Income tax (expense) benefit	(74,100)	(361)	
Minority interest in loss (income) of subsidiaries	(7,920)		
Income (loss) from continuing operations	254,456	(2,720)	
Basic and diluted income from continuing operations per common share			
Shares used in computing basic and diluted income from continuing operations per common share			

Table of Contents

Unaudited condensed pro forma consolidated income statements

Notes

(A) Mechel Steel Group OAO Historical Financial Data

Mechel Steel Group OAO historical financial data is derived from our audited statements for the year ended December 31, 2003, and the unaudited consolid six months ended June 30, 2004, presented elsewhere in this prospectus. We a October 2003 and, accordingly, KMP is included in our historical results of op acquisition, October 16, 2003, to December 31, 2003. We acquired our contro accordingly, Izhstal is included in our historical results of operations from the 2004, to June 30, 2004, and in our historical consolidated balance sheet as of J

(B) Korshunov Mining Plant OAO Historical Financial Data

On December 25, 2002, we acquired 62.5% of the common shares of KMP fo million in cash. The voting rights for these shares, however, were restricted du proceedings, and the investment was carried at cost. Until the ratification on S of the Settlement Agreement with KMP s creditors (we were the second large which was owed in arrears for taxes and social charges, including various pen interest did not provide for the ability to exercise either control or significant i restrictions were completely removed and we obtained full control over KMP upon which the acquisition of KMP was accounted for using the purchase met

Despite the lack of control over KMP, we continued to increase our stake in K 2003, acquired an additional 7.7% of the common shares for approximately $1 cash paid for the shares of KMP, we provided loans and other continuing supp to pay the current liabilities and the tax and commercial debt arrears of KMP p Agreement. At the date of acquisition, the cost of our investment in KMP s e of its voting shares, and the amount of loans and advances provided to KMP a

(C) Izhstal OAO Historical Financial Data

On May 14, 2004, we acquired a 26.9% interest in Izhstal at an auction held b our total interest in Izhstal to 59.4% of its total voting shares, comprising com Subsequent to May 14, 2004, we continued to increase our interest in Izhstal, market, and by the end of May 2004, we had accumulated 61.6% of the voting for using the purchase method of accounting. For our total holding of shares o in cash.

(D) Acquisition of KMP and Izhstal

These reflect the acquisition adjustments relating to the KMP and Izhstal acqu
accounted for in accordance with the purchase method of accounting. The acq
allocation of purchase price for each acquisition to the respective acquired tan
liabilities. The allocation reflects the estimated fair values of the tangible and i
on the respective acquisition dates of KMP and Izhstal. Negative goodwill, *i.e*
the net assets acquired over the purchase price paid, if any, has been allocated
amounts that otherwise would have been assigned to all of the acquired assets
than investments accounted for by the equity method; (2) assets to be disposed
assets; and (4) any other current assets.

Table of Contents

Unaudited condensed pro forma consolidated income statements

We believe the assumptions underlying the unaudited condensed pro forma co
are reasonable. The unaudited condensed pro forma consolidated income state
solely for informational purposes and are not necessarily indicative of the com
might have been achieved for the period indicated, nor is it necessarily indicat
example, the pro forma information does not reflect cost savings that we expe
synergies, as these expected cost savings and operational synergies may not be
integration costs, in each case, for the periods presented.

(E) Purchase Accounting Adjustments

a. Adjustments to depreciation and amortization as a result of the impac
adjustments for KMP and Izhstal property, plant and equipment; thes
valuation of cost of goods sold and general, administrative, selling an
well as the amount of loss recognized on the disposal of property, pla
course of business during 2003.

b. Adjustment to record the impact on depletion of the acquired mineral
estimated fair value of $76.7 million for KMP during the period befo
no mineral licenses.

The above pro forma adjustments are summarized below as an increase or (de
our pro forma income statement:

Cost of goods sold:
Depreciation and amortization(a)
Depletion and amortization of acquired mineral licenses(b)
Total pro forma adjustments to cost of goods sold
General, administrative and other operating expenses(a):
Disposal of property, plant and equipment
Depreciation and amortization
Total pro forma adjustments to general, administrative and other operating expenses

c. The adjustment to the income tax expense reflects the amount necess
income tax expense at our year-end effective tax rate of 27.6%.

(F) Intercompany Transactions

Reflects the elimination of intercompany revenue ($51.4 million) and intercon
goods sold ($45.7 million) relating to the trade operations between KMP and u
January 1, 2003, to October 15, 2003. We did not have transactions with Izhsta

(G) Interest Expense

Reflects the pro forma adjustments to interest expense arising from the debt in
acquisition of Izhstal shares. We obtained a $13.6 million ruble-denominated,
interest per annum and the interest charged on the debt outstanding until repay
forma adjustment as interest expense, for a total of $110,000 for the year ende
forma adjustment was made for the six months ended June 30, 2004, as the ab
included in the Mechel interest expense for this period.

(H) Minority Interests

Reflects the pro forma adjustment to record the minority s 38.4% interest in t
and for the six months ended June 30, 2004.

54

Table of Contents

Unaudited condensed pro forma consolidated income statements

(I) Purchase Accounting Adjustments

Adjustments to depreciation and amortization as a result of the impact of the p
for Izhstal property, plant and equipment; these adjustments also affected the v
($1.8 million) and general, administrative and other operating expenses ($0.9 r
income tax expense reflects the amount necessary to present the pro forma inc
effective tax rate of 22.0% for the six months ended June 30, 2004.

(J) Intercompany Transactions

Reflects the elimination of intercompany revenue and intercompany purchases
million) relating to trade operations between Izhstal and us during the period f
14, 2004.

Table of Contents

Management s discussion and analy condition and results of operations

The following discussion of our financial condition and results of operations s with our consolidated financial statements, related notes and other informatio prospectus. This section contains forward-looking statements that involve risk results may differ materially from those discussed in forward-looking statemen factors, including those described under Risk Factors and Cautionary No Statements.

THE REORGANIZATION

Mechel Steel Group OAO was incorporated on March 19, 2003, under the law connection with a reorganization to serve as a holding company for various ste owned by Messrs. Igor Zyuzin and Vladimir Iorich. These individuals acquire times from 1995 to the present and have acted in concert since that time pursu and Voting Agreement which requires them to vote the same way. The reorgar contribution of these companies by these individuals to Mechel in exchange fo stock of Mechel. Many of the contributed companies had shareholders other th and these shareholders were not involved in the reorganization and continue to certain of our subsidiaries.

The acquisition of these companies by Mechel Steel Group represents a reorga control, and has been accounted for in a manner akin to a pooling. Mechel Ste statements, therefore, have been prepared on the basis that Mechel Steel Grou presented since its inception and owned these companies to the same extent as Iorich in those periods.

In connection with the reorganization, in late 2003 and the first half of 2004, v stakes in (1) Belov Insurance Company ZAO, a small insurance company in w controlling stake in 2001, and (2) Uglemetbank ZAO, a small bank in which w stake in 1999, to their management and other unrelated investors. These comp companies and their employees with routine banking, finance and insurance se businesses have been classified as discontinued operations for all periods pres

In August 2004, we terminated production at Mechel Zeljezara, a Croatian ste Mechel Zeljezara s assets were acquired out of bankruptcy proceedings in Ma audited consolidated financial statements. We decided to terminate production significant increases in input costs and a persistent weakness in pipe prices. In a termination agreement providing for the return to the seller of the Mechel Ze

of the bank guarantee that we granted to the government of Croatia in the amo
donation of spare parts at Mechel Zeljezara in the amount of $1.8 million, in re
claims against us. See note 10 to our interim consolidated financial statements

BUSINESS STRUCTURE

Segments

We have organized our businesses into two segments:

the steel segment, comprising production and sale of semi-finished steel

Table of Contents

Management s discussion and analysis of financial condition and

specialty long products; carbon and stainless flat products; value-added
including hardware, forgings and stampings; and coke and coking produ

the mining segment, comprising production and sale of coal (coking and
which supplies raw materials to our steel business and also sells substan
third parties.

The table below sets forth by segment our primary steel and mining subsidiari
order by date of acquisition:

Name	Location	Business
Steel Segment		
Chelyabinsk Metallurgical Plant	Russia	Semi-finished steel products, carbon and specialty long and flat steel products, forgings, coke and coking products
Vyartsilya Metal Products Plant	Russia	Hardware
Beloretsk Metallurgical Plant	Russia	Long steel products, hardware limestone(2)
COST	Romania	Carbon and specialty long ste products, forgings, hardware
Urals Stampings Plant	Russia	Stampings
Industria Sarmei	Romania	Semi-finished steel products, long steel products, hardware
Mechel Nemunas	Lithuania	Hardware
Izhstal	Russia	Specialty and carbon steel lon products, hardware, stamping and forgings
Mining Segment		
Southern Kuzbass Coal Company	Russia	Coking coal concentrate, stea coal, steam coal concentrate
Sibirginsk Open Pit Mine	Russia	Coking coal, steam coal, stea coal concentrate
Krasnogorsk Open Pit Mine	Russia	Steam coal, steam coal concentrate
Tomusinsk Open Pit Mine	Russia	Coking coal, steam coal
Olzherassk Open Pit Mine	Russia	Coking coal, steam coal
Tomusinsk Group Processing Plant	Russia	Coking coal concentrate
Kuzbass Central Processing Plant	Russia	Coking coal concentrate
Siberian Central Processing Plant	Russia	Coking coal concentrate
Southern Urals Nickel Plant	Russia	Ferro nickel

Lenin Mine	Russia	Coking coal
Korshunov Mining Plant	Russia	Iron ore concentrate
Mechel Coal Resources	Kazakhstan	Coking coal, coking coal concentrate
Port Posiet	Russia	Shipping

(1) As of October 1, 2004, except for Lenin Mine, which is as of October 6, 2004. Som
preferred shares outstanding which have voting rights commensurate with common
have not been paid. We have calculated voting interest by including these preferred
dividends have not been paid.

(2) Our Pugachev limestone quarry is owned by Beloretsk Metallurgical Plant and is w

Table of Contents

Management s discussion and analysis of financial condition and

Intersegment sales

We are an integrated steel and mining group. Our mining segment supplies 10
coking coal requirements and a substantial portion of the steel segment s nick
segment also supplies wires, ropes and other hardware to our mining segment
operations, as well as coke for use in the production of nickel. The prices at w
are based on market prices, and these transactions are eliminated as intercomp
our consolidated financial statements. For the six months ended June 30, 2004
December 31, 2003 and 2002, mining segment sales to the steel segment amou
million and $69.6 million, respectively. For the six months ended June 30, 200
December 31, 2003 and 2002, steel segment sales to the mining segment amou
million and $39.0 million, respectively.

Following our acquisition of a majority stake in Korshunov Mining Plant in D
segment purchased a significant portion of its iron ore requirements from Kors
purchases were priced on an arm s-length basis. We subsequently consolidate
October 2003. These purchases, to the extent they date from prior to our conso
Plant, are not eliminated as intercompany transactions for purposes of our con
Additionally, we sell Korshunov Mining Plant s products to third parties. In 2
39% of our iron ore requirements from Korshunov Mining Plant. In 2004, in r
we began to export iron ore concentrate to China, and increased sales to neigh
while purchasing iron ore concentrate from Russian suppliers to meet our own
flexibility to continue to sell iron ore concentrate to China and to neighboring
elsewhere, and to source our iron ore requirements from local Russian iron ore
conditions in the Russian and global iron ore markets.

SUMMARY OF ACQUISITIONS

We have sought to develop an integrated steel and mining business through th
assets which we believe offer significant upside potential, particularly as we in
working practices and operational methods. Pending the implementation of th
integration strategies, our margins are initially adversely affected after each ac

Following is a summary of the terms of acquisition of our primary steel and m
Each of the acquisitions was accounted for using the purchase method of acco
operations of each acquired business are included in our consolidated income
dates of acquisition of control. In certain cases where we acquired our interest
period of time and thus control was not acquired until subsequent acquisitions
stake was acquired, these businesses were accounted for using the equity meth
appropriate. Our results of operations for the periods presented herein are thus
period due to these acquisitions and their accounting treatment.

Chelyabinsk Metallurgical Plant. Chelyabinsk Metallurgical Plant is a
BOF/EAF steel mill that produces coke, semi-finished and rolled carbo
and forgings. Glencore International, an international trading company,
biggest customers, acquired a 65.1% stake in Chelyabinsk Metallurgica
by the Russian government in 1992. In December 2001, we acquired Gl
Metallurgical Plant. We have paid a total of $133.0 million for our curr
Metallurgical Plant.

58

Table of Contents

Management s discussion and analysis of financial condition and

Southern Urals Nickel Plant. Southern Urals Nickel Plant operates tw
nickel processing facility. Southern Urals Nickel Plant was privatized b
1993. We acquired a 46.0% stake in Southern Urals Nickel Plant in Sep
stake to a controlling stake in December 2001. We have paid a total of
stake in Southern Urals Nickel Plant.

Lenin Mine. Lenin Mine produces coking coal. Lenin Mine was priva
government in 1993. We acquired a 26.9% stake in Lenin Mine through
from 1997. We acquired another 25% stake as a result of our acquisitio
Company in December 2001 from the Russian government. We subseq
Coal Company into Southern Kuzbass Coal Company. We have paid a
current stake in Lenin Mine.

Vyartsilya Metal Products Plant. Vyartsilya Metal Products Plant is a
wire, nails and steel nets. Vyartsilya Metal Products Plant was formed i
Vyartsilya Metal Products Plant OAO, which was privatized by the Kar
acquired a 88.1% stake in Vyartsilya Metal Products Plant from employ
We have paid a total of $0.1 million for our current stake in Vyartsilya

Beloretsk Metallurgical Plant. Beloretsk Metallurgical Plant is a hard
rod and a broad range of hardware. Beloretsk Metallurgical Plant was p
government in 1994. We acquired a 33.3% stake in Beloretsk Metallurg
2001, and increased our stake to a controlling interest in June 2002. In N
another 29.4% stake in Beloretsk Metallurgical Plant from the regional
2004, we acquired another 9.7% stake in Beloretsk Metallurgical Plant,
90.2%. Beloretsk Metallurgical Plant also owns the Pugachev limeston
$15.2 million for our current stake in Beloretsk Metallurgical Plant. Th
golden share in Beloretsk Metallurgical Plant, giving it the right to veto
and appoint a voting representative on the board of directors.

Combinatul de Oteluri Speciale Targoviste. COST is a Romanian stee
products and forgings. We acquired an 79.7% stake in COST from the
August 2002. At the time we acquired COST, it was in bankruptcy proc
consisted of $3.5 million in cash and a commitment on our part to inves
modernization of the plant and upgrade of its capacity over five years, a
maintain its workforce level for five years. Under the transaction docum
pledged to the Romanian government until we fulfill our commitments.

Urals Stampings Plant. Urals Stampings Plant is Russia s largest pro
specialty steel and heat-resistant titanium alloys for the aerospace, powe
Stampings Plant was privatized by the Russian government in 1993. W
Urals Stampings Plant from third parties in April 2003 for $11.3 millio

Industria Sarmei. Industria Sarmei is a Romanian steel mill that prod
hardware, including wires, ropes and nails. We acquired a 73.4% stake
Romanian government in June 2003. The consideration consisted of $2
commitment on our part to invest $19.0 million in the modernization of
capacity over five years, a commitment to spend $3.6 million in enviro
commitment to maintain its workforce level for five years. In connectio
debt of Industria Sarmei was converted into shares, and we subsequentl
million, increasing our stake to 79.8%. Under the transaction

Table of Contents

Management s discussion and analysis of financial condition and

documents, our stake in Industria Sarmei is pledged to the Romanian go
commitments.

Mechel Nemunas. Mechel Nemunas is a Lithuanian hardware plant th
steel products, nails, rods and nets. We acquired a 75.1% stake in Mech
cash in October 2003. From November to December 2003, we acquired
Mechel Nemunas for $1.0 million in cash.

Korshunov Mining Plant. Korshunov Mining Plant operates three surf
ore concentrating plant. Korshunov Mining Plant was privatized by the
acquired a 62.5% interest in Korshunov Mining Plant in December 200
proceedings. In September 2003, a court approved a debt settlement pla
in Korshunov Mining Plant at cost until we acquired control in October
results since that time. We have paid a total of $132.3 million (includin
current stake in Korshunov Mining Plant.

Mechel Coal Resources. Mechel Coal Resources is a newly-formed K
holding our Kazakh coal assets. It consists of (1) the assets of Coal Was
coal washing plant, which we acquired in December 2003 for $1.0 milli
million in assumed debt; and (2) the assets of K.O. Gorbachev Mine, an
mine primarily producing coking coal, which we acquired in May 2004
cash.

Port Posiet. Port Posiet is located in Russia s Far East on the Sea of J
stake in Port Posiet for $30.0 million in cash in February 2004. We inte
coal concentrate, as well as steel products, to Asia through this port.

Izhstal. Izhstal is a Russian specialty steel plant which produces rolle
and forgings. We acquired a 61.6% stake in Izhstal for $25.1 million in
2004. The regional government has a golden share in Izhstal, giving it t
shareholder decisions and appoint a voting representative on the board o

The acquisition of Chelyabinsk Metallurgical Plant in December 2001, an inte
coking batteries, was the most significant steel acquisition and it is the center o
Prior to its acquisition, we were primarily a coal mining and trading company.
we had been running Chelyabinsk Metallurgical Plant on a contract basis, our
selling Chelyabinsk Metallurgical Plant s products and we had supplied it wit
requirements, so we were already familiar with its operations and customers. T
Metallurgical Plant in June 2002, a market leader in hardware in Russia and w
operations had been selling prior to its acquisition, significantly expanded our
category, and this presence was also bolstered by our acquisition of Vyartsilya
2002. Beloretsk Metallurgical Plant and Vyartsilya Metal Products Plant are su
by Chelyabinsk Metallurgical Plant. Our downstream product mix was also fu
of Urals Stampings Plant in April 2003, which uses Chelyabinsk Metallurgical
value-added stampings. We further solidified our presence in the Russian spec
acquisition of Izhstal in May 2004. Additionally, our Eastern European acquis
Industria Sarmei in June 2003 and Mechel Nemunas in October 2003, marked
COST produces specialty long products and Industria Sarmei and Mechel Nem
Mechel Nemunas is supplied with semi-finished steel from our Russian operat

Within the mining segment, our acquisitions of Southern Urals Nickel Plant in
Korshunov Mining Plant in October 2003 added ferro nickel and iron ore conc
mining segment, and provided us with the ability to internally source a substan

Management s discussion and analysis of financial condition and

material needs. Mechel Coal Resources represents the expansion of our minin
focusing on the coal-rich regions of Kazakhstan. It consists of a coal washing
mine producing primarily coking coal.

RESULTS OF OPERATIONS

The following table sets forth our income statement data for the six months en

	Six months end June 30, 2004	
	amount	% reven
	(in thousands	
Revenue, net	1,630,063	
Cost of goods sold	(985,370)	
Gross margin	644,693	
Selling, distribution and operating expenses	(295,587)	
Operating income	349,106	
Other income and expense, net	(12,630)	
Income before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principle	336,476	
Income tax expense	(74,100)	
Minority interest in loss (income) of subsidiaries	(7,920)	
Income from continuing operations	254,456	
Loss from discontinued operations, net of tax		
Extraordinary gain, net of tax		
Changes in accounting principle, net of tax		
Net income	254,456	

The following table sets forth our income statement data for the years ended D
2001.

	Year ended December 31, 2003	Year ende December 31

	amount	% of revenues	amount	% rev
	(in thousands of U.S. dollars, ex			
Revenue, net	2,050,088	100.0	1,314,149	
Cost of goods sold	(1,440,053)	(70.2)	(947,527)	
Gross margin	610,035	29.8	366,622	
Selling, distribution and operating expenses	(417,259)	(20.4)	(277,478)	
Operating income	192,776	9.4	89,144	
Other income and expense, net	(20,018)	(1.0)	(18,083)	
Income before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principle	172,758	8.4	71,061	
Income tax expense	(47,759)	(2.3)	(2,653)	
Minority interest in loss (income) of subsidiaries	18,979	0.9	10,433	
Income from continuing operations	143,978	7.0	78,841	
Loss from discontinued operations, net of tax	(2,422)	(0.1)	(1,835)	
Extraordinary gain, net of tax	5,740	0.3	1,388	
Changes in accounting principle, net of tax	(3,788)	(0.2)	10,859	
Net income	143,508	7.0	89,253	

Management s discussion and analysis of financial condition and

Six months ended June 30, 2004, compared to six months ended J

Revenues

Consolidated revenues increased by $699.5 million, or 75.2%, to $1,630.1 mil
June 30, 2004, from $930.6 million in the six months ended June 30, 2003. Th
revenues by segment.

Revenues by segment

Steel segment
To third parties
To mining segment
Total
Mining segment
To third parties
To steel segment
Total
Eliminations
Consolidated revenues
% from steel segment
% from mining segment

Steel segment

Our steel segment revenues in the six months ended June 30, 2004, increased b
$1,307.9 million from $778.8 million in the six months ended June 30, 2003. T
revenues is primarily explained by the following increases:

Rebar sales increased by $120.6 million, or 79.5%, due to price increase
by $69.2 million, or 83.5%, due to price increases and particularly as a
prices for the higher-quality wire rod we produce at Beloretsk Metallur
Sales of semi-finished products increased by $123.5 million, or 226.3%
volume increases.
Hardware sales were higher by $48.8 million, or 85.8%, including an in
$33.8 million, or 83.6%, and an increase in rope sales of $8.7 million, o
price increases.
Sales of carbon and low-alloy flat products increased by $37.9 million,
to price increases.
Sales of stainless and alloyed long products increased by $7.7 million,
to price increases.
Carbon and low-alloyed long product sales grew by $41.0 million, or 5
increases.
High quality forgings and forged alloy sales increased by $15.7 million
to price and volume increases.
Sales of coke and coking products to third parties increased by $7.9 mil
mining segment, which uses coke in the production of nickel, grew by
both cases primarily as a result of substantial increases in the price of c

62

Table of Contents

Management s discussion and analysis of financial condition and

- Tube sales increased by $8.6 million, or 157.6%, primarily as a result o
- Pig iron sales increased by $31.0 million, or 465.6%, primarily as a resu
- Sales of steel products to our mining segment increased by $0.9 million

In addition to the above, the following increases were related to acquisitions:

- Revenues at Mechel Zeljezara for the first two months of 2004, Urals S months of 2004 and Industria Sarmei for the first five months of 2004, v comparative analysis by product above, amounted to $74.2 million.
- Revenues at Mechel Nemunas and Izhstal for the six months ended Jun million.

These increases in steel products sales were offset by sales decreases as follow

- Sales of MMK products in the six months ended June 30, 2003, amount January 2004, we stopped reselling MMK products. See Certain Trans Transactions Magnitogorsk Iron & Steel Works.
- Stainless flat product sales decreased by $6.8 million, or 13.4%, mostly
- Trading sales of iron ore from Korshunov Mining Plant in the six month amounted to $19.8 million and were included in steel segment sales; aft consolidation in October 2003, its revenues are being reflected in the m

Excluding intersegment sales, export sales were 50.2% of steel segment sales 30, 2004, compared to 47.3% in the six months ended June 30, 2003.

Mining segment

Our total mining segment sales in the six months ended June 30, 2004, increas 108.2%, to $522.6 million from $251.0 million in the six months ended June 3

Coking coal concentrate sales to third parties increased by $74.7 million, or 91 increases, as well as to a 15.5% increase in sales volume. Coking coal concent segment increased by $56.2 million, or 92.9%, to satisfy increased steel produ Metallurgical Plant. Steam coal and steam coal concentrate sales to third partie 70.0%, due equally to price and volume increases.

Nickel sales to third parties increased by $34.0 million, or 148.7%, primarily c
supplied to the steel segment increased by $2.0 million, or 10.2%.

We recorded iron ore sales in the mining segment beginning in October 2003 v
Korshunov Mining Plant. For the six months ended June 30, 2004, sales to thi
million and supplies to the steel segment amounted to $22.0 million, for a tota

These increases in mining products sales were partly offset by a decrease of $4
services sales, consisting primarily of transportation, blasting, and municipal s
energy.

Excluding intersegment sales, export sales were 72.6% of mining segment sale
30, 2004, compared to 43.7% in the six months ended June 30, 2003. The incr
export sales was due to higher export prices in relation to domestic prices (the
of our mining products increased by $18 per tonne, whereas the weighted aver
mining products increased by $6 per tonne), as well as increased export volum
higher export prices.

Management s discussion and analysis of financial condition and

Cost of goods sold and gross margin

Consolidated cost of goods sold was 60.4% of consolidated revenues in the six
as compared to 69.6% of consolidated revenues in the six months ended June
increase in the consolidated gross margin percentage in the six months ended
30.4% in the six months ended June 30, 2003. Cost of goods sold primarily co
materials (including products purchased for resale), direct payroll, depreciation
sets forth cost of goods sold and gross margin by segment for the six months e
including as a percentage of segment revenues.

Cost of goods sold and gross margin by segment	Six months e June 30, 20 amount	% seg rev
	(in thousands of U	
Steel segment		
Cost of goods sold	964,118	
Gross margin	343,785	
Mining segment		
Cost of goods sold	221,686	
Gross margin	300,908	

Steel segment

Steel segment cost of goods sold increased by $391.3 million, or 68.3%, to $9
ended June 30, 2004, from $572.8 million in the six months ended June 30, 20
sold was 73.7% of segment revenues, as compared to 73.5% in the six months

Mining segment

Mining segment cost of goods sold increased by $47.4 million, or 27.2%, to $
ended June 30, 2004, from $174.3 million in the six months ended June 30, 20
margin percentage increased from 30.6% in the six months ended June 30, 200
ended June 30, 2004. The improvement in the mining segment s gross margin
increase in the average sales price of coal and nickel, which increased by 57%

Table of Contents

Management s discussion and analysis of financial condition and

Selling, distribution and operating expenses

Selling, distribution and operating expenses increased by $102.2 million, or 52
six months ended June 30, 2004, from $193.4 million in the six months ended
of consolidated revenues, selling, distribution and operating expenses decrease
ended June 30, 2004, as compared to 20.8% in the six months ended June 30,
and operating expenses consist primarily of selling and distribution expenses,
provision for doubtful accounts and general, administrative and other operatin
sets forth these costs by segment for the six months ended June 30, 2004 and 2
of segment revenues.

	Six months ende	
	June 30, 2004	
		% o
Selling, distribution and operating expenses by segment	**amount**	**segm reven**
	(in thousands of U.S	
Steel segment		
Selling and distribution expenses	96,550	
Taxes other than income tax	18,086	
Provision for doubtful accounts	1,058	
General, administrative and other operating expenses	64,377	
Total	180,071	
Mining segment		
Selling and distribution expenses	77,021	
Taxes other than income tax	7,286	
Provision for doubtful accounts	(754)	
General, administrative and other operating expenses	31,963	
Total	115,516	

Steel segment

Selling and distribution expenses consisted almost entirely of transportation ex
activities, and decreased as a percentage of steel segment revenues from 10.1%
30, 2003, to 7.4% in the six months ended June 30, 2004, primarily as a result
own railway freight and forwarding company for our transportation needs, wh
2002.

Taxes other than income tax includes property and land taxes, road users tax a
to $18.1 million in the six months ended June 30, 2004, an increase of $1.8 mi
million in the six months ended June 30, 2003. As a percentage of segment rev
from 2.1% to 1.4%. Property and land taxes amounted to $10.4 million in the s
2004, an increase of $1.3 million, or 14.1%, from $9.1 million in the six montl
an increase in the property tax base (as a result of putting into operation new f

Provision for doubtful accounts decreased by $5.6 million, or 84.0%, from $6.
ended June 30, 2003, to $1.1 million in the six months ended June 30, 2004, d
aging of the accounts receivable as of the respective period ends.

General, administrative and other expenses, which consisted of payroll and rel
rent and maintenance, legal and consulting expenses, office expenses and othe
million, or 49.6%, to $64.4 million in the six months ended June 30, 2004, fro
months ended June 30, 2003, and decreased as a percentage of segment revenu

Table of Contents

Management s discussion and analysis of financial condition and

from 5.5% in the six months ended June 30, 2003 compared to 4.9% in the six
Payroll and related social taxes increased by $13.6 million, primarily due to ac
Social expenses increased by $3.0 million. Rent and maintenance, business tra
expenses increased by $2.6 million. Professional expenses, which include audi
engineering fees, increased by $0.8 million.

Mining segment

Selling and distribution expenses consisted almost entirely of transportation ex
activities, and increased as a percentage of mining segment revenues from 11.
June 30, 2003, to 14.7% in the six months ended June 30, 2004, primarily as a
export sales with higher cost of transportation than domestic sales, partly offse
own railway freight and forwarding company for our transportation needs, wh
2002.

Taxes other than income tax increased by $0.6 million, or 9.7%, from $6.6 mi
June 30, 2003, to $7.3 million in the six months ended June 30, 2004. Property
$0.4 million due to an increase in the property tax base (as a result of putting i

Provision for doubtful accounts was negative in both periods due to an improv
accounts receivable as of the respective period ends. Some of the accounts rec
fully provided for in previous periods were collected during each of the six-mo
2004 and 2003.

General, administrative and other expenses increased by $18.8 million, or 143
months ended June 30, 2004, from $13.1 million in the six months ended June
increase as a percentage of segment revenues from 5.2% to 6.1%. Salaries and
by $7.4 million, social expenses increased by $2.8 million, legal and consultin
and rent and maintenance and office expenses increased by $0.9 million. The i
expenses was primarily due to the acquisition of Korshunov Mining Plant in C
increases at our coal companies.

Operating income

Operating income increased by $259.8 million, or 290.7%, to $349.1 million i
2004, from $89.4 million in the six months ended June 30, 2003. Operating in
consolidated revenues increased from 9.6% in the six months ended June 30, 2
months ended June 30, 2004, due to the substantial improvement in the gross m

relatively stable selling, distribution and operating expenses compared to grow

The table below sets out operating income by segment, including as a percenta

Operating income by segment	Six months ended June 30, 2004 amount	% of segment revenu
	(in thousands of U.S	
Steel segment	163,714	1
Mining segment	185,392	3

Steel segment

Steel segment operating income in the six months ended June 30, 2004, increa 168.9%, to $163.7 million from $60.9 million in the six months ended June 30

66

Table of Contents

Management s discussion and analysis of financial condition and

percentage increased from 7.8% to 12.5% due to the stability in the gross marg
growth in selling, distribution and operating expenses compared to the growth

Mining segment

Mining segment operating income in the six months ended June 30, 2004, incr
551.1%, to $185.4 million from $28.5 million in the six months ended June 30
percentage increased from 11.3% to 35.5% due to significant growth in segme
growth in selling, distribution and operating expenses.

Other income and expense, net

Other income and expense, net consists of income (loss) of equity investees, in
other income and foreign exchange gain. The table below sets forth these costs
30, 2004 and 2003, including as a percentage of sales:

Other income and expense, net	Six months en June 30, 200 amount	% reve
	(in thousands of U.	
Income (loss) from equity investees	2,595	
Interest income	1,125	
Interest expense	(30,022)	
Other income, net	10,635	
Foreign exchange gain (loss)	3,037	
Total	(12,630)	

The income from equity investees in the six months ended June 30, 2003, was
Kuzbass Coal Company. Most of the income from equity investees in the six m
related to Mechel Energy AG, and also included income from investees of Sou

Interest income increased by $1.0 million to $1.1 million in the six months end
million in the six months ended June 30, 2003. Our businesses earned interest
held with financial institutions. Interest expense increased by $9.8 million, or 4
six months ended June 30, 2004, from $20.2 million in the six months ended J
related to an increase in short-term debt and long-term debt, as well as to debt
million.

In the six months ended June 30, 2004, we recorded other income of $10.6 mi
following: gains of $18.0 million from fines and penalties forgiven due to the
prior period taxes and social charges owed by our Russian subsidiaries to the g
audited consolidated financial statements), a loss of $2.1 million on the sale of
million on the sale of investment securities, loss of $0.3 million on other sales
million.

In the six months ended June 30, 2004, foreign exchange gain was $3.0 millio
million in the six months ended June 30, 2003.

Income tax expense

Income tax expense increased by $51.0 million to $74.1 million in the six mon

Management s discussion and analysis of financial condition and

from $23.1 million in the six months ended June 30, 2003, and our effective ta
27.7%. The decrease in the effective tax rates is due primarily to the recognitio
forgiveness of fines and penalties (see above), which is non-taxable, as well as
generated in jurisdictions having lower tax rates.

Minority interest

Minority interest in income of subsidiaries amounted to $7.9 million in the six
compared to a minority interest in loss of subsidiaries of $6.6 million in the six
Minority interest in income of subsidiaries in the current period consisted prim
shareholders in the net income of Chelyabinsk Metallurgical Plant and our coa
$10.1 million, partly offset by the share of minority shareholders in the net los
Plant and COST. Minority interest in loss of subsidiaries in the prior period wa
share of minority shareholders in the net losses of Beloretsk Metallurgical Plan

Income from continuing operations

Income from continuing operations in the six months ended June 30, 2004, wa
$67.7 million in the six months ended June 30, 2003, as a result of the factors

Income from discontinued operations

As of December 31, 2002, we had committed to a plan to discontinue and sell
Russian bank providing banking services to our coal subsidiaries, and Belov In
insurance company providing life and property insurance to our coal subsidiar
$1.3 million in the six months ended June 30, 2003, associated with these com

Extraordinary gain

In accordance with SFAS No. 141 and SFAS No. 142, the excess of the fair va
the purchase price (after reducing the value of non-current assets to zero) in th
was related to the acquisitions of minority interests in Industria Sarmei in June
extraordinary gain, net of tax, in the six months ended June 30, 2003.

Changes in accounting principle

Upon adoption of SFAS No. 143 on January 1, 2003, we recorded approximat
benefit, as a charge to cumulative effective changes in accounting principles. S
consolidated financial statements.

Net income

For the reasons set forth above, our net income increased in the six months en
million, or 275.6%, from $67.7 million in the six months ended June 30, 2003
months ended June 30, 2004.

Table of Contents

Management s discussion and analysis of financial condition and

Year ended December 31, 2003, compared to year ended Decembe

Revenues

Consolidated revenues increased by $735.9 million, or 56.0%, to $2,050.1 mil
million in 2002. The following table sets out revenues by segment.

Revenues by segment
Steel segment
To third parties
To mining segment
Total
Mining segment
To third parties
To steel segment
Total
Eliminations
Consolidated revenues
% from steel segment
% from mining segment

Steel segment

Our steel segment revenues in 2003 increased by $627.8 million, or 59.8%, to
million in 2002. The increase in steel segment revenues is primarily explained

Rebar sales increased by $102.8 million, or 49.1%, due to price increas
by $60.2 million, or 53.7%, due to price increases and particularly as a
prices for the higher-quality wire rod we produce at Beloretsk Metallur
Hardware sales were higher by $50.7 million, or 71.2%, including an in
$32.1 million, or 60.5%, due to volume increases, and an increase in ro
million, or 80.9%, due to price increases.

Sales of carbon and low-alloy flat products increased by $41.2 million,
due to price increases, particularly as a result of an increase in the prop
sales of these products.

Trading sales of iron concentrate ore from Korshunov Mining Plant pri
October 2003 increased by $34.8 million, which after consolidation are
segment.

Sales of stainless and alloyed long products increased by $23.5 million,
due to volume increases.

Carbon and low-alloyed long product sales grew by $20.4 million, or 2
increases, as well as an increase in export volumes. A decrease in dome
price increases.

Stainless flat product sales were higher by $14.2 million, or 20.5%, due
Forgings and forged alloy sales increased by $11.9 million, or 54.9%, p
volume increases.

Table of Contents

Management s discussion and analysis of financial condition and

Sales of coke and coking products to third parties increased by $10.1 m
mining segment, which uses coke in the production of nickel, grew by $
cases primarily as a result of substantial increases in the price of coke.
Sales of carbon and low-alloyed forgings increased by $7.6 million, or 4
in both volumes and prices.
Pig iron sales increased by $5.7 million, or 59.4%, primarily as a result
Sales of MMK products increased by $68.2 million, or 44.0%, primarily
We purchased hot-rolled and cold-rolled plates and coils and galvanized
internationally through our trading subsidiary, Mechel Trading. Starting
reselling MMK products. See Certain Transactions Related Party Tra
Steel Works.

In addition to the above, the following increases were related to acquisitions:

Revenues at Mechel Zeljezara, Urals Stampings Plant, Industria Sarmei
were acquired in March, April, June and October 2003, respectively, an
Revenues at Vyartsilya Metal Products Plant for the first four months o
seven months of 2003, which are not included in the comparative analy
to $96.4 million.

These increases in steel products sales were offset by sales decreases as follow

Sales of steel products to our mining segment decreased by $10.3 millio
year.
Sales of semi-finished products to Beloretsk Metallurgical Plant, Vyarts
Urals Stampings Plant in 2002 in the amount of $36.7 were no longer re
their acquisition.

Excluding intersegment sales, export sales were 44.6% of steel segment sales
2002. The decrease in the proportion of our steel segment sales represented by
increases in domestic prices in relation to export prices.

Mining segment

Our total mining segment sales in 2003 increased by $227.5 million, or 61.1%
million in 2002.

Coking coal concentrate sales to third parties increased by $56.3 million, or 45
increases, as well as to an 11.1% increase in sales volume. Coking coal concen

segment increased by $97.9 million, or 247.1%, as coke production at Chelyab
than doubled. Steam coal and steam coal concentrate sales increased by $18.5
due to price increases.

Nickel sales to third parties increased by $28.7 million, or 55.8%, as volumes
supplied to the steel segment increased by $10.0 million, or 33.4%, primarily d

We recorded iron ore concentrate sales in the mining segment beginning in Oc
consolidation of Korshunov Mining Plant, with sales to third parties of $20.1 m
segment of $8.3 million, for a total increase of $28.4 million.

Table of Contents

Management s discussion and analysis of financial condition and

These increases in mining products sales were partly offset by a decrease of $1
and services sales, consisting primarily of transportation, blasting and municip
energy.

Excluding intersegment sales, export sales were 45.1% of mining segment sal
in 2002.

Cost of goods sold and gross margin

Consolidated cost of goods sold was 70.2% of consolidated revenues in 2003,
consolidated revenues in 2002, resulting in an increase in the consolidated gro
29.8% from 27.9% in 2002. The table below sets forth cost of goods sold and
2003 and 2002, including as a percentage of segment revenues.

	Year end December 31	
Cost of goods sold and gross margin by segment	**amount** (in thousan	**se re**
Steel segment		
Cost of goods sold	1,247,380	
Gross margin	431,015	
Mining segment		
Cost of goods sold	420,736	
Gross margin	179,020	

Steel segment

Steel segment cost of goods sold increased by $445.9 million, or 55.6%, to $1
$801.5 million in 2002. Steel segment cost of goods sold was 74.3% of segme
76.3% in 2002. The improvement in the steel segment s gross margin was pri
in the average sales price and partly related to improvements in our working p
methods. These improvements were partially offset by our acquisitions of und
Eastern Europe. As we integrate these acquisitions and continue to introduce i
practices and operational methods, we expect this average gross margin to imp

Mining segment

Mining segment cost of goods sold increased by $166.0 million, or 65.2%, to $
$254.7 million in 2002. Mining segment gross margin percentage decreased fr
2003. The deterioration in the mining segment gross margin percentage was at
in the price of coke which, although supplied by our steel segment, is transferr
the production of nickel) at market-based prices.

Table of Contents

Management s discussion and analysis of financial condition and

Selling, distribution and operating expenses

Selling, distribution and operating expenses increased by $139.8 million, or 50
from $277.5 million in 2002. As a percentage of consolidated revenues, selling
expenses decreased to 20.4% in 2003, as compared to 21.1% in 2002. The tabl
by segment for 2003 and 2002, including as a percentage of segment revenues

Selling, distribution and operating expenses by segment	Year ende December 31, amount	% seg reve
	(in thousan	
Steel segment		
Selling and distribution expenses	152,972	
Taxes other than income tax	32,612	
Goodwill impairment		
Provision for doubtful accounts	9,935	
General, administrative and other operating expenses	106,170	
Total	301,689	
Mining segment		
Selling and distribution expenses	61,546	
Taxes other than income tax	12,105	
Goodwill impairment		
Provision for doubtful accounts	76	
General, administrative and other operating expenses	41,843	
Total	115,570	

Steel segment

Selling and distribution expenses consisted almost entirely of transportation ex
activities, and decreased as a percentage of steel segment revenues from 12.3%
primarily as a result of our increasing use of our own railway freight and forw
transportation needs, which we established at the end of 2002.

Taxes other than income tax include property and land taxes, road users tax, ar
amounted to $32.6 million in 2003, an increase of $11.2 million, or 52.0%, fro
percentage of segment revenues, these taxes declined from 2.0% to 1.9%. Prop
to $18.4 million in 2003, an increase of $7.6 million, or 71.0%, from $10.8 mi
in the property tax rate. We also incurred fines and penalties in the amount of
of the conclusion of tax reviews of Chelyabinsk Metallurgical Plant, Beloretsk
trading subsidiaries which are now dormant. Beginning from January 1, 2003,
abolished, which tax amounted to $8.2 million in 2002.

Provision for doubtful accounts increased by $7.2 million, or 257.9%, from $2
million in 2003, and increased as a percentage of segment revenues from 0.3%
attributable to our recent acquisitions: Mechel Zeljezara in the amount of $1.0
amount of $0.6 million and COST in the amount of $0.6 million. In addition, w
bad debts in the amount of $2.5 million in 2003 at Chelyabinsk Metallurgical P
other receivables.

General, administrative and other expenses, which consisted of payroll and rel
rent and maintenance, legal and consulting expenses, office expenses and othe
million, or 158.5%, to $106.2 million in 2003 from $41.1 million in 2002,

---

Table of Contents

Management s discussion and analysis of financial condition and

representing an increase as a percentage of segment revenues from 3.9% to 6.3
taxes increased by $35.9 million, primarily due to acquisitions and salary incre
Metallurgical Plant and Beloretsk Metallurgical Plant. Rent, maintenance and
$10.4 million. Professional expenses, which include audit, accounting, legal an
by $7.4 million, primarily as a result of our reorganization, establishment of re
first-time application of U.S. GAAP in the preparation of our consolidated fina
this offering, as well as several ongoing management information system proj
Metallurgical Plant, such as the transition to new accounting software. Asset w
2003 amounted to $3.3 million, primarily due to the closure of a steel-making
Plant. Social expenses increased by $2.9 million.

Mining segment

Selling and distribution expenses consisted almost entirely of transportation ex
activities, and decreased as a percentage of mining segment revenues from 10.
primarily as a result of increased use of our own railway freight and forwardin
transportation needs, which we established at the end of 2002.

Taxes other than income tax increased by $3.2 million, or 35.8%, from $8.9 m
in 2003. Property and land taxes increased by $3.1 million due to an increase i
Beginning from January 1, 2003, the road user tax was abolished, which amou

In 2002, goodwill in the amount of $7.2 million was impaired, relating to Usin
in that period) and Uglemetbank (which continued to experience losses throug
in Uglemetbank was disposed of in late 2003 and the first half of 2004.

Provision for doubtful accounts decreased to $0.1 million in 2003 from $0.8 m
improvement in the aging of the accounts receivable as of the respective perio

General, administrative and other expenses increased by $14.8 million, or 54.5
from $27.1 million in 2002, representing a decrease as a percentage of segmen
Salaries and related social taxes increased by $7.1 million, legal and consultin
million, rent and maintenance and office expenses increased by $2.1 million a
$1.2 million.

Operating income

Operating income increased by $103.6 million, or 116.3%, to $192.8 million i
2002. Operating income as a percentage of consolidated revenues increased fr
2003 due to the improvement in the gross margin percentage and the slower g
and operating expenses compared to growth in consolidated revenues.

The table below sets out operating income by segment, including as a percenta

Operating income by segment	Year ende December 31, amount	% seg rev
	(in thousands of U	
Steel segment	129,326	
Mining segment	63,450	

Table of Contents

Management s discussion and analysis of financial condition and

Steel segment

Steel segment operating income in 2003 increased by $74.6 million, or 136.3%
million in 2002. Operating margin percentage increased from 5.2% to 7.7% du
margin and the slower growth in selling, distribution and operating expenses c
segment revenues.

Mining segment

Mining segment operating income in 2003 increased by $29.0 million, or 84.4
million in 2002. Operating margin percentage increased from 9.2% to 10.6% c
distribution and operating expenses compared to growth in segment revenues,
the gross margin.

Other income and expense, net

Other income and expense, net consists of income (loss) of equity investees, in
other income and foreign exchange gain. The table below sets forth these costs
as a percentage of sales:

	Year ended December 31, 20	
		% c
Other income and expense, net	**amount**	**reven**
	(in thousands of U.S	
Income (loss) from equity investees	1,221	
Interest income	2,292	
Interest expense	(48,528)	
Other income, net	26,719	
Foreign exchange gain	(1,722)	
Total	(20,018)	

The majority of loss from equity investees in 2002 arose in relation to Belorets
our acquisition of control. Income from equity investees in 2003 was related p
Southern Kuzbass Coal Company.

Interest income decreased by $2.2 million to $2.3 million in 2003 from $4.4 m
interest income on promissory notes received from their customers and on cas
institutions. We have significantly reduced the use of promissory notes, and in

Interest expense increased by $11.8 million, or 32.0%, to $48.5 million in 200
This increase related to an increase in short-term borrowings and long-term de
acquired businesses of $0.4 million.

In 2003, we recorded other income of $26.7 million, primarily consisting of th
million from fines and penalties forgiven due to the timely payment of restruct
social charges owed by our Russian subsidiaries to the government (see note 1
financial statements), a gain of $2.7 million on the sale of promissory note, a g
of investment securities and a gain of $1.4 million from our being released fro
obligations for which the statute of limitations had lapsed.

In 2003, foreign exchange loss was $1.7 million, as compared to a gain of $9.
from January 1, 2003, Russia no longer meets the criteria for a highly inflation
commencing January 1, 2003, our Russian subsidiaries changed their function

---

Table of Contents

Management s discussion and analysis of financial condition and

dollar to the ruble. See note 3 to our audited consolidated financial statements.
nominal terms against the U.S. dollar in 2002 and appreciated against the U.S.
exchange gains in 2002 were driven by devaluation of payables denominated i
exchange losses in 2003 were driven by devaluation of receivables denominat

Income tax expense

Income tax expense increased by $45.1 million to $47.8 million in 2003 from
effective tax rate increased to 27.6% from 3.7% as a result of a significant inc
expenses and a change in the property, plant and equipment book to tax bases
the book to tax bases difference resulting from the remeasurement of property
local currency (rubles) into the functional currency (U.S. dollars) using histori
reporting purposes, as required for companies operating in a hyperinflationary
permanent difference that reduced the effective tax rate for 2002 by 22.7%. Ef
Russia no longer met the criteria for a highly inflationary economy and, theref
related to the remeasurement of property, plant and equipment in 2002 becam
change from permanent to temporary treatment was primarily responsible for
rate between the periods. See note 15 to our audited consolidated financial sta

Minority interest

Minority interest in loss of subsidiaries amounted to $19.0 million in 2003 co
Minority interest in loss of subsidiaries in 2003 consisted primarily of the sha
the net losses of Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Pla
$18.3 million. Minority interest in loss of subsidiaries for these companies in 2

Income from continuing operations

Income from continuing operations in 2003 was $144.0 million, compared to
result of the factors explained above.

Income from discontinued operations

As of December 31, 2002, we had committed to a plan to discontinue and sell
Russian bank providing banking services to our coal subsidiaries, and Belov I

insurance company providing life and property insurance to our coal subsidiar
$2.4 million in 2003 as a result of operations and loss on disposal of Uglemet
Company, compared to a loss of $1.8 million in 2002 associated with these co

Extraordinary gain

In accordance with SFAS No. 141 and SFAS No. 142, the excess of the fair va
the purchase price (after reducing the value of non-current assets to zero) in th
$1.4 million which was related to the acquisitions of minority interests in Indu
subsidiaries of Southern Kuzbass Coal Company in December 2002 was recor
of tax, in 2003 and 2002, respectively.

Table of Contents

Management s discussion and analysis of financial condition and

Changes in accounting principle

Upon adoption of SFAS No. 143 on January 1, 2003, we recorded approximat
benefit, as a charge to cumulative effective changes in accounting principles. S
consolidated financial statements.

Net income

For the reasons set forth above, our net income increased in 2003 by $54.3 mi
million in 2002 to $143.5 million in 2003.

Year ended December 31, 2002, compared to year ended Decembe

Revenues

Consolidated revenues increased by $294.4 million, or 28.9%, to $1,314.1 mi
million in 2001. The following table sets out revenues by segment.

Revenues by segment

Steel segment
To third parties
To mining segment
Total
Mining segment
To third parties
To steel segment
Total
Eliminations

Consolidated revenues	
% from steel segment	
% from mining segment	

Steel segment

Our steel segment revenues increased by $370.2 million, or 54.4%, to $1,050.0
2001. In 2001, the operations of our steel segment consisted exclusively of res
were purchasing from Chelyabinsk Metallurgical Plant and Beloretsk Metallur
at the end of 2001 and in 2002, respectively. Revenues attributable to sales of
plants increased by $428.1 million, or 109.5%, from $391.1 million in 2001 to
increase was primarily due to the fact that after we acquired these plants, we w
steel products manufactured at these plants which we were not able to source f
including higher-margin products such as stainless plates, alloyed steels and fo

Other factors which explain the increase in revenues associated with these plan
domestic and export prices of steel products, as well as slightly higher across-t
increases in production at these plants in 2002 as compared to 2001. In 2002, o
included four months of operations of COST and seven months of operations o
Plant, which we did not have during 2001, which amounted to $29.0 million a
2002. In addition, our steel segment supplied coke, wires, ropes and other

Table of Contents

Management s discussion and analysis of financial condition and

hardware to our mining segment in 2002, which were recorded at $39.0 millio
sales in 2001 were negligible because we did not own steel producing assets i

These increases in steel products sales were offset by several factors. In 2002,
manufacturers, primarily MMK, declined by $80.5 million. Additionally, sales
segment to Chelyabinsk Metallurgical Plant in 2001, such as ferroalloys and s
sales after our consolidation of Chelyabinsk Metallurgical Plant. These sales d

Excluding intersegment sales, export sales were 50.8% of steel segment sales
2001, as domestic steel prices rose.

Mining segment

Our mining segment revenues increased by $32.2 million, or 9.5%, to $372.2
million in 2001. At the end of 2001, we acquired Southern Urals Nickel Plant,
nickel for resale prior to its acquisition. Revenues related to Southern Urals Ni
million, or 291.2%, from $20.8 million in 2001 to $81.5 million in 2002, due t
plant s production after its acquisition. In 2002, we also started supplying fer
Nickel Plant to our steel segment s Chelyabinsk Metallurgical Plant.

Revenues related to coal increased by $24.2 million, or 10.1%, from $239.2 m
in 2002. Steam coal sales decreased by $1.9 million, or 1.8%, in 2002 as comp
shipment volumes decreased by 664,000 tonnes, or 11.9%, as a result of a 550
Mosenergo, our principal customer of steam coal, and a 114,000 tonnes decrea
dressing mill at Krasnogorsk Open Pit Mine, which produces a higher-margin
separating coal waste. The volume decrease was offset in part by an increase o
price of steam coal, which was a result of higher exports and higher-margin st
concentrate sales increased by $24.1 million, or 17.8%, in 2002 as compared t
by 577,000 tonnes, while prices increased by an average of $1 per tonne.

These increases were offset as re-sales of iron ore concentrate to Chelyabinsk
$46.6 million in the year ended December 31, 2001, and which were considere
segment sales in 2001, were no longer considered as such following Chelyabi
consolidation on December 27, 2001.

Excluding intersegment sales, export sales were 49.6% of mining segment sal
in 2001. Export sales increased as export prices for coal increased while dome

Table of Contents

Management s discussion and analysis of financial condition and

Cost of goods sold and gross margin

Consolidated cost of goods was 72.1% of consolidated revenues in 2002, as co consolidated revenues in 2001, resulting in a decrease in the consolidated gros (27.9%) as compared to 2001 (29.3%). The table below sets forth cost of good segment for 2002 and 2001, including as a percentage of segment revenues.

	Year end December 3	
Cost of goods sold and gross margin by segment	amount (in thousa	se re
Steel segment		
Cost of goods sold	801,481	
Gross margin	249,073	
Mining segment		
Cost of goods sold	254,667	
Gross margin	117,549	

Steel segment

Steel segment cost of goods sold was 76.3% of segment revenues, as compare an increase in the steel gross margin percentage in 2002 (23.7%) as compared improvement in gross margin percentage in 2002 was primarily attributable to of steel plants. The nature of the steel segment s cost of goods sold also chang steel plants from which we had been purchasing products for resale, effectivel margin to us, as well as allowing us to re-allocate certain costs previously incl other expense categories. All costs of production, which were previously refle products purchased for resale, were recorded in our financial statements as cos materials, direct payroll, depreciation and energy costs. Operational improvem contributed to improved margins.

Mining segment

Mining segment cost of goods sold increased by $79.9 million, or 45.7%, in 20 of goods sold relating to nickel, which constituted 22.3% of total mining segm

increased by $42.5 million, or 304.5% in 2002 as compared to 2001, as nickel
2001, nickel cost of goods sold consisted of purchases of nickel from Southern
acquired at the end of 2001, whereas nickel cost of goods sold in 2002 consist
production incurred.

Cost of goods sold relating to coal and coal concentrate, which together consti
segment cost of goods sold in 2002, increased by $24.2 million, or 18.0%, in 2
Depreciation, depletion and amortization included in coal cost of goods sold in
133.4%, primarily due to the additional depreciation, depletion and amortizatio
which we acquired at the end of 2001, and Sibirginsk Open Pit Mine, arising f
mining facilities. The remaining increase in coal cost of goods sold primarily r
ruble-denominated costs such as wages and fuel.

Mining gross margin percentage decreased in 2002 (31.6%) as compared to 20
increases in coal production costs explained above and a change in the produc
which are characterized by lower margins relative to coal sales.

An additional factor in the decline in gross margin was the exclusion of re-sale
Chelyabinsk Metallurgical Plant, which were considered as third-party mining

Table of Contents

Management s discussion and analysis of financial condition and

were no longer considered as such following Chelyabinsk Metallurgical Plant
27, 2001. The gross margin of iron ore concentrate sales was significantly hig

Selling, distribution and operating expenses

Selling, distribution and operating expenses increased by $83.6 million, or 43.
from $193.9 million in 2001. As a percentage of consolidated revenues, sellin
expenses increased to 21.1% in 2002 as compared to 19.0% in 2001. The table
distribution and operating expenses by segment for 2002 and 2001, including
revenues.

Selling, distribution and operating expenses by segment	Year ended December 31, 2 amount (in thousands of U	% seg rev
Steel segment		
Selling and distribution expenses	129,033	
Taxes other than income tax	21,457	
Goodwill impairment		
Provision for doubtful accounts	2,776	
General, administrative and other operating expenses	41,075	
Total	194,341	
Mining segment		
Selling and distribution expenses	39,073	
Taxes other than income tax	8,915	
Goodwill impairment	7,219	
Provision for doubtful accounts	846	
General, administrative and other operating expenses	27,084	
Total	83,137	

Steel segment

Selling and distribution expenses consisted primarily of transportation expens
activities (94%), and decreased as a percentage of steel segment revenues in 2
primarily due to a decrease in steel segment export sales from 64.9% in 2001

Taxes other than income tax included property and land taxes, road users tax,
amounted to $21.5 million in 2002 compared to $1.2 million in 2001. The ste
faced certain taxes, which were not incurred by our trading operations in 200
million in 2002) and land taxes ($6.5 million in 2002). In addition, road users
2002 from $1.0 million in 2001, resulting from our acquisition of steel faciliti
tax is imposed on the markup, while for production companies the tax is impo
revenues. Beginning from January 1, 2003, the road users tax was abolished.

Provision for doubtful accounts increased to $2.8 million in 2002 from $1.3 m
relatively stable as a percentage of sales. The increase in provision for doubtf
plants: Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant and CO

General, administrative and other expenses, which consisted of payroll and re
rent and maintenance, legal and consulting expenses, office expenses and othe
million, or 457.2%, to $41.1 million in 2002 from $7.4 million in 2001. The la

Table of Contents

Management s discussion and analysis of financial condition and

increase in these expenses was related to the addition of steel-making facilities
changing nature of our steel segment from trading operations to both manufac
in these expenses were primarily increases of $11.8 million for payroll and rel
for social expenses, $5.4 million for depreciation, $4.3 million for rent and ma
office expenses. The increase in payroll and related social taxes arose primaril
the administrative staff of the newly acquired companies.

Mining segment

Selling and distribution expenses remained relatively stable as a percentage of
2002 as compared to 2001.

Taxes other than income tax increased by $3.4 million, or 60.5%, in 2002 to $
2001. This increase related primarily to property and land taxes, which increas
acquisitions (Southern Urals Nickel Plant and Usinsk Mine). Road users tax in
the increased taxable base relating to the mining segment (for trading compani
mark up, while for production companies the tax is imposed on the entire amo
from January 1, 2003, the road users tax was abolished.

In 2002, goodwill in the amount of $7.2 million was impaired, relating to Usin
in that year) and Uglemetbank (which continued to experience losses through
Uglemetbank was disposed of in late 2003 and early 2004. We intend to sell o
Uglemetbank during the first half of 2004.

Provision for doubtful accounts decreased by $1.6 million, or 65.6%, to $0.8 m
million in 2001. This decrease was related to the reorientation of sales of cokin
parties to our steel segment.

General, administrative and other expenses increased by $11.7 million, or 76.6
from $15.3 million in 2001. A significant factor was the addition of nickel fac
Payroll and related social taxes increased by $5.4 million in 2002 to $11.7 mil
as a result of the addition of the administrative staff of the newly acquired nick
increased by $2.2 million and social expenses increased by $1.4 million.

Operating income

Operating income decreased by $15.6 million, or 14.9%, to $89.1 million in 20
2001. Operating income as a percentage of consolidated revenues decreased fr
2002 as a result of the decrease in gross margins combined with increases in se
operating expenses, as explained above. The table below sets out operating inc
percentage of segment revenues.

	Year ende December 31,	
Operating income by segment	**amount**	**% seg reve**
	(in thousands of U	
Steel segment	54,732	
Mining segment	34,412	

80

Table of Contents

Management s discussion and analysis of financial condition and

Steel segment

Steel segment operating income in 2002 increased by $54.6 million to $54.7 m
2001. Operating margin percentage increased to 5.2% in 2002 from 0.0% in 20
steel segment operating margin percentage is due to our acquisition and operat
operational improvements at these plants.

Mining segment

Mining segment operating income in 2002 decreased by $70.2 million to $34.
2001. Operating margin percentage decreased from 30.8% in 2001 to 9.2% in
decrease in gross margins combined with the increases in general, administrati
expenses, as explained above.

Other income and expense, net

Other income and expense, net consists of interest income (loss) of equity inve
expense, other income and foreign exchange gain. The table below sets forth t
2001, including as a percentage of sales:

	Year ended December 31, 20	
		% c
Other income and expense, net	**amount** (in thousands of U.S	**reven**
Income (loss) from equity investees	(2,675)	
Interest income	4,447	
Interest expense	(36,773)	
Other income, net	7,794	
Foreign exchange gain	9,094	
Total	(18,083)	

The majority of the loss (73.5%) from equity investees arose in relation to Bel
to our acquisition of control.

Interest income increased by $4.0 million to $4.5 million in 2002 from $0.5 m
related primarily to new acquisitions. Our recently-acquired businesses earned
notes received from their customers and on the cash balances held with financ

Interest expense increased by $22.2 million, or 153.2%, to $36.7 million in 20
Out of this increase, $21.0 million related to existing debt of businesses acqui
2001 and 2002, the weighted average rate of interest on our indebtedness was

In 2002, we recorded other income of $7.8 million, consisting of gains of $4.0
released from certain accounts payable obligations for which the statute of lim
$3.8 million from fines and penalties forgiven due to the timely payment of re
and social charges owed by our Russian subsidiaries to the government (see no
consolidated financial statements).

In 2002, we recorded an increase in foreign exchange gains of $7.3 million att
debt and income tax liabilities of new businesses that we acquired at the end o

---

Table of Contents

Management s discussion and analysis of financial condition and

Income tax expense

Income tax expense decreased by $27.5 million, or 91.2%, to $2.7 million in 2
2001. Our effective tax rate decreased to 3.7% in 2002 from 32.6% in 2001, pr
basis differences attributable to property, plant and equipment in the steel segm
acquisition of Chelyabinsk Metallurgical Plant in the end of 2001.

Minority interest

Minority interest in loss of subsidiaries amounted to $10.4 million in 2002 as c
in income of subsidiaries of $15.5 million in 2001. In 2002, minority interest i
comprised of the share of minority shareholders in the net losses of Chelyabin
Beloretsk Metallurgical Plant and COST in the amount of $15.8 million. Exclu
loss of subsidiaries, minority interest in net income of subsidiaries decreased b
decrease is primarily attributable to the decrease in net income of coal subsidia
explained above.

Income from continuing operations

Income from continuing operations in 2002 was $78.8 million, compared to $4
of the factors explained above.

Loss from discontinued operations

As of December 31, 2002, we had committed to a plan to discontinue and sell
Russian bank providing banking services to our coal subsidiaries, and Belov In
insurance company providing life and property insurance to our coal subsidiar
Uglemetbank and Belov Insurance Company had combined losses of $1.8 mil
respectively.

Extraordinary gain

In accordance with SFAS No. 141, the excess of the fair value of net assets ac
(after reducing the value of non-current assets to zero) in the amounts of $1.4
related to the acquisitions of minority interests in subsidiaries of Southern Kuz
November 2001 and December 2002, respectively, was recorded as extraordin
consolidated income statements for the years ended December 31, 2002 and 2

Changes in accounting principle

As required by SFAS No. 142, we wrote off and recognized as income unamo
negative goodwill in the amount of $10.9 million in 2002, related to the acquis
Southern Kuzbass Coal Company in 2000. See note 3(c) to our audited consol

Net income

For the reasons set forth above, our net income increased by $41.8 million, or
2001 to $89.3 million in 2002.

Table of Contents

Management s discussion and analysis of financial condition and

LIQUIDITY AND CAPITAL RESOURCES

Capital requirements

Our principal on-going financing requirements are to finance production of ste mining operations, and to fund the following major activities:

- Future growth through acquisitions;
- Capital expenditures, including the purchase of equipment, modernizati
- Retirement of our short-term and portions of our long term debt;
- Changes in working capital; and
- General corporate purposes.

We anticipate that acquisitions, capital expenditures and repayments of outsta most significant uses of funds for the next several years.

We continue to consider acquisitions as one of our major growth strategies. Hi strategy came from cash flows from existing operations, external financing sou the form of contributions to our charter capital. We intend to finance acquisitio flow generated by our business, as well as external debt.

Our business is heavily dependent on plant and machinery for the production o well as investments in our mining operations. Investments to maintain and exp accordingly, an important priority and have a significant effect on our cash flo operations. We expect our capital expenditures to increase significantly in the Business Capital Improvements Program for the objectives of our capital e Over the next five years, *i.e.,* through 2009, we expect our overall capital expe $900 million, relatively evenly distributed throughout this period. We plan to f out of our cash flows from operations and financing activities, including the pr failure to undertake planned expenditures on production facilities could advers maintain and/or enhance our competitive position and develop higher margin p

In the near future we plan to extinguish about $70 million of short-term debt th longer-term, ruble-denominated bonds. We have not identified the specific sho retire, but intend to focus, wherever practical, on ruble-denominated short-tern debt as of June 30, 2004, and December 31, 2003, was $538.0 million and $46 Quantitative and Qualitative Disclosures About Market Risk for informati instruments, the maturity profile of debt, currency and interest rate structure. S consolidated financial statements.

Mechel Steel Group declared a dividend of 149 million rubles (or approximate
2004, which was paid in October 2004. Other than this dividend, we have not
on our common shares since our incorporation on March 19, 2003. Certain co
dividends to our controlling shareholders in amounts of $26.3 million, $13.4 n
years ended December 31, 2003, 2002 and 2001, respectively. Commencing i
ended December 31, 2004, we expect to declare and pay an annual dividend e
income, as determined under U.S. GAAP, subject to any applicable Russian le
Policy and Description of Capital Stock and Certain Requirements of Russ
Capital Stock Dividends.

Table of Contents

Management s discussion and analysis of financial condition and

Capital resources

We plan to finance our capital requirements through a mix of cash flows from
activities. Historically, our major sources of cash have been cash provided by
and we expect that these sources will continue to be our principal sources of c
intend to increasingly substitute longer-term debt for short-term debt as we di
from the proceeds from the current offering, we intend to continue to rely prin
operations and borrowings to meet our future working capital and other capita
depend on off-balance sheet financing arrangements.

Net cash provided by operating activities was $208.0 million and $43.5 millio
30, 2004 and 2003, respectively, and $119.5 million, $81.1 million and $34.8
December 31, 2003, 2002 and 2001, respectively.

The principal reason for the constant growth of net cash provided by operating
profitability of our business. The operating cash inflows are derived from pay
steel and mining products, reduced by cash disbursements for direct labor, raw
distribution and operating expenses, interest expense and income taxes.

Changes in working capital items period to period, including as a result of ext
continue to have a significant effect on cash provided by operating activities.
of purchased raw materials may warrant maintaining higher inventory levels i
price increases, deteriorating economic conditions may result in delayed colle
and vendors may require more prompt payments as a condition of doing busin
of our business has required and will continue to require higher levels of work
ended June 30, 2004, operating cash flows were lower by $78.6 million than t
due to our maintenance of higher inventory levels during the period. In 2003,
by $110.6 million than they would otherwise have been due to our maintenanc
during the year. See Trend Information Inventory. In 2001, operating cas
than they would otherwise have been due to an increase in accounts receivable

Net cash utilized by investing activities was $207.8 million, $209.9 million, $
in the six months ended June 30, 2004, and in the years ended December 31, 2
respectively. Substantially all of the cash for investing activities related to the
various machinery and equipment. Expenditures for acquisition of businesses
$106.9 million, $21.1 million and $47.8 million in the six months ended June
December 31, 2003, 2002 and 2001, respectively. Capital expenditures amoun
million, $61.0 million and $38.0 million in the six months ended June 30, 200
December 31, 2003, 2002 and 2001, respectively.

Net cash provided by financing activities was $43.8 million, $103.1 million, $
the six months ended June 30, 2004, and in the years ended December 31, 200
In 2003, two of our Russian subsidiaries issued long-term ruble-denominated
were used to finance our capital expenditures and repay our short-term borrow

On February 4, 2003, Chelyabinsk Metallurgical Plant issued ruble-den
principal amount of 1 billion rubles (approximately $31 million). The b
par value. Interest is payable every six months in arrears. The interest ra
was determined upon the issuance based on the bids of buyers and comp
rate for the second, third and fifth coupon periods is set by us is made p
respective coupon period starts. Bondholders are entitled to early

---

Table of Contents

Management s discussion and analysis of financial condition and

redemption of the bonds at face value before the second, third and fifth
rate for the fourth and sixth coupon periods are set as equal to the rate f
coupon period. The bonds are guaranteed by our subsidiary Southern K
obligatory redemption date of the bonds is February 4, 2006. In August
of these bonds from bondholders exercising their right of early redempt
December 31, 2003, was $22.2 million. At June 30, 2004, the balance o
million primarily due to our resale of the previously repurchased bonds.
On June 19, 2003, Mechel Trading House issued ruble-denominated bo
amount of 3 billion Rubles (approximately $98 million). The bonds wer
Interest is payable every six months in arrears. The interest rate for the
determined upon the issuance based on the bids of buyers and comprise
for the second, third and fifth coupon periods is set by us and is made p
respective coupon period starts. Bondholders are entitled to early redem
before the second, third and fifth coupon periods. The interest rate for t
periods are set as equal to the rate for the immediately preceding coupo
an option to demand repayment of the bonds starting June 19, 2006, wi
on June 19, 2009. The balance outstanding at June 30, 2004, and Decen
million and $101.9 million, respectively (such difference being a result
dollar/ruble exchange rates).

Proceeds from the offering will be used for a combination of purposes, includi
acquisitions. See Use of Proceeds.

Liquidity

We had cash and cash equivalents of $63.5 million at June 30, 2004, and $19.
Of these amounts, $41.3 million and $13.7 million was held in U.S. dollars, e
and $22.2 million and $5.6 million was held in rubles and other currencies of
respectively. A majority of our cash and cash equivalents are held by Chelyab
Southern Urals Nickel Plant and our principal trading companies, Mechel Tra
Mechel Trading House.

As of June 30, 2004, and December 31, 2003, we had unused credit lines of a
$4.3 million, respectively, out of total available credit lines of $677.3 million
respectively. These credit lines permit drawings at a weighted average interes
6.8% at June 30, 2004, and December 31, 2003, respectively. We have not ha
will have, difficulty gaining access to short-term financing sufficient to meet

The following table summarizes our liquidity as of June 30, 2004, and Decem

Estimated Liquidity

Cash and cash equivalents	
Amounts available under credit facilities	
Total estimated liquidity	

We had a working capital deficit of $39.3 million, $148.0 million and $149.4 r
December 31, 2003 and 2002, respectively. We expect to improve our working

Table of Contents

Management s discussion and analysis of financial condition and

position significantly through completion of this offering and through the repl
longer-term debt.

We believe that our liquidity will be adequate to satisfy our obligations for the
spending for the major items of our capital expenditures currently in progress
2004 through 2006. See Business Capital Improvements Program. Future
including the funding of acquisitions and capital expenditures, debt service fo
any amounts that may ultimately be paid in connection with contingencies (in
Business Litigation), are expected to be financed by a combination of inte
non-core asset sales), proceeds from the sale of stock, borrowings and other e
However, our business may not generate sufficient operating cash flow and ex
not be available in an amount sufficient to enable us to service or refinance ou
liquidity needs. Moreover, our ability to rely on some of these alternatives cou
as the liquidity of the Russian and other financial markets, prevailing interest
Russian government s policies regarding ruble and foreign currency borrowi

Our opinion concerning liquidity and our ability to avail ourselves in the futur
mentioned in the above forward-looking statements are based on currently ava
extent that this information proves to be inaccurate, future availability of finan
Factors that could affect the availability of financing include our performance
including cash provided from operating activities), levels of inventories and a
international debt and equity markets, investor perceptions and expectations o
the global financial climate, and, in particular, with respect to borrowings, the
and credit ratings by rating agencies.

Other than as described above and elsewhere in this prospectus, no significant
30, 2004.

Contractual Obligations and commercial commitments

The following table sets forth the amount of our contractual obligations and c
December 31, 2003.

Contractual Obligations and commercial commitments	Total	Les than 1 ye
		(in th

Short-Term Borrowings(1)	308,969	308,9
Long-Term Debt Obligations(1)	155,436	33,1
Purchase Obligations(2)	18,644	18,6
Restructured Taxes Payable(3)	122,597	25,7
Asset Retirement Obligations(4)	13,937	1,9
Other Long-Term Liabilities	1,418	
Commitments under Subsoil Licenses(5)	13,000	

(1) Does not include interest. In 2003, our interest expense was $48.5 million and we p
net of amounts capitalized.

(2) Accounts payable for capital expenditures.

(3) Consists of Russian and Romanian restructured prior period taxes and social charge
penalties. This does not include $124.2 million in current period taxes and social co
December 31, 2003. See note 13 to our audited consolidated financial statements. T
income taxes. In 2003, our income tax expense amounted to $47.8 million and we p
income taxes.

(4) See note 3(x) to our audited consolidated financial statements.

86

Table of Contents

Management s discussion and analysis of financial condition and

(5) We have certain environmental and safety commitments under the licensing agreem
We estimate that we will spend approximately $13 million in total to satisfy these c
Matters Subsoil Licensing Maintenance and Termination of Licenses. Due to the
flexibility to make these expenditures over a period of time, we do not track these c

In the course of acquisition of our Romanian subsidiaries, we undertook certai
future capital expenditures connected with the development of production faci
to invest $21.1 million in the modernization of the plant and upgrade of its cap
from the date of acquisition (August 2002). For Industria Sarmei, we committe
modernization of the plant and upgrade of its capacity over a period of five ye
(June 2003). An additional commitment to invest in environmental protection
for and amounted to $3.6 million. As of June 30, 2004, the total of unfulfilled
approximately $33.2 million. These investments are required to be made in an
of their respective acquisitions, and our investment commitments are secured l
subsidiaries.

INFLATION

Inflation in the Russian Federation was 20.2% in 2000, 18.6% in 2001, 15.1%
With the exception of our coal operations in 2002, inflation has generally not l
results of operations in recent years, primarily because producers in the marke
compete are able to increase selling prices in line with increases in ruble-deno

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARK

In the normal course of business, our financial position is routinely subject to a
exposed to market risks associated with foreign currency exchange rates, inter
prices. We are also subject to the risks associated with the business environme
including the collectibility of accounts receivable.

Except for a single instance of hedging foreign currency exchange rates risk m
do not enter into hedge transactions to manage the risks specified above.

We do not hold or issue derivative financial instruments for trading purposes.

Currency risk

The functional currencies for our Russian and Romanian subsidiaries are the r
U.S. dollar is the functional currency of our other international operations. Ou
dollar.

As the economies of Russia and Romania were considered highly inflationary
and December 31, 2003, respectively, transactions and balances of our Russia
already measured in U.S. dollars were remeasured as if the functional currency
accordance with the relevant provisions of SFAS No. 52, Foreign Currency T
remeasurement process is to produce the same results that would have been re
had been kept in U.S. dollars. Under this method, monetary assets and liabiliti
exchange rate as of the balance sheet dates. Non-monetary assets and liabilitie
non-monetary assets, liabilities and shareholders equity, are stated at their ac
restated from their historic cost, by applying the historical exchange rate as at
transaction. Income and expenses are restated by applying the monthly averag
statement of cash flows are translated at the monthly average exchange rates a
exchange rates on the dates of the transactions. Foreign

Table of Contents

Management s discussion and analysis of financial condition and

currency differences arising from remeasurement of the local currencies to U.S
consolidated income statement as Foreign exchange gain (loss).

Effective from January 1, 2003, Russia no longer meets the criteria for a highl
purposes of applying SFAS No. 52. Accordingly, for the periods starting Janu
Russian subsidiaries no longer remeasure transactions and balances from ruble
rubles into U.S. dollars using the current rate method as prescribed by SFAS N
adjustments resulting from the process of translating financial statements from
the reporting currency are included in determining other comprehensive incom

The initial implementation of this change had the effect of decreasing the U.S.
net assets of our Russian subsidiaries by $30.9 million and increasing the accu
income by the same amount. The impact of the change was to record $30.9 mi
ended December 31, 2003, as a component of accumulated net other compreh
shareholders equity section of the consolidated balance sheet.

The Russian ruble and the Romanian lei are generally not convertible outside
respectively, so our ability to hedge against further devaluation by converting
significantly limited. Further, our ability to convert Russian rubles and Roman
Russia and Romania, respectively, is subject to rules that restrict the purposes
payment in foreign currencies are allowed.

In December 2002, we engaged in series of forward transactions to buy U.S. d
in total for euros to hedge our exposure to movements in foreign currency exc
euro-denominated accounts receivable of Mechel Trading, our Swiss trading c
not designated as a hedge for accounting purposes. Such forward transactions
during the year ended December 31, 2003. We intend to continue to engage in

During the year ended December 31, 2003, we acquired other subsidiaries hav
Romania, Croatia and Lithuania, one in each country. The functional currenci
Lithuanian operations are their respective local currencies, the Croatian kuna a
were added to the list of our exposure foreign currencies.

Table of Contents

Management s discussion and analysis of financial condition and

We are exposed to movements in the ruble and euro exchange rates relative to
currency. The following table sets forth our monetary assets and liabilities by

Balance as of December 31, 2003	U.S. dollar	ruble	euro
		(in thousands of	
Current Assets:			
Cash and cash equivalents	9,894	5,916	332
Trade receivables, net	46,458	21,475	16,359
Due from related parties	399	28,131	
Deferred income taxes		6,496	
Prepayments and other current assets	10,317	157,151	236
Total current assets	67,068	219,169	16,927
Current Liabilities:			
Short-term borrowings and current maturities of long-term debt	(140,538)	(163,760)	(6,635)
Accounts payable and accrued expenses:			
Advances received	(36,510)	(36,616)	
Accrued expenses and other current liabilities	(14,201)	(44,390)	
Taxes and social charges payable	(5,878)	(137,905)	
Trade payables to vendors of goods and services	(36,879)	(66,503)	(6,486)
Due to related parties	(8,075)	(5,812)	
Asset retirement obligation		(1,556)	
Deferred income taxes	(3,424)	(13,459)	
Deferred revenue	(52,662)	(251)	
Total current liabilities	(298,167)	(470,252)	(13,121)
Long-term Liabilities:			
Restructured taxes and social charges payable, net of current portion		(89,363)	
Long-term debt, net of current portion	(9,956)	(102,548)	
Asset retirement obligation, net of current portion		(10,959)	
Due to related parties			
Deferred income tax		(95,007)	
Other long-term liabilities	(1,081)	(321)	
Total long-term liabilities	(11,037)	(298,198)	
Minority interest		(184,344)	
Net monetary assets (liabilities)	(242,136)	(733,625)	3,806

The table below summarizes our debt position by currency and rate method.

	U.S. dollar	rubl
	(in thou	
Total debt including	150,494	266,3
Fixed-rate debt	136,327	266,3
Variable-rate debt	14,167	

Table of Contents

Management s discussion and analysis of financial condition and

Interest rate risk

Our interest rate exposure results mainly from debt obligations. At December
amounting to $464.4 million, which comprised variable-rate borrowings of $1
fixed-rate borrowings of $450.2 million (96.9%).

We have not entered into transactions designed to hedge against interest rate r
current, or future indebtedness. Once the market in Russia for hedging instrum
our options for hedging interest rate risks and may enter into such arrangemen

The table below presents the principle cash flows and related range of interest
dates, of our variable and fixed-rate debt obligations as of December 31, 2003

		Expected maturity date as of Decembe				
	Currency	2004	2005	2006	2007	There-after
			(in thousands of U.S. dollars)			
Variable-rate U.S. dollar debt:						
Raiffeisenbank	U.S. dollar	7,000				
Raiffaisenbank	U.S. dollar	5,667				
Mosnarbank	U.S. dollar	1,500				
Total		14,167				
Fixed-rate U.S. dollar debt:						
BNP	U.S. dollar	52,768				
Alfa-bank	U.S. dollar	32,048				
BCP	U.S. dollar	4,242				
Sberbank	U.S. dollar	1,650		2,209		
Die Erste Vienna	U.S. dollar	3,280				
Raiffeisenbank	U.S. dollar	1,521				
ING Bank	U.S. dollar	1,401				
Credit Suisse	U.S. dollar	1,287				
VBP	U.S. dollar	1,234				
Uralsib	U.S. dollar	1,155				
Uglemetbank	U.S. dollar	679				
Latekobank	U.S. dollar	540				
Other banks	U.S. dollar	688				
Corporate Lenders	U.S. dollar	31,149		380		

Total		133,642	2,589	
Fixed-rate euro debt:				
BNP, Geneva	euro	6,635		
Total		6,635		
Fixed-rate ruble debt:				
Sberbank	ruble	62,591		
Gazprombank	ruble	29,809		
Uralsib	ruble	10,115		
Bank of Moscow	ruble		3,400	
Uglemetbank	ruble	2,193		
Bank Zenit	ruble	2,000		
Vserossiyskiy Bank	ruble	1,976		
Vneshtorgbank	ruble	1,901		
Kuzbassugolbank	ruble		1,700	
Alfa-bank	ruble	861		
Other banks	ruble	10		
Bonds	ruble			101,852

90

Table of Contents

Management s discussion and analysis of financial condition and

	Currency	2004	2005	2006	2007	There-after
		Expected maturity date as of December 31, (in thousands of U.S. dollars)				
Bonds	ruble	22,150				
Corporate Lenders	ruble	14,924				
Promissory notes	ruble	7,958		15		2,948
Total		156,488		5,115		104,800
Fixed-rate lei debt:						
APAPS	lei	27,091	2,389	2,392	1,687	3,339
Raiffaisenbank	lei	2,103				
BCR	lei	1,226				
BRD	lei	509				
Unicredit Buhuresti	lei	232				
Total		31,161	2,389	2,392	1,687	3,339
Total debt:		342,093	2,389	10,096	1,687	108,139

The carrying amounts of short-term loans approximate their fair values due to
that the carrying value of our long-term debt approximates its fair value.

Commodity price risk

In the normal course of our business, we are primarily exposed to market risk
the purchase, production and sale of steel products, and to a lesser extent, to th
of coal, coke and other products.

We do not use commodity derivatives or long-term sales or supply agreements
price risks.

Under certain of our steel products sales agreements we grant a third-party res
under which the selling price, which is typically prepaid by the reseller, is sub
the level of market prices when the reseller delivers the products to the end cu
selling price adjustments occur within an eight- to 16-week period from the da
the reseller. As of December 31, 2003 and 2002, we had 156,410 and 152,342

products in the distribution channel for which we received prepayments in the
$32.1 million, respectively. See Critical Accounting Estimates Revenue re

Equity price risk

As disclosed in Note 8 to our audited consolidated financial statements includ
2003 and 2002, we had a significant cost method equity investment in MMK.
to market risk of fluctuations in equity prices.

These investments are shares of Russian companies that are not publicly trade
values are not available. Currently, it is not practicable for us to estimate the fa
because we have not yet obtained or developed the valuation models necessar
cost of obtaining an independent valuation is believed by the management to b
significance of the investments. Therefore, these investments are omitted from
disclosure presented herein.

We do not use derivative instruments or any other arrangements to manage ou

---

Table of Contents

Management s discussion and analysis of financial condition and

CRITICAL ACCOUNTING ESTIMATES

The preparation of our consolidated financial statements requires management
assumptions that affect the reported amounts of assets and liabilities, the disclo
liabilities at year-end, and the reported amount of revenues and expenses durin
regularly evaluates these estimates. Management estimates are based on histor
other assumptions that are believed to be reasonable under the circumstances,
basis for making judgments about the carrying values of assets and liabilities t
from other sources. Accordingly, actual results may differ materially from cur
different assumptions or conditions.

The value of property, plant and equipment pertaining to non-controlling shar
minority interests resulting from acquisitions of various subsidiaries has been
rather than at historical cost as required by U.S. GAAP.

Management believes that the following are the more significant judgments ar
preparation of the financial statements.

Accounting for business combinations

During the past years, we have completed several significant business combin
we may continue to grow our business through business combinations. We acc
using the purchase method of accounting.

The accounting for business combinations under the purchase method is comp
significant judgment. Under the purchase method of accounting, a business co
purchase price based upon the fair value of the consideration given, whether it
stock or the assumption of liabilities. The assets and liabilities acquired are me
the purchase price is allocated to the assets and liabilities based upon these fai
values of the assets and liabilities acquired involves the use of judgment, since
liabilities acquired do not have fair values that are readily determinable. Differ
determine fair values, including market prices, where available, appraisals, co
similar assets and liabilities and present value of estimated future cash flows, a
estimates involve the use of significant judgment, they can change as new info

The most difficult estimations of individual fair values are those involving pro
identifiable intangible assets. We use all available information to make these f
for major business acquisitions, typically engage an outside appraisal firm to a

determination of the acquired long-lived assets. We have, if necessary, up to o
closing date to finish these fair value determinations and finalize the purchase

Goodwill represents the excess of the purchase price over the fair value of the
identifiable net assets resulting from business acquisitions and is originally sta
date goodwill is allocated to the reporting units to which it relates. Annually, o
an earlier review is necessary, the carrying value of the reporting unit is compa
value. If the estimated fair value is less than the carrying value, goodwill is im
down in accordance with SFAS No. 142, Goodwill and Other Intangible Asset
and 2002, we reported goodwill of $5.4 million and $3.3 million, respectively.
December 31, 2003, 2002 and 2001, we recognized goodwill impairment of $n
respectively.

Table of Contents

Management s discussion and analysis of financial condition and

Negative goodwill represents the excess of the fair value of the acquired identi
purchase price of the acquisition. Negative goodwill was allocated to the acqu
for deferred taxes and long-term investments in marketable securities, if any, u
The remaining negative goodwill was amortized to income over its estimated l
adoption of SFAS No. 142 on January 1, 2002. The remaining unamortized ne
2002, was recognized in the income statement as a change in accounting princ
No. 141, Business Combinations, any negative goodwill remaining after reduc
acquired in a business combination shall be recognized as an extraordinary ite
the investees accounted for under the equity method, the excess of cost of the s
our share of fair value of their net assets as of the acquisition date is treated as
consolidated subsidiaries, SFAS No. 142 requires that goodwill from equity m
amortized over its estimated useful life. Subsequent changes to the value of th
share of income or losses including impairment of the embedded goodwill are
income statements.

Mineral licenses and mining long-lived assets

We use estimates for proven and probable reserves, recoverable resources ther
future coal, nickel and iron ore prices. Such estimates and assumptions affect t
reserves rights at the date of its acquisition, impairment of mineral reserves rig
and the ability to realize income tax benefits associated with deferred tax asset

Estimates of mineral reserves are based primarily on engineering evaluations.
using the units-of-production method over the shorter of the license term or th
probable reserve depletion period. In March 2004, the FASB ratified the conse
Issues Task Force on Issue No. 04-2, Whether Mineral Rights Are Tangible o
resolves the inconsistency between the Task Force s consensus that mineral ri
guidance in SFAS No. 141 that characterizes mineral rights as intangible asset
determined mineral rights or licenses are tangible assets. The adoption of this c
on our financial position or results of operations.

Our estimate of mineral reserves together with estimates of sales volumes and
significant factors used in performing annual impairment assessments of our lo
including mineral reserves rights. Changes in estimates of reserves and other a
and volumes could materially influence these assessments. Should our estimat
prices not materialize, significant impairments of our long-lived mining assets
and assumptions also affect the rate at which depreciation and depletions are c

Because currently there is no history of subsoil licenses renewals, our existin
long-lived mining assets are being depleted/depreciated over the periods cover
deposit-by-deposit basis.

Management evaluates its estimates and assumptions on an ongoing basis; hov
differ from those based on such estimates and assumptions. As of December 3
amount of our mineral licenses amounted to $160.1 million and $81.0 million,

Stock-based compensation

We follow the provisions of SFAS No. 123, Accounting for Stock-Based Co
compensation arrangement with one of our executives. SFAS No. 123 general
account for stock-based compensation under the provisions of SFAS No. 123

Table of Contents

Management s discussion and analysis of financial condition and

provisions of APB Opinion No. 25, Accounting for Stock Issued to Employe
accordance with the provisions of SFAS No. 148, Accounting for Stock-Base
Disclosure an amendment of SFAS No. 123. Because the fair value account
models that were not developed for use in valuing employee stock awards, we
stock-based compensation in accordance with the provisions of APB Opinion
interpretations.

Accordingly, the compensation cost was recognized based on the excess, if an
shares on the measurement date (July 1, 2003) over the amount the executive
We are recognizing compensation expense on a straight-line basis over the re
award through April 15, 2004.

We do not present pro forma disclosures as if the fair value method had been a
substantially the same given that the exercise price of the award was zero.

Revenue recognition

Revenue is recognized on an accrual basis when earned and realizable, which
are delivered to customers. In some instances, while title of ownership has bee
recognition criteria have not been met as the selling price is subject to adjustm
when the customer receives the product. Accordingly, in those instances, reve
goods sold are recorded as deferred revenues and deferred cost of inventory in
balance sheets and are not recognized in the consolidated income statement un
determinable, which typically occurs when the price is settled with the end-cus
to 16-week period from the date of the goods delivery. Sales are recognized ne
discounts and allowances and associated sales taxes (VAT) and export duties.

We categorize revenues as follows:

- Domestic
  - Russia: sales of Russian production within Russia
  - Other domestic: sales of non-Russian production within the coun
- Export: sales of production outside of country of production.

Property, plant and equipment

For other than mineral licenses and other long-lived mining assets and process
record depreciation primarily using the straight-line method on a pro rata basis

The following useful lives are used as a basis for recording depreciation:

Category of asset
Buildings
Land improvements
Operating machinery and equipment
Transportation equipment and vehicles
Tools, furniture, fixtures and other

The remaining useful economic lives of our property, plant and equipment are
basis.

We evaluate carrying value of our property, plant and equipment for impairme
impairment exist.

Table of Contents

Management s discussion and analysis of financial condition and

Accounts receivable

Accounts receivable are stated at net realizable value. We review the valuation
regular basis. The allowance for doubtful accounts is estimated based on histo
collections and future expectations of conditions that might affect the collectib

Deferred income taxes

We record a valuation allowance to reduce our deferred tax assets to an amoun
be realized. In estimating levels of future taxable income, we have considered
in recent years and would, if necessary, consider the implementation of pruder
strategies to generate future taxable income. If future taxable income is less th
assumed in determining the deferred tax asset, then an increase in the valuatio
a corresponding charge against income. On the other hand, if future taxable in
been assumed in calculating the deferred tax asset, the valuation reserve could
corresponding credit to income.

Litigation, claims and assessments

We are subject to various lawsuits, claims and proceedings related to matters i
Accruals of probable cash outflows have been made based on an assessment o
settlement strategies. It is possible that results of operations in any future peric
by changes in assumptions or by the effectiveness of these strategies.

We record liabilities for potential tax deficiencies. These liabilities are based c
the risk of loss. In the event that we were to determine that tax-related items w
deficiencies or that items previously not considered to be potential deficiencie
potential tax deficiencies (as a result of an audit, tax ruling or other positions c
the liability would be recorded through income in the period such determinatic
Business Litigation for a description of certain tax-related contingencies.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Asset Retirement Obligations

Effective January 1, 2003, we adopted SFAS No. 143, Accounting for Asset applies to legal obligations associated with the retirement and removal of long requires entities to record the fair value of an asset retirement obligation (ARC when it is incurred (typically when the asset is installed at the production locat recorded, the entity capitalizes the cost by increasing the carrying amount of th equipment. Over time, the liability is increased for the change in its present va capitalized cost is depreciated over the useful life of the related asset.

Upon adoption of SFAS No. 143 on January 1, 2003, we recorded approximat benefit, as a charge to cumulative effective changes in accounting principles. A accounting principle resulted in an increase in property, plant and equipment o retirement obligation liability of $9.3 million. The application of SFAS No. 14 continuing operations by $2.6 million, net income by $6.4 million (after incom basic and diluted share, for the year ending December 31, 2003. The following sheet impact of our initial adoption of SFAS No. 143 as of January 1, 2002, co if the provisions of SFAS No. 143 had been applied during all periods affected

Table of Contents

Management s discussion and analysis of financial condition and

Asset retirement cost included in the related mining assets	
Accumulated depreciation of capitalized asset retirement costs	
Asset retirement cost, included in mining assets, net	
Asset retirement obligation	

We have numerous asset removal obligations that we are required to perform u
asset is permanently taken out of service. Most of these obligations are not exp
years into the future and will be funded from general company resources at the
retirement obligations primarily relate to our steel and mining production facil
and dump areas and our mines. The following table presents the movements in
December 31, 2003.

Asset retirement obligation	
Balance at beginning of year	
Liabilities incurred in the current period	
Liabilities settled in the current period	
Accretion expense	
Revision in estimated cash flow	
Translation and other	
Balance at end of year	

Guarantees

In November 2002, the Financial Accounting Standards Board issued Interpre
Accounting and Disclosure Requirements for Guarantees, Including Indirect G
Others. It elaborates on the disclosures to be made by a guarantor about its obl
guarantees that it has issued. It also clarifies that a guarantor is required to reco
guarantee, a liability for the fair value of the obligation undertaken in issuing t
interpretation is applicable on a prospective basis to guarantees issued or modi
disclosure requirements are effective for financial statements ending after Dec
of Interpretation No. 45 on January 1, 2003 did not have a material impact on
results of operations.

Consolidation of Variable Interest Entities

In December 2003, the FASB issued Interpretation No. 46R, Consolidation of
Interpretation of ARB No. 51, which revised Interpretation No. 46, issued in J
addresses the consolidation of business enterprises (variable interest entities) t
(ownership of a majority voting interest) of consolidation does not apply. It fo
indicate control. It concludes that in the absence of clear control through votin
exposure (variable interest) to the economic risks and potential rewards from t
assets and activities are the best evidence of control. Variable interests are righ
economic gains or losses from changes in the value of the variable interest ent
Variable interests may arise from financial instruments, service contracts, and
enterprise holds a majority of the variable interests of an entity, it would

---

Table of Contents

Management s discussion and analysis of financial condition and

be considered the primary beneficiary. The primary beneficiary would be requ
and the results of operations of the variable interests entity in its financial state

We will adopt FIN 46R in 2004. We have not determined what impact, if any,
financial position or results from operations.

TREND INFORMATION

Steel industry

We expect the Russian steel industry to continue to benefit from domestic and
2003, domestic consumption of steel products rose 10% year-on-year and we
continue to grow, with engineering, construction and tube production being th
demand. The construction industry, in particular, is the most dynamically deve
growth rate of approximately 14% in 2003.

The global demand for steel has been increasing by 3% per annum, and is exp
in the near term, despite a decrease in Chinese demand. More control over pro
consolidation in Western Europe and bankruptcy-related closures in North Am
increasing supply-side discipline among producers, which has supported the st
18 months. During that period, steel inventory levels have been reduced, whic
prices in the near term, although likely not at the levels recently seen. The exte
occur will depend on a number of factors, including primarily the sustainabilit
of a slowdown in China and the extent and pace of economic recovery in Euro

Steel prices remained strong in the first half of 2004, and we expect global ste
of 2005, and begin to decrease during the second half of 2005, due in part to in
producers respond to the generally favorable demand and pricing environment
slowdown in China. We expect steel prices in Russia to generally track interna

Coal industry

The Asian countries are among the major net importers of sea-borne steam and
strong demand, inventory levels in the coal industry have been significantly re
levels despite capacity expansions, primarily in Australia. Coking coal prices a

the steel industry, and are likely to continue rising in 2005 due to increases in t as due to the shortage and high prices for steel scrap which result in the greate requiring coke. Coke supply remains constrained globally due to fully utilized Chinese coke exports expected to further decrease, which will put further pres levels during 2004 and 2005. Announced plans for supply increases in Austral expected longer-term increases in demand from Brazil and India. The steam co non-steel related factors, and we expect prices to remain high in 2004 and 200 2006, driven by demand growth from power and industrial users and restockin

Iron ore industry

The iron ore industry is currently characterized by high demand from Asia and constraints. Capacity expansions are primarily targeted to meeting the demand in China, although demand from China has decreased in recent months. The ou depend on supply and demand balance in the industry, but we do not anticipate

---

Table of Contents

Management s discussion and analysis of financial condition and

increase in iron ore production will be such as to shift this balance significantl
ore to remain high.

Nickel industry

Nickel prices have increased significantly since 2001. Stock-building ahead of
production in 2004, strong demand from China and speculative demand, comb
facilities of Inco, the world s second largest producer, have underpinned the p
demand and prices will remain relatively stable through the remainder of 2004
However, by 2006, lower demand growth particularly in stainless steel, coupl
in China should force a reduction in the nickel price.

Sales

Within the context of a positive demand and pricing environment, we expect t
production levels and shipments as we continue to increase our production cap
Chelyabinsk Metallurgical Plant. See Business Steel Business Steel Produc
continuing improvement in the Russian steel market will increase our domesti
our overall steel sales.

We also expect our mining segment sales to increase as we continue productio
coking coal sales will trend towards an even split between internal consumptio
third-party sales consisting primarily of sales to Europe and Ukraine, with incr
We also expect to increase our export sales of steam coal, given the significan
currently exists. We believe that our mining segment may help to counterbala
steel prices, as we increase our iron ore sales to China, assuming sustained Ch

Inventory

The recent downturn in the Chinese steel sector has resulted in an increase in c
concentrate. We expect that this inventory will gradually decrease as domesti
it will cease to be a significant factor when our new sinter plant at Chelyabins
operate in the first half of 2005.

Overall, our raw materials inventory was at twice the amount at December 31, December 31, 2002, and outpaced growth in the cost of goods sold (12.5% and of goods sold in 2003 and 2002, respectively), due to the growth in our busine significantly higher prices for scrap and ferroalloys in Eastern Europe and Rus higher stock levels in order to hedge against further price increases. Similar tre inventory continued in 2004 (12.7% and 10.9% as a percentage of cost of good June 30, 2004 and 2003, respectively, on an annualized basis).

Costs

Our steel costs per tonne should remain relatively stable, as higher production continuing integration of our recent steel acquisitions and efficiency and outpu targeted capital expenditure program, particularly at Chelyabinsk Metallurgica payroll costs and raw material prices and potential increases in electricity and as we continue to introduce operational and technical changes at our plants all their products, we expect to be better able to control our cost increases. The ne will allow us to substantially increase our ability to internally source

---

98

Table of Contents

Management s discussion and analysis of financial condition and

our iron ore feed requirements, without the need to utilize third-party processi
continuous casters should provide both efficiency and production increases. W
improvements to reduce our energy requirements per tonne, partially reducing
increases in electricity and natural gas tariffs.

Within our mining segment, we expect our coal costs per tonne to increase gra
payroll costs, while nickel costs per tonne should decrease significantly in 200
and operational improvements, before beginning to gradually increase thereaf
per tonne to remain relatively stable.

SEASONALITY

Seasonal effects have a relatively limited impact on our results. Nonetheless, s
reduction in sales volumes (and a concomitant increase in inventories) is typic
fourth quarters of the financial year as a result of the general reduction in econ
the New Year holiday period in Russia and elsewhere. We also maintain large
winter months in order to avoid potential supply disruptions due to inclement
on the Russian construction market, which also experiences slowdowns in the
sales of steam coal typically increase during the second and third quarters as a
purchases by utilities for the winter.

Consumption of combustive, lubricative and energy supplies during the winte
than during the rest of the year. In addition, railroad carriers demand that iron-
and coal concentrate be partially dried for transportation during the winter mo
during that time.

Table of Contents

Industry

GLOBAL STEEL INDUSTRY OVERVIEW

Steel is one of the most important, multi-functional and adaptable materials in
be the backbone of industrial development. Steel s versatility is attributable to
formable, weldable, hard, resistant to corrosion, water and heat, 100% recyclal
Among the myriad industries in which steel is used are the construction, transp
industries. Steel is also used in the production of power lines, pipelines, white

The steel industry is affected by a combination of factors, including periods of
worldwide production capacity and the existence of, and fluctuations in, steel
measures. Steel prices respond to supply and demand and have fluctuated in re
industry-specific economic conditions.

The steel industry operates predominantly on a regional basis given the high c
example, the top five producers in each of Japan and the EU control more than
regional markets. However, despite the limitations associated with transportati
restrictive effects of protective tariffs, duties and quotas, global imports and ex
decade.

While steel production has been historically concentrated in the EU, North An
Soviet Union, steel production in China and the rest of Asia has grown in impo
2003, China was the largest single producer of steel at 220 million tonnes, as w
steel at 237 million tonnes. China imports steel to meet its requirements, and i
importer of steel over the next decade, even after taking into account the plann
capacity. The EU, the United States and Japan were the next largest producers
Russian steel production substantially declined between 1990 and 1998, but ha
The following table sets forth raw steel production data by country or region fo

	2003	2002	20
			(in
China	220	182	1
EU	160	159	1
Japan	111	108	1
United States	91	92	
Russia	61	59	
Other Asia	97	92	
Other Europe	48	45	
Other	157	149	1

Total	945	886	8

Source: International Iron and Steel Institute

The strategy and product mix of steel producers generally varies between prod
producers in emerging markets. Historically, commodity steel producers in inc
limited export markets due to the high cost of transporting steel relative to the
grades. In the second half of the last century, producers in emerging markets b

100

Table of Contents

Industry

compete with industrialized country steel producers as they took advantage of
in their countries to offset high transportation costs. In response, producers in
invested heavily in new technology and capacity to produce high value-added
differentiate their product portfolio and protect their margins by reducing their
prices. However, these similar and simultaneous investments resulted in a buil
overcapacities and have put pricing pressures on the value-added segments.

Recently, the growth and consolidation of both steel consumers and raw mater
bargaining power of steel producers and put further pressure on their margins.
with a phase of industry consolidation. Usinor, Arbed and Aceralia in Europe
world s largest steel company, as did Kawasaki Steel and NKK in Japan, crea
Birmingham Steel and ISG acquired Acme, LTV and Bethlehem Steel in the U
enabled the steel companies to lower their production cost and allowed for a m
discipline, including through selective capacity closures. Despite this consolid
that the top five companies Arcelor Group (Luxembourg), Nippon Steel Corp
LNM Group (the Netherlands) and JFE Steel (Japan) accounted for only 18%
Arcelor accounted for only 5%.

RUSSIAN STEEL INDUSTRY OVERVIEW

Following the collapse of the Soviet Union, the Russian steel industry suffered
production from over 77 million tonnes in 1991 to 44 million tonnes in 1998.
by nearly 39%, and in 2003, Russia produced 61 million tonnes of raw steel, o
making it the world s fourth largest producer of crude steel. Russia also produ
rolled products in 2003, operating at about 90% of installed capacity. Of this a
51% of the total output of rolled steel) were exported, comprising 8% of all gl
and finished steel products, making Russia the number three exporter of such
Germany. Semi-finished products comprised 43% of exports. Overall, the Rus
51% of its output abroad and benefits from healthy global markets, particularly
important market for Russian producers.

Domestic consumption is also on the rise, driven by both upstream and downs
consumption in the Russian economy in 2003 remained relatively low at 229 k
nearly 398 kilograms in 1992 and substantially less than in such countries as J
kilograms per capita, the United States, which consumed 318 kilograms per ca
Europe, which consumed on average 462 kilograms per capita.

Russian steel producers tend to focus on vertical integration, which allows the
materials (*e.g.*, coking coal for pig iron and non-ferrous metals for stainless ste
from customers up the product chain. In addition, Russian companies are mod
steel production facilities, achieving significant reductions in manufacturing c
below those of Western European producers, and improving product quality ar

decade, the share of open-hearth furnaces decreased from 53% in 1990 to 22%
continuous casting increased from 23% to 59% during the same period.

Domestic market

Steel production in Russia decreased from 1991 through 1998 as a result of the
Russia during this period and the consequent reduced demand from the primar
construction, infrastructure and engineering industries and the military sector.

Domestic consumption of rolled steel products in Russia has followed a U-sha

Table of Contents

Industry

Consumption was at 65 million tonnes in 1990 and it declined steadily due to
industry, reaching bottom in 1998 when consumption was a mere 13 million t
devaluation of the ruble in 1998 resulted in economic growth and a sharp pick
steel products. Consumption grew by 24% in 1999, which was followed by 43
outpacing both GDP and industrial production growth. In 2003, consumption

Russia does not import significant quantities of steel. Imported steel comprise
consumed in Russia during 2003.

Export market

Asia, the Middle East and the EU are the dominant export destinations for Ru
which is the largest steel importer in the world, accounted for 13% and 38% o
and cold rolled steel exports in 2003, respectively. In 2003, Russian producers
rolled products, of which semi-finished products (slabs and billets) accounted
and long products for 16%. The abolition of steel export duties in 2002 by the
improved the export market.

Exports of rolled products gradually gained importance during the 1990s, incr
in 1991 to 27 million tonnes in 2003. Exports currently represent over 51% of

The following table sets forth by percentage the export destinations for Russia

Region
Asia
Europe
Middle East
CIS (other than Russia)
Africa
North and South America
Total

Source: Metall-Expert

Producers

The Russian steel industry is characterized by a relatively high concentration o
largest steel companies accounting for 82% of Russia s total steel products. T
divided into two groups by product type. MMK, Severstal and Novolipetsk Iro
focus mainly on flat products, while EvrazHolding and Mechel Steel Group pr
We are the second largest producer of long products in Russia after EvrazHold

We are also the largest comprehensive producer of specialty steels and alloys i
a number of relatively small companies for example, Oskol Electric Metallurg
Metallurgical Plant, or ZMK, and Electrostal that make various specialty stee
these competitors produces only a limited range of products and lags significa
overall production of specialty steels.

102

Table of Contents

Industry

The following table provides information on Russian rolled steel production v
each producer s main products.

Company	Output (in thousands of tonnes)
EvrazHolding[1]	11,009
MMK	10,162
Severstal	8,807
NLMK	8,234
Mechel Steel Group	3,506
NOSTA	2,469
OEMK	2,119
Other	4,647
Total	50,953

Source: Chermet

(1) EvrazHolding consists of Nizhny Tagil Metallurgical Plant, Zapadno-Sibirsky Meta
(ZapSib) and Kuznetsky Metallurgical Plant.

GLOBAL COAL INDUSTRY OVERVIEW

There are two principal types of coal: steam (thermal) coal and coking (metall
in electricity generation, while coking coal is used to manufacture coke for use
metallurgical applications. Coking coal is harder than steam coal and it swells
which characteristic is essential in steel making operations. Approximately 50
is used per tonne of steel produced. Hard coking coal is supplemented by the c
coal, or PCI, at rates of 100 200 kilograms per tonne of steel. PCI uses cheape
coal to cut down costs.

In recent years, the global coal industry has consolidated partly as a result of o
non-mining companies leaving the sector. The top five export coal producers (
Anglo-American, Xstrata and Drummond) now supply 40% of the total traded
producers controlling 60%. As a result, coal suppliers have gained more pricin

RUSSIAN COAL INDUSTRY OVERVIEW

Russia possesses the world s second largest coal reserves after the United Sta
157 billion tonnes, accounting for 16% of the world s proven coal reserves. In
million tonnes of coal, of which about 75% was steam coal and the balance wa
70% of Russia s coking coal output was controlled by Russian steel producers

Coal production is heavily concentrated in the Kuznetsky Basin and the Kansk
east of the Ural mountains. The two basins together accounted for 66% of Rus
Kuznetsky producing primarily coking coal and Kansko-Achinskii producing
approximately 20% of the coal produced in Russia was consumed in the Europ

The export of coal has been growing over the past several years. In 2003, Russ
approximately 60 million tonnes of coal, 20% higher than in 2002.

Table of Contents

Industry

GLOBAL NICKEL INDUSTRY OVERVIEW

The stainless steel industry dominates nickel use, accounting for over 70% of
Nickel scrap makes up approximately half of the stainless steel raw materials
scrap supplies are becoming tighter, there has been an increase in demand for

The supply of primary nickel is dominated by the world s largest producer, N
arctic Siberia and northwestern Russia. It accounted for 20% of the world s to
2003. The Canadian producer, Inco, is the next-largest producer, accounting fo
primary nickel production in 2003. The top five producers of nickel accounted
primary nickel production in 2003.

RUSSIAN NICKEL INDUSTRY OVERVIEW

Russia ranks second in the world by nickel reserves, on par with Canada and f
country s reserves are estimated at 6.6 million tonnes of contained nickel, or
Nickel accounts for 89% of Russia s nickel reserves. Its reserves are made up
and Kola Peninsulas, and are also rich in copper, cobalt and precious metals. T
is comprised of deposits of poorer silicate ores of the Central and Southern Ur
Nickel Plant and Ufaleinickel.

Russia accounts for over 330,000 tonnes of the total 1.4 million tonnes of nick
Norilsk Nickel produced 260,000 tonnes of nickel, complemented by smaller-
Ural Nickel Plant and Ufaleinickel. Over 90% of Russian nickel production w
market for primary nickel presently limited to approximately 25,000 tonnes. C
highly dependent on international metal prices as quoted at the London Metal

GLOBAL IRON ORE INDUSTRY OVERVIEW

The iron ore industry is characterized by a high degree of consolidation, with
trade controlled by Rio Tinto, CVRD and BHP Billiton. The major producing
Australia. Several projects in Australia, Brazil and South Africa are expected t

Traditionally, Europe, Japan and China have been the major iron ore consump
the CIS, South Korea and Thailand have higher growth rates as the European a

Following an economic slowdown in 2001 and concurrent reduced iron ore de
2002, with China and certain CIS countries showing significant increases in de
increases in steel production in these countries.

Iron ore production has experienced falling production costs due to productivi
remain a major cost constraint, comprising about half of total costs in 2003. Fr
regional segregation of the industry.

RUSSIAN IRON ORE INDUSTRY OVERVIEW

Russia produced 85.8 million tonnes of iron ore in 2003, accounting for 8% of
however, has higher production costs than other large producing countries suc
more complex extraction processes. Iron ore exports totaled 17.7 million tonn
production, in 2003. Imports totaled 12.9 million tonnes.

The 13 largest Russian mining companies accounted for 95% of total iron ore
three producers accounting for 53%. Approximately 55% of Russia s iron ore

---

104

Table of Contents

Industry

controlled by Russian steel producers in 2003. Production is concentrated in th
Northwest district (18%) and the Urals district (14%), which together account

Total iron ore feed consumption of Russian steel mills is composed of concent
sinter (8%).

STEEL-MAKING PROCESS AND TYPES OF STEEL

The principal raw material used to produce steel is iron ore. Mined iron ore is
mixed with limestone and coke. The mixture is sintered and then fed, in altern
blast furnace. This is injected with hot air and the coke burns to produce carbo
the iron oxide to reduce the latter (by removing the oxygen) to produce pig iro
and 1-2% non-ferrous elements). Pig iron is processed further in a basic oxyge
produce liquid or raw steel, so called because it still must undergo additional r
furnace, pig iron from the blast furnace is purified in an oxygen converter and
products, such as limestone and scrap, which burn off most of the unwanted m
leaving raw steel as the end product. Other metals, such as manganese and nic
specific alloying characteristics. Globally, approximately 65-70% of raw steel
furnaces, which are integrated, large-scale operations that generally must prod
annum to be economic.

Another method of raw steel production is the electric arc furnace (also called
normally a much smaller operation producing 200,000-300,000 tonnes per ann
30-35% of raw steel is made in EAFs. In the electric arc furnace, steel is recyc
from electricity that arcs between graphite electrodes and a metal bath. This pr
almost all stainless steel and other alloyed steel products, and for most long ca
is not an economically competitive production method for high-purity flat carb

Steel products are broadly subdivided into two categories flat and long produc
products such as slabs, which may be converted into hot rolled or cold rolled c
are used primarily in manufacturing industries, such as the white goods and au
products are used for construction-type applications (beams, rebars). To create
raw steel is cast in continuous casting machines or casting forms, where it is co
products. The molten steel is poured and solidified to produce either blooms o
transformed into long products), or into slabs (used for flat products).

All semi-finished products are then rolled at high temperatures, a process know
drawn and flattened through rollers to give the metal the desired dimensions ar
Some steel products go through an additional step of rolling at ambient temper
rolling. For cold rolled applications, coils are placed in the annealing furnace a

Fahrenheit, then gradually cooled to room temperature over a four-day period.
the metal to give it uniform properties for future fabrication. Oil may be applie
from rust.

The properties of steel may be modified to render it suitable for its intended fu
various stages of the production process of small amounts of other metals or m
the steel, varying the metal s chemical composition. For example, the carbon
order to change its malleability, or other elements can be added to give it new
chrome and nickel to produce more rust-resistant stainless steel. The alloying
process of coating already rolled steel with certain materials to give it addition

Table of Contents

Industry

metallurgical and anti-corrosion properties, as with stainless steel cord (claddi
electrogalvanized sheet for the automobile industry) or tin (tin plate for tin anc

Table of Contents

Business

OVERVIEW

We are a low-cost integrated steel and mining group focused on the production
as mining products such as coal, iron ore and nickel. In 2003 and in the first ha
$2.05 billion and $1.63 billion, respectively. We are the largest and most comp
steels and alloys in Russia, producing 52% of total Russian specialty steel outp
our nearest competitor. We are also the second largest producer of long produc

Our steel business comprises the production and sale of semi-finished steel pro
long products, carbon and stainless flat products and value-added downstream
hardware, stampings and forgings. Our steel business also produces significan
internal use and for sales to third parties.

We have substantial coal, iron ore and nickel mining interests in Russia and K
supply our own steel production or sell to third parties depending on price diff
from local suppliers and sales to foreign and domestic customers. We are capa
the coking coal, 92% of the iron ore and 55% of the nickel requirements of ou
case of iron ore that third parties process certain quantities of our iron ore conc
In addition, we are the only specialty steel manufacturer in the world capable o
of these raw materials. We were the second largest producer of coking coal in
market share. We also control 24% of the coking coal washing capacity in Rus

Additionally, we own 17.1% of the common shares of Magnitogorsk Iron and
Russia s largest producer of flat products, with reported revenues of $3.05 bil
and in the first half of 2004, respectively, under International Financial Report

OUR HISTORY AND DEVELOPMENT

We trace our beginnings to a small coal trading operation in Mezhdurechensk
Siberia in the early 1990s. Since that time, through strategic acquisitions in Ru
shareholders have built Mechel into a large, integrated steel and mining group
Russia, Romania and Lithuania and coke production and coal, iron ore, nickel
Russia. With each of our acquisitions, we implement improved operational and
are generally able to realize significant increases in production efficiency and
targeted capital expenditures. We also devote the management, technological a
necessary to integrate new acquisitions into all aspects of our business, includi
and steel, production methodologies and sales and distribution.

Set forth below are our primary steel and mining acquisitions:

- Ø By 2000, we had acquired most of our coal interests, consisting of sever
processing plants, all located within close proximity to each other in Me
southwestern part of Siberia. These operations, now consolidated under
Company, produced 14.2 million tonnes of coal in 2003.

- Ø In 2001, we acquired:

Chelyabinsk Metallurgical Plant, an integrated blast furnace and
produced 2.6 million tonnes of coke, 4.2 million tonnes of raw st

Table of Contents

Business

of rolled products in 2003 and which is located in Chelyabinsk, border with Kazakhstan; and

Southern Urals Nickel Plant, consisting of two open-pit nickel m facility which produced 13,524 tonnes of nickel products in 2003 in the southern Urals.

Ø In 2002, we acquired:

Vyartsilya Metal Products Plant, a rolling mill which produced 5 2003 and which is located in Sortavala, Karelia, in northwest Ru Finland;

Beloretsk Metallurgical Plant, a rolling mill which produced a to products in 2003, including 244,766 tonnes of wire rod and 260, which is located in Beloretsk, in the southern Urals;

Pugachev limestone quarry, consisting of a quarry and processin 522,644 tonnes of limestone in 2003 and which is located close t Urals; and

COST, a steel mill which produced 441,930 tonnes of raw steel a products in 2003 and which is located in Targoviste, Romania.

Ø In 2003, we acquired:

Mechel Zeljezara, a Croatian steel mill that produced pipes, whic August 2004 due to its high input costs and a persistent weaknes

Urals Stampings Plant, a forging and stamping mill which produ specialty steel stampings in 2003 and which is located in Chebar Urals;

Industria Sarmei, a steel mill which produced 260,681 tonnes of rolled products and 70,228 tonnes of hardware in 2003 and whic Romania;

Korshunov Mining Plant, consisting of three iron ore mines and which produced 3.5 million tonnes of iron ore concentrate in 200 Zheleznogorsk-Ilimskiy, in eastern Siberia;

Mechel Nemunas, a hardware plant which produced 22,044 tonn and which is located in Kaunas, Lithuania; and

Coal Washing Factory-38, a coal washing plant which produced concentrate in 2003 and which is located near Karaganda, Kazak Resources.

Ø In 2004, we acquired:

Port Posiet, a port located in Russia s Far East on the Sea of Japa tonnes of cargo handling capacity and over 120,000 tonnes of wa processed 845,000 tonnes of cargo, mostly coal, metals and ferro

Gorbachev Mine, an underground coal mine located in Kazakhst

Izhstal, a Russian specialty steel producer located in Izhevsk, Ud produced approximately 427,000 tonnes of raw steel, 264,000 to tonnes of hardware and 17,000 tonnes of stampings and forgings

Table of Contents

Business

Our Mechel name, which is derived from a combination of the Russian wor metallurgical) and Chelyabinskii (meaning Chelyabinsk), has been associat Metallurgical Plant. Chelyabinsk Metallurgical Plant commenced operations i the Russian steel industry.

STRATEGY

Our goal is to expand our position in Russia as a leading supplier of carbon lo supplier of specialty long products, to further develop our position as a compe products, to expand our mining business and to capitalize on the synergies der integrated group. We also intend to leverage our core businesses, where appro value-added downstream businesses.

The key elements of our strategy include the following:

- *Expand our Position as a Leading Producer of Carbon Long Products* built a solid presence in this sector, including a market-leading position sales in rebar and wire rod. We intend to improve these positions furthe addition of substantial new production capacity achieved by targeted, co expenditures. We plan to increase our raw steel and rolled steel product and 5.0 million tonnes in 2004, respectively, to 8.2 million and 7.1 mill primarily at our Chelyabinsk Metallurgical Plant. Additionally, we seek factors in Russia:

  If the economy continues to expand, the demand for long produc construction industry, should increase, providing us with additio Substantial infrastructure repairs and industrial upgrade needs sh products.

- *Develop and Expand our Position as a High-Quality, Low-Cost Produc Products.* We are Russia s primary producer of specialty long produc higher-margin business provides us with substantial opportunities to in profitability for the following reasons:

  Our low-cost production provides us with a competitive base for Europe, Asia and the CIS countries.
  The Russian market for specialty long products has considerable from domestic engineering and manufacturing sectors recovers fr the past few years.

Ø *Expand our Mining Business*. We intend to build on our substantial m
following goals:

Develop our existing coal and iron ore reserves, particularly in or
coking coal and iron ore concentrate to third parties. We plan to i
from approximately 15.2 million tonnes in 2004 to 16.6 million t
concentrate production from approximately 4.0 million tonnes in
2007.

Make selective acquisitions of coal and other mining enterprises,
particularly in Russia and other CIS countries, as strategic opport

---

Table of Contents

Business

Maintain our flexibility to internally source raw-material inputs f
business, depending on price differentials between purchases fro
sales to foreign and domestic customers.

Ø *Enhance our Position as a Low-Cost Producer.* We intend to further i
reduce our manufacturing costs by:

Selectively investing in technology and capital improvements, in
continuous casters in our steel-making.
Preserving our cost advantages in our labor, raw materials and en
Achieving additional savings by fully integrating recent acquisiti

Ø *Further Capitalize upon Synergies between our Core Businesses.* In a
deriving from our status as an integrated group, we believe that additio
opportunities will arise as we benefit from economies of scale and conti
recent acquisitions, in particular by implementing improvements in wor
operational methods. We regularly evaluate the manner in which our su
their raw material needs and transfer products within the group in order
most efficient way, and we expect to identify and take advantage of furt
between our core businesses.

Ø *Selectively Expand our Downstream Capacity.* We intend to continue
value-added downstream businesses such as hardware, stampings and f
reach our customer base, including in new markets. This downstream in

Is a logical extension of our specialty and low-carbon long produ
higher-margin, next value-added step for products that we alread
Is in a market less cyclical than the upstream market, reducing ou
downturns.
Moves us closer to our final customers, enabling us to better und
influence buyer behavior and respond quickly to change.

Ø *Selectively Expand our Internal Logistics Capabilities.* We intend to s
logistics capabilities, currently centered on our railway freight and forw
by our recent acquisition of Port Posiet, located on the Sea of Japan, to
transportation expenses.

Ø *Maintain Strong Export Sales.* We intend to maintain our strong relati
export customers. Although we are focused on maintaining our market
sales, which constituted 55% of our total sales in the first half of 2004,
and reduce our reliance on the Russian market in the event that it were t

Implementation of these strategies is subject to a number of risks. See Risk F
risks.

COMPETITIVE STRENGTHS

Our main competitive strengths are the following:

- Ø *Low-Cost Producer.* Our base of operations in Russia and integrated s
of a number of cost advantages vis-à-vis foreign producers.

Business

Low-Cost Raw Materials. We internally source all of the cokin
of the iron and nickel requirements of our steel segment. Our mir
steel production facilities have long and established operating his
additional cost savings through internally sourcing these raw mat
internally source also gives us a better bargaining position with o
us to control our raw material costs.
Inexpensive Energy. We internally satisfy about 38% of our ele
co-generation facilities, and purchase most of the remainder at lo
purchase natural gas from Gazprom at low, regulated prices for o
production needs. See Risk Factors Risks Relating to Our Busi
and restructuring in the energy sector could materially adversely
Low Labor Costs. Russia has very low labor costs, including fe
as compared to the United States, Western Europe, Japan and So
Cost Management. We view strict cost management and increa
fundamental aspects of our day-to-day operations, and continuall
efficiency of our mining and steel-making operations. With our a
integration of Chelyabinsk Metallurgical Plant, Beloretsk Metallu
Nickel Plant and Korshunov Mining Plant in the past few years,
record of turning around underperforming steel-making and mini
implementing improved operational and management practices, l
production costs and improved product quality.

Ø *Ability to Internally Source Significant Amounts of Raw Materials.* W
sourcing 100% of the coking coal, 92% of the iron ore and 55% of the n
segment, assuming in the case of iron ore that third parties process certa
concentrate into sinter and pellets, which comprise the ultimate form of
making process. We are also currently expanding our iron ore processin
able to internally process more of our iron ore concentrate into sinter, m
fully self-sufficient in our iron ore feed requirements, assuming current
levels. While other steel producers have certain captive raw-materials su
manufacturer in the world with its own nickel production facilities. We
of coking coal, iron ore and nickel provides us significant advantages o
as higher stability of operations, better control of quality of end product
improved flexibility and planning latitude in the production of our steel
and the ability to respond quickly to market demands and cycles. Moreo
of iron ore and coal, the two primary raw materials inputs into the steel-
increasingly concentrated among fewer companies, resulting in weaker
makers. Our integration strategy has allowed us to minimize the advers
and keep our raw materials costs down. In addition, our ability to sourc
within Russia means that we are not exposed to the expected shortages

Ø *Ability to Improve Cost Efficiency with Relatively Modest Capital Expe*
believe that relatively modest capital improvements will allow us to dec
production costs and improve our margins. For example, we expect the
of continuous casting at our plants to result in substantial improvements
efficiency.

Table of Contents

Business

- Ø *Ability to Increase Current Production Cost Effectively.* We believe th
competitive advantage over our competitors in our ability to increase ou
cost effectively because our substantial existing infrastructure can acco
production lines through brownfield development. Moreover, due to ou
location in Russia, which has some of the largest reserves of coal and ir
positioned than our European competitors to secure raw materials for a
For example, we plan to increase Chelyabinsk Metallurgical Plant s rav
production capacity from 5.0 million and 4.0 million tonnes, respective
5.8 million tonnes, respectively, in 2007.

- Ø *Significant Domestic Market Shares in Specialty Steel and Carbon Long*
important market and we have significant domestic market shares in all
carbon long products. We believe we have established a strong reputatio
within Russia and certain of our key export markets.

- Ø *Established Export Market Presence.* We export a substantial portion
sales and distribution network in 10 countries and agents in 28 addition
which constituted 55% and 45% of our total sales in the first half of 200
allow us to diversify our sales, provide us with additional growth oppor
on the Russian market in the event that it were to experience a downtur

- Ø *Well-Situated for Construction Market.* The location of our primary st
Chelyabinsk Metallurgical Plant, in the southern Urals makes it better s
primary competitor in this market, to serve the Russian construction ma
constituted approximately 17% of our steel segment sales in 2003.

- Ø *Value-Added Product Line.* We produce long products for a broad ran
including forgings and stampings, wire rod for metal cord production a
hardware (wires, nails, nets, ropes and rope products). Downstream pro
with higher-margin opportunities.

- Ø *Track Record of Successful Acquisitions.* Building upon our success i
operations of Southern Kuzbass Coal Company in the late 1990s and fo
revitalization of Chelyabinsk Metallurgical Plant, a specialty steel manu
primary customers of coking coal, in the last few years we have acquire
hardware manufacturing operations that we can supply with our steel. W
we implement improved operational and management practices, and we
significant increases in production efficiency and volume with only mo
expenditures. For example, at Chelyabinsk Metallurgical Plant, COST,
Southern Urals Nickel Plant and Vyartsilya Metal Products Plant, shipm
by 17%, 21%, 40%, 63% and 392% as compared to shipments in the ye
also devote the management, technological and logistical resources nec
acquisitions into all aspects of our business, including the supply of raw
methodologies and sales and distribution. We have a good track record
and maintaining excellent relations with the local communities where w

- Ø

Increasing Control over Logistics. Our increasing internal logistics ca
our railway freight and forwarding company, and enhanced by our recen
located on the Sea of Japan, help us to optimize our transportation expe

---

112

Table of Contents

Business

- Ø *Strong and Focused Management Team.* Our current management tea all aspects of our businesses and has successfully transformed us from a a large, integrated steel producer. Our two founding shareholders remai management of our business, with Mr. Zyuzin serving as our Chairman Chief Executive Officer and a member of our board. Our Chief Operatin has significant experience from his previous positions at Glencore Inter officer at Chelyabinsk Metallurgical Plant. Many of our directors and o floor jobs or in mines and moved up into management positions over th

STEEL BUSINESS

Our steel business comprises production and sale of semi-finished steel produc products, carbon and stainless flat products, and value-added downstream met stampings and forgings. Within these product groups, we are further able to ta end-user requirements. Our steel business is supported by our mining business and coking coal), iron ore, nickel and limestone. Our mining business also sell materials to third parties. See Mining Business.

Our production

The following table sets out our production volumes by primary steel product within these categories.

Production
Coke
Coking Products
Pig Iron
Semi-Finished Steel Products, including:
Carbon and Low-Alloyed Semi-Finished Products
Long Steel Products, including:
Stainless Long Products
Alloyed Long Products
Rebar
Wire-Rod
Low-Alloyed Engineering Steel
Flat Steel Products, including:
Stainless Flat Products
Carbon and Low-Alloyed Flat Products
Forgings, including:
Stainless Forgings

Alloyed Forgings
Carbon and Low-Alloyed Forgings
Forged Alloys
Stampings
Hardware, including:
Wire
Ropes

Table of Contents

Business

In the first half of 2004 and in 2003, with the exception of our foreign subsidia
all of our steel products using internally sourced coke, pig iron, raw steel and s
We purchase small quantities of semi-finished steel products from local steel p
justified. In 2003, we purchased under 10,000 tonnes of semi-finished steel pr

Sales of steel products

The following table sets forth our revenues by primary steel segment product c
products within these categories (including as a percentage of total steel segm
indicated. Steel segment sales data presented in Steel Business does not inc
mining segment.

Revenues	6 months 2004 amount	6 months 2004 % of revenues	2003 amount	2003 % of revenues	2002 amount	2002 % of rev
	(in millions of U.S. dollars, except for pe					
Coke	22.6	2%	29.5	2%	22.9	
Coking Products	8.0	1%	15.3	1%	11.7	
Pig Iron	37.4	3%	15.4	1%	9.7	
Semi-Finished Steel Products,(2) including:	183.7	14%	99.5	6%	127.6	
Carbon and Low-Alloyed Semi-Finished Products	181.1	14%	98.4	6%	121.1	
Long Steel Products, including:	612.2	48%	750.5	46%	428.7	
Stainless Long Products	8.8	1%	22.2	1%	7.0	
Alloyed Long Products	36.7	3%	43.9	3%	31.5	
Rebar	282.6	22%	359.2	22%	209.5	
Wire-Rod	159.4	13%	174.8	11%	90.4	
Carbon and Low-Alloyed Engineering Steel	97.3	8%	107.2	7%	70.9	
Flat Steel Products, including:	122.1	10%	172.9	11%	117.4	
	44.1	3%	83.2	5%	69.0	

Stainless Flat Products					
Carbon and Low-Alloyed Flat Products	78.2	6%	89.5	5%	48.2
Forgings, including:	42.2	3%	67.6	4%	37.6
Stainless Forgings	5.1	0%	12.8	1%	6.2
Alloyed Forgings	8.9	1%	15.6	1%	7.8
Carbon and Low-Alloyed Forgings	22.2	2%	28.5	2%	15.9
Forged Alloys	5.9	1%	10.7	1%	7.6
Stampings	35.0	3%	23.5	1%	
Hardware, including:	152.5	12%	154.0	9%	71.2
Wire	100.2	8%	103.6	6%	53.1
Ropes	21.7	2%	27.0	2%	12.7
Other[3]	51.8	4%	308.0	19%	184.7
Total	1,267.8	100%	1,636.1	100%	1,011.5

(1) Product subcategory revenue data for 2001 is unavailable.

114

Table of Contents

Business

(2) The decline in our semi-finished steel product sales in 2003 relates to our acquisitio Metallurgical Plant. Prior to the acquisition, our sales of semi-finished steel to Belo to third parties, whereas after the acquisition these sales are considered intercompar our consolidated results. The acquisition contributed to the increases in our sales of which Beloretsk Metallurgical Plant manufactured from semi-finished steel supplie Plant.

(3) Our resales of MMK products, primarily plates, coils and galvanized sheets, constit Specifically, in 2003, 2002 and 2001, our resales of MMK products were $223.1 m million, comprising 13.6%, 15.3% and 30.3% of our steel segment revenues, respec Starting in January 2004, we stopped reselling MMK products. Also included are sa $21.0 million in the first half 2004 and $26.0 million in 2003. In August 2004, we t factory, Mechel Zeljezara.

The following table sets forth by percentage of sales the regions in which our s sold for the periods indicated.

Region(1)	6 months 2004
Russia	42.0%
Other CIS	2.9%
Europe	31.4%
Asia	20.0%
Middle East	1.7%
United States	0.7%
Other	1.1%
	100.0%

(1) The regional breakdown of sales is based on the geographic location of our custome end users of our products, as our distributor customers resell and, in some cases, fu

During the first half of 2004 and in 2003, our steel segment sales outside of Ru and Asia. Sales in Europe accounted for 31.4% and 29.4% of our total steel se periods, respectively. European sales during these periods were largely to Swi followed by Romania (6.9% and 7.2%), Austria (2.2% and 2.9%) and German consisted of mostly sales to Glencore International (see below). Sales in Asia a of our total steel segment sales during these periods, respectively, consisting o followed by Vietnam (4.4% and 4.2%) and Taiwan (1.9% and 1.0%). Middle I accounted for 1.7% and 3.3% of our total steel segment sales during these peri largest markets were Israel (0.4% and 1.1%), United Arab Emirates (0.5% and 0.5%).

Sales of our steel products to Glencore International in Europe comprised 9.9% our total steel segment sales in the first half of 2004 and in 2003, 2002 and 200 record as European sales. Glencore International resells these steel products pr Middle East and Asia. In the first half of 2004 and in 2003, customers in the M and 44.2%, respectively, of these sales, with most of these sales being to Iran,

accounted for 63.1% and 33.8%, respectively, of these sales. See Marketing
below for a further description of our steel product sales to Glencore.

Table of Contents

Business

The following table sets forth information on our domestic and export sales of
categories for the periods indicated. We define export sales as sales by our Ru
customers located outside their respective countries. We define domestic sales
foreign subsidiaries to customers located within their respective countries.

Products	6 months 2004	2
	(in millions of U.S	
Coke	22.6	2
Domestic (%)	100%	10
Export (%)		
Coking Products	8.0	1
Domestic (%)	100%	10
Export (%)		
Pig Iron	37.4	1
Domestic (%)	36%	9
Export (%)	64%	
Semi-Finished Steel Products	183.7	9
Domestic (%)	7%	2
Export (%)	93%	7
Long Steel Products	612.2	7
Domestic (%)	53%	6
Export (%)	47%	3
Flat Steel Products	122.1	1
Domestic (%)	49%	6
Export (%)	51%	3
Forgings	42.2	6
Domestic (%)	50%	6
Export (%)	50%	3
Stampings	35.0	2
Domestic (%)	88%	9
Export (%)	12%	
Hardware	152.5	1
Domestic (%)	73%	7
Export (%)	27%	2
Other[(1)]	51.8	3
Domestic (%)	51%	2
Export (%)	49%	7
Total	1,267.8	1,
Domestic (%)	50%	5
Export (%)	50%	4

(1)

Our resales of MMK products, primarily plates, coils and galvanized sheets, constit
Specifically, in 2003, 2002 and 2001, our resales of MMK products were $223.1 m
million, comprising 13.6%, 15.3% and 30.3% of our steel segment revenues, respec
our resales of MMK products were exports. Starting in January 2004, we stopped re
included are sales of tubes, which amounted to $21.0 million in the first half of 200
August 2004, we terminated production at our tube factory, Mechel Zeljezara.

116

Table of Contents

Business

The end users of our steel products vary. Our rebars are principally used in the
main end users of our wire rods are small wire-drawing operations. Our carbo
(covers, floor plates), the automotive industry (spare parts) and pipe manufact
(non-critical applications). Our high-quality round bars are used in various mo
automotive industry (spare parts, gear boxes), the machinery industry (hydrau
shipbuilding industry (forged parts), the basic materials industry (molds, balls
industries. Our forgings and stampings are primarily used in the automotive, a
and food and consumer goods sectors.

The following table sets forth by percentage a breakdown of our shipment vol
in Russia by industry sector within the Russian market in 2003.

Use by Industry	Metal Works, Hardware Plants	Pipe Factories	Construction	Engineering	Railw Construc Repa
Semi-Finished Steel Products		59%	5%	32%	
Long Steel Products	6%	5%	52%	32%	1%
Flat Steel Products	4%	7%	7%	71%	
Forgings		21%		72%	
Stampings				47%	
Hardware	7%	1%	23%	21%	23%

(1) Including the defense, aerospace, petrochemical, textile, food and consumer goods s

Marketing and Distribution

We use flexible sales strategies that are tailored to our customers and the mark
House, headquartered in Moscow, coordinates our Russian sales and has six s
Trading AG, headquartered in Zug, Switzerland, together with its subsidiaries
Supply Limited, headquartered in Schaan, Liechtenstein, coordinates all expo
operates representative offices in each of our core international markets.

Our overall sales strategy is to develop long-term, close partnerships with the
part of our end-user strategy, we research sales to distributors to identify the e
steel capabilities and products to these customers. With respect to our largest e
established working committees, composed of our manufacturing engineers a

committees meet quarterly to monitor the performance of our products and ens specifications and quality requirements are consistently met. These committee opportunity to discuss their future needs with us. Our sales force also regularly many of our other customers. We attend industry conferences and advertise in our products and capabilities. Through these efforts, we have established a stro within Russia and other countries of the CIS, Central and Eastern Europe, Sou East.

Domestic sales

The Moscow headquarters of Mechel Trading House serves as the central dom products. Our Moscow office provides additional customer service for, and co and most important customers, and the information gathered is directly provid Moscow office, by virtue of its location, is also well suited to develop new cus Russian manufacturers headquartered in Moscow or those companies that have

Table of Contents

Business

centralized purchasing offices in Moscow. The Moscow office is also involved
requests for proposals, which is the most common method by which Russian c
raw materials.

Our domestic steel production facilities are located in large industrial areas and
relationships dating from Soviet times with local end-user customers. Mechel
branches in Chelyabinsk, Beloretsk, Vyartsilya, Ufa, Chebarkul and St. Peters
long-standing customer relationships. By virtue of their proximity both to proc
local sales forces provide highly specialized and technical sales and service su

We also operate warehouses near our production facilities in Chelyabinsk, Ufa
Moscow, St. Petersburg, Ekaterinburg and Rostov-Don, where we sell our stee
walk-in basis. We realize higher margins on these sales compared to our other
such warehouses in other large Russian metropolitan areas in the future. Throu
potential new end-user customers of our products and market our production c
to them.

Mechel Trading House has a salaried sales force of approximately 293 employ

Export sales

Most of our international steel sales are made to independent distributors, whi
smaller quantities to end users. Mechel Trading and its subsidiaries operate of
the following 10 countries:

Asia		Europe	
China	Taiwan	Austria	Belgiu
Philippines	Vietnam	Liechtenstein	Roman
		Switzerland	

We also work with agents in 28 additional countries. We have an international
facilitates communications between our production facilities and the end users
mind local and international customs in business dealings, including language
centralized international sales organization offers comprehensive and coordina
services to our international customers.

Most of our distributor customers are based in one location close to end users.
relationships employing local sales forces and maintaining local sales offices,
the markets in which end users of our products are located.

Glencore International is the largest customer of our exported steel segment pr
2004 and in 2003, 2002 and 2001, we sold $126.1 million, $189.9 million, $17
in steel products to Glencore, respectively, comprising 9.9%, 11.6%, 17.6% ar
segment sales, respectively, during these periods. Starting in November 2004,
made pursuant to a framework contract providing for the sale of a minimum of
carbon steel products per quarter at market-based prices. This framework cont
2007. The products purchased by Glencore consist of wire rod, rebar, billets, h
are then resold by Glencore abroad, principally to purchasers in Asia and the M

Table of Contents

Business

Mechel Trading and its subsidiaries also sell steel products to wholesalers on a
open and covered warehouse areas in the following locations:

Antwerp, Belgium. We use open and covered areas in the Port of Antw
stock both rolled and forged bars, and intend to expand the product offe
such as wire rods and nails.

Ho Chi Minh City, Vietnam. We have leased a 12,000 square meter pl
for a 47-year term, and intend to construct a 1,000-2,000 square meter w
intend to stock a wide range of our products at this location, which will
higher-margin sales to end users of our products. We may also expand t
service center, offering value-added services.

Mechel Trading also researches and collects information about the steel marke
equipment in order to understand and anticipate new developments in the steel
information on the state of international steel markets to our management. Me
have approximately 93 employees.

Distribution

Rail transportation is used for nearly all shipments from our production faciliti
customers, wholesale warehouses or sea ports. Overall, approximately 75% of
rail and 25% by ships. Deliveries from warehouses and ports to customers is p
2002, Mechel Trading House has operated its wholly owned subsidiary, Mech
forwarding company that also arranges warehousing for our stock. Mecheltran
consisting of 93 open cars and 208 pellet cars, and also leases an additional 20
transported domestically approximately 25 million tonnes of our cargo in 2003
was comprised of coal and iron ore.

In addition, in February 2004, we acquired Port Posiet, located in Russia s Fa
port has 1.4 million tonnes of cargo handling capacity and over 120,000 tonne
processed 845,000 tonnes of cargo, mostly coal, ferroalloys and metals, in 200
coal concentrate and steam coal to Asia from this port.

Market share and competition

In our core international markets we primarily compete with Russian and Ukra
global steel manufacturers focus more on value-added and higher-priced produ
factors include price, distribution, product quality and customer service.

In the Russian market, we compete on the basis of price and quality of steel pr
product range and service, technological innovation and proximity to custome
characterized by relatively high concentration of production, with the five larg
including us, accounting for 82% of overall domestic steel output in 2003.

Following is a brief description of Russia s other four largest steel producers:

EvrazHolding, which consists of Nizhny Tagil Metallurgical Plant, Zap
Plant (ZapSib), and Kuznetsky Metallurgical Plant, is effectively the lar
consolidated basis, accounting for 21% of Russia s total rolled product
EvrazHolding focuses on the production of long products (including reb

Table of Contents

Business

MMK accounted for 20% of Russian rolled steel production in 2003. M
comprised mostly of flat products, representing 81% of its commercial
output. Domestically, MMK is a significant supplier to the oil and gas a
sectors. MMK exported 55% of its output in 2003, with Asia accountin
Middle East for 16% of its total exports. In addition to its core business
also acquired two producers of hardware, and has its own iron ore minin
production facilities are located in Magnitogorsk in the southern Urals.
the common and 12.2% of the preferred shares of MMK.

Severstal had an 17% market share of Russian rolled steel production in
specializes in flat products and is a leading manufacturer of strip, cold-r
galvanized sheet. Domestic sales accounted for 60% of Severstal s outp
oil and gas industry as its leading customer, closely followed by the aut
Severstal also controls UAZ, a domestic off-road car-maker, Vorkuta-U
Kuzbassugol, which completely satisfy Severstal s coking coal require

NLMK produces primarily hot-rolled and cold-rolled flat steel, galvaniz
pipes and other steel products. Exports accounted for 65% of the compa
were comprised primarily of slabs. Domestically, NLMK s largest cust
pipe industries, followed by companies in the automotive sector. NLMK
Russian rolled steel production in 2003. The company s facilities are lo
of Moscow.

These five companies, including us, can be divided into two groups by produc
NLMK focus mainly on flat products, while EvrazHolding and we produce pri
the largest and most comprehensive producer of specialty steels and alloys in R
Russian specialty steel output, over three times as much as our nearest compet
Metall-Expert. We are also the second largest producer of long products in Ru
significant market shares in both carbon and specialty steel long products, acc

In the Russian carbon long market segment, our primary products and our mar
according to Metall-Expert:

Reinforcement bar In rebar, we compete in the 6 40 millimeters rang
market was dominated by Mechel (41%) and EvrazHolding (45%). At p
domestic market for rebar is protected from Ukrainian imports by a 21%
introduced in August 2002 for three years.

Wire rod There were four major producers of wire rod in Russia in 20
(35%), Mechel (26%), Severstal (18%) and MMK (10%). We produce s
quality and widest ranges of wire rod (5 10 millimeters) among Russia

We were the leader in the domestic specialty long product market in 2003, pro
output. Our production was more than the combined output of our three neares
OEMK (17%), ZMK (9%) and Electrostal (8%). We had significant market sh
stainless long products (39%) and tool steel (47%) in 2003.

OEMK, an integrated steel mill specializing in long carbon and specialty steel
speciality steel competitor, is located in the southwest of Russia and serves cu
and ball-bearing industries. Other Russian specialty steel producers, like Elect
us in terms of overall specialty steel production, according to Metall-Expert.

We were also the largest producer of engineering long steel products in Russia
competitors in this market were OEMK (20%), Severstal (11%) and Serov Me

---

Table of Contents

Business

(11%). In 2003, we were the leader in the production of alloyed engineering st
containing engineering steel (32%), where we were ahead of our nearest comp
respectively), ZMK (10% and 15%, respectively), Serov Metallurgical Plant (
Red October Metallurgical Plant (6% and 12%, respectively), according to Me

We were also Russia s largest producer of stainless flat products, with an 80%
2003, according to Chermet.

We were the third largest producer of hardware in Russia in 2003 with a 12%
Severstal (36%) and MMK (22%), according to MetalTorg.ru. For hardware p
however, our share was substantially higher. For example, according to inform
our estimates, we had a 57% share of the spring wire market and a 51% share
market during 2003.

Raw materials

The principal raw materials we use in the making of steel are coke (produced f
nickel, ferrous scrap and limestone. The following table sets forth the percenta
requirements that we satisfied internally during 2003:

Product
Coking Coal
Iron Ore(1)
Nickel

(1) Based on Korshunov Mining Plant, which we only started consolidating in October

We are 100% self-sufficient in our requirements of coking coal, with Southern
having supplied 3.4 million tonnes of coking coal concentrate to Chelyabinsk
process coking coal concentrate into coke at Chelyabinsk Metallurgical Plant.
steel-making operations at Chelyabinsk Metallurgical Plant and our nickel sme
Urals Nickel Plant. In 2003, we produced and internally used 2.2 million tonn
facilities and produced and sold another 0.4 million tonnes of coke to third par
requirements are not material.

Our steel making operations use iron ore in the form of pellets, sinter, concent
form of the iron ore feed into the steel making process, however, consists of p
our steel-making operations used 5.5 million tonnes of iron ore feed, approxim

and 51% in the form of sinter, and we internally sourced 39% of our total iron
this period. We are capable of internally sourcing 92% of the iron ore requiren
assuming that third parties process certain quantities of our iron ore concentrat
Korshunov Mining Plant supplied us with 1.4 million tonnes of iron ore conce
for 100% of our total iron ore concentrate needs in this period. Iron ore concen
Chelyabinsk Metallurgical Plant. We purchase most of the remaining part of o
form of pellets, from domestic suppliers such as Mikhailovsky Mining Plant a
under annual contracts on market terms.

In 2003, we used approximately 8,807 tonnes of nickel in the production of sta
steels. We sourced approximately 55% of our nickel requirements in 2003 fron
smelting operations at Southern Urals Nickel Plant. We source other nickel gra
Ufaleinickel and other smaller nickel producers.

Table of Contents

Business

Our steel making technology is primarily based on the basic oxygen furnaces,
raw steel production. Ferrous scrap represents just 22% of feedstock, and we a
raw material, sourcing the balance from various scrap traders. Electric arc furn
steel-making at COST and Industria Sarmei, our Eastern European facilities.

We source most of our limestone requirements from third parties and a portion
2003, we used approximately 0.9 million tonnes of limestone in the production
approximately 33,930 tonnes was supplied by Pugachev.

Steel making requires significant amounts of electricity to power electric arc f
convert coal to coke. In 2003, our steel making operations consumed approxin
electricity, of which 2.3 billion kWh was used at Chelyabinsk Metallurgical Pl
at other Russian facilities and 0.8 billion kWh was used at our Eastern Europe
Metallurgical Plant has a cogeneration power facility, which produced 1.8 bill
internal consumption in 2003, yielding 75% self-sufficiency at that plant and 3
the group, including mining operations. The balance was purchased from local
our power-generating facilities work on blast furnace and coke gas, which are
steel-making operations, and natural gas, which we purchase from Gazprom. I
billion cubic meters of blast furnace gas, 1.1 billion cubic meters of coke gas a
natural gas.

Large amounts of water are also required in the production of steel. Water serv
cleaning agent. It is also used to cool the steel, to carry away waste, to help pr
power and to dilute liquids. One of the principal sources of water is rivers, and
recirculate a portion of water used for their production needs. For example, Ch
uses 130,000 cubic meters of river water and 70,000 cubic meters of water fro
Vyartsilya Metal Products Plant sources all of its water needs from a local rive
obtains 70% of its water from the public water supplies. Southern Urals Nicke
needs through recycling. COST sources all of its production water needs from

Transportation costs are a significant component of our production costs and a
price-competitiveness in the export markets. Rail transportation is our principa
materials from our mines to processing facilities and products to domestic cust
shipment overseas. For a description of our railway freight and forwarding sub
Business Marketing and Distribution Distribution above.

For a description of how seasonal factors impact our use and reserve levels of
Discussion and Analysis of Financial Condition and Results of Operations Se

Steel production facilities

We generally own, lease or have a right of perpetual use of the properties on w
facilities are located. Most of the land on which Chelyabinsk Metallurgical Pla
Products Plant are located is used pursuant to a right of perpetual use. The land
Metallurgical Plant, Izhstal, Urals Stampings Plant and Mechel Nemunas are l
which COST and Industria Sarmei are located is owned.

The main manufacturing processes at Chelyabinsk Metallurgical Plant, Belore
Stampings Plant, Izhstal, Industria Sarmei and COST are ISO 9001:2000 certi

---

Table of Contents

Business

Chelyabinsk Metallurgical Plant

Our raw steel production in Russia takes place at Chelyabinsk Metallurgical P
Plant is an integrated blast furnace and BOF/EAF steel mill that produces coke
carbon and specialty steel products and forgings. Its customer base is largely c
tube manufacturers, and customers from the construction, engineering and bal
sources all of its coking coal needs from our Southern Kuzbass Coal Company
and nickel needs from our Korshunov Mining Plant and our Southern Urals Ni

Chelyabinsk Metallurgical Plant s principal production lines include a BOF w
converters; two EAF workshops equipped with two electric arc ovens; three co
machines; an argon-oxygen refining machine; three continuous billet-casters; l
rolling mill for 200-320 millimeters and 80-180 millimeters square billets; thr
millimeters diameter round bar and 75-156 millimeters square bar, 6.5-10 mill
bands and shaped beams; a hot-rolled flat product workshop with a thick sheet
hot-rolled sheets of up to 1,800 millimeters wide and up to 20 millimeters thic
mill for up to 1,500 millimeters wide and up to 6 millimeters thick hot-rolled c
workshop for 0.3-4 millimeters cold-rolled stainless sheet; and a forging and p
with five presses and forging machines of 1,250-2,000 tonnes and seven cokin

The following table sets forth the capacity, the capacity utilization rate and the
for each of Chelyabinsk Metallurgical Plant s principal production areas.

Production Areas	Capacity in 2003	Capacity Ut Rate in 2
Sintering	2,200,000	
Pig Iron	3,300,000	
Steel-making	4,600,000	
Rolling	3,300,000	
Forging and pressing	72,000	
Coking	3,400,000	

Beloretsk Metallurgical Plant

Beloretsk Metallurgical Plant is a hardware plant that produces wire rod and a
semi-finished steel products supplied by Chelyabinsk Metallurgical Plant. Its c
construction and engineering industries.

Beloretsk Metallurgical Plant s principal production lines include a steel-rolli
wire mill for production of wire rod of 5.5-12 millimeters diameter and a numb
equipped with drawing, winding, unwinding, rewinding, polishing and rope m
ovens.

The following table sets forth the capacity, the capacity utilization rate and the
for each of Beloretsk Metallurgical Plant s principal production areas.

		Capacity Uti
Production Areas	**Capacity in 2003**	**Rate in 2**
Rolling	520,000	
Hardware	260,000	

Table of Contents

Business

Vyartsilya Metal Products Plant

Vyartsilya Metal Products Plant is a hardware plant that produces low carbon,
zinc-plated nails, and steel and polymeric-coated nets, from wire rod supplied
Plant. The plant s customers are largely from the construction, automotive an

Vyartsilya Metal Products Plant s principal production facilities include draw
mesh-weaving machines.

The following table sets forth the capacity, the capacity utilization rate and the
for Vyartsilya Metal Products Plant s principal production area.

Production Areas	Capacity in 2003	Capacity Uti Rate in 2
Hardware	68,000	

Urals Stampings Plant

Urals Stampings Plant is Russia s largest producer of stampings from specialt
titanium alloys for the aerospace, oil and gas, heavy engineering, railway trans
industries. Urals Stampings Plant sources its specialty steel needs from Chelya

Urals Stampings Plant s principal production facilities include 1.5-25 tonne s
inker machines.

The following table sets forth the capacity, the capacity utilization rate and the
for Urals Stampings Plant s principal production area.

Production Areas	Capacity in 2003	Capacity Util

	Rate in 20
Stamping	100,000

COST

COST is a major Romanian EAF steel mill that produces specialty and carbon
hardware. COST is the largest producer of long products (including rebars) an
second largest producer of raw steel in Romania, according to Siderom. The p
the engineering, automotive, tool, ball-bearing, tube, hardware and constructio

COST s principal production lines include two EAF workshops equipped wit
tonne capacity and of 75 tonne capacity; steel vacuum processing and treatmen
billets caster; a blooming machine for 80-400 millimeters square and 90-145 r
continuous long products rolling mills for 20-80 millimeters round bars, 24-57
60-70 millimeters square bars, 6-12 millimeters thick and 60-120 millimeters v
bundle rod and reinforcing steel; a forging and pressing workshop; and a calib

124

Table of Contents

Business

The following table sets forth the capacity, the capacity utilization rate and the
for each of COST s principal production areas.

Production Areas	Capacity in 2003	Capacity Uti Rate in 2
Steel-making	527,000	
Rolling	780,000	
Forging and pressing	37,400	
Hardware	67,000	

COST experienced low capacity utilization rates due to high production costs
quality. We plan to lower production costs and improve product quality.

Industria Sarmei

Industria Sarmei is a Romanian EAF steel mill and a leading domestic hardwa
products, including carbon and alloyed wire rod, rebar and hardware, includin
nets, electric cables and nails, as well as carbon and low-alloyed billets. The p
the construction and engineering industries.

Industria Sarmei s principal production lines include an EAF steel-making wo
75-tonne and one five-tonne oven; blooming with a continuous rolling mill fo
120-150 millimeters round billets; one wire-rolling mill and two medium-size
millimeters wire rod, 12-36 millimeters round, square and hexagonal bars, bu
hardware workshops equipped with drawing, nail-making and zinc-plating ma

The following table sets forth the capacity, the capacity utilization rate and the
for each of Industria Sarmei s principal production areas.

Production Areas	Capacity in 2003	Capacity Utiliz Rate in 200
Steel-making	363,000	

Rolling	330,000
Hardware	100,000

Mechel Nemunas

Mechel Nemunas is a Lithuanian hardware plant that produces wire, calibrated
nets. Its customers are primarily from the construction, engineering and furnit

Mechel Nemunas s principal production facilities include drawing mills, and
net-weaving, net-wicking and contact-welding machines.

The following table sets forth the capacity, the capacity utilization rate and the
for Mechel Nemunas s principal production area.

Production Areas	Capacity in 2003	Capacity Utiliz Rate in 200
Hardware	90,300	

Mechel Nemunas experienced low capacity utilization rates due to high produ
product quality. We plan to lower production costs and improve product qualit
equipment, replacing an old air compressor and installing new annealing-zinc

Table of Contents

Business

Izhstal

Izhstal is a Russian specialty steel producer located in the city of Izhevsk, Udr
customer base is largely comprised of companies from the aircraft, defense, au
engineering, oil and gas and construction industries.

Izhstal s principal production lines include six EAF of 25 to 28 tonnes each; t
130-135 tonnes each; blooming machine for 100-220 millimeters square billet
products rolling mills for 30-120 millimeters round bars, 30-90 millimeters sq
bars; and one continuous small long products wire mill for 5.5-29 millimeters
and 12-27 millimeters hexagonal light sections, reinforced steel and bands. It a
equipped with various drawing mills, a pickling line and a forging workshop,
sledge hammers and press-cutters.

The following table sets forth the capacity and the capacity utilization rate for
production areas.

Production Areas	Capacity in 2003	Capacity Utiliz Rate in 200
Steel-making	800,000	
Rolling	1,000,000	
Hardware	98,000	
Forging and stamping	60,000	

Izhstal experienced low capacity utilization rates due to high production costs
products. We plan to lower production costs through supplying Izhstal with ou
iron and nickel, as well as through capital expenditures for targeted purposes
continue to integrate this new acquisition into our operations.

Significant investments

MMK

We own 17.1% of the common and 12.2% of the preferred shares of MMK. M
Russian rolled steel production in 2003 and has 12 million tonnes of steel-mak
and Competition for a description of MMK s business.

Of the remaining common shares, the government of the Russian Federation o
MMK, its management controls, directly or indirectly, approximately 58%, inc
the form of treasury shares which the management votes. The government has
intention to privatize the shares that it owns, although each year the privatizati
press reports indicate that the privatization may occur in the end of 2004 or du
government took a significant step towards allowing the privatization by remo
strategic assets. In the event that the government moves ahead with a privatiza
owns, we will review the terms of the tender and our strategy with respect to o
determination at that time whether and to what extent we should participate in
with our stake in MMK.

126

Table of Contents

Business

The following table sets forth key production and financial data for MMK.

	6 months
MMK	2004
Rolled steel production	5.1
	(i
Revenues[1]	2,166
Net profit[1]	524
EBITDA[1]	793

Source: MMK Internet website and public sources

(1) Under International Financial Reporting Standards.

Management services

Hammer and Sickle OAO

In July 2004, we were engaged by Hammer and Sickle OAO, a specialty steel
manage the company for a one-year term, subject to substantial oversight by H
Directors.

Trade restrictions

Trade restrictions in the form of tariffs, duties and quotas are widespread in th
are less exposed than most other Russian steel producers since restrictions on
been directed against flat products, whereas most of our exports consist of lon
and rebars. In addition, the abolition by the Russian government of steel expor
effectively improved the Russian steel export market.

In 2003, approximately 80% of our steel segment revenues were derived from
were subject to import restrictions. We describe below the main applicable tra
markets.

European Union

Our steel sales to the EU constituted approximately 9.3% and 9.7% of our tota
2003 and the first half of 2004, respectively. The Russian government and the
Enterprise have an export quota system in place whereby Russian exports to th
stipulated amount for each product category until the end of 2004. We expect
continue after 2004. The quota by product category is distributed between the
procedure developed by the Ore Mining and Smelting Trade Union of Russia.
each product category, a company s export quota allocation is calculated on th
company of the particular product over the past three years to the EU market (
weighting), and on the company s market share in domestic production of the
given a 30% weighting). After the quotas are calculated, the Russian Ministry
confirms formal quota allocations, and the Russian Ministry of Economic Dev
export licenses for these quotas. In 2003, the quota covered approximately 85
exported to the EU, although in 2004, we may increase the sales of products th

In 2004, the total EU quota for Russian steel was set at 1,822,101 tonnes, and
the total quota. In 2003, the total EU quota for Russian steel was 1,270,858 to
of the total quota, and we used approximately 96% of our quota. As quotas are

---

Table of Contents

Business

granted by product category, usage of our individual quotas varied. For examp
with respect to long products other than beams and wire rod was at 88%, whil
was at 98%. In 2004, the total quota was increased by 551,243 tonnes, and we
42,240 tonnes with respect to export of wire rod to Mechel Nemunas, our hard
regular increase of 28,454 tonnes. We started exporting wire rod to this hardw
around the time we acquired it. We received this special allocation because Li
2004, and steel exports to Lithuania thus became subject to the EU export quo
Lithuanian quota will be sufficient for the next few years. See Risk Factors
and Industry We face numerous protective trade restrictions in the export of c

In addition, an antidumping duty in the amount of 50.7% is applicable for exp
cables manufactured by Beloretsk Metallurgical Plant until August 2006. Ther
exports of our Romanian products to the EU.

China

In 2003, our sales of cold-rolled steel products to China comprised approxima
segment revenues and 42.6% of our total steel segment exports to China. In Ja
anti-dumping duties of up to 29% on cold-rolled steel imports from Russia. Th
September 2003 and will last for five years. Currently, none of our steel segm
to these duties.

United States

The United States has a quota system in place with respect to certain Russian s
flat-rolled carbon quality steel products and certain cut-to-length carbon steel p
quota agreement provides for quotas and reference prices on Russian exports o
carbon-quality steel products to the United States and is currently under sunse
quotas between specific Russian producers and the execution of export license
with the same procedure that applies to exports to the EU market. In 2003, we
governed by this agreement to the United States. There are no trade restriction
Romanian or Lithuanian products to the United States.

The United States also had a quota system in place with respect to imports of p
zinc-plated sheets and some other products from Russia which expired on July
to expand our steel product exports to the U.S. market, and have established a
purpose. We expect, however, that depending on market conditions, the Unite
anti-dumping duties or other types of trade restrictions which might force us t
United States below current levels. In December 2003, the United States also
the form of tariffs on most Russian steel exports to the United States after the

determined them to be inconsistent with the requirements of the WTO.

MINING BUSINESS

Our mining business supports our steel business, and it also sells substantial ar
nickel to third parties.

Our products

Our main products comprise coking coal concentrate, steam coal, steam coal c
iron ore concentrate. Among the key advantages of our mining business is the

---

Table of Contents

Business

coking coal, the low level of volatile matters in our steam coal and our moderr
primarily built during the 1970s and 1980s, including facilities built as recentl

The following table sets forth third-party sales of our mining products (by volu

Product	6 months 2004
Coking coal concentrate	2,275
Steam coal	3,026
Nickel	5
Iron ore concentrate	980

The following table sets forth revenues by product, as further divided between
(including as a percentage of total mining segment revenues) for the periods in

Product	6 months 2004 amount	6 months 2004 % of revenues	2003 amount	2003 % of revenues	2002 amount	2002 % of reve
	(in millions of U.S. dollars, except for perce					
Coking coal concentrate	155.3	43%	180.1	43%	123.8	
Domestic Sales (%)	38%		92%		82%	
Export (%)	62%		8%		18%	
Steam coal	90.2	25%	120.0	29%	101.5	
Domestic Sales (%)	25%		29%		25%	
Export (%)	75%		71%		75%	
Iron ore concentrate	48.4	13%	20.1	5%		
Domestic Sales (%)	11%		100%			
Export (%)	89%					
Nickel	56.9	16%	80.1	19%	51.4	

Domestic Sales (%)						
Export (%)	100%		100%		100%	
Other[(1)]	11.5	3%	13.6	4%	26.0	
Total	362.3	100%	413.9	100%	302.6	
Domestic Sales (%)	27%		55%		50%	
Export (%)	73%		45%		50%	

(1) Includes revenues from transportation, distribution, construction and other miscella customers.

Table of Contents

Business

Marketing and distribution

Our mining products are marketed domestically through Mechel Trading Hous
Mechel Trading in a manner similar to our steel products. The following table
sales the regions in which our mining segment products were sold for the peri

	6 months	
Region[(1)]	2004	20
Russia	27.4%	5
Other CIS	12.2%	
Europe	48.9%	4
Asia	5.1%	
Middle East		
United States	6.4%	
Other		
	100.0%	10

(1) The regional breakdown of sales is based on the geographic location of our custome
end users of our products, as our distributor customers resell and, in some cases, fu

Domestic sales

We generally do not involve intermediaries in the domestic distribution of our
coking and steam coal and iron ore customers are generally located in large in
long-standing relationships with us. We do not sell our nickel products within

In 2003, MMK was the largest customer of our mining business, accounting fo
mining segment. MMK purchased mostly coking coal and iron ore concentrat
stopped selling raw materials to MMK.

We ship our coking coal concentrate from our coal washing facilities, located
railway directly to key customers, including steel producers. Our largest dome
coal concentrate is Urals Steel (NOSTA), accounting for 22.8% of our total co
9.8% of our total mining segment sales in the first half of 2004. We conclude s
customers on an annual basis, and sell about 10% of our coking coal on the sp

Our internal consumption of steam coal is negligible, and we sell substantially
parties. Mosenergo, Moscow s electricity generating and distribution compan
is our largest domestic customer of steam coal, accounting for 6.4% and 10.2%
and 1.6% and 3.0% of our total mining segment sales in the first half of 2004 a
ship our steam coal from our warehouses by railway directly to key customers
electric power stations. Sales contracts for steam coal are concluded with custo

Iron ore concentrate is shipped via railway directly from Korshunov Mining P
domestic customer, ZapSib, accounted for 6.9% of our total iron ore concentra
mining segment sales in the first half of 2004. Prices are set quarterly.

Export sales

Among our mining products, we export ferro nickel, coking coal, steam coal c
anthracite steam coal and iron ore concentrate.

Table of Contents

Business

In the first half of 2004, our largest customer was Glencore, accounting for 24
mining segment. In the years ended December 31, 2003, 2002 and 2001, Glen
16.8% and 3.1% of the revenues of our mining segment, respectively. Glencor
coking coal concentrate and iron ore concentrate.

We export our coking coal concentrate primarily to Ukraine and Japan. In the
was our largest foreign customer of coking coal concentrate, accounting for 10
revenues and 4.3% of our total mining segment revenues. US Steel Kosice in S
customer of iron ore concentrate in 2003, accounting for 15.6% of our total co
and 6.8% of our total mining segment revenues. Shipments are made by railwa

In February 2004, we acquired Port Posiet, located in Russia s Far East on the
million tonnes of cargo handling capacity and over 120,000 tonnes of warehou
845,000 tonnes of cargo, mostly coal and ferroalloys, in 2003. We plan to ship
concentrate, as well as steel products, to Asia from this port.

Our exports of steam coal are primarily to Belgium, Slovakia, Turkey and the
together accounted for 68.3% and 66.2% of our total steam coal sales and 17.0
mining segment sales in the first half of 2004 and in 2003, respectively. Most
long-standing customers, such as two Slovakian power stations, under annual
monthly. We also sell to traders. Steam coal is shipped to customers from our
some cases, by ship from Russian and Ukrainian ports.

We also began to export iron ore concentrate to China during 2004. Sales to C
total iron ore concentrate sales and 8.2% of our total mining segment sales in t
iron ore concentrate to China by rail and by sea.

We sell all of our nickel that we do not use internally to Glencore Internationa
quoted by LME, less a certain discount. See Certain Transactions Material C
The nickel is delivered by railway from Southern Ural Nickel Plant to either th
port of Kaliningrad, and it is then forwarded on by Glencore to end users.

Market share and competition

Coal

As a result of mergers and acquisitions undertaken primarily by steel producer
producers has decreased from 250 in the mid-1990s to less than 100 in 2003. C
domestic coal mining companies have generally enjoyed a relatively stable cus

We are the second largest coking coal producer in Russia, with a 12% market
share with respect to overall Russian coal production, according to Rosinform
the coking coal washing capacity in Russia, according to Rosinformugol. The
compete with are:

Kuzbassrazrezugol, located in Kuzbass, which accounted for 7% of Rus
Russia s total coal output in 2003 and is controlled by Ural Mining-Me
non-ferrous metals producer.

Kuzbassugol, located in Kuzbass, which accounted for 5% of Russia s
total coal output in 2003 and, according to press reports, is controlled b
Group through its subsidiary, SUEK. Kuzbassugol satisfies 40% of Sev
requirements.

Table of Contents

Business

Yuzhkuzbassugol, located in Kuzbass, which accounted for 19% of Rus
and 6% of Russia s total coal output in 2003 and is controlled by Evraz
subsidiary, Kuznetskugol.

Raspadskaya Mine, located in Kuzbass, which accounted for 12% of R
and 3% of Russia s total coal output in 2003 and is 20% owned by Evr
Mezhdurechye, located in Kuzbass, which accounted for 5% of Russia
total coal output in 2003 and, according to press reports, is affiliated wi
and Bagomes. We own 13.1% of Mezhdurechye.
Ispat-Karmet, located in Kazakhstan and controlled by LNM Group, pr
which is supplied to MMK.

Source: Rosinformugol

In the domestic coal market, we compete primarily on the basis of price, as we
of coal, which depends upon the quality of our production assets and the quali
Competition in the steam coal market is also affected by the fact that most stea
near specific steam coal sources and had their equipment customized to utilize
produced at the relevant local source. Outside of Russia, competition in the ste
driven by coal quality, including volatile matters and calorie content.

Iron ore

The Russian iron ore market is generally characterized by high demand and li
product quality as the main factor driving prices. The market is dominated by
the top three producers representing 53% of total production.

The following table lists the main Russian iron ore concentrate producers in 2
of total production, location, key customer base and controlling shareholders.

	Iron ore concentrate production (in thousands of tonnes)	Share of total production	Customer base
Lebedinsky GOK	19,020	22%	NLMK, MMK, Mechel
Mikhailovsky GOK	15,625	18%	NLMK, MMK, Mechel
Stoylensky GOK	11,225	13%	NLMK, Severstal
Kachkanarsky GOK	8,609	10%	NTMK, ZSMK

Karelsky Okatysh	7,436	9%	Severstal
Kovdorsky GOK	4,674	6%	Severstal
Olenegorsky GOK	3,527	4%	Severstal
Korshunov Mining Plant	3,509	4%	ZapSib, Mechel
KMAruda	1,809	2%	NLMK
Bogoslovskoe RU	1,366	2%	NTMK
Vysokogorsky GOK	1,310	2%	NTMK
Irbinskoe RU	1,292	2%	ZapSib, KMK
Sheregeshkoe RU	1,236	1%	ZapSib, KMK
Other	5,120	5%	
Total	85,758	100%	

Source: Rudprom

Nickel prices and demands are driven by international markets. See Industry and Industry Russian Nickel Industry Overview.

132

Table of Contents

Business

Coal production

Southern Kuzbass Coal Company and its subsidiaries operate five active coal of Mezhdurechensk in the southwestern part of Siberia. The mines are located Russia s largest coal producing region. This basin trends for approximately 30 northwest-southeast direction and averages about 120 kilometers in width. Th Krasnogorsk, Tomusinsk, Olzherassk and Sibirginsk, and one underground mi mine was also added to the Sibirginsk mine in November 2002. Production sta Krasnogorsk in 1954, at Tomusinsk in 1959, at Sibirginsk in 1973 (open-pit) a Olzherassk in 1980. Current subsoil licenses for Krasnogorsk, Tomusinsk, Olz are valid until December 1, 2013, February 12, 2012, January 1, 2014, January 2013, respectively.

We primarily own or have a right of perpetual use of the properties on which o located.

Coal is mined using traditional open-pit or underground mining methods. Foll stage, a combination of shovels and draglines is used for moving coal and was Production at the underground mines is predominantly from longwall mining. the amount of impurities in the coal, the coal is processed in a wash plant, whe are removed. Coking coal concentrate is then transported to steel plants for co steel-making. Steam coal is shipped to utilities which use it in furnaces for stea electricity.

The coal produced by our mines is predominately low-sulfur (0.3%) bituminou coking coal range from 6,861 to 8,488 kcal/kg on a moisture- and ash-free bas coal range from 6,627 to 8,286 kcal/kilogram on a moisture- and ash-free basi

The table below summarizes our coal production by mine and type of coal for

	6 months 2004		2003		2002	
	tonnes	% of production	tonnes	% of production	tonnes	% produ
			(tonnes in thousands)[(2)]			
Coking Coal						
Krasnogorsk Pit						
Tomusinsk Pit	1,304	31.0%	2,727	31.4%	2,290	
Olzherassk Pit	681	16.2%	1,210	14.0%	1,092	
	1,240	29.5%	2,868	33.1%	1,949	

Sibirginsk (Pit & Mine)					
Lenin Mine(2)	977	23.3%	1,871	21.6%	1,617
Other(3)					321
Total Coking Coal	4,202	100.0%	8,676	100.0%	7,269
Steam Coal					
Krasnogorsk Pit	2,294	73.9%	3,773	68.8%	3,714
Tomusinsk Pit					436
Olzherassk Pit	78	2.5%	270	4.9%	266
Sibirginsk (Pit & Mine)	734	23.6%	1,442	26.3%	1,364
Lenin Mine					
Total Steam Coal	3,106	100.0%	5,485	100.0%	5,780
Total Coal	7,308		14,160		13,049
% Coking Coal		57.5%		61.3%	
% Steam Coal		42.5%		38.7%	

(1) We have included full year production at Lenin Mine for 2001 although we started
December 2001.

(2) Tonnages are reported on a wet basis.

Table of Contents

Business

(3) Production of Usinsk Mine and Uglekop Mine. Usinsk Mine produced 256,000 ton coal in 2002 and 2001, respectively. Uglekop Mine produced 65,000 tonnes and 67 and 2001, respectively. These mines are currently closed for economic reasons.

We also operate three coal washing plants located near our coal mines in Sout feed enriched by our washing plants in 2003, about 72% (11.8 million tonnes) mining operations, and 28% (4.6 million tonnes) from the nearby Raspadsk an tolling basis. In 2003, the capacity of our washing plants in Russia accounted total domestic coking coal washing capacity in Russia. In addition, in Decemb Washing Factory-38, a coal washing plant near the city of Karaganda, Kazakh 720,000 tonnes of coal, which is supplied from nearby third-party coal mines, coking coal concentrate in 2003, most of which was supplied to Chelyabinsk M

We own 13.1% of Mezhdurechye, a Russian coal producer which accounted f and 2% of Russian total coal output in 2003.

Iron ore and concentrate production

Korshunov Mining Plant operates three iron ore mines, Korshunovsk, Rudnog a concentrating plant located outside of the town of Zheleznogorsk-Illimsky, 1 Bratsk in eastern Siberia.

The Korshunovsk mine is located near the concentrating plant, and started pro Rudnogorsk mine is located about 85 kilometers to the northwest of the conce production in 1982. The Tatianinsk mine is located about 10 kilometers to the plant, and started production in 1986. All three mines produce a magnetite ore licenses for Korshunovsk, Rudnogorsk and Tatianinsk are valid until June 1, 2 2012, respectively.

We have a right of perpetual use of the properties on which Korshunov Minin located.

All three mines are conventional open-pit operations. Following a drilling and a combination of truck and/or rail to the concentrator plant. At the concentrato to a fine particle size, then separated into an iron concentrate slurry and a wast separators. The iron ore is upgraded from approximately 29.2% Fe to a concen Fe. Tailings are pumped to a tailings dam facility located adjacent to the conce is sent to disk filters which remove the water to a moist filter cake, and then to The filter cake is then shipped to customers via rail during warmer months, bu must be dried further to prevent freezing in the rail cars. Korshunov Mining Pl

134

Table of Contents

Business

The table below summarizes our iron ore and iron ore concentrate production

	6 months 2004		2003(1)		
		Grade		Grade	
	tonnes	(% Fe)	tonnes	(% Fe)	to
			(tonnes in thous		
Korshunovsk ore production	2,978	25.7%	5,631	26.8%	2
Rudnogorsk ore production	1,746	35.7%	2,483	37.0%	1
Tatianinsk ore production	180	32.5%	258	31.2%	
Total ore production	4,905	29.5%	8,372	30.0%	4
Iron ore concentrate production	1,895	62.6%	3,509	n/a	1

(1) We have included full year production at Korshunov Mining Plant for 2003, 2002 a started consolidating its results in October 2003.

(2) Tonnages are reported on a wet basis.

Nickel ore and Nickel production

Southern Urals Nickel Plant operates two open-pit nickel ore mines, Sakhara a production plant in Orsk.

The Sakhara mine is located east of the Ural Mountains in the Chelyabinsk Re south of the town of Subutak, which is located on a main-line railroad 20 kilor Magnitogorsk, an industrial center in the Chelyabinsk Region. Stripping of ov 1983, and stripping of the main pit started in 1986. Shipments to Southern Ura 375 kilometers south of Sakhara) started in 1994 when Southern Urals Nickel from the Kempirsay deposit in Kazakhstan. Production at Sakhara has been co current subsoil license is valid until April 1, 2013.

The Buruktal mine is located east of the south tip of the Ural Mountains, in the border with Kazakhstan. It lies near the town of Svetly, which is located 230 k end of a rail line. Mining at Buruktal began in 1968, and has been continuous license is valid until December 31, 2012.

We generally have a right of perpetual use of the properties on which Souther and mines are located, though we lease some of the area on which the Burukta

Both the Sakhara and Buruktal mining operations are typical of Russian open-
weathered lateritic ores and overburden can be directly loaded by electric shov
without any drilling or blasting. The ore is stockpiled and then loaded into rail
Urals Nickel Plant. Overburden waste is hauled to dumping locations inside th
possible or placed in dumps adjacent to the pit.

Nickel ore from both mines is transported by rail to our nickel production plan
lies east of the south tip of the Ural Mountains, close to the border with Kazak
is processed into sinter, which is smelted (with the addition of coke and limest
put through oxygen converters to produce converter matte and tailings. Conve
ferro nickel. Ferro nickel is shipped via rail from Orsk to our Chelyabinsk Me
Petersburg or Kaliningrad for export.

Table of Contents

Business

The following table summarizes our nickel ore and nickel products production

	6 months 2004		2003		
		Grade		Grade	
	tonnes	(% Ni)	tonnes	(% Ni)	to
			(tonnes in thousands		
Sakhara ore production	663	1.09%	1,435	1.08%	
Buruktal ore production	632	1.09%	1,164	1.02%	
Total ore production	1,295	1.09%	2,599	1.05%	
Nickel production	6.4	n/a	13.5	n/a	

(1) We have included full year production at Southern Urals Nickel Plant for 2001 alth consolidating its results in December 2001.
(2) Tonnages are reported on a wet basis.

Limestone production

The Pugachev limestone quarry is an open-pit mine located approximately 12 of Beloretsk in the Ural Mountains. The mine is connected to the Beloretsk rai rail spur. A road system also connects the mine to regional customers of aggre mine. The quarry was developed in 1952 to support Beloretsk Metallurgical P which are currently closed. We acquired the Pugachev limestone quarry as par Metallurgical Plant in June 2002. The current subsoil license is valid until Janu

Pugachev uses conventional mining technology. Ore is drilled and blasted, the into haultrucks. Relatively minor amounts of waste are hauled to external dum stockpiles located adjacent to the crushing and screening plant. Ore is crushed size fraction. Product is separated into three categories for sale: 0-20 millimete product and 40-80 millimeters product.

The quarry produces both high-grade flux limestone for use in steel making ar limestone for use in road construction. The flux limestone and aggregate limes limestone, but they are produced in different fraction sizes, which determines use. In 2003, almost 75% of the limestone produced at Pugachev was shipped with approximately 8% shipped to Chelyabinsk Metallurgical Plant and 17% s purchase limestone from third parties for our own use.

The table below summarizes our limestone production for the periods indicate

	6 month 2004
Limestone production	278.6

(1) We have included full year production at Pugachev for 2002 and 2001 although we results in June 2002.

Currently, limestone production is limited by the size of the crushing and scree capacity of approximately 600,000 tonnes per year. We are in the process of e crushing and screening plant capacity to increase our total production capacity year.

136

Mineral reserves

Our mineral reserves are based on exploration drilling and geological data, and
deposit which could be economically and legally extracted or produced at the
determination. Each year we update our reserve calculations based on actual p
including economic viability and any new exploration data. Our reserves, cons
reserves, meet the standards set by the SEC in its Industry Guide 7. See Glos

We retained the U.S.-based engineering firm Pincock, Allen & Holt, or PAH,
review of the mineral resources and reserves at each of the mines. Since PAH
previous Russian experience, they were familiar with Russian methodologies a
standards and were well qualified to conduct a review of our reserve estimates
visits to all of the mining properties in order to collect data and review the ope
visits, PAH reviewed the available information and conducted economic evalu

PAH reviewed the methodology and data used to develop the resource estimat
reserve estimates. For this review, PAH examined property geologic maps, wh
hole locations, geologic interpretations, and grades. Where possible, PAH com
drill hole logs. In some cases, the original drill logs were not available because
archives rather than at the mine site. PAH discussed with the mine geologist th
the resource estimates. PAH found that, as with most Russian properties, the a
exploration, sampling and ore body definition met or exceeded U.S. standards
information for the mines is not in electronic format. As a result, PAH was no
of the geologic models. However, based on gross checks of the resource estim
data, the operating history and past experience in Russia, PAH believes that th
reasonable. Reserve estimates are only based on that portion of the resource th
potential classification as proven and probable reserves.

For the reserve economic test, PAH had each of the mines develop long-term l
incorporated these into cash flows for each of the mines to verify that the resou
requirement to be classified as a reserve. Typically, Russian mines do not com
review when reporting reserve estimates. Reported reserves are based on the re
and the cash flow analysis.

Russian subsoil licenses are issued for defined boundaries and specific periods
declared reserves are contained within the current license boundary. Additiona
requirement of the SEC, only material that is scheduled to be mined during the
subsoil licenses based on planned production was included in reserves.

Our subsoil licenses expire on dates falling in 2009 through 2014. These subso
terminated prior to, or not be extended at, the time of their expiration. See Ri
Business and Industry Our business could be adversely affected if we fail to o
licenses and permits or fail to comply with the terms of our licenses and permi
to Our Business and Industry Deficiencies in the legal framework relating to s
licenses to the risk of governmental challenges and, if our licenses are suspend
unable to realize our reserves, which could materially adversely affect our bus
and Regulatory Matters Subsoil Licensing.

In addition to our mineral reserves, we have mineral deposits. Our mineral dep
reserves in all respects (and have been reviewed by PAH), except that the depo
within the license boundary but is scheduled to be extracted beyond the license
not contained within the license boundary. In both such cases, we expect to be

Table of Contents

Business

obtain the legal right to extract such deposit in the future, but we have a limite
and the Russian legal system provides regulatory authorities with discretion in
Risk Factors Risks Relating to Our Business and Industry Our business cou
obtain or renew necessary licenses and permits or fail to comply with the term
and Risk Factors Risks Relating to Russian Legislation and the Russian Leg
the Russian legal system and Russian legislation create an uncertain environm
activity and thus could have a material adverse effect on our business and the

Summary	Coal		Iron Ore
	Coking	Steam	
	(quantities in thousands		
Reserves	74,846	66,259	84,043
Grade (%)	53.0%*	47.0%*	30.9%
Deposits	43,997	35,903	104,105
Grade (%)	55.1%*	44.9%*	30.4%

* Shows percent of the type of coal.

Coal

As of January 1, 2004, we had coal reserves (proven and probable) totaling 14
approximately 53.0% was coking coal. The table below summarizes coal reser

Coal Reserves	Coking Coal
	(quant
Krasnogorsk	
Tomunsinsk	10,516
Olzherassk	8,610
Sibirginsk	34,720
Lenin	21,000
Total	74,846
% of Total	53.0%

(1) Heating values (in kcal/kg) are reported on a moisture- and ash-free basis.
(2) Tonnages are reported on a wet in-place basis.

Table of Contents

Business

As of January 1, 2004, we had coal deposits totaling 79.9 million tonnes, of w
coking coal. The table below summarizes coal deposits by mine.

Coal Deposits	Coking Coal
	(quant
Krasnogorsk	
Tomunsinsk	
Olzherassk	13,545
Sibirginsk	19,952
Lenin	10,500
Total	43,997
% of Total	55.1%

(1) Heating values (in kcal/kg) are reported on a moisture- and ash-free basis.
(2) Tonnages are reported on a wet in-place basis.

Iron ore

As of January 1, 2004, we had iron ore reserves (proven and probable) totalin
average iron grade of 30.9%. The table below summarizes iron ore reserves by

Iron Ore Reserves[1] [2]
Korshunovsk
Rudnogorsk
Tatianinsk
Total

(1) Includes adjustments for dilution and mine recovery, based on historical records.
(2) Based on a price of $26.60 per tonne of iron ore concentrate, at an exchange rate of
(3) Tonnages are reported on a dry basis.
(4) Metallurgical recovery is projected to be 82% for Korshunovsk, 74% for Rudnogor

As of January 1, 2004, we had iron ore deposits totaling 104.1 million tonnes a
30.4%. The table below summarizes iron ore deposits by mine.

Iron Ore Deposits(1) (2)

Korshunovsk
Rudnogorsk
Tatianinsk
Total

(1) Includes adjustments for dilution and mine recovery, based on historical records.
(2) Based on a price of $26.60 per tonne of iron ore concentrate, at an exchange rate of
(3) Tonnages are reported on a dry basis.
(4) Metallurgical recovery is projected to be 82% for Korshunovsk, 74% for Rudnogor

Table of Contents

Business

Nickel ore

As of January 1, 2004, we had nickel ore reserves (proven and probable) totali
average nickel grade of 1.05%. The table below summarizes nickel ore reserve

Nickel Ore Reserves(1) (2)

Sakhara
Buruktal
Total

(1) Includes adjustments for dilution and mine recovery, based on historical records.
(2) Based on a price of $3.60 per pound of nickel, at an exchange rate of 31.27 rubles p
(3) Tonnages are reported on a dry basis.
(4) Metallurgical recovery is projected to be 73%.

As of January 1, 2004, we had nickel ore deposits totaling 52.6 million tonnes
1.03%. The table below summarizes nickel ore deposits.

Nickel Ore Deposits(1) (2)

Sakhara
Buruktal
Total

(1) Includes adjustments for dilution and mine recovery, based on historical records.
(2) Based on a price of $3.60 per pound of nickel, at an exchange rate of 31.27 rubles p
(3) Tonnages are reported on a dry basis.
(4) Metallurgical recovery is projected to be 73%.

Limestone

As of January 1, 2004, we had limestone reserves (proven and probable) totali
CaO.

Limestone Reserves(1) (2)

Pugachev

(1) Includes adjustments for dilution and mine recovery, based on historical records.
(2) Based on a price of $3.20 per tonne of limestone, at an exchange rate of 31.27 ruble

As of January 1, 2004, we had limestone deposits totaling 45.0 million tonnes

Limestone Deposits(1) (2)

Pugachev

(1) Includes adjustments for dilution and mine recovery, based on historical records.
(2) Based on a price of $3.20 per tonne of limestone, at an exchange rate of 31.27 ruble

CAPITAL IMPROVEMENTS PROGRAM

Our capital improvements program emphasizes reductions in raw-material use
integration of our operating subsidiaries, expansion of our product range and i
protection, labor safety and working conditions. Our planned capital improver

140

Table of Contents

Business

estimated to cost approximately $900 million from 2005 through 2009, 70% o
steel business and 30% in the mining business.

More specifically, we intend to focus on the following:

- Realizing cost savings through the replacement of older equipment, intr technologies and reduction of production bottlenecks. In particular, we related cost-cutting which can be realized relatively quickly. For examp share of continuous casting in our raw steel production from 20% in 20 cutting costs by 8%, increasing productivity by 17% and increasing the produce; and
- Improving our product quality through procurement of new equipment maintain the reliability of grade composition, mechanical properties and

Over the past three years, we have refurbished a number of our upstream and Chelyabinsk Metallurgical Plant and have implemented a number of maintena expansion measures at Southern Kuzbass Coal Company.

We plan to leverage this experience in managing start-up phases and adequate continue our capital program at Chelyabinsk Metallurgical Plant, Southern Ku other subsidiaries.

The following table sets out by segment and facility the major items of our cap progress or expected to be commenced in 2004-2006.

Project	Estimated Production Increase and/or Other Improvements	Total Planned Expenditures* (in millions of U.S. dollar
STEEL BUSINESS		
Chelyabinsk Metallurgical Plant		
Expansion and Modernization of Sinter Production	Increase in sinter-production capacity	$78
Reconstruction of Coking Battery #7	Increase in output by approximately 500,000 tonnes p.a. of coke and 15,000 tonnes p.a. of coking products	$44

Reconstruction of Blast Furnace #3	Increase in capacity Reduction in coke usage	$73
Modernization and expansion of transportation and logistics capacities	Construction of intra-plant railways, roads and purchases of specialty trucks	$20

Table of Contents

Business

Project	Estimated Production Increase and/or Other Improvements	Total Planned Expenditures* (in millions of U.S. doll
Construction of Long Products Continuous Caster #4	Increase in output of continuously cast billets by 1.2 million tonnes p.a. Reduction in steel usage Production of 300,000 tonnes p.a. of continuously cast tube billets Reduction in power usage New product development	$46
Construction of Long Products and Tube Billets Continuous Caster #5	Reduction in steel usage Reduction in power usage New product development	$50
Modernization of rolling mill 300-2	Increase in capacity by 100,000 tonnes p.a.	$20
Energy Program	Increase in co-generation capacities by 37 MW Installation of 12 additional oxygen recipients Construction of two 500 cubic meters/hour argon gasification units	$20
Reconstruction of Blast Furnace #5	Increase in capacity	$25
Reconstruction of EAF Workshop #6	Increase in steel production by approximately 270,000 tonnes p.a.	$10
Construction of Continuous Wire-rod Rolling Mill 320/150	Increase in output by 900,000 tonnes p.a. New product development Reduction in steel usage Product quality improvements	$50

Modernization of Flat Products Capacities	Improvements in quality of stainless flat products	$30
Modernization of Oxygen Converter Workshop	Reduction in melting process time	$9

142

Table of Contents

Business

Project	Estimated Production Increase and/or Other Improvements	Total Planned Expenditures* (in millions of U.S. do
Beloretsk Metallurgical Plant		
Modernization of hardware equipment	Increase in production of copper-plated welding wire by 9,000 tonnes p.a. Increase in production of spring wire by 10,000 tonnes p.a. Produce new value-added features Environmental improvements	$ 10
Modernization of Continuous Wire Mill 150	Increase in wire-rod capacity by 90,000 tonnes p.a. Reduction in steel usage Reduction in gas usage Product quality improvement	$5
Izhstal		
Modernization of capacities	Product (rolled products and hardware) quality improvement Cost reduction	$9
COST		
Reconstruction of EAF #2	Increase of capacity by 93,000 tonnes p.a. of steel Increase in density of scrap charge Reduction in power consumption Reduction in electrode usage Reduction in refractory usage Reduction in melting period	$7

	Reduction in dust emissions	
Reconstruction of Steel Continuous Caster	Increase in production of continuously cast billets by 280,000 tonnes p.a. Reduction in steel usage Reduction in natural gas usage Reduction in electricity usage Expansion of product mix through alloyed steel	$8
Installation of Scoop-Type Vacuum Degasser	Reduction in processing costs	$5

Table of Contents

Business

Project	Estimated Production Increase and/or Other Improvements	Total Planned Expenditures* (in millions of U.S. d
Industria Sarmei		
Construction of Long Products Continuous Caster	Production of continuously cast billets of 380,000 tonnes p.a. Reduction in steel usage Reduction in electricity usage Reduction in natural gas usage	$12
Modernization of Hardware Production	New products (low-alloyed wire) output of 48,500 tonnes p.a. Increase of annealed and zinc-coated wire production by 8,000 tonnes p.a. Increase of nail production by 8,000 tonnes p.a. Production of 8,000 tonnes p.a. of wire rod Production of 50,000 tonnes p.a. of rebar	$10
MINING BUSINESS		
Southern Kuzbass Coal Company		
Output increase	Increase in coal production by approximately 1.0 million tonnes p.a.	$157
Reconstruction of Krasnogorsk Washing Plant #1	Increase of capacity by 900,000 tonnes p.a. of concentrate Improvement in steam coal concentrate quality	$11
Construction of Krasnogorsk Washing Plant #2	Increase of capacity by 3.0 million tonnes p.a. of steam coal concentrate	$20
Expansion of Sibirginsk Underground Mine	Increase in coking coal output by 1.5 million tonnes p.a.	$20

144

Business

Project	Estimated Production Increase and/or Other Improvements	Total Planned Expenditures* (in millions of U.S. doll
Korshunov Mining Plant		
Expansion of Concentrate Production Facilities	Increase of capacity by 800,000 tonnes p.a. of concentrate	$25
	Increase of capacity by 2.4 million tonnes p.a. of iron ore	
Southern Urals Nickel Plant		
Introduction of Cokeless Ferro nickel Production Technology	Reduction in production cost	$10
Expansion of Nickel Mines	Increase in nickel ore output by 212,000 tonnes p.a.	$9
Construction and Replacement of Furnace Oxygen Units	Supplies for cokeless ferro nickel production	$25

* We estimate that approximately $55.5 million of planned expenditures for these proj
2004. As of June 30, 2004, we spent $141.6 million of our total $330.5 million capit

OPERATIONS IMPROVEMENTS

We maintain research programs at the corporate level and at certain of our bus research and applied technology development activities, primarily focused on through improvements in working practices and operational methods. At our c Department of Long-Term Planning and Technological Development, which e researchers. We also contract with third-party consultants from the metallurgic research institutions to produce development concepts and conduct feasibility

In addition to these activities performed at our corporate level, each of Chelya Beloretsk Metallurgical Plant and Izhstal have specialized research divisions v involved in the improvement of existing technologies and products.

Our operations are not materially dependent on patents.

Table of Contents

Business

EMPLOYEES

At June 30, 2004, we employed approximately 84,982 people as follows:

Company (including its subsidiaries)	Primary Location	Primary Function
Chelyabinsk Metallurgical Plant	Russia	Steel
Southern Kuzbass Coal Company	Russia	Coal
Izhstal	Russia	Steel
Beloretsk Metallurgical Plant	Russia	Steel
Industria Sarmei	Romania	Steel
COST	Romania	Steel
Southern Urals Nickel Plant	Russia	Nickel
Korshunov Mining Plant	Russia	Iron Ore
Urals Stampings Plant	Russia	Steel
Mechel Zeljezara[(1)]	Croatia	Steel
Vyartsilya Metal Products Plant	Russia	Steel
Port Posiet	Russia	Shipping
Mechel Nemunas	Lithuania	Steel
Mechel Trading House	Russia	Sales and Distributio
Mechel Steel Group	Russia	Corporate
Mechel Trading	Switzerland	Sales and Distributio
Other	Russia, CIS	Coal, Steel
Total		

(1) We terminated production at Mechel Zeljezara in August 2004.

At December 31, 2003, we employed approximately 73,426 people as follows

Company (including its subsidiaries)	Primary Location	Primary Function
Chelyabinsk Metallurgical Plant	Russia	Steel
Southern Kuzbass Coal Company	Russia	Coal
Beloretsk Metallurgical Plant	Russia	Steel
Industria Sarmei	Romania	Steel
COST	Romania	Steel
Southern Urals Nickel Plant	Russia	Nickel

Korshunov Mining Plant	Russia	Iron Ore
Urals Stampings Plant	Russia	Steel
Mechel Zeljezara[1]	Croatia	Steel
Vyartsilya Metal Products Plant	Russia	Steel
Mechel Trading House	Russia	Sales and Distributio
Mechel Nemunas	Lithuania	Steel
Mechel Trading	Switzerland	Sales and Distributio
Mechel Steel Group	Russia	Corporate
Total		

(1) We terminated production at Mechel Zeljezara in August 2004.

Table of Contents

Business

At December 31, 2002 and 2001, we employed the following number of peopl

Company (including its subsidiaries)
Chelyabinsk Metallurgical Plant
Southern Kuzbass Coal Company
Beloretsk Metallurgical Plant
COST
Southern Urals Nickel Plant
Vyartsilya Metal Products Plant
Mechel Trading House
Mechel Trading
Total

Employees of Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant,
Korshunov Mining Plant and Urals Stampings Plant are members of the Ore M
Union of Russia, and employees of Southern Kuzbass Coal Company are mem
Trade Union of Coal Industry Workers. Employees of COST are members of
COST.

We consider our relationship with our employees to be good.

INSURANCE

The insurance industry is not yet well developed in Russia, and many forms of
in more economically developed countries are not yet available in Russia on c
coverage for business interruption. At present, our facilities are not insured, ar
business interruption or loss of key management personnel.

Our Russian subsidiaries maintain obligatory insurance, which includes insura
(including ecological) for injuries and losses caused by accidents in dangerous
third-party liability for injuries caused during construction and operation of hy
auto insurance. Sometimes our Russian subsidiaries insure real estate interest a
all instances and for all significant assets. Mechel Metal Supply maintains con
including marine, liability, including products liability, and trade indemnity. In
operational insurance.

LITIGATION

Other than the legal proceedings described below, we are not involved in any l
believe to be material.

Korshunov Mining Plant has a significant number of ongoing tax disputes, all
and penalties pertaining to its bankruptcy or the bankruptcy settlement agreem
$103.5 million. We are contesting these tax claims and have not recorded an a
consolidated financial statements.

In addition, some of our Russian trading subsidiaries are currently contesting t
underestimation of profits tax and value-added tax based on varying interpreta
1999 to 2002. These subsidiaries are no longer active, and we no longer use th
gave rise to these tax claims. As we consider the chances of successfully conte
very low, we recorded an accrual of $29.0 million as of December 31, 2003.

Table of Contents

Regulatory matters

We describe below certain regulatory matters that are applicable to our Russia

LICENSING OF OPERATIONS

We are required to obtain numerous licenses, authorizations and permits from
authorities for our operations. The Federal Law on Licensing of Certain Types
2001, as amended, as well as other laws and regulations, set forth the activities
establish procedures for issuing licenses. In particular, some of our companies
permits to carry out their activities, including, *inter alia*:

- the use of subsoil, which is described in more detail in Subsoil Licen
- the use of water resources;
- the discharge of pollutants into the environment;
- the handling of hazardous waste;
- storage and use of explosive, flammable and/or dangerous materials;
- operation of industrial facilities;
- construction;
- fire control;
- medical operations; and
- transportation activities.

These licenses are usually issued for a period of five years and may be extende
licensee. Licenses for the use of natural resources may be issued for shorter or
licenses for the use of surface water resources may be issued for periods of up
expiration of a license, it may be extended upon application by the licensee. C
also have unlimited terms.

Regulatory authorities maintain considerable discretion in the timing of issuin
requirements imposed by these authorities may be costly, time-consuming and
commencement or continuation of exploration or production operations. Furth
public at large possess rights to comment on and otherwise participate in the li
through challenges in the courts. Accordingly, the licenses we need may not b
be issued in a timely fashion, or may impose requirements which restrict our a
or to do so profitably.

As part of their obligations under licensing regulations and the terms of our lic
companies must comply with numerous industrial standards, employ qualified
equipment and a system of quality controls, monitor operations, maintain and

upon request, submit specified information to the licensing authorities that cor

SUBSOIL LICENSING

In Russia, mining minerals requires a subsoil license from the state authorities
mineral deposit, as well as the right (through ownership, lease or other right) t
licensed mineral deposit is located. In addition, as discussed above, operating
respect to specific mining activities.

Table of Contents

Regulatory matters

The primary law regulating subsoil licensing is the Law on Subsoil Resources
amended, or the Subsoil Law, which sets out the regime for granting licenses f
production of mineral resources. The Procedure for Subsoil Use Licensing, or
adopted by Resolution of the Supreme Soviet of the Russian Federation on Jul
regulates the exploration and production of mineral resources. According to bo
Licensing Regulation, subsurface mineral resources are subject to the joint jur
regional authorities.

There are two major types of licenses: (1) an exploration license, which is a no
the right of geological exploration and assessment within the license area, and
grants the licensee an exclusive right to produce minerals from the license area
licenses are issued as combined licenses, which grant the right to explore, asse
the license area. A subsoil license defines the license area in terms of latitude,

There are two major types of payments with respect to the extraction of miner
the use of subsoil under the Subsoil Law and (2) the minerals extraction tax un
make these payments could result in the suspension or termination of the subso
Law-mandated payments are not material to our mining segment s results of o
extraction tax is calculated as a percentage of the value of minerals extracted.
for coal, 4.8% for iron ore and 8% for nickel. In 2003, we incurred the mineral
of $9.1 million.

The term of the license is set forth in the license. Prior to January 2000, explor
maximum term of five years, production licenses a maximum term of 20 years
assessment and production licenses a maximum term of 25 years. After amend
January 2000, exploration licenses may still have a maximum term of five yea
have a one-year term in a limited number of special cases, but are generally gr
operational life of the field based on a feasibility study; and combined explora
licenses can be issued for the term of the expected operational life of the field
These amendments did not affect the terms of licenses issued prior to January
apply for extensions of such licenses for the term of the expected operational l
with the amended Subsoil Law. The term of a subsoil license runs from the da
the Russian Federal Geological Fund.

Issuance of licenses

Subsoil licenses are generally issued by the Federal Agency for Subsoil Use. M
production licenses owned by companies derive from (1) pre-existing rights gr
up to the enactment of the Subsoil Law to state-owned enterprises that were su
course of post-Soviet privatizations; or (2) tender or auction procedures held in
Russian Civil Code, the Subsoil Law and the Licensing Regulation contain the
tenders and auctions. The Subsoil Law allows for production licenses to be iss

procedure only in limited circumstances, such as instances when a mineral dep
of an exploration license at its own expense during the exploration phase.

Extension of licenses

The Subsoil Law permits a subsoil licensee to request an extension of a produc
complete the production from the subsoil plot covered by the license or the pro
land once the use of the subsoil is complete, provided the user complies with t

Table of Contents

Regulatory matters

conditions of the license and the relevant regulations.

In order to extend a subsoil license, a company must file an application with th
the license.

The Order of the Ministry of Natural Resources No. 439-R, dated October 31,
following issues be considered by the relevant governmental authorities when
an amendment: (1) the grounds for the amendments, with specific information
impact payments by the licensee to the federal and local budgets; (2) complian
conditions of the license; and (3) the technical expertise and financial capabili
implement the conditions of the amended license.

The factors that may, in practice, affect a company s ability to obtain the appr
include (1) its compliance with the license terms and conditions; (2) its manag
expertise relating to subsoil issues, including experience in amending licenses
management with federal and/or local governmental authorities, as well as the
description of additional factors that may affect Russian companies ability to
Factors Risks Relating to Our Business and Industry Our business could be a
obtain or renew necessary licenses and permits or fail to comply with the term
See also Risk Factors Risks Relating to Our Business and Industry Deficien
to subsoil licensing subject our licenses to the risk of governmental challenges
suspended or terminated, we would be unable to realize our reserves, which co
our business and results of operations and Risk Factors Risks Relating to R
Legal System Weaknesses relating to the Russian legal system and Russian le
environment for investment and business activity and thus could have a materi
business and the value of our ADSs.

Maintenance and termination of licenses

A license granted under the Subsoil Law is generally accompanied by a licens
provides that there be two parties to any subsoil licensing agreement: the feder
The licensing agreement sets out the terms and conditions for the use of the su

Under a licensing agreement, the licensee makes certain environmental, safety
For example, the licensee makes a production commitment to bring the field in
and to extract an agreed-upon volume of natural resources each year. The licen
commitments with respect to social and economic development of the region.
licensee must return the land to a condition which is adequate for future use. A
set out in a license are based on mandatory rules contained in Russian law, cer
agreement are left to the discretion of the licensing authorities and are often ne

However, commitments relating to safety and the environment are generally n
we will be able to meet the commitments set forth in our licensing agreements
will spend approximately $13 million in total over the next several years.

The fulfillment of a license s conditions is a major factor in the good standing
licensee fails to fulfill the license s conditions, upon notice, the license may b
authorities. However, if a subsoil licensee cannot meet certain deadlines or ac
exploration work or production output as set forth in a license, it may apply to
conditions, though such amendments may be denied.

150

Table of Contents

Regulatory matters

The Subsoil Law and other Russian legislation contain extensive provisions fo
licensee can be fined or the license can be suspended or terminated for the reas
breaches of the law, upon the occurrence of a direct threat to the lives or health
in the local area, or upon the occurrence of certain emergency situations. A lic
violations of material license terms. Although the Subsoil Law does not spe
failure to pay subsoil taxes and failure to commence operations in a timely ma
grounds for termination of licenses. Consistent underproduction and failure to
project would also likely constitute violations of material license terms. In add
that the violation by a subsoil licensee of any of its obligations may constitute
license.

If the licensee does not agree with a decision of the licensing authorities, inclu
license termination or the refusal to re-issue an existing license, the licensee m
administrative or judicial proceedings. In certain cases of termination, the licen
cure the violation within three months of its receipt of notice of the violation. I
within such a three-month period, no termination or other action may be taken

LAND USE RIGHTS

Russian legislation prohibits the carrying out of any commercial activity, inclu
land plot without appropriate land use rights. Land use rights are needed and o
the license area actually being used, including the plot being mined, access are
mining-related activity is occurring.

Under the Land Code of the Russian Federation of October 25, 2001, as amend
companies generally have one of the following rights with regard to land in th
ownership; (2) right of free use for a fixed term; or (3) lease.

A majority of land plots in the Russian Federation are owned by federal, regio
which, through public auctions or tenders or through private negotiations, can
rights to the land to third parties.

Companies may also have a right of perpetual use of land that was obtained pr
Code; however, the Federal Law on Introduction of the Land Code of October
exceptions, requires companies using land pursuant to rights of perpetual use e
or to enter into a lease agreement relating to, the land with the relevant federal
authority owner of the land by January 1, 2006. See Risk Factors Risks Rela
Industry The potential implementation by the Russian government of a law re
purchase or lease the land on which they operate may have a material adverse
condition.

Our mining subsidiaries generally have a right of perpetual use of their plots o
lease agreements. A lessee generally has a priority right to enter into a new lar
upon the expiration of a land lease. In order to renew a land lease agreement, t
lessor (usually state or municipal authorities) for a renewal prior to the expirat
agreement for a period of longer than one year must be registered with the rele

ENVIRONMENTAL

We are subject to laws, regulations and other legal requirements relating to the
including those governing the discharge of substances into the air and water, th
hazardous substances and waste, the cleanup of contaminated sites, flora

Table of Contents

Regulatory matters

and fauna protection and wildlife protection. Issues of environmental protectio primarily by the Federal Law on Environmental Protection of January 10, 200 Protection Law, as well as by number of other federal and local legal acts.

Pay-to-pollute

The Environmental Protection Law establishes a pay-to-pollute regime adm authorities. The Ministry of Natural Resources has established standards relati the environment and, in particular, limits for emissions and disposal of substan resource extraction. A company may obtain approval for exceeding these statu regional authorities, depending on the type and scale of environmental impact. approval, a plan for the reduction of the emissions or disposals must be develo cleared with the appropriate governmental authority. Fees, as set forth in a gov on a sliding scale for both the statutory or individually approved limits on emi pollution in excess of these limits: the lowest fees are imposed for pollution w intermediate fees are imposed for pollution within the individually approved li imposed for pollution exceeding such limits. Payments of such fees do not reli responsibility to take environmental protection measures and undertake restora 2003, we incurred such fees in the amount of $2.0 million.

Ecological approval

Any activities that may affect the environment are subject to state ecological a accordance with the Federal Law on Ecological Expert Examination of Noven Conducting operations that may cause damage to the environment without stat result in the negative consequences described in Environmental Liability be

Enforcement authorities

The Federal Service for the Supervision of the Use of Natural Resources, the F Environmental, Technological and Nuclear Supervision, the Federal Service fo Environmental Monitoring, the Federal Agency on Subsoil Use, the Federal A Federal Agency on Water Resources (along with their regional branches) are i control, implementation and enforcement of relevant laws and regulations. The Ministry of Natural Resources is responsible for coordinating the activities of area. Such regulatory authorities, along with other state authorities, individuals non-governmental organizations, also have the right to initiate lawsuits for the caused to the environment. The statute of limitations for such lawsuits is 20 ye

Environmental liability

If the operations of a company violate environmental requirements or cause ha
individual or legal entity, a court action may be brought to limit or ban these o
company to remedy the effects of the violation. Any company or employees th
environmental regulations may be subject to administrative and/or civil liabilit
criminally liable. Courts may also impose clean-up obligations on violators in
imposing fines.

Subsoil licenses generally require certain environmental commitments. Althou
substantial, the penalties for failing to comply and the clean-up requirements a

Table of Contents

Regulatory matters

Reclamation

We conduct our reclamation activities in accordance with the Basic Regulation
Removal, Preservation, and Rational Use of the Fertile Soil Layer, approved b
December 22, 1995, of the Ministry of Natural Resources. In general, our recla
a technical stage and a biological stage. In the first stage, we backfill the pits, g
level the surface of the mounds, and add clay rock on top for greater adaptabil
biological stage, we plant conifers (pine, larch, cedar) on horizontal and gently
and bushes to reinforce inclines. Russian environmental regulations do not req
approximate original contour (AOC) of the property as is required, for exampl

Environmental protection programs

We have been developing and implementing environmental protection progra
subsidiaries. Such programs include measures to aid in our adherence to the li
pollution and storage of industrial waste, introduction of environmentally frie
construction of purification and filtering facilities, the repair and reconstructio
systems, the installation of metering systems, reforestation and the recycling o
We are member of Ecological Movement for Specific Activities, a non-pro
and facilitates the implementation of environmental programs and individual p
institutions.

HEALTH AND SAFETY

Due to the nature of our business, much of our activity is conducted at industri
workers, and workplace safety issues are of significant importance to the opera

The principal law regulating industrial safety is the Federal Law on Industrial
Facilities of July 21, 1997, as amended, or the Safety Law. The Safety Law ap
facilities and sites where certain activities are conducted, including sites where
where alloys of ferrous and non-ferrous metals are produced and where certain
Safety Law also contains a comprehensive list of dangerous substances and the
extends to facilities and sites where these substances are used.

There are also regulations that address safety rules for coal mines, the product
blast-furnace industry, steel smelting, alloy production and nickel production.
apply to certain industries, including metallurgical and coke chemical enterpri

Any construction, reconstruction, liquidation or other activities in relation to re
subject to a state industrial safety review. Any deviation from project documen
construction, reconstruction and liquidation of industrial sites is prohibited unl
expert and approved by the Federal Service for Environmental, Technological

Companies that operate such industrial facilities and sites have a wide range o
Law and the Labor Code of Russia effective February 1, 2002, as amended, or
they must limit access to such sites to qualified specialists, maintain industrial
insurance for third-party liability for injuries caused in the course of operating
also requires these companies to enter into contracts with professional wreckin
own wrecking services in certain cases, conduct personnel training programs,
inform the Federal Service for Environmental, Technological and Nuclear Sup
maintain these systems in good working order.

Table of Contents

Regulatory matters

In certain cases, companies operating industrial sites must also prepare declara
summarize the risks associated with operating a particular industrial site and m
and will take to mitigate such risks and use the site in accordance with applica
requirements. Such declaration must be adopted by the chief executive officer
personally responsible for the completeness and accuracy of the data contained
declaration, as well as a state industrial safety review, are required for the issu
operation of a dangerous industrial facility.

The Federal Service for Environmental, Technological and Nuclear Supervisio
field of industrial safety. In case of an accident, a special commission led by a
Service for Environmental, Technological and Nuclear Supervision conducts a
cause. The company operating the hazardous industrial facility where the acci
an investigation. The officials of the Federal Service for Environmental, Techn
Supervision have the right to access industrial sites and may inspect document
compliance with safety rules. The Federal Service for Environmental, Technol
may suspend or terminate operations or impose administrative liability.

Any company or individual violating industrial safety rules may incur adminis
individuals may also incur criminal liability. A company that violates safety ru
impacts the health of an individual may also be obligated to compensate the in
well as health-related damages.

EMPLOYMENT AND LABOR

Labor matters in Russia are primarily governed by the Labor Code. In addition
relationships between employers and employees are regulated by various fede
Law on Collective Contracts and Agreements of March 11, 1992, as amended;
Procedure of Settlement of Collective Labor Disputes of November 23, 1995,
on Employment in the Russian Federation of April 20, 1996, as amended; the
Fundamentals of Protection of Labor in the Russian Federation of July 17, 199

Employment contracts

As a general rule, employment contracts for an indefinite term are concluded v
labor legislation expressly limits the possibility of entering into term employm
employment contract may be entered into for a fixed term of up to five years i
relations may not be established for an indefinite term due to the nature of the
performance of such duties as well as in other cases expressly identified by fed

An employer may terminate an employment contract only on the basis of the s
the Labor Code, including:

liquidation of the enterprise or downsizing of staff;
failure of the employee to comply with the position s requirements due
problems;
systematic failure of the employee to fulfill his or her duties;
any single gross violation by the employee of his or her duties; and
provision by the employee of false documents or misleading informatio
employment contract.

154

Table of Contents

Regulatory matters

An employee dismissed from an enterprise due to downsizing or liquidation is
compensation including a severance payment and, depending on the circumsta
certain period of time.

The Labor Code also provides protections for specified categories of employe
of liquidation of an enterprise, an employer cannot dismiss minors, expectant
under the age of three, single mothers with a child under the age of fourteen o
under the age of 14 without a mother.

Any termination by an employer that is inconsistent with the Labor Code requ
a court, and the employee may be reinstated. Lawsuits resulting in the reinstat
employees and the payment of damages for wrongful dismissal are increasing
tend to support employees rights in most cases. Where an employee is reinst
must compensate the employee for unpaid salary for the period between the w
reinstatement, as well as for mental distress.

Work time

The Labor Code generally sets the regular working week at 40 hours. Any tim
week, as well as work on public holidays and weekends, must be compensated

Annual paid vacation leave under the law is generally four weeks. Our employ
and open-pit mining works or other work in harmful conditions may be entitle
ranging from six to 36 working days.

The retirement age in the Russian Federation is 60 years for males and 55 yea
retirement age for male miners who have worked in underground mines for at
have worked in underground mines for at least seven years and six months, is
respectively. Persons who have worked as miners in open-pit mines and/or un
years may also retire, regardless of age.

Salary

The minimum salary in Russia, as established by federal law, is calculated on
600 rubles (currently approximately $20). Although the law requires that the n

minimum subsistence level, the current minimum wage is generally considere
subsistence level.

Strikes

The Labor Code defines a strike as the temporary and voluntary refusal of wo
with the intention of settling a collective labor dispute. Russian legislation co
legal strikes. Participation in a legal strike may not be considered by an emplo
an employment contract, although employers are generally not required to pay
for the duration of the strike. Participation in an illegal strike may be adequate

TRADE UNIONS

Although recent Russian labor regulations have curtailed the authority of trad
significant influence over employees and, as such, may affect the operations o
Russia. In this regard, our management routinely interacts with trade unions i
treatment of our employees and the stability of our business.

Table of Contents

Regulatory matters

The activities of trade unions are generally governed by the Federal Law on T
Guaranties of Their Activity of January 12, 1996, as amended, or the Trade U
legal acts include the Labor Code of Russia, the Federal Law on Collective C
March 11, 1992, as amended, and the Federal Law on the Procedure for Settle
Disputes of November 23, 1995, as amended, which provide for more detailed
activities of trade unions.

The Trade Union Law defines a trade union as a voluntary union of individual
and other interests that is incorporated for the purposes of representing and pro
of its members. National trade union associations, which coordinate activities
Russia, are also permitted.

As part of their activities, trade unions may:

- negotiate collective contracts and agreements such as those between the
federal, regional and local governmental authorities and other entities;
- monitor compliance with labor laws, collective contracts and other agre
- access work sites and offices, and request information relating to labor i
management of companies and state and municipal authorities;
- represent their members and other employees in individual and collectiv
management;
- participate in strikes; and
- monitor redundancy of employees and seek action by municipal authori
suspend mass layoffs.

Russian laws require that companies cooperate with trade unions and do not in
Trade unions and their officers enjoy certain guarantees as well, such as:

- legal restrictions as to rendering redundant employees elected or appoin
management of trade unions;
- protection from disciplinary punishment or dismissal on the initiative of
without prior consent of the management of the trade union and, in certa
the consent of the relevant trade union association;
- retention of job positions for those employees who stop working due to
management of trade unions;
- protection from dismissal for employees who previously served in the m
union for two years after the termination of the office term; and
- provision of the necessary equipment, premises and transportation vehic
the trade union free of charge, if provided for by a collective bargaining

If a trade union discovers any violation of work condition requirements, notifi
with a request to cure the violation and to suspend work if there is an immedia

employees. The trade union may also apply to state authorities and labor inspe
that an employer does not violate Russian labor laws. Trade unions may also i
which may lead to strikes.

To initiate a collective labor dispute, trade unions present their demands to the
then obliged to consider the demands and notify the trade union of its decision
unresolved, a reconciliation commission attempts to end the dispute. If this pro
labor disputes are generally referred to mediation or labor arbitration.

Table of Contents

Regulatory matters

The Trade Union Law provides that those who violate the rights and guarantie
their officers may be subject to disciplinary, administrative and criminal liabil
of the Russian Federation on Administrative Misdemeanors of December 30, 2
the Russian Federation of June 13, 1996, currently has provisions specifically
general provisions and sanctions may be applicable.

Table of Contents

Management

DIRECTORS AND EXECUTIVE OFFICERS

Our directors and executive officers include:

Name	Year of Birth	Position
Igor V. Zyuzin[(1)]	1960	Chairman
Vladimir F. Iorich[(1)]	1958	Director a
Alexey G. Ivanushkin	1962	Director a
Sir Andrew M. Wood[(2)]	1940	Director
Roger I. Gale[(2)]	1952	Director
A. David Johnson[(2)]	1937	Director
Serafim V. Kolpakov	1933	Director
Alexander E. Yevtushenko	1947	Director
Valentin V. Proskurnya	1945	Director
Svetlana V. Ardentova	1973	Chief Fin
Vladimir I. Tytsky	1950	Senior Vi Integratio
Vladimir A. Polin	1962	Senior Vi
Jan A. Castro	1967	Senior Vi and Gener

(1) Party to the Ownership, Control and Voting Agreement dated August 1, 1995. See and Risk Factors Risks Relating to Our Business and Industry We will be contro business and affairs collectively and whose interests could conflict with those of the

(2) Member of the Audit Committee of the Board of Directors.

Igor V. Zyuzin has been the Chairman of our Board of Directors since March Group was organized. Mr. Zyuzin also serves as the Chairman of the Board of Kuzbass Coal Company, a position he has held since May 1999. From 1997 to Chairman of the Board of Directors of Mezhdurechensk Coal Company, which Kuzbass Coal Company, and a member of the Board of Directors of Kuzbass C Mr. Zyuzin has over 16 years of experience in the coal mining industry and ho mining from Tula Polytechnic University. Mr. Zyuzin also has a degree in coa economics. Mr. Zyuzin beneficially owns 47.8% of our common shares, inclu 50% of the capital stock of Conares Holding AG, which owns 26.6% of our co

Vladimir F. Iorich has been our Chief Executive Officer since January 2004 Directors since March 2003. Since 1995, Mr. Iorich has served as the Presiden overseeing our export sales and financing. From 2001 to 2004, he served as a Russian steel producer in which we own 17.1% of the common and 12.2% of t has over 23 years of engineering, marketing and management experience in th holds a degree in engineering and economics from Kemerovo Polytechnic Uni Chairman of the Board of Directors and President of Conares Holding AG. Mr

47.8% of our common shares, including through his ownership of 50% of the c
Holding AG, which owns 26.6% of our common shares.

Alexey G. Ivanushkin has been our Chief Operating Officer since January 20
of Directors since March 2003. Mr. Ivanushkin served as our Chief Executive
January 2004. Mr. Ivanushkin also serves as the Chairman of the Board of Dir
Metallurgical Plant, a position he has held since June 2002. From December 1

158

Table of Contents

Management

2002, Mr. Ivanushkin served as the General Director of our Chelyabinsk Meta
November 1999, he was the director of the ferrous metals and ferroalloy depar
Glencore International AG, an international diversified natural resources grou
Chelyabinsk Metallurgical Plant. Mr. Ivanushkin graduated from the Moscow
Relations (MGIMO) with a degree in economics and international affairs.

Sir Andrew M. Wood has been a member of our Board of Directors since Oc
Chairman of the Board of the Russo-British Chamber of Commerce, a Directo
Investment Trust, and a Director of The PBN Company. Sir Andrew retired fr
Service in 2000 after serving as Ambassador to Moscow from 1995 to 2000 a
from 1985 to 1989. This latest posting in Moscow was the third of his posting
began his diplomatic career in 1964. He also twice served in the British Emba
and Belgrade. Sir Andrew has acted as adviser to the British Prime Minister, T
investment issues and has worked with a number of multinationals at the CEO
GlaxoSmithKline, Diageo and Renaissance Capital. He is a member of the Ad
Consultants and Construction Bureau, and has worked closely with the Confe
Russia-related matters. Sir Andrew received his B.A. and M.A. from King s C

Roger I. Gale has been a member of our Board of Directors since October 20
Chairman of the Board of Directors and Chief Executive Officer of Wavecrest
communications service provider. He is also a founder and director of Starnor
and media consultancy. From 1999 to 2001, he was Chairman and co-founder
a wireless access services provider. From 1996 to 1998, Mr. Gale was Chief E
AIG-Brunswick Capital Management, a $300 million Russian investment fun
worked for the International Finance Corporation (IFC), including as the Chie
the Russian Federation from 1991 to 1996. Mr. Gale also worked for the Asia
years, and has lectured in economics at the University of New England (Austr
Zealand). Mr. Gale holds a Higher National Diploma from The Royal Agricul
Master of Economics from the University of New England.

A. David Johnson has been a member of our Board of Directors since Octobe
currently Chairman of the Board of Directors of Joy Mining Machinery UK L
underground mining systems and services, a position he has held since 2002.
was Managing Director of Joy Mining Machinery UK Ltd. From 1986 to 199
Managing Director of Dosco Overseas Engineering, a UK-based mining equip
began as a mining engineer in 1960. He also worked at the UK National Coal
Johnson is Joy Mining Machinery s representative on both the Coal Industry
Coal Institute. From 1990 to 1992, he served as President of the Association o
Companies. In 1998, he was awarded the Order of Friendship by the Russian
Russian coal industry. Mr. Johnson is a qualified mining engineer having obta
Qualifications Board Certificate in 1958.

Serafim V. Kolpakov has been a member of our Board of Directors since Jun
Dr. Kolpakov has served as President of the International Metallurgists Union
research organization. From 1991 to 1992, he was Vice President of the Adva

Moscow, a public consulting and research organization. From 1985 to 1991, D
Metallurgy of the USSR and, from 1978 to 1985, First Deputy Minister and D
the USSR. From 1970 to 1978, he was the General Director of Novolipetsk Ir
integrated steel mill, where he began as a foreman in 1963.

Table of Contents

Management

Dr. Kolpakov graduated from the Moscow Institute of Steel and Alloys with a
Doctor of Technical Sciences. He is a member of the International Engineerin
Academy of Russia (holding the position of Vice President) and the Presidium
Technologies and Processes. Dr. Kolpakov has invented more than 400 steel-r
improvements, and authored over 500 scientific publications. He has received
awards, including the State Prize of the USSR in 1981 and 1985, the Prize of t
USSR (twice) and the title of Honorable Metallurgist of the Russian Federatio

Alexander E. Yevtushenko has been a member of our Board of Directors sin
2004, Dr. Yevtushenko served as First Vice President of Sokolovskaya OAO,
of Russian coal mining and engineering enterprises. From 1999 to 2000, he wa
Committee of Inter-State Eurasian Association of Coal and Metals. From 199
First Deputy Fuels and Energy Minister of Russian Federation. From 1973 to
positions, including as General Director at Raspadskaya Mine in Kuzbass, one
coal mines. Dr. Yevtushenko graduated from the Siberian Metallurgical Institu
engineering. He is a Doctor of Engineering and a member of Academy of Min
Yevtushenko is the author of more than 50 scientific publications, including
Industry of Russia, a study for which he was awarded the 2002 Science and
government. He has received a number of government awards, including the ti
Russian Federation in 1997.

Valentin V. Proskurnya has been a member of our Board of Directors since
also currently serves as a Director of MMK, a major Russian steel producer in
common and 12.2% of the preferred shares. From March 2002 until March 20
the Deputy General Director of Mechel Trading House, and was its General D
March 2002. From 1998 to 2001, Mr. Proskurnya served as the First Deputy D
Kuzbass Coal Company, in charge of economic and financial analysis. Mr. Pr
engineering, financial and management experience in the coal mining industry
economics from the Higher School of Trade Unions. Mr. Proskurnya has been
of the Miner s Glory order by the Russian government. In addition, in 199
him the title of Honorable Economist of the Russian Federation.

Svetlana V. Ardentova has been our Chief Financial Officer since March 20
February 2003, Ms. Ardentova served as the General Director of Roszerno ZA
group of agriculture-related companies. From 1995 to 2002, she held various p
Foods OJSC, a manufacturer of dairy and juice products listed on the New Yo
recently serving as their Chief Financial Officer. At Wimm-Bill-Dann, from 2
director of the financial department; from 1999 to 2000, she was the head of th
division of the financial department; and from 1998 to 1999, Ms. Ardentova w
methodology and technology division of the economics department. Ms. Arde
Academy of Management with a degree in management.

Vladimir I. Tytsky has been our Senior Vice President-Strategy and Integrati
also a member of our Board of Directors from March 2003 to June 2004. Fron
served as Deputy General Director of Mechel Trading House, in charge of ma

through 2002, he occupied various positions at Chelyabinsk Metallurgical Pla
Deputy General Director-Marketing and Sales. Mr. Tytsky holds a degree in c
Dnepropetrovsk Metallurgy Institute.

Vladimir A. Polin has been our Senior Vice President-Production since July 2
June 2003, Mr. Polin served as the Executive Director-First Deputy General D

160

Table of Contents

Management

Beloretsk Metallurgical Plant. From September 2001 to August 2002, Mr. Pol
Chelyabinsk Metallurgical Plant. Mr. Polin has almost 20 years of floor and m
manufacture and marketing of steel products, and holds a degree in metallurgy
University.

Jan A. Castro has been our Senior Vice President-Corporate Affairs and Gen
Mr. Castro has also served as the General Counsel of Mechel Trading, a positi
2002 until March 2003. Prior to joining us, Mr. Castro worked for Latham & V
law firm, where he advised clients on public and private offerings of equity an
public offerings of Mobile TeleSystems OJSC and Wimm-Bill-Dann Foods O
Exchange, as well as on merger and acquisition transactions. Mr. Castro recei
Columbia University.

All of our directors were elected on October 14, 2004, and their terms expire o
shareholders meeting, which will take place between March 1 and June 30, 2
our directors and executive officers is Krasnopresnenskaya Naberezhnaya 12,
Federation.

COMPENSATION

Our directors and executive officers were paid an aggregate of $4.0 million fo
provided to us during 2003. The total amount set aside for pension, retirement
our directors and executive officers as of December 31, 2003, was $8,000.

BOARD PRACTICES

Board of Directors

Members of our Board of Directors are elected by a majority vote of sharehol
meeting using a cumulative voting system. Directors are elected for one-year t
unlimited number of times. Our Board of Directors currently consists of nine r
independent. The Board of Directors is responsible for our overall manageme
our shareholders. See Description of Capital Stock and Certain Requirement
Meetings of Shareholders for more information regarding the competence of
of the members of our Board of Directors, as well as the members of the boar
subsidiaries, serve pursuant to contracts. These contracts do not provide for an
their directorship.

Audit Committee

Our audit committee consists of Sir Andrew Wood, Roger Gale and David Joh
non-management member. The purpose of this committee is to assist the Boar
responsibilities regarding:

- the quality and integrity of our financial statements;
- our compliance with legal and regulatory requirements;
- the independent auditor s qualifications and independence; and
- the performance of our internal audit function and independent auditor.

REVIEW COMMISSION

The review commission verifies the accuracy of our financial reporting under
supervises our financial activity. The members of our review commission are
shareholders for a term of one year. A director may not simultaneously be a m
commission. Our review commission currently has three members: Svetlana A
Nadezhda Galushina. We do not have any specific terms of reference under w
operates.

CORPORATE GOVERNANCE PRINCIPLES

Our corporate governance principles are based on the Russian Corporate Gove
the Russian government and supplement the obligations of the Board of Direc
our charter and internal rules of procedure. The principles are intended to ensu
monitored in a responsible and value-driven manner. They include the protecti
comprehensive disclosure and transparency requirements and rules governing
committed to continue to adapt our corporate governance principles to best-pr
corporate governance principles are available at www.mechel.com.

We have a majority independent Board of Directors pursuant to the requireme
Exchange applicable to U.S. companies.

We are in compliance with applicable corporate governance requirements of t
listed companies that are foreign private issuers, such as Mechel, to follow the
practice where it differs from the NYSE requirements. In addition, we have vo
other requirements applicable to U.S. companies under NYSE listing standard
of NYSE listing standard 303A showing our compliance therewith and/or the
governance practices followed by us is available on our Internet website at w

CODE OF BUSINESS CONDUCT AND ETHICS

Our code of business conduct and ethics is available at www.mechel.com.

MANAGEMENT SHARE BONUS AND SHARE OPTION PLANS

We are considering establishing a share bonus plan and/or share option plan fo
If we establish such plans, we will set aside treasury shares in an amount not e
common shares. The common shares to be delivered under these plans are cur
owned subsidiary, Mechel Trading AG. See Principal and Selling Sharehold

---

162

Table of Contents

Certain transactions

MATERIAL CONTRACTS

Glencore Nickel Contract

We have an agreement with Glencore International AG to supply it with the gr
and all of our total export tonnage during the period of August 2001 to Decem
we had delivered a total of 24,437 tonnes of nickel under this contract. The pri
determined in U.S. dollars on the basis of nickel prices quoted by LME, less a

RELATED PARTY TRANSACTIONS

Magnitogorsk Iron & Steel Works

We own 17.1% of the common and 12.2% of the preferred shares of MMK, an
serves as a member of their Board of Directors.

In the years ended December 31, 2003, 2002 and 2001, MMK purchased 2.9 m
tonnes and 2.9 million tonnes of coking coal, respectively, from us generating
million, $90.7 million and $100.6 million, respectively. In 2003, MMK purcha
ore concentrate from Korshunov Mining Plant for $36.5 million. Starting in Ja
raw materials to MMK.

In the years ended December 31, 2003, 2002 and 2001, we purchased MMK s
million, $105.3 million and $123.0 million, respectively, which we resold inte
subsidiary, Mechel Trading. These products consisted of hot-rolled and cold-ro
galvanized sheets. As of January 2004, we stopped reselling MMK products.

CMS-Dubai

Until January 2003, Dennis Ruf, the Chief Operating Officer at Mechel Metal
in CMS-Dubai, a company engaged in trading business in Dubai. CMS-Dubai
us at market prices and resells them. In addition, CMS-Dubai sells products fr
with us, and also operates a steel service center in Dubai, cutting steel to custo
steel for third parties.

During the years ended December 31, 2003, 2002 and 2001, CMS-Dubai purc
million and $5.3 million, respectively, of steel products from us. We sell our p
interest-free deferred payment basis. As of December 31, 2003, CMS-Dubai o

Conares Holding AG

Conares Holding, a Swiss company, is a shareholder of Mechel and is benefic
and Iorich. We engaged in transactions with Conares Holding in connection w
Holding also provided financing to us, as well as received financing from us, i
reorganization.

As of June 30, 2004, Conares Holding did not owe us any amounts, but we ow
$0.8 million under a loan repayable in the second half of 2004.

Table of Contents

Certain transactions

Uglemetkooperatsia ZAO

Uglemetkooperatsia, a Russian company, is owned by Mr. Zyuzin. Uglemetko
us, as well as received financing from us, in connection with our reorganizatio

As of June 30, 2004, Uglemetkooperatsia owed us $12.4 million. The financin
interest-free. We owed Uglemetkooperatsia a total of $0.6 million as of June 3
2003, the debt of Uglemetkooperatsia to one of our subsidiaries was written of
million.

Uglemet ZAO

Uglemet, a Russian company, is owned by Mr. Zyuzin. Uglemet provided us v
rent and financing, as well as received financing from us. Amounts of equipme
space provided by Uglemet to us in the first six months of 2002 totaled $0.03

As of December 31, 2003, Uglemet owed us $5,000. The financing provided t
our reorganization was interest-free. We owed Uglemet a total of $47,000 as o

MetHol OOO

MetHol, a Russian company, is a shareholder of Mechel and is owned by Mr.
financing from us in relation to our reorganization.

As of June 30, 2004, MetHol owed us $3.0 million and we owed MetHol $0.3

Mechel Energy AG

Mechel Energy AG, formerly named Conares Eagle AG, in which we own 50
purchased coal from us in the first six months of 2004 in the amount of $31.4
Mechel Energy AG owed us $5.9 million.

Equity investments

Purchase and sale transactions with our equity investments amounted to $3.8 m
six months ended June 30, 2004, respectively. We also received and provided
investments. As of June 30, 2004, these companies owed us $9.4 million. We
million as of June 30, 2004.

Mechel Metal Supply

In October 2004, Mechel Trading concluded an agreement to transfer 1,072,31
held by it to two employees of Mechel Metal Supply Limited, our Lichtenstein
for 20% and 5%, respectively, of the shares of this subsidiary owned by these

---

Table of Contents

Principal and selling shareholders

The following table sets forth information regarding the current beneficial own
adjusted to reflect the sale of shares in the form of ADSs in this offering by:

- each person known by us to own beneficially any of our outstanding sha
- all our directors and executive officers; and
- each selling shareholder.

The following table assumes no exercise of the underwriters over-allotment o
additional 6,244,062 shares in the form of ADSs from the selling shareholders

Name of Beneficial Owner	Shares Beneficially Owned Before the Offering Number	%	Shar Offer
Igor V. Zyuzin[1]	183,048,907.5	47.80%	4,162
Vladimir F. Iorich[2]	183,048,907.5	47.80%	4,162
Mechel Trading AG[3]	13,152,065	3.43%	
All other directors, officers and employees	3,638,206	0.95%	
Free Float	81,000	0.02%	
Total	382,969,086	100.00%	8,325

(1) Mr. Zyuzin is Chairman of our Board of Directors. See Management. His busine
Naberezhnaya 12, Moscow 123610, Russian Federation. Of the shares beneficially
shares are held through MetHol OOO and 50,926,280.5 shares are held through Con
owns on an equal basis with Mr. Iorich. Mr. Zyuzin is a party to the Ownership, Co
August 1, 1995. Both Mr. Zyuzin and MetHol OOO are selling shareholders in this

(2) Mr. Iorich is our Chief Executive Officer and a member of our board of directors. S
address is Krasnopresnenskaya Naberezhnaya 12, Moscow 123610, Russian Federa
owned by Mr. Iorich, 63,442,734 shares are held through Britta Investments Ltd. an
through Conares Holding AG, a company he owns on an equal basis with Mr. Zyuz
Ownership, Control and Voting Agreement dated August 1, 1995. Both Mr. Iorich a
selling shareholders in this offering.

(3) Mechel Trading AG is wholly owned by us. In our U.S. GAAP consolidated financ
this prospectus, these shares are considered treasury shares.

None of our shareholders have voting rights different from any other holders o
knowledge, none of our shares are currently held by investors in the U.S. Base
believe we are not directly or indirectly owned or controlled by another corpor
there are no arrangements the operation of which may result in a change of con
the share issuance on April 29, 2003, in connection with the reorganization, th

significant changes in the beneficial percentage ownership held by any major s

Table of Contents

Principal and selling shareholders

Ownership, Control and Voting Agreement of August 1, 1995

Our principal shareholders, Igor Zyuzin and Vladimir Iorich, have acted in co
Ownership, Control and Voting Agreement which requires them to vote the sa
requires them to take all actions stated therein on the basis of the principal of p

- joint investment activities, which are defined in the agreement as acquis and service sectors;
- to take all actions in relation to the management of joint assets pursuant
- in the event that the parties cannot agree upon an action relating to a joi and evenly split the benefits arising from the disposition;
- to distribute all profits, income and other tangible and/or intangible ben activity evenly;
- to maintain their ownership parity with respect to their combined stake to the agreement so that, at all times, they own equal stakes in such asse not own equal stakes, to ensure that the principle of parity remains in pl and benefits owed to, the party owning a lesser stake); and
- to conduct all matters and/or relations between them that are not reflect accordance with the principle of parity.

The agreement is governed by the laws of Switzerland. Any dispute arising ou
agreement will be settled by arbitration in accordance with the Swiss Rules of

Following the offering, these shareholders will continue to be bound by this ag
Relating to Our Business and Industry We will be controlled by two sharehol
affairs collectively and whose interests could conflict with those of the holders

166

Table of Contents

Description of capital stock and certai
of Russian legislation

We describe below our registered common shares, the material provisions of c
of this prospectus and certain requirements of Russian legislation. In addition
to review our charter, which is included as an exhibit to the registration statem

OUR PURPOSE

Article 3 of our charter provides that our primary purpose is to earn profit, as v
highest-quality products for our customers.

DESCRIPTION OF CAPITAL STOCK

General

Pursuant to our charter, we have the right to issue registered common shares, p
securities provided for by the legislation of the Russian Federation with respec
currently consists of 497,969,086 authorized common shares, each with a nom
which 382,969,086 shares are fully paid, issued and outstanding. Under Russia
refers to the aggregate nominal value of the issued and outstanding shares. No
or outstanding. Preferred shares may only be issued if amendments have been
a resolution of the general meeting of shareholders. None of our capital stock i
conditionally or unconditionally to be put under option. Since we were recentl
holding company for certain companies owned by our shareholders, 99.97% o
paid for with the stock of these companies. The Joint Stock Companies Law re
our shares that we acquire within one year of their acquisition or, failing that, r
refer to such shares as treasury shares for purposes hereof. Russian legislation
such treasury shares. Any of our shares that are owned by our subsidiaries are
under Russian law (*i.e.*, they are considered outstanding shares), and we are ab
dispose of such shares without any further corporate actions by our shareholde
Trading, a wholly owned subsidiary, owns 3.43% of our outstanding common
our U.S. GAAP consolidated financial statements included elsewhere in this p
considered treasury shares (*i.e.*, they are considered not outstanding).

We are a joint stock company with fewer than 1,000 holders of voting shares f
provisions of the Joint Stock Companies Law described below. We will contin
holders of voting shares for purposes of these provisions following our initial p

depositary will be considered under Russian law as the holder of all of our AD

Rights attaching to common shares

Holders of our common shares have the right to vote at all shareholder meetin
Stock Companies Law and our charter, all of our common shares have the sam
their holders identical rights. Each fully paid common share, except for treasu
right to:

- freely transfer the shares without the consent of other shareholders;
- receive dividends;

Table of Contents

Description of capital stock and certain requirements of Russian l

participate in shareholders meetings and vote on all matters of shareho
transfer voting rights to its representative on the basis of a power of atto
elect and dismiss members of the board of directors and the review com
if holding, alone or with other holders, 2% or more of the voting stock,
our fiscal year, make proposals for the annual shareholders meeting ar
board of directors and the review commission;
if holding, alone or with other holders, 10% or more of the voting stock
directors the calling of an extraordinary shareholders meeting or an un
commission;
demand, under the following circumstances, repurchase by us of all or s
owned by it, as long as the holder voted against or did not participate in
decision approving the action:

reorganization;
conclusion of a major transaction, as defined under Russian law;
amendment of our charter that restricts the holder s rights;

upon liquidation, receive a proportionate amount of our property after o
are fulfilled;
have free access to certain company documents, receive copies for a rea
holding alone or with other holders, 25% or more of the voting stock, ha
accounting documents and minutes of the management board meetings;
exercise other rights of a shareholder provided by our charter, Russian l
shareholders meetings approved in accordance with its competence.

Preemptive rights

Our charter provides existing shareholders with a preemptive right to purchase during an open subscription in an amount proportionate to their existing sharel Stock Companies Law provides shareholders with a preemptive right to purch securities during a closed subscription if the shareholders voted against or did the decision approving such subscription. The preemptive right does not apply existing shareholders, provided that each such shareholder may acquire a who convertible securities being placed in an amount proportionate to its existing h

Dividends

The Joint Stock Companies Law and our charter set forth the procedure for de annual dividends that we distribute to our shareholders. According to our char to a shareholders meeting by a majority vote of the board of directors, and ap meeting by a majority vote. A decision on quarterly dividends must be taken w of the respective quarter; a decision on annual dividends must be taken at the a meeting. The dividend approved at the shareholders meeting may not be mor by the board of directors. Dividends are distributed to holders of our shares as

shareholders meeting approving the dividends. See General Meetings of S
Participation. Dividends are not paid on treasury shares.

168

Table of Contents

Description of capital stock and certain requirements of Russian l

The Joint Stock Companies Law allows dividends to be declared only out of n
Russian accounting standards and as long as the following conditions have bee

- the charter capital of the company has been paid in full;
- the value of the company s net assets is not less (and would not becom
proposed dividend payment) than the sum of the company s charter cap
reserve fund and the difference between the liquidation value and the pa
and outstanding preferred shares of the company;
- the company has repurchased all shares from shareholders having the ri
- the company is not, and would not become as the result of the proposed

Distributions to shareholders on liquidation

Under Russian legislation, liquidation of a company results in its termination v
obligations to other persons as legal successors. Our charter allows us to be liq

- by a three-quarters majority vote of a shareholders meeting; or
- by a court order.

Following a decision to liquidate the company, the right to manage our affairs
commission which, in the case of voluntary liquidation, is appointed by a shar
involuntary liquidation, is appointed by the court. Creditors may file claims w
by the liquidation commission, but which may not be less than two months fro
notice of liquidation by the liquidation commission.

The Civil Code gives creditors the following order of priority during liquidatio

- individuals owed compensation for injuries or deaths;
- employees;
- secured creditors;
- federal and local governmental entities claiming taxes and similar paym
non-budgetary funds; and
- other creditors in accordance with Russian legislation.

The remaining assets of a company are distributed among shareholders in the

payments to repurchase shares from shareholders having the right to de
payments of declared but unpaid dividends on preferred shares and the
preferred shares, if any; and
payments to holders of common and preferred shares on a pro rata basis

Liability of shareholders

The Civil Code and the Joint Stock Companies Law generally provide that sha
stock company are not liable for the obligations of a joint stock company and
investment. This may not be the case, however, when one person or entity is c
made by another person or entity. The person or entity capable of determining
effective parent. The person or entity whose decisions are capable of being
effective subsidiary. The effective parent bears joint and several

---

Table of Contents

Description of capital stock and certain requirements of Russian l

responsibility for transactions concluded by the effective subsidiary in carryin

- this decision-making capability is provided for in the charter of the effe between such persons; and
- the effective parent gives binding instructions to the effective subsidiar

Thus, a shareholder of an effective parent is not itself liable for the debts of th subsidiary, unless that shareholder is itself an effective parent of the effective not be personally liable for our debts or those of our effective subsidiaries unl

In addition, an effective parent is secondarily liable for an effective subsidiary becomes insolvent or bankrupt resulting from the action or inaction of an effe matter how the effective parent s capability to determine decisions of the effe through ownership of voting securities or by contract. In these instances, othe subsidiary may claim compensation for the effective subsidiary s losses from the effective subsidiary to take any action or fail to take any action knowing th action would result in losses.

Share capital increase

We may increase our charter capital by

- issuing new shares, or
- increasing the nominal value of already issued shares using the compan

Generally, a decision to increase the charter capital by issuing additional share value of issued shares requires a majority vote of a shareholders meeting. In above the number of authorized and non-issued shares provided in our charter amendment, which requires a three-quarters majority vote of a shareholders

The Joint Stock Companies Law requires that newly issued shares be sold at m circumstances where (1) existing shareholders exercise a preemptive right to p 90% of the price paid by third parties, or (2) fees of up to 10% are paid to inte fees paid may be deducted from the price. The price may not be set at less tha shares. The board of directors and an independent appraiser value any in-kind

Russian securities regulations set out detailed procedures for the issuance and
stock company. These procedures require

- prior registration of a share issuance with the Federal Service for the Fi
- public disclosure of information relating to the share issuance; and
- following the placement of the shares, registration and public disclosure of shares.

Our shareholders approved the issuance of shares for this offering on January
shares was registered under Russian securities laws on April 29, 2004. We wil
comply with all other applicable filing requirements.

Capital decrease; share buy-backs

The Joint Stock Companies Law does not allow a company to reduce its charte
charter capital required by law, which is 100,000 rubles for an open joint stock

---

170

Table of Contents

Description of capital stock and certain requirements of Russian l

charter requires that any decision to reduce our charter capital, whether throug of shares or a reduction in the nominal value of the shares, be made by a majo meeting. Additionally, within 30 days of a decision to reduce our charter capit to our creditors and publish this decision. Our creditors would then have the ri of publication or receipt of our notice, repayment of all amounts due to them, a damages.

The Joint Stock Companies Law allows our shareholders or our board of direc of up to 10% of our shares in exchange for cash. The repurchased shares must one year of their repurchase or the shareholders must decide to cancel such sha capital.

The Joint Stock Companies Law allows us to repurchase our shares only if, at

- our charter capital is paid in full;
- we are not and would not become, as a result of the repurchase, insolve
- the value of our net assets is not less (and would not become less, as a r repurchase) than the sum of our charter capital, the reserve fund and the the liquidation value and par value of our issued and outstanding prefer
- we have repurchased all shares from shareholders having the right to de under legislation protecting the rights of minority shareholders, as descr

Russian legislation and our charter provide that our shareholders may demand their shares so long as the shareholder demanding repurchase voted against or on the decision approving any of the following actions:

- reorganization;
- conclusion of a major transaction, as defined under Russian law; or
- amendment of our charter in a manner which results in restrictions of th

We may spend up to 10% of our net assets calculated under Russian accountin redemption demanded by the shareholders. If the value of shares in respect of exercised their right to demand repurchase exceeds 10% of our net assets, we each such shareholder on a pro-rata basis.

Registration and transfer of shares

Russian legislation requires that a joint stock company maintain a register of it
our registered common shares is evidenced solely by entries made in such regi
may obtain an extract from our register certifying the number of shares that su
Registrator OAO maintains our shareholder register.

The purchase, sale or other transfer of shares is accomplished through the regi
shareholder register, or the registration of the transfer with a depositary if shar
registrar or depositary may not require any documents in addition to those requ
order to transfer shares in the register. Refusal to register the shares in the nam
request of the beneficial holder, in the name of a nominee holder, may be chal

Table of Contents

Description of capital stock and certain requirements of Russian l

Reserve fund

Russian legislation requires that each joint stock company establish a reserve f the company s losses, redeem the company s bonds and repurchase the comp funds are not available. Our charter provides for a reserve fund of 5% of our c mandatory annual transfers of at least 5% of our statutory net profits until the r requirement.

GENERAL MEETINGS OF SHAREHOLDERS

Procedure

The powers of a shareholders meeting are set forth in the Joint Stock Compa shareholders meeting may not decide issues that are not included in the list o Stock Companies Law and our charter. Among the issues which the sharehold decide are:

- charter amendments;
- reorganization or liquidation;
- election and removal of the members of the board of directors;
- determination of the number, nominal value and type of authorized shar shares;
- changes in the company s charter capital;
- appointment and removal of the members of the company s review con commission;
- approval of certain interested party transactions and major transactions;
- distribution of profits; and
- redemption by the company of issued shares in cases provided for by th

Voting at a shareholders meeting is generally on the principle of one vote pe exception of the election of the board of directors, which is done through cum generally passed by a majority vote of the voting stock present at a shareholde law requires a three-quarters majority vote of the voting stock present at a shar the following:

- charter amendments;
- reorganization or liquidation;
- major transactions involving assets in excess of 50% of the balance shee company;

determination of the number, nominal value and type of authorized shar
such shares;
repurchase by the company of its issued shares;
any issuance of shares or securities convertible into common shares by
issuance by open subscription of common shares or securities convertib
case, constituting 25% or more of the number of issued and outstanding

The quorum requirement for our shareholders meeting is met if shareholders (
accounting for more than 50% of the issued voting shares are present. If the 5
met, another shareholders meeting with the same agenda may (or, in the case

172

Table of Contents

Description of capital stock and certain requirements of Russian l

must) be scheduled and the quorum requirement is satisfied if shareholders (or
accounting for at least 30% of the issued voting shares are present at that meet

The annual shareholders meeting must be convened by the board of directors b
each year, and the agenda must include the following items:

- determination of the number and election of members of the board of di
- approval of the annual statutory report, balance sheet and profit and loss
- approval of distribution of profits, including approval of annual dividen
- approval of an independent auditor for statutory accounts; and
- approval of review commission.

The shareholders meeting also approves compensation for members of our bo
or group of shareholders owning in the aggregate at least 2% of the issued vot
proposals for the agenda of the annual shareholders meeting and may nomina
directors and the review commission. Any agenda proposals or nominations m
no later than January 30.

Extraordinary shareholders meetings may be called by the board of directors
request of the review commission, the independent auditor of the statutory acc
of shareholders owning in the aggregate at least 10% of the issued voting share

A general meeting of shareholders may be held in a form of a meeting or by ab
meeting contemplates the adoption of resolutions by the general meeting of sh
attendance of the shareholders or their authorized representatives for the purpo
issues of the agenda, provided that if a ballot is mailed to shareholders for part
in such form, the shareholders may complete and mail the ballot back to the co
attending the meeting. A general meeting of the shareholders by absentee ballo
determination of shareholders opinions on issues on the agenda by means of

The following issues cannot be decided by a shareholders meeting by absente

- election of directors;
- election of the review commission;
- approval of a company s independent auditor for statutory accounts; an
- approval of the annual report, balance sheet, profit and loss statement u
- distributions of profits, including approval of annual dividends, if any.

Notice and participation

In accordance with the decision to amend our charter taken by our shareholder shareholders entitled to participate in a general shareholders meeting must be the meeting is to be held in direct form or by absentee ballot, no less than 30 d meeting, and such notification shall specify the agenda for the meeting. Howe shareholders meeting to elect the board of directors by cumulative vote, shar 50 days prior to the date of the meeting. Only those items that were set out in t at a general shareholders meeting.

The list of persons entitled to participate in a general shareholders meeting is our shareholder register on the date established by the board of directors, whic

Table of Contents

Description of capital stock and certain requirements of Russian l

be earlier than the date of adoption of the board resolution to hold a general sh
than 50 days before the date of the meeting (or, in the case of a shareholders
directors by cumulative vote, not more than 65 days before the date of the mee

The right to participate in a general meeting of shareholders may be exercised

- by personally participating in the discussion of agenda items and voting
- by sending an authorized representative to participate in the discussion thereon;
- by absentee ballot; or
- by delegating the right to fill out the absentee ballot to an authorized rep

BOARD OF DIRECTORS

Our charter provides that our entire board of directors is up for election at each meeting and that our board of directors is elected through cumulative voting. U shareholder may cast an aggregate number of votes equal to the number of vot shareholder multiplied by the number of persons to be elected to our board of may give all such votes to one candidate or spread them between two or more expiration of their term, the directors may be removed as a group at any time v of a shareholders meeting.

The Joint Stock Companies Law requires at least a five-member board of direc companies, at least a seven-member board of directors for a joint stock compa holders of voting shares, and at least a nine-member board of directors for a jo than 10,000 holders of voting shares. Only natural persons (as opposed to lega the board. Members of the board of directors are not required to be shareholde number of directors is determined by the company s charter or decision of the charter, as amended by the decision of our shareholders taken on October 14, directors shall consist of nine members, and the majority of our directors shall

The Joint Stock Companies Law generally prohibits the board of directors fro within the exclusive competence of the general shareholders meeting. Our bo direct the general management of the company, and to decide the following iss

- convening annual and extraordinary shareholders meetings, except in specified in the Joint Stock Companies Law;
- setting a date, time and place for the shareholders meeting;

approval of the agenda of the shareholders meeting and determination
shareholders entitled to participate in a shareholders meeting;
placement of our bonds and other securities, except in certain circumsta
charter;
determination of the price of our property and of our securities to be pla
for by the Joint Stock Companies Law;
repurchase of our shares, bonds and other securities in certain cases pro
Companies Law;
formation of our executive bodies, including appointment of the genera
of their powers and the establishment of their compensation;
recommendation on the amount of a dividend and the payment procedu

174

Table of Contents

Description of capital stock and certain requirements of Russian l

recommendation on the amount of remuneration and compensation to b
review commission and on the fees payable for the services of an indep
the use of our reserve fund and other funds;
the creation of branches and representative offices;
approval of internal documents, except for those documents whose appr
of the company s shareholders or general director;
approval of major and interested party transactions in the cases provide
Companies Law;
determination of our business priorities;
increasing our charter capital by issuing additional shares within the lim
capital, except in certain circumstance specified in our charter;
approval of decisions on share issuances and of the prospectus relating t
as of reports on the results of such share issuances;
decision on our participation in other organizations, with the exception
companies, commercial or industrial groups, or other associations of co
shareholders vote is required by our charter;
approval of our share registrar; and
other issues, as provided for by the Joint Stock Companies Law and our

Our charter generally requires a majority vote of the directors present for an ac of actions for which Russian legislation requires a unanimous vote or a majori independent directors, as described herein. A board meeting is considered duly competent to act when at least five directors, including at least one independen addition, our charter requires the presence of at least three quarters of the total at least one third of the total number of independent directors, for board meeti on certain matters specified in our charter.

INTERESTED PARTY TRANSACTIONS

Under the Joint Stock Companies Law, certain transactions defined as intere approval by disinterested directors or shareholders of the company. Intereste transactions involving a member of the board of directors or member of any ex any person that owns, together with any affiliates, at least 20% of a company person who is able to direct the actions of the company, if that person, or that p children, adoptive parents or children, brothers or sisters or affiliates, is:

a party to, or beneficiary of, a transaction with the company, whether di
intermediary;
the owner of at least 20% of the issued voting shares of a legal entity th
of, a transaction with the company, whether directly or as a representati
a member of the board of directors or a member of any management bo
to, or beneficiary of, a transaction with the company, whether directly o
intermediary.

The Joint Stock Companies Law requires that an interested party transaction b
1,000 shareholders be approved by a majority vote of the independent director

---

Table of Contents

Description of capital stock and certain requirements of Russian l

who are not interested in the transaction. An independent director is a perso
preceding the decision was not, the general director, a member of any executiv
company. Additionally, such person s spouse, parents, children, adoptive pare
sisters may not occupy positions in the executive bodies of the company. For c
shareholders, an interested party transaction must be approved by a majority v
interested in the transaction if the number of these directors is sufficient to con

Approval by a majority of shareholders who are not interested in the transactio

- the value of such transaction or a number of interrelated transactions is value of the company s assets determined under Russian accounting sta
- the transaction or a number of interrelated transactions involves the issu shares or securities convertible into voting shares, or secondary market amount exceeding 2% of the company s issued voting stock;
- the number of directors who are not interested in the transaction is not s quorum; or
- all the members of the board of directors of the company are interested independent director.

Approval by a majority of shareholders who are not interested in the transactio
interested party transaction if such transaction is substantially similar to transa
company and the interested party in the ordinary course of business before suc
party with respect to the transaction.

The approval of interested party transactions is not required in the following in

- the company has only one shareholder that simultaneously performs the body of the company;
- all shareholders of the company are deemed interested in such transactio
- the transactions arise from the shareholders executing their preemptive shares of the company;
- the transactions arise from the repurchase, whether mandatory or not, by shares; or
- the company is merging with another company, when the latter owns m of the voting capital stock of the company.

MAJOR TRANSACTIONS

The Joint Stock Companies Law defines a major transaction as a transactio
involving the acquisition or disposal, or a possibility of disposal, of property h
of the balance sheet value of the assets of a company as determined under Rus
the exception of transactions completed in the ordinary course of business or t

placement of common shares or securities convertible into common shares. M
assets ranging from 25% to 50% of the balance sheet value of the assets of a c
approval by all members of the board of directors or, failing to receive such ap
of a shareholders meeting. Major transactions involving assets in excess of 5
the assets of a company require a three-quarters majority vote of a shareholder

176

Table of Contents

Description of capital stock and certain requirements of Russian l

CHANGE IN CONTROL

Anti-takeover protection

Russian legislation requires that any person that intends, either individually or acquire 30% or more (including, for such purposes, the shares already owned l of the common shares of a company having more than 1,000 holders of comm but no more than 90, days prior written notice to the company. Additionally, provides that a person acquiring either individually, or together with its affiliat such purposes, the shares already owned by this person or its affiliates) of the with more than 1,000 holders of common shares, within 30 days of acquiring t of the common shares or securities that are convertible into common shares at be lower than the weighted average price of the common shares over the six m acquisition. These requirements also apply to any acquisitions of each subsequ common shares of a company by a person already holding (together with its af common shares of such company. If the acquirer fails to observe these require voting only those shares it purchased in compliance with these requirements. T buyout offer of securities may be waived in a company s charter or by a resol of a shareholders meeting, excluding the votes of the person (and its affiliate as amended by the decision taken by our shareholders on October 14, 2004, do requirement.

Approval of the Russian Federal Antimonopoly Service

Pursuant to Russian antimonopoly legislation, transactions exceeding a certain with a combined value of the assets under Russian accounting standards that e companies registered as having more than a 35% share of a commodity marke shareholder (or a group of affiliated shareholders) holding more than 20% of t company must be approved in advance by the Federal Antimonopoly Service.

Because the rights of beneficial owners of our ADSs may not be recognized un bank for our ADSs may be required to obtain such approval for deposits of ou of our voting capital stock, and for any subsequent deposits.

EXCHANGE CONTROLS

The Federal Law on Currency Regulation and Currency Control in effect as of government and the Central Bank of Russia to regulate and restrict certain fore

including certain types of payments in foreign currency, operations involving
ADSs) and domestic securities (including our common shares), as well as cert
rubles between residents and non-residents of Russia. As the new regulatory re
untested, it is currently unclear how it will be applied in practice. In particular
will be more or less restrictive than the prior laws and regulations it has replac

Capital import and export restrictions

Pursuant to the Federal Law on Currency Regulation and Currency Control, th
Bank of Russia have the power to restrict, in particular, the following operatio

investments (not involving the acquisition of securities) by Russian resi
participatory interests in joint ventures with foreign investors or acquire
investors;
acquisition of Russian securities by foreign investors and foreign securi

Table of Contents

Description of capital stock and certain requirements of Russian l

grants or receipts of loans and credits between residents and non-residen
payments for export-import transactions with settlement over 180 days
exceptions, over three to five years) following completion.

Restrictions that may be introduced include:

the requirement to perform the operations listed above through special b
authorized Russian banks (the requirement to use a special account);
the requirement to deposit in a special non-interest bearing account with
Russian bank (the reservation requirement) a monetary sum of:
up to 100% of the amount of the foreign currency operation in qu
time not exceeding 60 days; or
up to 20% of the amount of the foreign currency operation in que
time not exceeding one year.

As of the date hereof, the requirement to use a special account has been introd
of Russian securities by foreign investors and foreign securities by Russian inv
grant or receipt of loans and credits between residents and non-residents of Ru
operations are subject to the requirement to use special accounts:

the receipt by residents of Russia from non-residents of foreign currenc
maturities of less than three years;
the acquisition of foreign securities (such as ADSs) by Russian investor
the acquisition of Russian securities (such as our shares) by foreign inve

As of the date hereof, the reservation requirement has been introduced, in part

the receipt by residents of Russia of foreign currency loans and credits v
years, in the amount of 3% of the loan/credit for one year; and
the acquisition of foreign securities (such as ADSs) by Russian investor
sum paid for the securities for 15 days.

While at present restrictions imposed on foreign currency operations are limite
of the government and the Central Bank of Russia enable them to:

increase the reservation requirements by an increase in the amount and/
and/or
extend the reservation requirements and other restrictions to other types
envisaged by the Federal Law on Currency Regulation and Currency Co

Additionally, Russian companies must repatriate 100% of their receivables fro
services (with a limited number of exceptions concerning, in particular, certai
and convert 25% of export receivables in foreign currency into rubles within s
they were received. Furthermore, certain types of cross-border operations may
including, for example, transactions with domestic securities, such as our shar
non-residents of Russia. These requirements increase balances in our ruble-de
consequently, our exposure to currency devaluation risk.

178

Table of Contents

Description of capital stock and certain requirements of Russian l

Restrictions on the remittance of dividends, interest or other paym

The Federal Law on Foreign Investments in the Russian Federation of July 9,
foreign investors the right to repatriate their earnings from Russian investment
Russian exchange control regime may materially affect your ability to do so.

Ruble dividends on common shares may be paid to the depositary or its nomin
dollars by the depositary for distribution to owners of ADSs without restriction
non-residents of Russia for U.S. dollars outside Russia without regard to Russ
long as the buyer is not a Russian resident for currency control purposes. How
rubles into U.S. dollars is also subject to the availability of U.S. dollars in Rus
Although there is an existing market within Russia for the conversion of ruble
interbank currency exchange and over-the-counter and currency futures marke
this market is uncertain. At present, there is no market for the conversion of ru
outside of Russia and no viable market in which to hedge ruble and ruble-deno

NOTIFICATION OF FOREIGN OWNERSHIP

Foreign persons registered as individual entrepreneurs in Russia who acquire s
company and foreign companies that acquire shares in a Russian joint stock co
Russian tax authorities within one month following such acquisition if they are
Russian tax authorities at the time of acquisition. Russian law is unclear as to w
companies that are not registered with the Russian tax authorities at the time o
register solely for the reason of such share acquisitions. Other than this notific
requirements or restrictions with respect to foreign ownership of our shares.

RTS TRADING

The following table sets forth the high and low trading prices per common sha
listing of our common shares on the Russian Trading System (RTS).

Month
July 2004
August 2004
September 2004
October 2004[(1)]

(1) Through October 28, 2004.

Table of Contents

Comparison of shareholders rights u and Delaware law

The following describes some of the material differences between certain shar and Delaware law.

SHAREHOLDERS MEETINGS

Russia

Russian law requires every joint stock company to hold an annual general shar than two months and not more than six months after the end of every financial June 30 of each year. The quorum requirement for a shareholders meeting is representatives) accounting for more than 50% of the issued voting shares are requirement is not met, another shareholders meeting with the same agenda meeting, must) be scheduled and the quorum requirement is satisfied if shareh accounting for at least 30% of the issued voting shares are present at that meet

Russian law requires that the annual statutory report, balance sheet and profit distribution of profits, including approval of annual dividends (if any) be appr shareholders meeting. Furthermore, the company s independent auditor and approved at the annual general meeting. The agenda of the annual shareholder election of the members of the board of directors.

The annual shareholders meeting must be convened by the board of directors meetings may be called by the board of directors on its own initiative, or at the commission, the independent auditor or a shareholder or group of shareholders least 10% of the issued voting shares as of the date of the request. For further meeting see Description of Capital Stock and Certain Requirements of Russi of Shareholders.

Delaware

Under Delaware law, unless directors are elected by written consent in lieu of meeting of the stockholders shall be held for the election of directors on a date company s bylaws. Stockholders may, unless the certificate of incorporation

consent to elect directors. A quorum for a meeting of stockholders is met if a m
present (in person or through a representative) to vote, unless a different quoru
the certificate of incorporation or bylaws. In no case may the quorum be set be
shares (or one third of a class of shares for classified shares). In addition, any c
transacted at the annual meeting. If an annual meeting is not held within 30 da
such a meeting, or is not held for a period of 13 months after the last annual m
Chancery may summarily order a meeting to be held upon the application of a

Delaware law also permits special meetings of shareholders to be called by the
persons authorized to do so by the company s certificate of incorporation or b

---

180

Table of Contents

Comparison of shareholders rights under Russian and Delaware

VOTING RIGHTS, GENERALLY

Russia

Under Russian law, every holder of common shares in a joint stock company h general meetings of shareholders. Each shareholder is entitled to one vote for e charter capital, with the exception of cumulative voting procedures for electio preferred shares have no right to vote at general meetings of shareholders unle Joint Stock Company Law. Any shareholder of a company entitled to attend a shareholders may appoint another person to act for such shareholder by proxy detailed description of the shareholders rights, see Description of Capital St Russian Legislation.

Delaware

Under Delaware law, each stockholder is entitled to one vote for each share of stockholder, unless otherwise provided in the certificate of incorporation of th entitled to vote at a meeting of stockholders may authorize another person or p stockholder by proxy for up to three years from its date, or for a longer period provides.

CUMULATIVE VOTING

Cumulative voting is a system for electing directors whereby the number of vo vote in an election of directors equals the number of shares held by the shareh of open directorships. Under cumulative voting, a shareholder may cast all or a votes for a single candidate or for any number of candidates.

Russia

Under Russian law, each shareholder may cast an aggregate number of votes e shares held by such shareholder multiplied by the number of persons to be elec and the shareholder may give all such votes to one candidate or spread them b Before the expiration of their term, the directors may be removed as a group a majority vote of a shareholders meeting. See Description of Capital Stock a

Russian Legislation Board of Directors.

Delaware

Under Delaware law, stockholders do not have the right to elect directors by c
is granted in the company s certificate of incorporation.

PREEMPTIVE RIGHTS

Russia

Under Russian law, shareholders have a preemptive right to purchase shares o
an open subscription in an amount proportionate to their existing shareholding
shareholders with a preemptive right to purchase shares or convertible securiti
if the shareholders voted against or did not participate in the voting on the dec
subscription. The preemptive right does not apply to a closed subscription to e
that each such shareholder may acquire a whole number of shares or convertib
amount proportionate to their existing shareholdings. See Description of Cap
Requirements of Russian Legislation.

Table of Contents

Comparison of shareholders rights under Russian and Delaware

Delaware

Delaware law provides that no stockholder shall have preemptive rights to pur
the company unless the certificate of incorporation of the company expressly g

APPRAISAL RIGHTS

Russia

A shareholder of a Russian joint stock company may demand repurchase of al
as the shareholder demanding repurchase voted against or did not participate i
approving reorganization, conclusion of a major transaction or amendment of
manner which results in restrictions of the shareholder s rights. In this case, a
independent appraiser to determine a price for the shares to be repurchased. Fo
Description of Capital Stock and Certain Requirements of Russian Legislatio
Stock Capital Decrease; Share Buy-Backs.

Delaware

A stockholder of a Delaware corporation participating in certain major corpora
certain circumstances, be entitled to appraisal rights pursuant to which the stoc
amount of the fair value of the shares held by that stockholder (as determined
consideration the stockholder would otherwise receive in the transaction.

SHAREHOLDER APPROVAL OF CORPORATE MATTERS BY WRIT

Russia

Under Russian law, any decision of the shareholders may be taken without a m
absentee ballot, with the exception of decisions on the election of directors and
commission, approval of the company s independent auditor and approval of
profit and loss statement, as well as any distribution of profits, including appro
All shareholders entitled to participate in a general shareholders meeting mus

whether the meeting is to be held in direct form or by absentee ballot, no less t
the meeting unless the law or a company s charter provides for a longer notic
Capital Stock and Certain Requirements of Russian Legislation General Mee
Participation.

Delaware

Under Delaware law, any action required to be taken at any annual or special r
be taken without a meeting, without prior written notice and without a vote, if
the action to be taken is signed by the number of holders of outstanding stock
authorize or take the action at a meeting at which all shares entitled to vote the
unless otherwise provided in the certificate of incorporation of the company. F
any action by less than unanimous consent must be given to shareholders who

SHAREHOLDER ACCESS TO AND INSPECTION OF CORPORATE

Russia

Pursuant to Russian law, each fully paid common share, except for treasury sh
have free access to certain company documents, receive copies for a reasonabl

---

182

Table of Contents

Comparison of shareholders rights under Russian and Delaware

holding alone or with other holders, 25% or more of the voting stock, have fre
documents and minutes of the management board meetings. In addition, any s
may apply to a company or its registrar (depending on whether the company it
maintains the register of shareholders) for a copy of an extract from the registe
such holder s rights to the shares, and the company or its registrar shall furnis

Delaware

Delaware law allows any stockholder to inspect and make copies of the stock
and the other books and records of a Delaware company for a purpose reasona
interest as a stockholder. If the company refuses to permit an inspection or doe
within five business days, the stockholder may apply to the Delaware Court of
compel the inspection.

AMENDMENTS TO CHARTER

Russia

Amendments to the charter of a Russian joint stock company require a three-q
voting stock present at a shareholders meeting. In certain limited cases deter
Company Law, a decision on amendments to the charter may be taken by the b
company.

Delaware

Amendments to the certificate of incorporation of a Delaware corporation requ
holders of a majority of the outstanding shares entitled to vote thereon or such
in the certificate of incorporation; a provision in the certificate of incorporatio
number or proportion of the directors or of the holders of any class of stock th
corporate law may not be amended, altered or repealed except by such greater

BUSINESS COMBINATIONS

Russia

Under Russian law, a transaction, or a series of transactions, involving the acq disposal, of property having the value of 25% or more of the balance sheet val as determined under Russian accounting standards, with the exception of trans ordinary course of the company s business or transactions involving the place shares or securities convertible into such shares, requires (i) unanimous approv company s board of directors or, failing that, a simple majority vote of its sha transactions with property having the value between 25% and 50% of the bala assets; or (ii) a three-quarters majority vote of the company s shareholders n property having the value in excess of 50% of the balance sheet value of the c transactions are defined as major transactions. For additional detail, see D Certain Requirements of Russian Legislation Major Transactions.

Delaware

With certain exceptions, a merger, consolidation or sale of all or substantially corporation must be approved by the board of directors and a majority of the o vote thereon.

Table of Contents

Comparison of shareholders rights under Russian and Delaware

ANTI-TAKEOVER PROVISIONS

Russia

Russian legislation requires that any person that intends, either individually or acquire 30% or more (including, for such purposes, the shares already owned l of the common shares of a company having more than 1,000 holders of comm but no more than 90, days prior written notice to the company. Additionally, provides that a person acquiring, either individually or together with its affiliat such purposes, the shares already owned by this person or its affiliates) of the with more than 1,000 holders of common shares, within 30 days of acquiring t of the common shares or securities convertible into common shares at a marke than the weighted average price of the common shares over the six month peri acquisition. These requirements also apply to any acquisitions of each subsequ common shares of a company by a person already holding (together with its af common shares of such company. If the acquirer fails to observe the above rec power will be limited to only those shares purchased in compliance with these to make a buyout offer may be waived pursuant to a company s charter or a re vote of a shareholders meeting, excluding the votes of the person (and its aff charter, as amended by the decision taken by our shareholders on October 14, of this requirement. See Description of Capital Stock and Certain Requireme Legislation Change in Control Anti-takeover Protection.

Delaware

Delaware law contains a business combination statute that protects Delaware c takeovers and from actions following the takeover by prohibiting some transac gained a significant holding in the company.

Section 203 of the Delaware General Corporation Law prohibits business co sales and leases of assets, issuances of securities and similar transactions by a an interested stockholder that beneficially owns 15% or more of a company s after the person becomes an interested stockholder, unless:

- the transaction that will cause the person to become an interested stockh of directors of the target prior to the transaction;
- after the completion of the transaction in which the person becomes an stockholder, the interested stockholder holds at least 85% of the voting not including shares owned by persons who are directors and also office stockholders and shares owned by specified employee benefit plans; or

after the person becomes an interested stockholder, the business combin
of directors of the company and holders of at least 66.67% of the outsta
shares held by the interested stockholder.

A Delaware company may elect not to be governed by Section 203 by a provis
certificate of incorporation of the company or an amendment to the original ce
the bylaws of the company, which amendment must be approved by a majority
and may not be further amended by the board of directors of the company. Thi
until 12 months following its adoption.

184

Table of Contents

Comparison of shareholders rights under Russian and Delaware

DIRECTORS AND OFFICERS

Russia

According to Russian law, the board of directors exercises general supervision
exclusion of issues that fall within the competence of the general shareholders
Company Law requires at least a five-member board of directors for all joint s
seven-member board of directors for a joint stock company with more than 1,0
and at least a nine-member board of directors for a joint stock company with m
voting shares. Only natural persons (as opposed to legal entities) are entitled to
the board of directors are not required to be shareholders of the company. The
determined by the company s charter or decision of the shareholders meetin
of the board of directors, see Description of Capital Stock and Certain Requi
Legislation Board of Directors.

Delaware

According to Delaware law, the business and affairs of every company are ma
as provided in the company s certificate of incorporation. The board of directo
members, each of whom is a natural person. The actual number of directors sh
bylaws or in its certificate of incorporation. Directors need not be stockholders
or certificate of incorporation. The bylaws or certificate of incorporation may
for directors as well.

INTERESTED DIRECTOR TRANSACTIONS

Russia

Under Russian law, interested party transactions require approval by disinteres
the company. See Description of Capital Stock and Certain Requirements of
Party Transactions.

Interested party transactions are voidable if the statutory requirements set forth
Law for approving such transactions are not satisfied. Claims seeking to invali
transaction can be brought by the company or any of its shareholders.

Delaware

Interested director transactions are not voidable if (i) the material facts as to th
relationship or interests are disclosed or are known to the board of directors an
authorizes the transaction by the affirmative vote of a majority of the disintere
facts are disclosed or are known to the stockholders entitled to vote on such tra
specifically approved in good faith by a vote of the majority of shares entitled
transaction is fair as to the corporation as of the time it is authorized, approved

LIMITATIONS ON LIABILITY OF DIRECTORS

Russia

Under Russian law, the enforceability of any provision, whether contained in t
a company or in any contract with a company, that purports to exempt any dire
from any liability which by law would otherwise attach to such person in respe
breach of duty or breach of trust of which the person may be guilty in relation

Table of Contents

Comparison of shareholders rights under Russian and Delaware

to the company or to indemnify the person against any such liability is uncerta
legislation does not provide for or prohibit any indemnification of, or liability
to, directors or officers of joint stock companies. The enforceability of limitati
under Russian law. Currently, there is a conflict between the provisions of the
Joint Stock Company Law on this issue.

Pursuant to the Russian Civil Code and the Joint Stock Company Law, membe
joint stock company when exercising their rights and performing their obliga
the company, and exercise their rights and perform their duties regarding the c
faith. Russian law provides that a director is liable to a joint stock company f
culpable action or non-action unless other grounds and a different degree of lia
laws. Under the Joint Stock Company Law, a director who (i) voted against a
damages suffered by a joint stock company or (ii) did not participate in such v
damages.

The Joint Stock Company Law provides that a claim against any director to re
company can be brought (i) by the joint stock company itself or (ii) by shareho
least 1% of the common shares of the joint stock company. Also, creditors ger
proceed against directors of a company. However, if a company is in bankrupt
the company may be able to request the bankruptcy administrator to initiate pr
of the board of directors on behalf of the company.

Delaware

Delaware law permits a company to include a provision in its certificate of inc
limiting the personal liability of a director to the company or its shareholders f
director s fiduciary duty, provided that a director s liability shall not be limit

- for any breach of the director s duty of loyalty to the company or its sto
- for acts or omissions not in good faith or which involve intentional misc of law;
- under Section 174 of the Delaware General Corporation Law, which co dividends, stock purchases or redemption; or
- for any transaction from which the director derived an improper persona

INDEMNIFICATION OF OFFICERS AND DIRECTORS

Russia

The enforceability under Russian law of indemnities and liability insurance co
uncertain, as current Russian legislation does not provide for or prohibit any in
insurance policies with respect to, directors or officers of joint stock companie

Delaware

Delaware law provides that, subject to certain limitations in the case of derivat
company s stockholders in its name, a company may indemnify any individua
third-party suit or proceeding on account of being a director, officer, employee
against expenses, including attorneys fees, judgments, fines and amounts pai
incurred by the officer or director in connection with the action, through, amon
of a quorum consisting of directors who were not parties to the suit or proceed

---

Table of Contents

Comparison of shareholders rights under Russian and Delaware

- acted in good faith and in a manner the officer or director reasonably be not opposed to the best interests of the company or, in some circumstan opposed to its best interests; and
- in a criminal proceeding, had no reasonable cause to believe the officer unlawful.

To the extent a director, officer, employee or agent is successful in the defense proceeding, the company is required by Delaware law to indemnify the individ incurred thereby. Companies may also purchase insurance to cover the liability company could not legally indemnify him or her.

Table of Contents

Description of American Depositary S

Deutsche Bank Trust Company Americas, as depositary, will issue the ADSs r
offered hereby under a deposit agreement among ourselves, the depositary and
Each ADS will represent an ownership interest in three common shares. We w
common shares with OOO Deutsche Bank, the custodian under the deposit agr
ADS also will represent any securities, cash or other property deposited with t
not distributed directly to you. Your ADSs will be evidenced by what are kno
receipts, or ADRs, in the same way a share is evidenced by a share certificate.

Because the depositary s nominee will be the registered owner of the shares,
exercise the rights of a shareholder on your behalf. The obligations of the dep
agreement. The deposit agreement, the ADSs and the ADRs are governed by N

The following is a summary of the material terms of the deposit agreement. B
not contain all the information that may be important to you. For more comple
the entire deposit agreement, which also includes the form of ADR which con
copy of the deposit agreement has been filed as an exhibit to the registration st
prospectus forms a part. You may read and copy the registration statement and
SEC s Public Reference Room, which is located at 450 Fifth Street, N.W., Ro
20549. You can obtain information on the operation of the Public Reference R
1-800-SEC-0330. Copies of the deposit agreement and the form of ADR are a
the corporate trust office of Deutsche Bank Trust Company Americas, current
New York, New York 10005, and at the principal office of OOO Deutsche Ba
Ulitsa Schepkina 4, Moscow 129090. Deutsche Bank Trust Company Americ
are located at 60 Wall Street, New York, New York 10005. The depositary wi
trust office for the registration of ADRs and transfers of ADRs which, at all re
for inspection by ADS holders, provided that inspection shall not be for the pu
ADS holders in the interest of a business or object other than our business or a
agreement or the ADSs.

HOLDING THE ADSs

How will I hold my ADSs?

Until such time that we notify the depositary that (1) the placement report wit
underlying the ADSs offered pursuant to this prospectus has been registered b
Financial Markets and (2) we have received the proceeds of this offering, the A
book entry form, represented by a global ADR registered in the name of th
Company, or DTC. This means that the depositary will not issue ADRs to eac
issue one global ADR to DTC, and DTC will keep a computerized record of i

your broker) whose clients have purchased the ADSs. The participant will ther
who purchased the ADSs. Beneficial interests in the global ADR will be show
in the global ADR will be made only through, records maintained by DTC and

DTC has provided us the following information: DTC is a limited-purpose tru
New York Banking Law, a banking organization within the meaning of the
member of the United States Federal Reserve System, a clearing corporation

---

188

Table of Contents

Description of American Depositary Shares

meaning of the New York Uniform Commercial Code and a clearing agency
of Section 17A of the Securities Exchange Act of 1934, as amended. DTC hol
participants, known as direct participants, deposit with DTC. DTC also rece
participants of securities transactions, such as transfers and pledges, in deposit
computerized records for direct participants accounts. This eliminates the nee
participants include securities brokers and dealers, banks, trust companies, cle
other organizations. Euroclear and Clearstream Banking are direct participants
also used by other organizations such as securities brokers and dealers, banks a
through a direct participant. The rules that apply to DTC and its participants ar

DTC is owned by a number of its direct participants and by the New York Sto
American Stock Exchange, LLC, and the National Association of Securities D

The depositary will wire any cash distribution it receives on our shares represe
DTC s nominee. The depositary will treat DTC s nominee as the owner of th
Accordingly, the depositary will have no direct responsibility or liability to pa
ADR to owners of beneficial interests in the global ADR.

It is DTC s current practice, upon receipt of any cash payment, to credit direc
payment date according to their respective holdings of beneficial interests in th
DTC s records. In addition, it is DTC s current practice to assign any voting
accounts are credited with ADSs on a record date by using an omnibus proxy.
to owners of beneficial interests in the global ADR and voting by direct partic
customary practices between the direct participants and the owners of benefici
ADSs held for the account of customers registered in street name. Payment
direct participants and not of DTC, the depositary or us.

After registration of the placement report by the Federal Service for the Financ
receive the proceeds of this offering, you may hold ADSs either directly or ind
other financial institution, and the remaining part of this description assumes y
you hold the ADSs through your broker or financial institution nominee by me
discussed above or otherwise, you must rely on the procedures of that broker o
the rights of ADS holders described in this section. You should consult with y
institution to find out what those procedures are.

SHARE DIVIDENDS AND OTHER DISTRIBUTIONS

How will I receive dividends and other distributions on the shares

The depositary has agreed to pay to you the cash dividends or other distributio
on shares or other deposited securities, after deducting its fees and expenses. Y
distributions in proportion to the number of underlying shares that your ADSs
ADSs on the date established by the depositary in order to be eligible for divid
general, the depositary will attempt to set a record date for the ADSs that is the
for dividends and other distributions on the shares. It is possible, however, tha
dividends and other distributions on the shares and the record date used by the
not be the same.

Table of Contents

Description of American Depositary Shares

Cash

The depositary will promptly convert any cash dividend or other cash distribut
(including funds paid in respect of the ADSs to be refunded to holders of the A
the event the placement report is not registered by the Federal Service for the F
dollars, if it can do so on a reasonable basis and can transfer the U.S. dollars to
possible or if any governmental approval is needed and cannot be obtained, th
depositary to distribute U.S. dollars only to those ADS holders to whom it is p
distribute the currency it cannot convert into U.S. dollars to ADS holders or ho
ADS holders who have not been paid. It will not invest the currency it cannot c
for any interest.

Before making a distribution to the depositary, we will deduct any withholding
Russian law. See Taxation Russian Income and Withholding Tax Considera
distribute only whole U.S. dollars and cents and will round fractional cents do
the exchange rates fluctuate during a time when the depositary cannot convert
or all of the value of the distribution.

Common shares

The depositary may distribute new ADSs representing any common shares wh
or free distribution if we furnish it promptly with evidence satisfactory to it tha
ADSs is in compliance with applicable law. The depositary will distribute new
number of ADSs you already own. The depositary will only distribute whole A
shares which would require it to issue a fractional ADS and distribute the net p
does with cash. Alternatively, the depositary may elect, upon our instruction, t
ADS ratio to reflect the new common shares, subject to our furnishing to the d
to it that such ratio change is in compliance with applicable law.

Rights to receive additional shares

If we offer holders of our securities any rights to subscribe for additional com
the depositary, after consultation with us, has discretion to determine how thes
you as a holder of ADSs. We must first instruct the depositary to do so and fur
evidence that it is legal to do so. The depositary could decide it is not legal or p
available to you, or it could decide that it is only legal or practical to make the
not all, holders of the ADSs. The depositary may decide to sell the rights and d
same way as it does with cash. If the depositary decides that it is not legal or p
available to you or to sell the rights, the rights that are not distributed or sold c
will receive no value for them. The depositary is not responsible for a mistake

it is legal or practical to distribute the rights. The depositary is liable for dama
negligently or in bad faith.

If the depositary makes rights available to you, it will exercise the rights and p
your behalf. The depositary will then deposit the common shares and issue AD
rights if you pay it the exercise price and any other charges the rights require y

U.S. or Russian securities laws may restrict the sale, deposit, cancellation or tr
exercise of rights. For example, you may not be able to trade the new ADSs fr
case, the depositary may issue the new ADSs under a separate, restricted depo

Table of Contents

Description of American Depositary Shares

which will contain the same provisions as the deposit agreement, except for ch
restrictions in place.

Other distributions

The depositary will send you anything else we distribute on deposited securiti
legal, fair and practical. If it cannot make the distribution in that way, the depo
after consultation with us, decide to sell what we distributed and distribute the
as it does with cash, or it may decide to hold what we distributed, in which cas
newly distributed property.

The depositary is not responsible if it decides that it is unlawful or impractical
to any ADS holders. We have no obligation (including no obligation to registe
Russian securities laws) to take any action to permit the distribution of ADSs,
anything else to ADS holders. This means you may not receive the distributio
shares or any value for them if it is illegal or impractical for us or the deposita
you.

DEPOSIT, WITHDRAWAL AND CANCELLATION

How does the depositary issue ADSs?

The depositary will issue ADSs if you or your broker deposits shares with the
ADSs to be issued under this prospectus, we will arrange with the underwriter
shares.

Shares deposited in the future with the custodian must be accompanied by doc
showing that those shares have been properly transferred or endorsed to the pe
deposit is being made.

The custodian will hold all deposited shares, including those being deposited b
connection with the offering to which this prospectus relates, for the account o
no direct ownership interest in the shares and only have the rights as are set ou
custodian also will hold any additional securities, property and cash received o
deposited shares. The deposited shares and any such additional items are all re

securities.

Upon each deposit of shares, receipt of related delivery documentation and co
provisions of the deposit agreement, including the payment of the fees and exp
any taxes or charges, such as stamp taxes or stock transfer taxes or fees, the de
ADRs in the name of the person entitled thereto evidencing the number of AD
entitled. Alternatively, at your request, risk and expense, the depositary will de
depositary s principal New York office or any other location that it may desig

Deutsche Bank Trust Company Americas will keep books for the registration
offices. You may reasonably inspect such books for any purpose reasonably re
ADS holder.

How do ADS holders cancel an ADS and obtain deposited securiti

When you turn in your ADS at the depositary s office, upon payment of appli
an extract from the shareholders register evidencing your ownership of the un
to you at the custodian s office.

You have the right to cancel your ADSs and withdraw the underlying common
connection with:

- temporary delays caused by closing transfer books of the depositary or
shares in connection with voting at a shareholders meeting or the paym
- the payment of fees, taxes and similar charges; or
- compliance with any U.S. or foreign laws or governmental regulations r
withdrawal of the underlying shares.

U.S. securities laws provide that this right of withdrawal may not be limited by
deposit agreement.

*To ensure compliance with Russian law, you may not turn in your ADSs until (
respect to the shares underlying the ADSs we offer in this prospectus has been
Service for the Financial Markets and (2) we have received the proceeds of th
the shares being sold by the company can be traded on the RTS (which is expe
from the registration of the placement report), when you cancel your ADSs an
you will receive shares being sold by the selling shareholders, and only if all s
withdrawn will you receive shares being sold by the company, irrespective of*

TRANSMISSION OF NOTICES TO SHAREHOLDERS

We will promptly transmit to the depositary those communications that we ma
shareholders. If those communications were not originally in English, we will
request, the depositary will arrange for the timely mailing of copies of such co
holders and will make a copy of such communications available for inspection
Trust Office.

VOTING RIGHTS

How do I vote?

You do not have the right as an ADS holder to attend our shareholder meeting
depositary to vote the shares underlying your ADSs. As each ADS represents
instructions would relate to the voting of three shares for each ADS you hold.
to vote directly if you withdraw the common shares. However, you may not kn
sufficiently in advance to withdraw the common shares.

Upon receipt of timely notice from us, the depositary will notify you of the up
deliver notice of such meeting, and copies of voting materials (if and as receiv
you. The materials will describe the matters to be voted on and explain how yo
date specified by the depositary, may instruct the depositary to vote the comm
securities underlying your ADSs as you direct. For your instructions to be vali
them in writing on or before a date specified by the depositary. The depositary
subject to Russian law and the provisions of our charter, to vote or to have its
or other deposited securities as you instruct. The depositary will only vote or a
and will not vote any shares where no instructions have been received.

Russian statutory provisions currently do not expressly allow a single shareho
include the depositary as the owner of all the shares underlying the ADSs) to v
any agenda item, although Russian securities regulations expressly permit a de

192

Table of Contents

Description of American Depositary Shares

split the vote in accordance with the instructions from ADS holders. However, not have express statutory authority to split the vote with respect to the shares accordance with instructions from ADS holders, and given the untested nature the depositary may refrain from voting at all unless all ADS holders have instr same manner. Consequently, you may have significant difficulty in exercising shares that will underlie the ADSs. See Risk Factors Risks Related to our A voting rights with respect to the shares represented by our ADSs are limited by agreement for our ADSs and relevant requirements of Russian law.

We cannot assure you that you will receive the voting materials in time to ensu depositary to vote your shares. In addition, the depositary and its agents are no out voting instructions or for the manner of carrying out voting instructions. T able to exercise your right to vote and if your common shares are not voted as no recourse.

To ensure compliance with Russian law, you may not vote the shares underlyi placement report with respect to the shares underlying the ADSs we offer in th registered by the Federal Service for the Financial Markets and (2) we have r offering.

FEES AND EXPENSES

What fees and expenses will I be responsible for paying?

Persons depositing shares will be charged a fee for each issuance of ADSs, inc distributions of shares, rights and other property, and for each surrender of AD securities. The fee in each case is up to $5.00 for each 100 ADSs, or any portic surrendered. The depositary may also charge a fee of up to $0.01 per ADS ann expenses to inspect the records of the Russian share registrar for our shares. Y also may be charged the following expenses:

- stock transfer or other taxes and other governmental charges;
- cable, telex and facsimile transmission and delivery charges;
- transfer or registration fees for the registration of transfer of deposited s register in connection with the deposit or withdrawal of deposited secur
- expenses of the depositary in connection with the conversion of foreign
- expenses of the depositary in connection with the issuance of definitive

We will pay all other charges and expenses of the depositary and any agent of
custodian, pursuant to agreements from time to time between the company and
depositary may amend the fees described above from time to time.

PAYMENT OF TAXES

You will be responsible for any taxes or other governmental charges payable o
deposited securities underlying your ADSs. The depositary may refuse to trans
to withdraw the deposited securities underlying your ADSs until such paymen
amount of taxes owed from any payments to you. It may also sell deposited se
sale, to pay any taxes owed. You will remain liable if the proceeds of the sale

Table of Contents

Description of American Depositary Shares

enough to pay the taxes. If the depositary sells deposited securities, it will, if a
of ADSs to reflect the sale and pay to you any proceeds, or send to you any pr
paid the taxes.

RECLASSIFICATIONS, RECAPITALIZATIONS AND MERGERS

If we take actions that affect the deposited securities, including (1) any change
consolidation or other reclassification of deposited securities; (2) any distribut
distributed to you; or (3) any recapitalization, reorganization, merger, consolid
or substantially all of the assets of the company, then the cash, shares or other
depositary will become deposited securities, and the depositary may choose to

- distribute additional ADRs;
- distribute cash, securities or other property it has received in connection
- sell any securities or property received and distribute the proceeds as ca
- treat the cash, securities or other property it receives as part of the depo
will then represent a proportionate interest in that property.

The depositary may also, at our request, issue new ADSs or ask you to surrend
exchange for new ADSs identifying the new deposited securities.

AMENDMENT AND TERMINATION

How may the agreement be amended?

We may agree with the depositary to amend the deposit agreement and the AD
any reason. You will be given at least 30 days notice of any amendment that
charges, except for taxes and other charges specifically payable by ADS holde
or affects any substantial existing right of ADS holders. If an ADS holder cont
so notified of these changes, that ADS holder is deemed to agree to that amend
ADRs and the agreement as amended. An amendment can become effective be
necessary to ensure compliance with a new law, rule or regulation.

How may the agreement be terminated?

If the placement report with respect to the shares underlying the ADSs we offe
registered by the Russian Federal Service for the Financial Markets within 60
such later date to which we and the selling shareholders agree with the underw
issue a press release and to notify the depositary, the banks holding the escrow
underwriters and the NYSE of the termination of this offering by the close of
termination. In this instance, pursuant to the terms of the escrow and escrow-ty
underwriting agreement, all funds received in respect of the ADSs in the escro
together with interest, if any, accrued thereon for the period from the closing d
any additional amounts necessary so that the funds being released would be eq
ruble funds into U.S. dollars) to the original U.S. dollar proceeds of the offerin
depositary. The depositary will promptly distribute in U.S. dollars through DT
of the termination date the funds it has received from the escrow and escrow-ty
the provisions of the deposit agreement applicable to cash dividends and distri

Otherwise, the depositary may choose to terminate the deposit agreement or w
terminate the deposit agreement. The depositary may terminate the agreement

---

Table of Contents

Description of American Depositary Shares

time, it has notified us in writing that it would like to resign and we have not a
within 90 days following such notice. After termination, the depositary s only
deposited securities to ADS holders who surrender their ADSs and pay applica
or sell distributions received on deposited securities (but without liability for i
expiration of six months from the termination date, the depositary may sell the
remain and hold the net proceeds of such sales, without liability for interest, fo
not yet surrendered their ADSs. After selling the deposited securities, the depo
to account for those proceeds and other cash.

LIMITATIONS ON OBLIGATIONS AND LIABILITY TO ADS HOLDER

Limits on the obligations of the company and the obligations of th liability to ADS holders

The deposit agreement expressly limits our and the depositary s obligations a

We and the depositary:

- are only obligated to take the actions specifically set forth in the agreem negligence or bad faith;
- are not liable if either of us is prevented or delayed by law or circumsta control from performing our respective obligations under the agreement
- are not liable if either of us exercises or fails to exercise the discretion p
- have no obligation to become involved in a lawsuit or other proceeding securities or the ADSs or the agreement on your behalf or on behalf of a
- may rely upon any documents we believe in good faith to be genuine an presented by the proper party; and
- are not liable for any action based on advice or information from legal c any person presenting shares for deposit or any holder of ADSs believe be competent to give such advice or information.

We and the depositary have agreed to indemnify each other under certain circu
own and deal in any class of our securities and in ADSs.

REQUIREMENTS FOR DEPOSITARY ACTIONS

Before the depositary will issue or register transfer of an ADR, make a distribu
withdrawal of common shares, the depositary may require:

- payment of fees;
- payment of stock transfer or other taxes or other governmental charges
charged by third parties for the transfer of any common shares or other
- production of satisfactory proof of the identity of any signatory and gen
other information it deems necessary; and
- compliance with regulations it may establish, from time to time, consist
including presentation of transfer documents.

The depositary also may suspend the issuance of ADSs, the deposit of shares,
split-up or combination of ADRs or the withdrawal of deposited securities, un
provides otherwise, if the register for ADRs is closed or if we or the depositary
advisable.

Table of Contents

Description of American Depositary Shares

PRE-RELEASE OF ADSs

In certain circumstances, subject to the provisions of the deposit agreement, th
have instructed it not to do so, issue ADSs before deposit of the underlying co
pre-release of the ADS. The depositary may also deliver common shares upon
ADSs, even if the ADSs are cancelled before the pre-release transaction has be
closed out as soon as the underlying common shares are delivered to the depos
receive ADSs instead of common shares to close out a pre-release. Except as n
pre-release ADSs only under the following conditions:

before or at the time of the pre-release, the person to whom the pre-relea
represent to the depositary in writing that it or its customer owns the co
deposited;
the pre-release must be fully collateralized with cash or other collateral
appropriate; and
the depositary must be able to close out the pre-release on not more tha

In addition, the depositary will limit the number of ADSs that may be outstand
pre-release, although the depositary may disregard the limit from time to time,
do so.

*Although we and the selling shareholders will deliver the shares sold in this of
depositary, to ensure compliance with Russian law, all the ADSs issued under
deemed pre-released with our consent until (1) the placement report with resp
ADSs we offer in this prospectus has been registered by the Federal Service fo
we have received the proceeds of this offering.*

DISCLOSURE OF INTERESTS

*By purchasing ADSs, you agree to comply with our charter and the laws of th
United States and any other relevant jurisdiction regarding any disclosure req
of common shares, all as if the ADSs were, for this purpose, the common shar*

THE DEPOSITARY

Who is the depositary?

The depositary is Deutsche Bank Trust Company Americas. The depositary is
banking corporation and a member of the United States Federal Reserve Syste
supervision principally by the United States Federal Reserve Board and the Ne
Department. The depositary was incorporated on March 5, 1903, in the State o
office of the depositary is located at 60 Wall Street, New York, New York 100
BR1026. The principal executive offices of the depositary are located at 60 W
York 10005. The depositary operates under the laws and jurisdiction of the Sta

REGISTRAR

Who is the registrar?

The shares will be registered on the Russian share register maintained by the r
custodian, as nominee for the depositary. We have appointed NIKoil Registrat

---

Table of Contents

Description of American Depositary Shares

You should be aware that Russia s system of share registration and custody c
are not normally associated with investments in other securities markets. The
the unavailability of shares or for the failure to make any distribution of cash
shares as a result of that unavailability. See Risk Factors Risks Relating to
Russian Legal System The lack of a central and rigorously regulated share re
result in improper record ownership of our shares, including the shares under

What will we require the registrar to do for ADS holders?

We will, at any time and from time to time:

- take any and all actions necessary to assure the accuracy and completen
in the share register maintained by the registrar in respect of the shares
- use our best efforts to cause the registrar to provide the depositary, the
unrestricted access to the share register, as the depositary may, in its rea
appropriate, to permit the depositary, the custodian or their agents to co
than monthly, the number of deposited securities registered in the name
or their nominees, as applicable, pursuant to the terms of the deposit ag
- use our best efforts to cause the registrar to provide the depositary, the
request, with copies of extracts from the share register duly certified by
the depositary, in its reasonable discretion, deems sufficient;
- use our best efforts to cause the registrar to effect the re-registration of
deposited securities in the share register in connection with any deposit
shares or deposited securities under the agreement promptly and, in any
business days in Moscow from the time it is requested to do so by the d
custodian or any of their agents;
- permit, and use our best efforts to cause the registrar to permit, the depo
register any shares or other deposited securities held hereunder in the na
custodian or their nominees, which may, but need not be, a non-residen
- use our best efforts to cause the registrar promptly to notify the deposit
the registrar:
  - eliminates the name of a shareholder of ours from the share regis
a shareholder s interest in our shares where that shareholder alle
or publicly that such elimination or alteration is unlawful;
  - no longer will be able materially to comply with, or has engaged
not materially comply with, the provisions of the deposit agreem
  - refuses to re-register our shares in the name of a particular purch
or its respective seller alleges that such refusal is unlawful;
  - holds our shares for its own account; or
  - has materially breached the provisions of the deposit agreement
cure such breach within a reasonable time.

We will be solely liable for any act or failure to act on the part of the registrar
act arising in connection with any act or failure of the depositary or the custod

unavailability of deposited securities or for the failure of the depositary to mak
other distributions with respect thereto as a result of:

Table of Contents

Description of American Depositary Shares

any act or failure to act by us or our agents, including the registrar (othe
arising in connection with any act or failure of the depositary or the cus
any provision of our charter or any other instrument of ours governing t
any provision of any securities issued or distributed by us, or any offeri
securities.

What happens if there is a problem with the registrar s records?

Pursuant to the deposit agreement, the depositary or the custodian will confirm monthly, the number of deposited securities registered in the name of the depo nominees, as applicable. We and the depositary have agreed in the deposit agr depositary and the custodian shall be controlling for all purposes with respect deposited securities which should be registered in the name of the depositary, as applicable, pursuant to the terms of the deposit agreement.

The depositary has agreed in the deposit agreement that it will instruct the cust copies of share extracts or other evidence of verification provided to the depos agents pursuant to the deposit agreement. In the event of any material discrepa depositary or the custodian and the share register, then, if an officer of the dep such discrepancy, the depositary will promptly notify us. In the event of any d of the depositary or the custodian and the share register, we have agreed that, any notification from the depositary, we will:

use our best efforts to cause the registrar to reconcile its records to the r
custodian and to make such corrections or revisions in the share register
connection therewith; and
to the extent we are unable to so reconcile those records, and the numbe
records of the registrar differs by more than 0.5% from the number of sl
the depositary or the custodian, promptly instruct the depositary to notif
existence of the discrepancy.

Upon receipt of instruction from us, the depositary will notify the ADS holder deposit agreement. The depositary may, however, at any time notify the ADS received instructions from us. The depositary will cease issuing ADSs pursuan the records have been appropriately reconciled in the opinion of the depositary

ARBITRATION

Courts in the Russian Federation will not recognize or enforce judgments of th States of America or the courts of the State of New York.

Any dispute, controversy or cause of action brought against us under the depo
arbitration under the Commercial Arbitration Rules of the American Arbitratio
controversy or cause of action arises under the federal securities laws of the U
not have to be, submitted to arbitration at the election of the party bringing the
no authority to award punitive or other-than-actual damages and only may ma
deposit agreement.

If the dispute, controversy or cause of action arising out of the deposit agreem
it will be litigated in the federal or state courts in the Borough of Manhattan. V
service of process in New York.

198

Table of Contents

Taxation

The following discussion describes the material U.S. federal and Russian inco
consequences to a beneficial owner of common shares or ADSs. No opinion o
respect to the discussion under the heading Russian Income and Withholding
therefore, such discussion is not based on an opinion of counsel. A resident of
of the United States-Russia income tax treaty that is fully eligible for benefits
income tax treaty is referred to herein as a U.S. holder. Subject to certain pr
States-Russia income tax treaty relating to limitations on benefits, you general
United States for treaty purposes and entitled to treaty benefits if you are:

- liable, under the laws of the United States, for U.S. federal income tax (
of income from sources in the United States or capital situated therein)
residence, citizenship, place of incorporation, or any other similar criter
a partnership, trust or estate, residence is determined in accordance with
liable to tax with respect to such income); and
- not also a resident of the Russian Federation for Russian tax purposes.

The benefits under the United States-Russia income tax treaty discussed in thi
available to U.S. persons who hold ADSs or common shares in connection wit
the Russian Federation through a permanent establishment as defined in the U
treaty. Subject to certain exceptions, a U.S. person s permanent establishment
income tax treaty is a fixed place of business through which such person carrie
Russian Federation (generally including, but not limited to, a place of manage
factory). Under certain circumstances, a U.S. person may be deemed to have a
Russian Federation as a result of activities carried on in the Russian Federatio
person. This summary does not address the treatment of those holders.

The following discussion is based on:

- the United States Internal Revenue Code of 1986, as amended, the Trea
thereunder and judicial and administrative interpretations thereof;
- Russian legislation; and
- the United States-Russia income tax treaty (and judicial and administrat

all as in effect on the date of this prospectus. All of the foregoing are subject t
retroactive basis, after the date of this prospectus. This discussion is also based
the depositary, and assumes that each obligation in the deposit agreement and
performed in accordance with its terms. The discussion with respect to Russia
understanding of current Russian law and Russian tax rules, which are subject
interpretations. See Risk Factors Risks Relating to Russian Legislation and
System Weaknesses relating to the Russian legal system and Russian legislati
environment for investment and business activity and thus could have a materi
business and the value of our ADSs and Weaknesses and changes in the R

adversely affect our business and the value of our ADSs.

We believe, and the following discussion assumes, that for U.S. federal incom
passive foreign investment company, foreign personal holding company or for
the current taxable year and will not become a passive foreign investment com
company or foreign investment company in the future.

Table of Contents

Taxation

However, passive foreign investment company, foreign personal holding comp
company determinations are made annually and may involve facts that are not
example, it is not certain that we or one of our subsidiaries will not become a f
company in the future because more than 50% of either the total combined vot
voting stock or the total value of our stock is treated, for U.S. federal income t
more than five individuals who are citizens or residents of the United States, a
met. If we or one of our subsidiaries were a foreign personal holding company
as receiving a dividend at the end of each taxable year in an amount equal to it
corporation s undistributed foreign personal holding company income and wo
U.S. federal tax consequences. The American Jobs Creation Act of 2004, or th
law. The Act repeals the foreign personal holding company and foreign invest
years of foreign corporations beginning after December 31, 2004, and taxable
within which such taxable years of foreign corporations end.

The following discussion is not intended as tax advice to any particular invest
analysis or listing of all potential U.S. federal or Russian income and withhold
ownership of common shares or ADSs. We urge you to consult your own tax a
U.S. federal, state and local and Russian tax consequences of the ownership an
shares or ADSs under your own particular factual circumstances.

RUSSIAN INCOME AND WITHHOLDING TAX CONSIDERATIONS

The Russian tax rules applicable to U.S. holders are characterized by significa
absence of interpretive guidance. Russian tax authorities have not provided an
treatment of ADS arrangements, and there can be no certainty as to how the R
ultimately treat those arrangements. In particular, it is unclear whether Russian
holders as the beneficial owners of the underlying shares for the purposes of th
tax treaty. If the Russian tax authorities were not to treat U.S. holders as the be
underlying shares, then the benefits discussed below regarding the United Stat
would not be available to U.S. holders. See Risk Factors Risks Related to O
Market You may not be able to benefit from the United States-Russia double

Russian tax law and procedures are also not well developed, and local tax insp
autonomy and often interpret tax rules without regard to the rule of law. Both t
Russian tax law and the interpretation and application of those provisions by th
be subject to more rapid and unpredictable change than in jurisdictions with m

Currently, the Russian government is in the process of replacing the existing ta
comprehensive Tax Code, but it is unclear when this process will be complete
be affected. As of January 1, 1999, Part 1 (General) of the Tax Code went into
general principles of taxation in Russia, defines the legal status of taxpayers an
general rules of tax filings and tax control, as well as procedures for challengi

after the prior Law on Fundamentals of the Tax System of the Russian Federat
specify all the taxes that can be imposed by federal and local authorities. Furth
chapters (value-added taxes, excise tax, individual income tax and unified soci
Code went into effect. The Profit Tax Chapter and Mineral Extraction Tax of t
as of January 1, 2002.

Table of Contents

Taxation

Taxation of dividends

Dividends paid to U.S. holders generally will be subject to Russian withholdin for individual holders. This tax may be reduced to 5% to 10% under the Unitec treaty for U.S. holders; a 10% rate applies to dividends paid to U.S. holders ov entity s outstanding shares and 5% for U.S. holders, which is a legal entity, o outstanding shares. Given the depositary s status as the legal owner of all the possible that the depositary may claim entitlement to a reduced withholding ta regulations, authorization from the Russian tax authorities is not required to al rates under applicable double tax treaties provided that all of the numerous adr met. See United States-Russia Income Tax Treaty Procedures.

If the appropriate documentation has not been provided to us before the divide required to withhold tax at the full rate, and U.S. holders qualifying for a reduc States-Russia income tax treaty then would be required to file claims for refun Russian tax authorities. There is significant uncertainty regarding the availabil

Taxation of capital gains

U.S. holders generally should not be subject to any Russian income or withhol the sale, exchange, or other disposition of ADSs or common shares outside of are not sold to a Russian resident. Sales or other dispositions of ADSs or comn however, may be subject to Russian income or withholding taxes, and for such Russian resident purchaser may be required to withhold 20% to 30% of any ga However, there is no mechanism by which a Russian purchaser would be able purchasing ADSs from a U.S. holder in connection with the sale of ADSs on t

U.S. holders may be able to claim the benefits of a reduced rate of withholding income tax treaty on the disposition of common shares or ADSs to Russian res any withheld amounts at rates different from those provided in the treaty, by r Sates Russia income tax treaty and complying with the appropriate procedure

Regardless of the residence of the purchaser, a U.S. holder which is a legal ent Russian income or withholding taxes in connection with the sale, exchange or immovable property constitutes 50% or less of our assets or if ADSs are sold v they are legally circulated.

United States-Russia income tax treaty procedures

Under current rules, to claim the benefit of a reduced rate of withholding unde
income tax treaty, a non-resident generally must provide official certification f
eligibility for the treaty benefits in the manner required by Russian law.

A U.S. holder may obtain the appropriate certification by mailing completed f
name, social security number, tax return form number and the tax period for w
to: IRS-Philadelphia Service Center, Foreign Certification Request, P.O. Box
Pennsylvania 19114-0447. The procedures for obtaining certification are descr
Revenue Service Publication 686. As obtaining the required certification from
may take at least six to eight weeks, U.S. holders should apply for such certifi

---

Table of Contents

Taxation

If tax is withheld by a Russian resident on dividends or other amounts at the ra
the tax treaty, a U.S. holder may apply for a tax refund by filing a package of d
local tax inspectorate to which the withholding tax was remitted within three y
for U.S. holders which are legal entities, and within one year from the withhol
holders. The package should include the appropriate form (1012DT (2002) for
1011DT (2002) for dividend income), confirmations of residence of the foreig
copy of the agreement or other documents substantiating the payment of incom
beneficial ownership of the dividends recipient and the transfer of tax to the bu
the Tax Code the refund of the tax should be effected within one month after t
documents. However, procedures for processing such claims have not been cle
significant uncertainty regarding the availability and timing of such refunds.

Neither the depositary nor us will have any obligation to assist an ADS holder
of any tax forms.

UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

The following is a general description of the material U.S. federal income tax
if you are, for U.S. federal income tax purposes, a beneficial owner of ADSs o
citizen or resident of the United States, a corporation (including any entity trea
federal income tax purposes) created or organized in or under the laws of the U
subdivision thereof, an estate the income of which is subject to U.S. tax regard
U.S. court can exercise primary supervision over the administration of the trus
can control all substantial trust decisions or, if the trust was in existence on Au
elected to continue to be treated as a U.S. person. If a partnership (including an
for U.S. federal income tax purposes) is a beneficial owner of ADSs or commo
income tax treatment of a partner in the partnership will generally depend on t
activities of the partnership. Since your U.S. federal income and withholding t
depending upon your particular situation, you may be subject to special rules n
rules will apply, for example, if you are:

- an insurance company;
- a tax-exempt organization;
- a financial institution;
- a person subject to the alternative minimum tax;
- a person who is a broker-dealer in securities;
- an S corporation;
- an expatriate subject to Section 877 of the United States Internal Reven
- an owner of, directly, indirectly or by attribution, 10% or more of the ou shares; or
- an owner holding ADSs or common shares as part of a hedge, straddle, transaction.

In addition, this summary is generally limited to persons holding common sha
within the meaning of Section 1221 of the United States Internal Revenue Coc
currency is the U.S. dollar. The discussion below also does not address the eff
law or foreign tax law.

202

Table of Contents

Taxation

For purposes of applying United States federal income and withholding tax lav
treated as the owner of the underlying common shares represented by that AD

Taxation of dividends on common shares or ADSs

For U.S. federal income tax purposes, the gross amount of a distribution, inclu
taxes, with respect to common shares or ADSs will be treated as a taxable divi
current and accumulated earnings and profits, computed in accordance with U
principles. Under recently enacted legislation, for taxable years beginning afte
before January 1, 2009, if you are a non-corporate taxpayer, such dividends sh
applicable capital gains rate provided (1) certain holding period requirements a
case of ADSs, our ADSs continue to be listed on the New York Stock Exchan
exchange that is registered under section 6 of the Securities Exchange Act of 1
Nasdaq Stock Market) or (b) we are eligible for the benefits of the United Stat
and (3) we are not a foreign personal holding company, a foreign investm
investment company. Non-corporate U.S. holders are strongly urged to consu
the applicability of the lower capital gains rate to dividends received with resp
Distributions in excess of our current or accumulated earnings and profits will
reduce your tax basis in common shares or ADSs and, to the extent in excess c
as gain from a sale or exchange of such common shares or ADSs. You should
to calculate our earnings and profits for U.S. federal income tax purposes. If y
not be allowed a deduction for dividends received in respect of distributions or
which is generally available for dividends paid by U.S. corporations.

If a dividend distribution is paid in rubles, the amount includible in income wi
dividend, calculated using the exchange rate in effect on the date the dividend
regardless of whether the payment is actually converted into U.S. dollars. Any
currency exchange rate fluctuations during the period from the date the divide
to the date the rubles are converted into U.S. dollars will be treated as ordinary
required to recognize foreign currency gain or loss on the receipt of a refund o
pursuant to the United States-Russia income tax treaty to the extent the U.S. d
from the U.S. dollar equivalent of that amount on the date of receipt of the unc

Russian withholding tax at the rate applicable to you under the United States-F
be treated as a foreign income tax that, subject to generally applicable limitatio
for credit against your U.S. federal income tax liability or, at your election, ma
taxable income. If, however, the holder of an ADS is not treated as the owner
shares represented by the ADS for U.S. federal income tax purposes, then Rus
be treated as a foreign income tax eligible for credit as described in the preced
withheld at a rate in excess of the rate applicable to you under the United State
may not be entitled to credits for the excess amount, even though the procedur
practical likelihood that refunds will be made available in a timely fashion are

A dividend distribution will be treated as foreign source income and will gene
income or, in some cases, financial services income for U.S. foreign tax c
foreign tax credit limitation by reducing the number of classes of foreign sourc
years beginning after December 31, 2006. Under the Act, dividends generally
income but could, in the case of certain U.S. holders, constitute general

Table of Contents

Taxation

category income. The rules relating to the determination of the foreign tax cr
foreign tax credit, are complex and you should consult your own tax advisors

Taxation on sale or exchange of common shares or ADSs

The sale of common shares or ADSs will generally result in the recognition of
to the difference between the amount realized on the sale and your adjusted ba
ADSs. That gain or loss will be capital gain or loss if the common shares or A
hands and will be long-term capital gain or loss if the common shares or ADS
one year. If you are an individual, such realized long-term capital gain is gene
U.S. federal income tax. Limitations may apply to your ability to offset capita
income.

Deposits and withdrawals of common shares by you in exchange for ADSs wi
gain or loss for U.S. federal income tax purposes.

Gain realized on the sale of common shares or ADSs will generally be treated
therefore the use of foreign tax credits relating to any Russian taxes imposed u
You are strongly urged to consult your own tax advisors as to the availability
taxes withheld on the sale of common shares or ADSs.

Information reporting and backup withholding

Dividends and proceeds from the sale or other disposition of common shares o
United States or by a U.S.-related financial intermediary will be subject to U.S
and U.S. backup withholding tax, unless you are a corporation or other exemp
not be subject to backup withholding if you provide your taxpayer identificatio
loss of exemption from backup withholding has occurred. Holders that are not
subject to information reporting or backup withholding, but such holders may
certification as to their non-U.S. status.

Table of Contents

Shares eligible for future sale

Upon completion of the offering, we will have 416,270,745 issued common sh
357,772,401 shares will be held by our affiliates, as that term is defined und
exercise of the underwriters over-allotment option to purchase an additional
ADSs from the selling shareholders, and will be available for sale in the U.S. p
offering only if such sale is made pursuant to registration under the Securities
144 under the Securities Act. In general, under Rule 144 as currently in effect,
common shares are aggregated, including our affiliates, would be entitled to se
period a number of common shares that does not exceed the greater of:

1% of the then-outstanding common shares (4,162,707 common shares
consummation of the offering); and
the average weekly trading volume during the four calendar weeks prec
of the sale is filed with the SEC.

Sales under Rule 144 are also subject to certain provisions as to the manner of
the availability of current public information about us. Shares sold outside the
Regulation S would not be subject to these restrictions.

The selling shareholders, who will in the aggregate own 357,772,401 common
the offering, assuming no exercise of the underwriters over-allotment option.
underwriters that they will not dispose of or agree to dispose of any common s
common shares, including ADSs, during a period of 180 days from the date of
shareholders have further agreed to procure that their affiliates abide by this re
not apply to the disposal of any common shares or any interest in common sha
affiliates of such holder or to trustees for such holder and/or for such affiliates
provided that such transferee, before registration of any transfer of common sh
executes an undertaking in relation to such shares on similar terms to those de
form reasonably satisfactory to us and the underwriters; and to any other direc
shareholder that is a party to a lockup agreement with the underwriters and an
executes an undertaking in relation to such shares on similar terms to those de
have also agreed with the underwriters not to sell any common shares or any i
including ADSs, during a period of 180 days from the date of this prospectus.

Before this offering, there has been no public market for our ADSs, and we ca
that sales of our common shares or ADSs or the availability of those common
have on the market price prevailing from time to time of our ADSs. Sales of c
public market or the perception that such sales may occur may have an advers
market prices of our ADSs.

Table of Contents

Underwriting

We, our selling shareholders and the underwriters named below will enter into
with respect to the offering of our shares in the form of ADSs. Subject to the c
underwriting agreement, the underwriters will agree, severally and not jointly,
our selling shareholders the number of ADSs indicated in the following table.
global coordinator of the underwriters named below. The address of UBS is 1
EC2M 2PP, United Kingdom.

Underwriters	Us
UBS Limited	9,504,180
J.P. Morgan Securities Ltd.	725,624
Morgan Stanley & Co. International Limited.	725,624
Troika Dialog (Bermuda) Ltd. .	145,125

Our selling shareholders will agree to grant to the underwriters an option, exer
date of this prospectus, to purchase up to an additional 6,244,062 shares in the
initial public offering price listed on the cover page of this prospectus, less und
commissions. The underwriters may exercise this option only if the underwrite
total number of ADSs set forth in the table above. No more than 15% of the to
underwriters that are NASD members will be used to cover over-allotments so

The following table shows the per-ADS and total underwriting discounts and c
underwriters by us and our selling shareholders. Such amounts are shown assu
exercise of the underwriters option to purchase additional ADSs. The total ur
commissions are to be paid by us and our selling shareholders pro rata to the A
selling shareholders, respectively.

	Paid by us
Per ADS	$1.1025
Total	$12,238,36

The underwriters initially propose to offer the ADSs to the public at the prices
prospectus. If all the ADSs are not sold at the initial public offering price, the
the relevant offering price and the other selling terms.

We estimate that our and our selling shareholders share of the total expenses
estimated underwriting discounts and commissions, will be approximately $7.
pay 100%. The following table sets forth the various estimated expenses that v
with the sale and distribution of the ADSs, other than the estimated underwriti

206

Table of Contents

Underwriting

Securities and Exchange Commission registration fee	
New York Stock Exchange listing fee	
National Association of the Securities Dealers, Inc. filing fee	
Printing and engraving expenses	
Legal fees and expenses	
Accounting fees and expenses	
Miscellaneous	
Total	

We and our selling shareholders have agreed to indemnify the several underwr
under the Securities Act or to contribute to payments the underwriters are requ
liabilities. We have also agreed to reimburse the underwriters for certain out-o
with the offering of the ADSs.

The underwriters do not expect to make any sales to discretionary accounts.

The underwriters and their affiliates from time to time perform or may perforn
and other financial services for us and our affiliates for which the underwriters
advisory or transaction fees, as applicable, plus out-of-pocket expenses.

**LIMITATIONS PRIOR TO REGISTRATION OF PLACEMENT REPOR
OF NON-REGISTRATION**

You will not be permitted to withdraw from the depositary, or otherwise recei
exercise voting rights with respect to, the shares underlying the ADSs purchas
Russian Federal Service for the Financial Markets has registered the placemen
with the shares being issued and sold by us. Such limitation on withdrawal and
shares will not prohibit trading in the ADSs representing the shares.

Pending the registration of the placement report, the proceeds of this offering
dollar-denominated bank account with a foreign bank, in the case of the procee
ADSs by our selling shareholders, together with underwriting discounts and co
ruble-denominated bank accounts with a Russian subsidiary of a Western bank
the offering of shares and ADSs by us, acting as escrow agents under escrow a
among us, or the selling shareholders, as the case may be, the underwriters and
the event that the Federal Service for the Financial Markets denies registration
does not register the placement report by the termination date, which is 60 day
other date to which we, our selling shareholders and the underwriters agree:

we will be required to issue a press release and to notify the depositary, underwriters and the New York Stock Exchange by the close of busines termination of this offering; and

pursuant to the terms of the escrow agreements and the underwriting ag respect of the ADSs in the escrow-type and escrow accounts, together w thereon for the period from the closing date to the termination date, and necessary so that the funds being released would be equal (after convers dollars) to the original U.S. dollar proceeds of the offering will be relea

Table of Contents

Underwriting

See Risk Factors Risks Related to Our ADSs and the Trading Market The h
the shares underlying the ADS prior to the registration of a placement report fo
to register this placement report could result in the offering being held invalid

In this instance, the depositary will promptly distribute in U.S. dollars through
ADSs as of the termination date the funds it has received from the escrow and
amount to be returned in the event that the registration of the placement report
public offering price, which will be paid to the record holders of the ADSs on
of prior trading and the then-prevailing market price for the ADSs. Any attemp
the selling shareholders for the difference between the public offering price to
any, and the then-prevailing market prices for the ADSs would be subject to si
Limitation on Enforcement of Civil Liabilities for more information. The re
to Russian currency control regulations and may be prevented if there is a char

The holders of the ADSs will be entitled, as third-party beneficiaries to the und
actions against us to enforce our obligation in the underwriting agreement to re
received with respect to the ADSs (for refund to holders of ADSs) in the event
respect to the shares is not registered with the Federal Service for the Financia
the closing date or such other date to which we, our selling shareholders and th

STABILIZATION

In order to facilitate the offering of the ADSs, UBS Limited, on behalf of the u
transactions that stabilize, maintain or otherwise affect the price of the ADSs.
bid for and purchase ADSs in the open market to stabilize the price of the ADS
may sell more ADSs than the underwriters are obligated to purchase under the
creating a short position. A short sale is covered if the short position is no grea
available for purchase by the underwriters under the over-allotment option. UB
covered short sale by exercising the over-allotment option or purchasing ADS
determining the source of ADSs to close out a covered short sale, UBS Limite
things, the open market price of ADSs compared to the price available under t

UBS Limited, on behalf of the underwriters, may also sell ADSs in excess of t
creating a naked short position. UBS Limited must close out any naked short p
the open market. A naked short position is more likely to be created if the und
there may be downward pressure on the price of the ADSs in the open market
adversely affect investors who purchase in the offering.

As an additional means of facilitating the offering, the underwriting syndicate
concessions allowed to an underwriter or a dealer for distributing the ADSs in

repurchases previously distributed ADSs to cover syndicate short positions or
ADSs.

These activities may raise or maintain the market price of the ADSs above ind
prevent or retard a decline in the market price of the ADSs. UBS Limited is no
activities, and may end any of these activities at any time.

208

Table of Contents

Underwriting

TRADING MARKET AND LOCK-UP

Our shares are listed for trading on RTS under the symbol SGML, and the A
listing on the NYSE under the symbol MTL.

Prior to the offering, there has been a very limited public market for our shares
no public market for the ADSs. A liquid trading market for our shares or ADS
does develop, it may not be sustainable. The prices at which the shares and AD
markets after the offering may be lower than the price at which our ADSs are
offering. The initial public offering price will be determined by agreement am
and UBS. Among the factors to be considered in determining the initial public
prevailing market conditions, will be our historical performance, estimates of
earnings prospects, an assessment of our management and the consideration of
market valuation of companies in related businesses. Although our common sh
existing RTS share price will not necessarily be related to the initial public off

We and our selling shareholders will agree, subject to certain exceptions, not t
of, directly or indirectly, any shares in us or any ADSs representing such share
securities convertible into or exercisable or exchangeable for, shares in us or a
shares, or (2) enter into any swap or other agreement that transfers to another,
economic consequences of ownership of such shares or ADSs, options or othe
transaction described in this paragraph is to be settled by delivery of shares in
shares or other securities or in cash or otherwise, in each case for a period of 1
prospectus, without the prior written consent of UBS. Our selling shareholders
that their affiliates abide by these restrictions.

SELLING RESTRICTIONS

No action has been or will be taken in any jurisdiction other than the United S
offering of our shares or ADSs or the possession, circulation or distribution of
jurisdiction where action for that purpose is required. Accordingly, our shares
sold, directly or indirectly, and neither this prospectus nor any other offering m
connection with our shares or ADSs may be distributed or published in or from
except under circumstances that will result in compliance with any applicable
such country or jurisdiction.

No dealer, salesperson or other person has been authorized to give any informa
representation not contained in this prospectus, and, if given or made, such inf
not be relied upon as having been authorized by us or any underwriter. This pr
offer to sell or the solicitation of an offer to buy any securities other than the s

an offer to sell or the solicitation of an offer to buy such securities in any circu
solicitation is unlawful. Neither the delivery of this prospectus nor any sale ma
circumstances, create any implication that there has been no change in our affa
the information contained in this prospectus is correct as of a date after its date

United States

ADSs offered and sold in the United States will be offered and sold either thro
affiliates of the underwriters, or through underwriters who are themselves U.S

Table of Contents

Underwriting

to a registration statement. The underwriters may offer and sell ADSs outside
that are not subject to the registration requirements of the Securities Act pursu

Russian Federation

The underwriters agree that they have not offered or sold or otherwise transfer
otherwise transfer as part of the initial distribution or at any time thereafter any
to or for the benefit of any person (including legal entities) resident, incorpora
usual residence in the Russian Federation or to any person located within the t
Federation unless to the extent otherwise permitted by Russian law or regulatio
shares may not be sold or offered to or for the benefit of any person (including
incorporated, established or having their usual residence in the Russian Federa
within the territory of the Russian Federation except in compliance with Russi

The Netherlands

The shares or ADSs may not be offered, sold, transferred or delivered in or fro
their initial distribution or at any time thereafter, directly or indirectly, other th
insurance companies, securities firms, investment institutions, central governm
supranational organizations and other comparable entities, including, among o
companies of large companies or enterprises, that do trade or invest in securiti
profession or trade for their own account. Individuals or legal entities that do n
in the conduct of their profession or trade may not acquire the shares.

Japan

The underwriters agree that the shares or ADSs have not been and will not be
and Exchange Law of Japan and, accordingly, the underwriters have undertake
any shares or ADSs, directly or indirectly, in Japan or to, or for the benefit of,
others for re-offering or resale, directly or indirectly, in Japan or to any Japane
circumstances that will result in compliance with all applicable laws and regul
relevant Japanese governmental and regulatory authorities and in effect at the
of this paragraph, Japanese Person shall mean any person resident in Japan,
entity organized under the laws of Japan.

Canada

Each underwriter agrees that the ADSs will only be offered or sold, directly or
the Canadian provinces of British Columbia, Ontario and Québec and in comp
securities laws and, accordingly, any sales of ADSs will be made (1) through a
securities dealer or in accordance with an available exemption from the registe
requirements of applicable Canadian securities laws and (2) pursuant to an exe
requirements of such laws.

INFORMATION FOR CANADIAN INVESTORS

*This document is not, and under no circumstances is to be construed as, a pro
public offering of the securities described herein in Canada. No securities com
Canada has reviewed or in any way passed upon this document or the merits o
herein, and any representation to the contrary is an offence.*

Table of Contents

Underwriting

The offering is being made in the provinces of British Columbia, Ontario and
Provinces) by way of a private placement of ADSs. The offering in the Priva
made pursuant to this document through the underwriters named in this docum
agents who are permitted under applicable law to distribute such securities in

Representations and agreements by Canadian purchasers

Confirmations of the acceptance of offers to purchase any ADSs will be sent t
Placement Provinces who have not withdrawn their offers to purchase prior to
confirmations. Each purchaser of ADSs in the Private Placement Provinces wl
confirmation regarding the purchase of ADSs will, by the purchaser s receipt
represented to us, the selling shareholders and the dealer from which such pur
that such purchaser and any ultimate purchaser for which such initial purchase
entitled under applicable provincial securities laws to purchase such ADSs wi
qualified under such securities laws and, in the case of purchasers in province
services of a dealer registered pursuant to such securities laws, (2) is basing its
this document and not on any other information concerning us or the offering,
referred to below under the heading Canadian Resale Restrictions and (4)

where the purchaser is purchasing in British Columbia, such purchaser
with the benefit of the prospectus exemption and dealer registration exe
Section 5.1 of Multilateral Instrument 45-103 (MI 45-103) (that is, s
purchasing as principal and is an accredited investor within the mean
45-103);
where the purchaser is purchasing in Ontario, such purchaser is either a
the meaning of Section 204 of the Regulation to the *Securities Act* (Ont
or company registered as an international dealer under the *Securities*
purchasing from a fully registered dealer and, in either case, is purchasi
the prospectus exemption provided by Section 2.3 of Ontario Securities
(Rule 45-501) (that is, such purchaser is purchasing the ADSs as a pr
investor within the meaning of Section 1.1 of Rule 45-501);
where the purchaser is purchasing in Québec, such purchaser is a soph
within the meaning of Section 44 of the *Securities Act* (Québec) purcha
principal, or is a sophisticated purchaser within the meaning of Secti
Act (Québec) purchasing for the portfolio of a person managed solely b
as principal ADSs with an aggregate acquisition cost to such purchaser
Cdn$150,000 from a registered dealer with an unrestricted practice;
if the purchaser is a company, the purchaser was not established solely
ADSs in reliance on an exemption from applicable prospectus requirem
Provinces;
such purchaser is either purchasing ADSs as principal for its own accou
purchasing ADSs as principal for its own account in accordance with th
the province in which such purchaser is resident, by virtue of being one
designated trust company; (2) a designated insurance company; (3) a po
entity similarly deemed by those laws to be purchasing as principal for
purchasing on behalf of other beneficial purchasers;

Table of Contents

Underwriting

such purchaser is purchasing in respect of a trade for which there is an e
requirements of applicable Canadian securities laws or which is otherwi
laws;
such purchaser acknowledges and agrees that the offer and sale of ADS
exclusively through this document and was not made through an advert
in any printed media of general and regular paid circulation, radio or tel
form of advertising; and
acknowledges that the ADSs are being distributed in Canada on a privat
only and that any resale of ADSs must be in accordance with the requir
securities laws, which will vary depending on the relevant jurisdictions.

Language of document

Each purchaser of ADSs in Canada that receives a purchase confirmation here purchaser s express wish that all documents evidencing or relating in any way drafted in the English language only. *Chaque acheteur au Canada des valeurs confirmation à l égard de son acquisition reconnaît que c est sa volonté expr faisant foi ou se rapportant de quelque manière à la vente des valeurs mobiliè en anglais.*

Canadian resale restrictions

The distribution of the ADSs in the Private Placement Provinces is being made Accordingly, any resale of the ADSs must be made (1) through an appropriate accordance with an exemption from the registration requirements of applicable (2) in accordance with, or pursuant to an exemption from, the prospectus requi resale restrictions may not apply to resales made outside of Canada, depending Purchasers of ADSs are advised to seek legal advice prior to any resale of AD

Statutory rights of action (Ontario purchasers)

Section 4.2 of Rule 45-501 provides that when an offering memorandum, such to an investor to whom securities are distributed in reliance upon the accredit exemption in Section 2.3 of Rule 45-501, the right of action referred to in Sect (Ontario) (Section 130.1) is applicable. Section 130.1 provides purchasers v an offering memorandum with a statutory right of action against the issuer of s security holder for rescission or damages in the event that the offering memora contains a misrepresentation. Misrepresentation means an untrue stateme to state a material fact that is required to be stated or that is necessary to make or false in the light of the circumstances in which it was made.

Where this document, together with any amendment to it, is delivered to a pro
connection with a trade made in reliance on Section 2.3 of Rule 45-501, and th
misrepresentation which was a misrepresentation at the time of purchase of the
a statutory right of action against us and the selling shareholders for damages o
ADSs, for rescission, in which case, if the purchaser elects to exercise the righ
will have no right of action for damages, provided that the right of action for r
the purchaser only if the purchaser gives notice to the defendant, not more tha
transaction that gave rise to the cause of action, that the

Table of Contents

Underwriting

purchaser is exercising this right; or, in the case of any action, other than an ac
of: (1) 180 days after the plaintiff first had knowledge of the facts giving rise t
three years after the date of the transaction that gave rise to the cause of action

The defendant shall not be liable for a misrepresentation if it proves that the pu
with knowledge of the misrepresentation.

In an action for damages, the defendant shall not be liable for all or any portio
defendant proves do not represent the depreciation in value of the ADSs as a r
relied upon.

Subject to the paragraph below, all or any one or more of us and any selling sh
severally liable, and every person or company who becomes liable to make an
misrepresentation may recover a contribution from any person or company wh
have been liable to make the same payment, unless the court rules that, in all t
permit recovery of the contribution would not be just and equitable.

Despite the paragraph above, we shall not be liable where we are not receiving
distribution of the ADSs being distributed and the misrepresentation was not b
by us, unless the misrepresentation,

was based on information that was previously publicly disclosed by us;
was a misrepresentation at the time of its previous public disclosure; an
was not subsequently publicly corrected or superseded by us prior to th
distribution of the ADSs.

In no case shall the amount recoverable for the misrepresentation exceed the p
offered.

The foregoing statutory right of action for rescission or damages conferred is i
derogation from any other right the purchaser may have at law.

This summary is subject to the express provisions of the *Securities Act* (Ontari
made under it, and prospective investors should refer to the complete text of th

Enforcement of legal rights in Canada

All of our directors and officers (or their equivalents), the selling shareholders
herein may be located outside of Canada and, as a result, it may not be possibl
service of process within Canada upon us, the selling shareholders or such per
portion of our assets, the assets of the selling shareholders and such persons m
and, as a result, it may not be possible to satisfy a judgment against us, the sell
persons in Canada or to enforce a judgment obtained in Canadian courts again
such persons outside of Canada.

Canadian tax considerations and eligibility for investment

This prospectus does not address the Canadian tax consequences of ownership
purchasers of ADSs should consult their own tax advisers with respect to the C
considerations applicable to their individual circumstances and with respect to
investment by purchasers under relevant Canadian legislation.

Table of Contents

Underwriting

NYSE REQUIREMENTS

UBS Limited has informed the NYSE that the underwriters intend to sell the A
following NYSE requirements are met:

- the number of U.S. holders of 100 or more ADSs is 2,000 or more (incl
ADSs held in the name of the New York Stock Exchange members);
- the number of publicly held ADSs in the United States is 1.1 million or
- the aggregate market value of publicly held ADSs in the United States i

Table of Contents

Limitation on enforcement of civil liabi

Mechel Steel Group is incorporated under the laws of the Russian Federation. executive officers and all or a substantial portion of their and our assets are loc principally in Russia. As a result, you may not be able to effect service of proc upon us or our directors and executive officers or to enforce in U.S. courts jud our directors and executive officers in jurisdictions outside the United States, i liability provisions of U.S. securities laws. In addition, it may be difficult for y actions brought in courts in jurisdictions outside the United States, liabilities p laws.

Judgments rendered by a court in any jurisdiction outside the Russian Federati in the Russian Federation only if an international treaty providing for the recog judgments in civil cases exists between the Russian Federation and the country rendered and a federal law of the Russian Federation providing for the recogni court judgments is adopted. No such federal law has been passed and no such States and the Russian Federation for the reciprocal enforcement of foreign co

The deposit agreement with the depositary, Deutsche Bank Trust Company Ar of ADRs and the owners of a beneficial interest in book-entry ADRs, is gover New York and provides for actions brought by any party to the deposit agreem in New York in accordance with the Commercial Arbitration Rules of the Am Any action under U.S. federal securities laws or the rules or regulations promu submitted to arbitration by any party to the deposit agreement. The Russian Fe Nations (New York) Convention on the Recognition and Enforcement of Fore be difficult to enforce arbitral awards in the Russian Federation due to a numb inexperience of Russian courts in international commercial transactions, offici resistance to enforcement of awards against Russian companies in favor of for courts inability to enforce such orders and corruption. See Risk Factors Ri and the Russian Legal System.

We have appointed C T Corporation System as our agent for service of proces the ADSs and for actions under U.S. federal or state securities laws brought in located in the City of New York, Borough of Manhattan. We will submit to su appointment may not be respected by a Russian court.

Experts

The consolidated financial statements of Mechel Steel Group at December 31, the three years in the period ended December 31, 2003, as well as the consolid

Chelyabinsk Metallurgical Plant at December 31, 2001, and for the year then e
statements of Beloretsk Metallurgical Plant at June 14, 2002, and for the perio
financial statements of Korshunov Mining Plant at October 16, 2003, and Dec
period and year then ended, and consolidated financial statements of Izhstal at
the year then ended, appearing in this prospectus and the registration statemen
Young (CIS) Limited, Sadovnicheskaya Naberezhnaya 77, building 1, Moscov
independent registered public accounting firm, as set forth in their reports ther
qualification with respect to

Table of Contents

accounting for property, plant and equipment as described in Note 3(g) to the c
statements of Mechel Steel Group, Note 2(g) to the consolidated financial state
Metallurgical Plant, Beloretsk Metallurgical Plant and Izhstal and Note 2(f) to
statements of Korshunov Mining Plant) appearing elsewhere herein, and are in
reports given on the authority of such firm as experts in accounting and auditin
Limited, a member of Ernst & Young Global, is not a member of any professio

The information included in this prospectus regarding the mineral reserves is b
supported by Pincock, Allen & Holt, 274 Union Boulevard, Suite 200, Lakewo
international engineering firm, a division of Hart Crowser, in reliance upon the
experts in geology, mine planning, metallurgy, mineral evaluation and mineral
consent of such firm to its inclusion.

The valuation of property, plant and equipment at the acquisition dates for pur
financial statements and the opening balances of property, plant and equipmen
consolidated financial statements of Chelyabinsk Metallurgical Plant, Beloretsk
Korshunov Mining Plant and Izhstal, each of which are included elsewhere in
appraisal values provided by American Appraisal (AAR), Inc., 1st Khvostov P
Russian Federation, an internationally recognized appraisal company, in relian
firm as experts in property appraisals.

Legal matters

The validity of the ADSs offered hereby and certain U.S. tax matters will be p
Watkins LLP, New York, New York. The validity of the shares underlying the
passed upon for us by Liniya Prava, Moscow, Russian Federation. Certain lega
offering will be passed upon for the underwriters by Cleary, Gottlieb, Steen &

Where you can find more information

We have filed with the SEC a registration statement on Form F-1 with respect
represented by the ADSs being offered by this prospectus. This prospectus is a
statement. As permitted by SEC rules, this prospectus does not contain all the
in the registration statement and the accompanying exhibits and schedules. A r
Form F-6 has also been filed to register our ADSs. For further information abo
the ADSs offered by this prospectus, please refer to these registration statemen
refer to a contract or other document of ours in this prospectus, the reference i
you should refer to the exhibits and schedules that are a part of these registrati
contract or other document. You may read and copy these registration stateme
the SEC s Public Reference Room at 450 Fifth Street, N.W., Room 1024, Wa

obtain information on the operation of the Public Reference Room by calling t
These filings are also available at the website maintained by the SEC at http://

After the offering, we will be subject to the informational requirements of the
1934, as amended, applicable to foreign private issuers and will file annual rep
months of our fiscal year-end and other reports and information on Form 6-K
copy these reports and other information at the SEC s Public Reference Room

216

through its website. You can also inspect some of our reports and other inform
NYSE at 20 Broad Street, New York, New York 10005.

As a foreign private issuer, we are exempt from the rules under the Securities
amended, prescribing the furnishing and content of proxy statements, and our
shareholders will be exempt from the reporting and short-swing profit recover
Section 16 of the Securities Exchange Act of 1934, as amended.

Industry and market data

We have derived substantially all of the information contained in this prospect
competitors from publicly available information (including through subscripti
accuracy of this information without independent verification. In particular, w
Rosinformugol, Chermet, MetalTorg.ru, Metall-Expert, Rudprom and Sideron
sources for information about the Russian and Romanian steel and mining ind
International Iron and Steel Institute for global raw steel production data.

In addition, some of the information contained in this document has been deri
Russian government agencies. The official data published by Russian federal,
are substantially less complete or researched than those of Western countries.
produced on different bases than those used in Western countries. Any discuss
in this prospectus must, therefore, be subject to uncertainty due to concerns ab
reliability of available official and public information. The veracity of some o
Russian government may be questionable. In the summer of 1998, for exampl
State Committee on Statistics and a number of his subordinates were arrested
economic data to hide the actual output of various companies.

Table of Contents

Glossary

Billet: A semi-finished steel form that is used for steel long products such as b
shapes. A billet is different from a slab because of its outer dimensions; billets
centimeters square, while slabs are 75-225 centimeters wide and 18-25 centim
generally continuously cast, but they may differ greatly in their chemistry.

Blast furnace: A towering cylinder lined with heat-resistant (refractory) brick
to smelt iron from ore. Its name comes from the blast of hot air and gases fo
and limestone that load the furnace.

Bloom: A semi-finished steel form whose rectangular cross-section is more th
steel shape is broken down in the mill to produce rails, I-beams, H-beams and
part of the high-quality bar manufacturing process.

BOF: A basic oxygen furnace, which is a pear-shaped furnace, lined with refr
iron from the blast furnace and scrap into steel.

Carbon steel: A type of steel generally having no specified minimum quantity
containing only an incidental amount of any element other than carbon, silicon
and phosphorus.

Cladding: The method of applying a stainless steel coating to carbon steel or
alloying element content below 5%). Cladding increases corrosion resistance a
exclusive use of stainless steel.

Coating: The process of covering steel with another material (tin, chrome, zin
resistance.

Coils: Steel sheet that has been wound. A slab, once rolled in a hot-strip mill,
coils are the most efficient way to store and transport sheet steel.

Coke: The basic fuel consumed in blast furnaces in the smelting of iron. Coke
About 450 kilograms of coke are needed to process a tonne of hot metal, an an

than 50% of an integrated steel mill s total energy use. Coke is used because r
sporadically and reduces into a sticky mass. Processed coke, however, burns s
crushed by the weight of the iron ore in the blast furnace. It is produced inside
oven, in which coal is heated without oxygen for 18 hours to drive off gases ar

Coking coal: Bituminous coal used in the production of steel in basic oxygen
sulphur and phosphorous.

Cold rolling: Changes in the structure and shape of steel achieved through rol
temperature (often room temperature). It is used to create a permanent increase
the steel. It is effected by the application of forces to the steel which causes ch
enhancing certain properties. In order for these improvements to be sustained,
a certain range because the structural changes in the steel are eliminated by hig

Continuous casting: A method of pouring steel directly from a ladle through
form billets, blooms or slabs. Continuous casting avoids the need for large mil
Continuous cast slabs also solidify in a few minutes, versus several hours for a
chemical composition and mechanical properties are more uniform.

218

Table of Contents

Glossary

EAF: An electric arc furnace, which is a steel-making furnace where scrap is g
Heat is supplied from electricity that arcs from the graphite electrodes to the m

Ferro nickel: An alloy of iron and nickel used in making steel containing nick

Filter cake: The solid material extracted from a suspension through a filtratio

Flat-rolled steel/Flat products: Category of steel that includes sheet, strip an

Galvanized steel: Steel coated with a thin layer of zinc to provide corrosion re
parts, garbage cans, storage tanks, fencing wire, etc. Sheet steel normally must
galvanizing. Galvanized steel is subdivided into hot-dipped galvanized and ele
Electrogalvanizing equipment is more expensive to build and operate than hot
the steel maker more precise control over the weight of the zinc coating.

Heavy plate: Steel sheet with a width of up to five meters and a thickness of a
mainly used for construction, heavy machinery, shipbuilding or large diamete

Hot metal: The name for the melted iron produced in a blast furnace, containi
(above 1.5%). Solidified hot metal is called pig iron.

Hot mill: The rolling mill that reduces a hot slab into a coil of specified thickn
done at a relatively high temperature (when the steel is still red).

Hot rolled: Product that is sold in its as-produced state off the hot mill wit
processing steps, aside from being pickled and oiled (if specified).

Iron ore: Mineral containing enough iron to be a commercially viable source
making.

Iron ore concentrate: Iron ore containing the valuable minerals of an ore fro
material has been removed by undergoing treatment.

Lateritic: A soil horizon produced by intense leaching of bedrock, generally u
leave an iron- and aluminum-rich residue.

Long products: Classification of steel products that includes bars, rods and st
rather than flat.

Magnetite ore: Mineral containing enough magnetite to be used commerciall

Magnetic separator: A device used in a process when magnetically susceptib
gangue minerals by applying a strong magnetic field.

Non-reserve mineral deposits: A mineral deposit that is a coal-, iron-, nickel
has been sufficiently sampled and analyzed in trenches, outcrops, drilling and
assume continuity between sample points. However, this coal, iron, nickel or l
qualify as a commercially viable coal, iron, nickel or limestone reserve as pres
final comprehensive evaluation based upon unit cost per ton, recoverability an
concludes legal and economic feasibility. In particular, our non-reserve miner
economic feasibility standard but do not qualify as mineral reserves because th
within the license boundary but are scheduled to be extracted beyond the licen
contained within the license boundary. In both such cases, we expect to be abl
extract such deposits in the future, but we have a limited history of license ren
system provides regulatory authorities with discretion in matters of license ren
Relating to Our Business and Industry Our business could be adversely affect
necessary licenses and permits or fail to comply with

Table of Contents

Glossary

the terms of our licenses and permits and Risk Factors Risks Relating to R
Legal System Weaknesses relating to the Russian legal system and Russian le
environment for investment and business activity and thus could have a materi
business and the value of our ADSs.

Open-pit mining: A surface mining operation in which blocks of earth are du
ore contained in them.

Overburden: Worthless or low-grade surface material covering a body of use

Pig iron: See Hot metal.

Pipes: A tube used to transport fluids or gases. Pipe and tube are often used in
label applied primarily as a matter of historical use.

Probable reserves: Reserves for which quantity and grade and/or quality are c
similar to that used for proven reserves, but the sites for inspection, sampling a
apart or are otherwise less adequately spaced. The degree of assurance, althou
reserves, is high enough to assume continuity between points of observation.

Profiles: See Sections.

Proven reserves: Reserves for which (a) quantity is computed from dimensio
trenches, workings or drill holes; grade and/or quality are computed from the r
(b) the sites for inspection, sampling and measurement are spaced so closely a
well defined that size, shape, depth and mineral content of reserves are well-es

Pulverized coal (PCI): Finely ground/crushed coal.

Raw Steel: Steel in primary form of hot molten metal.

Rebar or Reinforcement bar: A commodity-grade steel used to strengthen co
construction.

Reserve: That part of a mineral deposit which could be economically and lega
time of the reserve determination.

Rolled steel (products): Steel produced to a desired thickness by being passe

Scrap (Ferrous): Ferrous (iron-containing) material that generally is remelted
electric arc furnaces. Integrated steel mills also use scrap for up to 25% of thei
Scrap includes waste steel generated from within the steel mill, through edge t
excess steel trimmed by auto and appliance stampers, which is auctioned to sc

Seamless pipes: Tubes made from a solid billet or bloom, which is heated, the
pressure. This rotational pressure creates an opening in the center of the billet,
mandrel to form a tube.

Sections: Blooms or billets that are hot-rolled in a rolling mill to form, among
shapes. Sections can also be produced by welding together pieces of flat produ
wide variety of purposes in the construction, machinery and transport industri
profiles.

Semi-finished steel: Steel shapes for example, blooms, billets or slabs that l
products such as beams, bars or sheet.

220

Table of Contents

Glossary

Sheet steel: Thin, flat-rolled steel created in a hot-strip mill by rolling a cast sl
side dimensions. The malleable steel lengthens to several thousand feet as it is
The most common differences among steel bars, strip, plate and sheet are mer
width and gauge (thickness).

Sintering: A process that combines iron-bearing particles into small chunks. F
too fine to withstand the air currents of the smelting process and were thrown
conserved because the chunks can be charged into the blast furnace.

Slab: The most common type of semi-finished steel. Traditional slabs measur
75-225 centimeters wide and are usually about 6-12 meters long, while the out
thin slab casters is approximately five centimeters thick. After casting, slab
rolled into coiled sheet and plate products.

Specialty steel: Soft-alloy steel produced by the addition of various metals (*e.*
quantities during the steel-making process to improve mechanical properties s
stress. Specialty steels are intermediary products between standard steel grade
a high content of nickel and chrome). Specialty steel products are typically us
specialty bar quality, bearing steel, tool steel and speed steel).

Steam coal: Coal suitable for use under steam boilers.

Strip: Thin, flat steel that resembles hot-rolled sheet, but it is normally narrow
and produced to more closely controlled thicknesses. Strip also may be cut fro
machine (see Sheet steel).

Tailings: Material rejected from a mine after the valuable minerals have been

Tubes: See Pipes.

Underground mining: Mining for extracting the ore below the surface.

Welded pipes: Rolled plates welded into tubes of various shapes, gauges and
of material.

Wire rod: Round, thin, semi-finished steel length that is rolled from a billet ar
Wire rod is commonly drawn into wire products or used to make bolts and nai
facilities) can run as fast as 6,000 meters per minute.

Table of Contents

Index to consolidated financial statem

Table of Contents

KORSHUNOV MINING PLANT OAO

Audited Consolidated Financial Statements

Audited Consolidated Financial Statements

IZHSTAL OAO

Audited Consolidated Financial Statements

Table of Contents

Mechel Steel Group OAO

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING

Shareholders and the Board of Directors

Mechel Steel Group OAO

We have audited the accompanying consolidated balance sheets of Mechel Ste
stock company (hereinafter referred to as the Group), as of December 31, 2
consolidated statements of income, cash flows and changes in shareholders e
in the period ending December 31, 2003. These financial statements are the re
management. Our responsibility is to express an opinion on these financial sta

We conducted our audits in accordance with the standards of the Public Comp
Board (United States). Those standards require that we plan and perform the a
assurance about whether the financial statements are free of material misstater
examining, on a test basis, evidence supporting the amounts and disclosures in
audit also includes assessing the accounting principles used and significant est
as well as evaluating the overall financial statement presentation. We believe t
reasonable basis for our opinion.

As more fully described in Note 3(g) to the consolidated financial statements,
equipment pertaining to non-controlling shareholders in the accounting for mi
acquisitions of various subsidiaries has been recorded at appraised values rathe
required by accounting principles generally accepted in the United States.

In our opinion, except for the effects of the matter discussed in the preceding p
statements referred to above present fairly, in all material respects, the consoli
Group at December 31, 2003, and 2002, and the consolidated results of its ope
each of the three years in the period ending December 31, 2003, in conformity
generally accepted in the United States.

As discussed in Note 3(x) to the financial statements, effective January 1, 200
of Financial Accounting Standards No. 143, Accounting for Asset Retiremer
Note 2(n) to the financial statements, effective January 1, 2002, the Group ado
Accounting Standards No. 142, Goodwill and Other Intangible Assets .

/s/ Ernst & Young (CIS) Limited

June 30, 2004

Moscow, Russia

Table of Contents

Mechel Steel Group OAO

CONSOLIDATED BALANCE SHEETS

(in thousands of U.S. dollars, except share amounts)	Notes
ASSETS	
Cash and cash equivalents	4
Accounts receivable, net of allowance for doubtful accounts of $23,312 in 2003, and $21,942 in 2002	5
Due from related parties	9
Inventories	6
Deferred cost of inventory in transit	3(n
Current assets of discontinued operations	2(n
Deferred income taxes	15
Prepayments and other current assets	7
Total current assets	
Long-term investments in related parties	8
Other long-term investments	8
Due from related parties	9
Non-current assets of discontinued operations	2(n
Property, plant and equipment, net	10
Mineral licenses, net	11
Deferred income taxes	15
Goodwill	2(n
Total assets	
LIABILITIES AND SHAREHOLDERS EQUITY	
Short-term borrowings and current maturities of long-term debt	12
Accounts payable and accrued expenses:	
Advances received	
Accrued expenses and other current liabilities	
Taxes and social charges payable	13
Trade payable to vendors of goods and services	
Due to related parties	9
Asset retirement obligation	3(x
Current liabilities of discontinued operations	2(n
Deferred income taxes	15
Deferred revenue	3(n
Total current liabilities	
Restructured taxes and social charges payable, net of current portion	13
Long-term debt, net of current portion	12
Asset retirement obligations, net of current portion	3(x
Due to related parties	9
Deferred income taxes	15
Other long term liabilities	
Commitments and contingencies	19
Minority interests	2(o
SHAREHOLDERS EQUITY	14

Common shares (10 Russian rubles par value; 497,969,086 shares authorized, 382,969,086 shares issued and 366,178,815 shares outstanding)
Treasury shares, at cost
Additional paid-in capital
Accumulated other comprehensive income
Retained earnings
Total shareholders equity
Total liabilities and shareholders equity

See accompanying notes to consolidated financial sta

F-4

Table of Contents

Mechel Steel Group OAO

CONSOLIDATED INCOME STATEMENTS

(in thousands of U.S. dollars, except share and per share amounts)	Notes	Year 2003
Revenue, net (including related party amounts of $211,943, $134,965 and $126,742, during 2003, 2002 and 2001, respectively)	18	$ 2,050,088
Cost of goods sold (including related party amounts of $212,492, $133,326 and $123,042, during 2003, 2002 and 2001, respectively)		(1,440,053)
Gross margin		610,035
Selling, distribution and operating expenses:		
Selling and distribution expenses		(214,519)
Taxes other than income tax	16	(44,717)
Accretion expense	3(x)	(2,433)
Goodwill impairment	2(n)	
Provision for doubtful accounts	5	(10,011)
General, administrative and other operating expenses	17	(145,579)
Total selling, distribution and operating expenses		(417,259)
Operating income		192,776
Other income and (expense):		
Income (loss) from equity investments	8	1,221
Interest income		2,292
Interest expense		(48,528)
Other income, net		26,719
Foreign exchange gain (loss)		(1,722)
Total other income and (expense), net		(20,018)
Income before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principles		172,758
Income tax expense	15	(47,759)
Minority interest in loss (income) of subsidiaries	2(o)	18,979
Income from continuing operations		143,978
Loss from discontinued operations, net of tax	2(m)	(2,422)
Extraordinary gain, net of tax	2(n)	5,740
Income before cumulative effect of changes in accounting principles		147,296
Change in accounting principle, net of tax	3(x)	(3,788)
Net income		$ 143,508

Currency translation adjustment			**46,921**
Comprehensive income		**$**	**190,429**
Basic and diluted earnings per share:	**14**		
Earnings per share from continuing operations		**$**	**0.39**
Income (loss) per share effect of discontinued operations			**(0.01)**
Earnings per share effect of extraordinary gain			**0.02**
Earnings per share effect of a change in accounting principle			**(0.01)**
Net income per share		**$**	**0.39**
Weighted average number of shares outstanding			**366,178,815**

See accompanying notes to consolidated financial sta

Table of Contents

Mechel Steel Group OAO

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Y
(in thousands of U.S. dollars)	**200**
Cash Flows from Operating Activities	
Net income	**$ 143.**
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation	**83.**
Depletion and amortization	**17.**
Negative goodwill amortization	
Foreign exchange gain	**1.**
Deferred income taxes	**(6.**
Provision for doubtful accounts	**10.**
Inventory write down	**4.**
Accretion expense	**2.**
Impairment of goodwill	
Minority interest	**(18.**
Effect of change in accounting principle	**3.**
Loss (income) from equity investments	**(1.**
Non-cash interest on long-term tax liabilities	**13.**
(Gain) loss on sale of property, plant and equipment	**4.**
(Gain) loss on sale of short-term investments	**(2.**
Loss on sale of discontinued operations	**1.**
Gain on accounts payable with expired legal term	
Gain on forgiveness of fines and penalties	**(10.**
Stock based compensation expense	**2.**
Amortization of capitalized costs on bonds issue	
Extraordinary gain	**(5.**
Changes in operating assets and liabilities, net of effects from acquisition of new subsidiaries:	
Accounts receivable	**(9.**
Inventories	**(110.**
Trade payable to vendors of goods and services	**(8.**
Advances received	**13.**
Accrued taxes and other liabilities	**20.**
Settlements with related parties	**(12.**
Current assets and liabilities of discontinued operations	**(**
Deferred revenue and cost of inventory in transit, net	**13.**
Other current assets	**(28.**
Net cash provided by operating activities	**119.**
Cash Flows from Investing Activities	
Acquisition of subsidiaries, less cash acquired	**(20.**
Acquisition of minority interest in subsidiaries	**(3.**
Investment in Korshunov Mining Plant	**(82.**
Investments in other non-marketable securities	**(29.**
Investments in equity affiliates	

Proceeds from disposal of discontinued operations	**5,**
Proceeds from disposal of non-marketable equity securities	**33,**
Proceeds from disposals of property, plant and equipment	**3,**
Purchases of property, plant and equipment	**(116,**
Net cash used in investing activities	**$ (209,**

continued on next page

Table of Contents

Mechel Steel Group OAO

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

	Yea
(in thousands of U.S. dollars, except share amounts)	**2003**
continued from previous page	
Cash Flows from Financing Activities	
Proceeds from short-term borrowings	**$ 781,525**
Repayment of short-term borrowings	**(747,815**
Dividends paid	**(26,282**
Proceeds from shares issued in subsidiary	
Proceeds from long-term debt	**112,736**
Loans and notes (issued) received to/from related parties	**6,397**
Repayment of long-term debt	**(23,482**
Net cash provided by financing activities	**103,079**
Effect of exchange rate changes on cash and cash equivalents	**991**
Net increase/(decrease) in cash and cash equivalents	**13,635**
Cash and cash equivalents at beginning of year	**5,668**
Cash and cash equivalents at end of year	**$ 19,303**
Supplementary cash flow information:	
Interest paid, net of capitalized	**$ (31,275**
Income taxes paid	**$ (53,884**
Non-cash Activities:	
Net assets of subsidiaries contributed by minority shareholders in exchange for shares issued by SKCC (Note 14)	**$ 4,428**
Assumption of debt at business combination (Note 2(i))	**$ 2,673**
Net assets of subsidiaries contributed by shareholders (Note 14)	**$**
Treasury shares issued to subsidiary (Note 14)	**$**

See accompanying notes to consolidated financial sta

Table of Contents

Mechel Steel Group OAO

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS

(in thousands of U.S. dollars, except share amounts)	Common shares Shares	Common shares Amount	Treasury shares Shares	Treasury shares Amount	Additional paid-in-capital	Ac com
Balances as of January 1, 2001	224,106,594	$ 71,354		$	$ 21,455	$
Contributions by Controlling Shareholders (Note 14)	107,281,213	34,158			71,319	
Treasury shares issued to subsidiary (Note 14)			(993,513)	(316)	(2,451)	
Net income						
Dividends						
Balances as of December 31, 2001	331,387,807	$ 105,512	(993,513)	$ (316)	$ 90,323	$
Contributions by Controlling Shareholders (Note 14)	51,581,279	16,423			7,673	
Treasury shares issued to subsidiary (Note 14)			(15,796,758)	(5,030)	(11,965)	
Net income						
Dividends						
Balances as of December 31, 2002	382,969,086	$ 121,935	(16,790,271)	$ (5,346)	$ 86,031	$
Net income						
Dividends						
Cumulative translation adjustment on opening balanses						
Cumulative translation adjustment for 2003						
Stock based compensation					2,200	
Issuance of subsidiary stock					4,428	
Balances as of December 31, 2003	382,969,086	$ 121,935	(16,790,271)	$ (5,346)	$ 92,659	$

See accompanying notes to consolidated financial sta

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2003 and, 2002, and for each of the three years in
31, 2003

(All amounts are in thousands of U.S. dollars, unless stated otherwise)

1. GENERAL INFORMATION AND BUSINESS

(a) Formation

Mechel Steel Group OAO (Mechel) was incorporated on March 19, 2003, u
Federation in connection with a reorganization to serve as a holding company
companies owned by two individual shareholders (the Controlling Sharehold
Shareholders, directly or through their affiliates, either acquired existing comp
or established new companies, at varying dates from 1995 through March 19,
Mechel after its formation. Mechel and its subsidiaries are collectively referre
forth below is a summary of the Group s primary subsidiaries:

Name of subsidiary	Registered in	Core business	Date cor acquire
Mechel Trading AG (MT)	Switzerland	Holding and trading	Jul 1, 19
Mechel Metal Supply AG (MMS)	Liechtenstein	Trading	Oct 30, 2
Mechel Trading House (MTH)	Russia	Holding and trading	Jun 23, 1
Southern Kuzbass Coal Company (SKCC), including its most significant subsidiaries:	Russia	Holding and trading	Jan 21, 1
Sibirginsk Open Pit Mine (SOPM)	Russia	Coal mining	Jan 21, 1
Krasnogorsk Open Pit Mine (KOPM)	Russia	Coal mining	Jan 21, 1
Tomusinsk Open Pit Mine (TOPM)	Russia	Coal mining	Jan 21, 1
Olzherassk Open Pit Mine (OOPM)	Russia	Coal mining	Dec 28, 1
Tomusinsk Group Processing Plant (TGPP)	Russia	Coal processing	Dec 31, 2
Kuzbass Central Processing Plant (KCPP)	Russia	Coal processing	Dec 31, 2
Lenin Mine (LM)	Russia	Coal mining	Dec 29, 2

Usinsk Mine (UM)	Russia	Coal mining	Dec 29, 2
Siberian Central Processing Plant (SCPP)	Russia	Coal processing	Dec 22, 2
Chelyabinsk Metallurgical Plant (CMP)	Russia	Steel products	Dec 27, 2
Southern Urals Nickel Plant (SUNP)	Russia	Nickel	Dec 27, 2
Vyartsilya Metal Products Plant (VMPP)	Russia	Steel products	May 24, 2
Beloretsk Metallurgical Plant (BMP)	Russia	Steel products	Jun 14, 2
Combinatul de Oteluri Speciale Targoviste S.A. (COST)	Romania	Steel products	Aug 28, 2
Mechel Zeljezara (MZ)	Croatia	Steel products	March 17,
Ural Stampings Plant (USP)	Russia	Steel products	April 24,
Korshunov Mining Plant (KMP)	Russia	Iron ore mining	Oct 16, 2
Industria Sarmei (IS)	Romania	Steel products	Jun 20, 2
Mechel Nemunas (MN)	Lithuania	Steel products	Oct 15, 2
Mechel Coal Resources	Kazakhstan	Coal processing	Dec 31, 2

(*) *Date when a control interest was acquired by either the Group or Contro*

Subsequent to December 31, 2003, as disclosed in Note 20, Subsequent even
equity interests in new subsidiaries.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(b) Controlling Shareholders and Reorganization

Since 1995, the Controlling Shareholders have acted in concert pursuant to a v
Voting Agreement, which requires them to vote all shares of Mechel s subsid
manner. The establishment of the Group in March 2003 involved the contribut
subsidiaries, acquired before March 19, 2003, by the Controlling Shareholders
the outstanding capital stock of Mechel, forming a new holding company via a

As a result of this restructuring, the Controlling Shareholders maintained their
subsidiaries through Mechel and Mechel became a direct holder of the stock o

Shareholders in each of Mechel s subsidiaries before the restructuring who we
did not contribute any shares in these subsidiaries to Mechel in exchange for it
outside the control group and these shareholders retained a minority interest in
extent minority interests existed in the entities under common control prior to
interests did not change as a result of the formation of Mechel and the reorgan

(c) Basis of Presentation

The formation of Mechel and contribution of the subsidiaries shares into Me
reorganization of entities under common control, and accordingly, has been ac
a pooling for the periods presented. The consolidated financial statements have
that Mechel existed for all periods presented since its inception, and was the m
contributed subsidiaries in all such periods, unless a subsidiary was acquired b
during the periods presented, in which case the consolidated financial statemen
operation of the acquired subsidiaries from the date control was acquired.

(d) Business

The Group operates in two business segments: steel (comprising steel and st
(comprising coal, iron ore and nickel), and conducts operations in Russia, Kaz
and Eastern Europe. The Group sells its products within Russia and foreign ma
the Group has added various businesses to explore new opportunities and buil

group. The Group operates in a highly competitive and cyclical industry; any l
industries may have an adverse effect on the Group s results of operations and
will require a significant amount of cash to fund capital improvements program
funds from operations, it expects to continue to rely on capital markets and oth
capital needs. A more detailed description of activity is provided within indivi
subsidiary acquisition.

2. ACQUISITIONS AND DISPOSALS

As disclosed in the preceding note, the Group experienced significant growth t
following describes business combinations between January 1, 2001, and Dece

(a) Chelyabinsk Metallurgical Plant (CMP)

On October 3, 2000, the Group entered into an agreement to acquire 65.1% of
$110,000 in cash, including $2,521 of cash acquired. The ownership and contr

---

F-10

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

was transferred to the Group on December 27, 2001, when all obligations in re
satisfied in full. Together with its holding of 17.3% of the CMP common shar
Group in September 2001 for a total consideration of $23,044, at December 27
of the common shares of CMP. Prior to December 27, 2001, the 17.3% interes
cost.

CMP is an integrated blast furnace and basic oxygen furnace (BOF)/electric ar
located in the southern Urals in Russia. CMP produces coke, semi-finished ste
specialty steel products and forgings. CMP was the Group s first steel making
this acquisition was primarily focused on coal. Prior to its acquisition, the Gro
coal to CMP and marketed CMP s products. The acquisition was intended to
to explore new opportunities in related business sectors. The Group has used a
CMP in the manner in which they were previously used.

The acquisition of CMP was accounted for using the purchase method of acco
value of the net assets acquired over the purchase price has been allocated as a
and $4,891 of the amounts that otherwise would have been assigned to propert
other non-current assets, respectively, in accordance with SFAS No. 141, Bu
of operations of CMP are included in the consolidated financial statements fro
control, December 27, 2001. The following table summarizes the fair values o
of acquisition of control:

Cash and cash equivalents
Other current assets
Property, plant and equipment
Other non-current assets
Current liabilities
Long-term liabilities
Deferred income taxes
Fair value of net assets acquired
Minority s share in net assets
Total investment

(b) Southern Urals Nickel Plant (SUNP)

On September 7, 2001, the Group acquired 46.0% of the common shares of SU
Subsequently, on December 27, 2001, the Group increased its interest in SUN
acquisition of control over CMP (see Note 2(a)), which owned 10% of SUNP
Between September 7, 2001 and December 27, 2001, the investment in SUNP
equity method of accounting. On January 30, 2002, the Group purchased an ad
shares of SUNP for $1,606 in cash. SUNP is located in the southern Urals in R
ore mining at two open-pit mines and the processing of nickel ore into ferro-ni
serve as an internal source of nickel for stainless steel production at CMP, whi
on the same date. Prior to its acquisition, the Group had marketed SUNP s pro
continues to use the assets of SUNP in the manner in which they were previou

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The acquisition of SUNP was accounted for using the purchase method of acc operations of SUNP are included in the consolidated financial statements from control, December 27, 2001. Total investment in SUNP at the control acquisit cash paid for shares and the Group s share in equity results of SUNP from Se 27, 2001, and was allocated to the fair values of net assets acquired at the date follows:

Cash and cash equivalents
Other current assets
Property, plant and equipment
Mining assets
Mineral licenses
Other non-current assets
Current liabilities
Long-term liabilities
Deferred income taxes
Fair value of net assets acquired
Goodwill
Total investment

At the date of acquisition, SUNP s historical book value of its net assets was Group obtained less than 100% ownership in SUNP, the minority interest in th $5,568 was added to goodwill, thereby increasing the total goodwill upon acqu accordance with Statement of Financial Accounting Standards (SFAS) No. SFAS No. 142, Goodwill and Other Intangible Assets , the Group will not a connection with the acquisition of SUNP, but goodwill will be subject to an an

(c) Mezhdurechensk Coal Company, Lenin Mine and Usinsk Min

On December 29, 2001, the Group acquired 100% of the shares of Mezhdurec for $5,105 in cash. Following the acquisition, on October 8, 2002, MCC was r Coal Company. At the time of its acquisition, MCC was a holding company w its own that had equity investments in various mining companies, including Le (UM) and certain subsidiaries of SKCC (OOPM, TGPP and KCPP). The acqu obtaining ownership of Lenin Mine and consolidating ownership of certain su acquisition of MCC was accounted for using the purchase method of accounti MCC are included in the consolidated financial statements from the date of ac

29, 2001.

LM is involved in underground coal mining in the Kuzbass Region in the sout
to the acquisition of MCC, the Group held 26.9% of the voting shares of LM,
December 2000 for $260 in cash and accounted for under the equity method o
Through the MCC acquisition, the Group obtained an additional 25% of the vo
its interest to 51.9%. The acquisition of LM was accounted for using the purch
results of operations of LM are included in the consolidated financial statemer
of control, December 29, 2001.

F-12

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

UM is involved in underground coal mining in the Kuzbass Region in the sout
to the acquisition of MCC, the Group held 25.8% of the voting shares of UM,
September 2000 for $26 in cash and accounted for under the equity method of
Through the MCC acquisition, the Group obtained additional 25% of the votir
interest to 50.8%. The acquisition of UM was accounted for using the purchas
results of operations of UM are included in the consolidated financial statemer
of control, December 29, 2001.

The Group has used and continues to use the assets of MCC and LM in the ma
previously used, while UM was closed in 2002 for economic reasons. Total in
at the control acquisition date was comprised of the cash paid for shares and th
of LM and UM from December 28, 2000, to December 29, 2001 and was alloc
assets acquired at the date of acquisition of control as follows:

Cash and cash equivalents
Other current assets
Property, plant and equipment
Mining assets
Mineral licenses
Other non-current assets
Current liabilities
Long-term liabilities
Deferred income taxes
Fair value of net assets acquired
Goodwill
Total investment

At the dates of acquisition, LM s and UM s historical book value of their net
as the Group obtained less than 100% ownership in LM and UM, the minority
net assets of $1,224 and $2,187, respectively, was added to goodwill, thereby
upon acquisition of UM and LM to $5,694. In accordance with SFAS No. 141
will not amortize the goodwill recorded in connection with the acquisition of U
subject to an annual test for impairment.

(d) Vyartsilya Metal Products Plant (VMPP)

On May 24, 2002, the Group acquired 88.1% of the voting shares of VMPP fo
hardware plant located in northwest Russia, producing low carbon, welding ar
nails and steel and polymeric-coated nets. VMPP was acquired to develop furt
steel business of the Group. VMPP sources its steel inputs from CMP. The Gr
use the assets of VMPP in the manner in which they were previously used.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The acquisition of VMPP was accounted for using the purchase method of acc operations of VMPP are included in the consolidated financial statements fron control, May 24, 2002. The following table summarizes the fair values of net a acquisition of control:

Cash and cash equivalents	
Other current assets	
Property, plant and equipment	
Current liabilities	
Deferred income taxes	
Fair value of net assets acquired	
Minority s share in net assets	
Total investment	

(e) Beloretsk Metallurgical Plant (BMP)

At different dates through June 14, 2002, the Group acquired a total of 50.7% $11,691 in cash. Prior to June 14, 2002, the Group did not have control over B influence through its ownership of 33.3% of the voting shares, which were acc December 27, 2001. Between December 27, 2001, and June 14, 2002, BMP w equity method of accounting (see Note 8(b)). Subsequently, in December 2002 additional 0.4% of voting shares of BMP.

BMP is a hardware plant located in the southern Urals in Russia, producing wi hardware. BMP was acquired to develop further the downstream side of the ste sources its steel inputs from CMP. Prior to its acquisition, the Group had mark Group has used and continues to use the assets of BMP in the manner in which

The regional government has special perpetual rights (the golden share) in I certain shareholder decisions and appoint a voting representative on the board to veto include: increases and decreases in share capital, amendments to the ch reorganization, investment in other legal entities, disposal or encumbrance of p total assets), and any transaction with a member of BMP s board, CEO or any 20% of BMP s outstanding stock. Management is of the opinion that this gold control over BMP.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The acquisition of BMP was accounted for using the purchase method of acco
operations of BMP are included in the consolidated financial statements from
control, June 14, 2002. Total investment in BMP at the control acquisition dat
paid for shares and the Group s share in equity results of BMP from Decemb
was allocated to the fair values of net assets acquired at the date of acquisition

Cash and cash equivalents	
Other current assets	
Property, plant and equipment	
Other non-current assets	
Current liabilities	
Long-term liabilities	
Deferred income taxes	
Fair value of net assets acquired	
Minority s share in net assets	
Total investment	

On November 5, 2003, the Group purchased from the government an addition
of BMP for $3,217 in cash. As a result, the Group increased its interest in BM
was accounted for using the purchase method of accounting. The excess of fai
over the purchase price of $8,129 was allocated proportionally to reduce the v
equipment and mineral reserves.

(f) Combinatul de Oteluri Special Targoviste S.A. (COST)

On August 28, 2002, the Group acquired 79.7% of the common shares of COS
Group also committed to invest up to approximately $21,072 to modernize the
as well as to maintain its workforce level for five years.

COST is a major EAF steel mill in Romania, producing carbon and specialty s
rebar, carbon and low-alloy tube billets, forgings, including rods and ingots. T
continues to use the assets of COST in the manner in which they were previou

The acquisition of COST was accounted for using the purchase method of acc
operations of COST are included in the consolidated financial statements from
control, August 28, 2002. The following table summarizes the fair values of n
acquisition of control.

Cash and cash equivalents	
Other current assets	
Property, plant and equipment	
Current liabilities	
Long-term liabilities	
Deferred income taxes	
Fair value of net assets acquired	
Minority s share in net assets	
Total investment	

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(g) Mechel Zeljezara

On February 6, 2003, the Group entered into an agreement to acquire substant
Sisak, a tube producer located in Croatia. As consideration, the Group paid $0
committed to invest $8,600 to modernize Zeljezara Sisak s plant and upgrade
maintain its workforce level for five years in return for receiving the business
registration of a new company, Mechel Zeljezara d.o.o. on March 17, 2003, w
Sisak were transferred to Mechel Zeljezara. The acquisition of Mechel Zeljeza
purchase method of accounting. The results of operations of Mechel Zeljezara
consolidated financial statements from the date of acquisition, March 17, 2003

(h) Urals Stampings Plant (USP)

On April 24, 2003, the Group acquired 93.8% of the common shares of USP f
located in the southern Urals and is Russia s largest producer of stampings fro
and titanium alloys. The acquisition of USP was accounted for using the purch
results of operations of USP are included in the consolidated financial stateme
of control, April 24, 2003. The following table summarizes the fair values of n
acquisition of control.

Cash and cash equivalents
Other current assets
Other non-current assets
Property, plant and equipment
Current liabilities
Deferred income taxes
Fair value of net assets acquired
Minority s share in net assets
Total investment

(i) Industria Sarmei

On June 20, 2003, the Group acquired 73.4% of the common shares of SC Ind
cash. Industria Sarmei is a Romanian steel mill that produces long steel produc
alloyed wire rod, rebar, hardware and carbon and low-alloy billets. The Group
Romanian government to invest $19,040 to modernize the plant and upgrade i
improve the environment and to maintain its workforce level for five years. Th
by the Group was discounted using 17% rate and included in the cost of invest
together with cash consideration paid.

In accordance with the purchase agreement, Industria Sarmei was obligated to
companies into shares. As a result of this conversion, on July 2, 2003, 6,356,3
certain Romanian utility companies. Immediately after this conversion, the Gr
54.8% of the common shares of Industria Sarmei. On August 1, 2003, the Gro
shares from the Romanian State Privatization Agency for a total consideration
this transaction, the Group s interest increased to 79.8%. The acquisition of In
for using the purchase method of accounting. The results of operations of Indu
consolidated financial statements from the date of acquisition of

F-16

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

control, June 20, 2003. The following table summarizes the fair values of net a
acquisition of control.

Cash and cash equivalents	
Other current assets	
Property, plant and equipment	
Current liabilities	
Deferred income taxes	
Fair value of net assets acquired	
Minority s share in net assets	
Extraordinary gain	
Total investment	

(j) Korshunov Mining Plant (KMP)

On December 25, 2002, the Group acquired 62.5% of the common shares of K
operation located in eastern Siberia, for the total consideration of $34,498 in c
lacked any voting rights as KMP was in bankruptcy proceedings; accordingly,
carried at cost. Until the ratification on September 29, 2003, by a court of a Se
KMP s creditors (the Group was the second largest creditor after the governm
for taxes and social charges, including various penalties and interest), and rem
administrator for KMP on October 16, 2003, the Group s equity interest in K
to exercise either control or significant influence over KMP. The control restri
removed and the Group obtained full control over KMP s operations on Octo
acquisition of KMP was accounted for using purchase method of accounting.
of operations of KMP in its consolidated financial statements beginning Octob
acquisition of control.

Despite the lack of control over KMP during bankruptcy proceedings, the Gro
stake in KMP s equity and in February 2003 acquired an additional 7.7% of th
Together with the cash paid for the shares in KMP, the Group provided loans
KMP, which were aimed to pay the current liabilities and the tax and commerc
pursuant to the Settlement Agreement. At the date of acquisition of control, th
in KMP s equity, in total comprising 70.3% of its voting shares, and the amou
to KMP amounted to a total investment of $132,302. The Group has used and
KMP in the manner in which they were previously used. The following table s
net assets acquired and liabilities assumed at the date of acquisition of control.

Cash and cash equivalents	
Other current assets	
Property, plant and equipment	
Mineral licenses	
Long lived assets	
Current liabilities	
Long-term liabilities	
Deferred income taxes	
Fair value of net assets acquired	
Total investment	

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The acquisition of KMP was intended to support the Group s policy of makin
complete and independent of other iron ore suppliers.

(k) Mechel Nemunas

On October 15, 2003, the Group acquired 75.1% of the common shares of Ne
hardware manufacturer with two operating subsidiaries (collectively, Meche
In November and December 2003, the Group purchased the remaining 24.9%
Nemuno Holding, and the remaining shares in its subsidiaries not already own
total of $1,000 in cash. As a result, the Group increased its interest in Nemuno
renamed Mechel Nemunas, and its subsidiaries to 100%. The acquisition of M
for using the purchase method of accounting. The results of operations of Mec
the consolidated financial statements from the date of acquisition of control, C
table summarizes the fair values of net assets acquired and liabilities assumed
control.

Cash and cash equivalents	
Other current assets	
Property, plant and equipment	
Current liabilities	
Deferred income taxes	
Fair value of net assets acquired	
Goodwill	
Total investment	

(l) Mechel Coal Resources

In June 2003, the Group established a Kazakh company, which on December
substantially all the operating assets of Mechel Coal Resources, a coal sinterin
of Kazakhstan, for approximately $1,000 in cash, and assumed $1,000 of the s
was accounted for using the purchase method of accounting. The results of op
Resources are included in the consolidated financial statements from the date
purchase transaction, which took place on December 31, 2003.

(m) Discontinued operations

By December 31, 2000, the Group had acquired 36.8% of the common shares
which provided insurance services (life and property) mainly to SKCC and its
On July 1, 2001, the Group acquired an additional 19.5% of the common shar
for $27 in cash, increasing its interest in Belov Insurance Company to 56.2%.

By December 31, 2000, the Group had acquired 66.5% of the common shares
provided banking services mainly to SKCC and its subsidiaries, for $633 in ca
acquired an additional 29.6% of the common shares of Uglemetbank for $4,43
in Uglemetbank to 96.1%.

The acquisitions of Belov Insurance Company and Uglemetbank were accoun
method of accounting. As Belov Insurance Company and Uglemetbank were p
SKCC and its subsidiaries, their assets and liabilities upon acquisition were in

---

F-18

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

segment. The results of operations of Belov Insurance Company and Uglemet consolidated financial statements from their respective dates of acquisition of October 20, 1999.

In June 2002, management committed to a plan to discontinue and sell substan Belov Insurance Company and Uglemetbank as they were considered non-cor had generated net losses since acquisition. In October 2003, the Group sold its Company for $641 in cash and in November and December 2003 reduced its i by selling its shares for $4,521 in cash. The divestiture of the equity stakes in Uglemetbank resulted in a loss on disposal of $1,175, net of tax.

On that basis, at December 31, 2002 and 2001 and for the years then ended an the sale, the Group s investments in Belov Insurance Company and Uglemet basis, as follows:

Condensed balance sheet select data	
Cash and cash equivalents	
Other current assets	
Total current assets	
Property, plant and equipment and other non-current assets	
Total non-current assets	
Accounts payable and accrued liabilities	
Total current liabilities	

As of and for the years ended Decem	
2003	2002

	Belov Insurance Company	Uglemet bank	Total	Belov Insurance Company	Uglemet bank	Total
Condensed income statement select data						
Revenues and operating gains	2,549	1,234	(3,783)	2,079	853	2,932
Operating income (loss)	546	(1,251)	(705)	212	(1,607)	(1,395)
Loss before taxes	321	(1,251)	(930)	(32)	(1,607)	(1,639)
Income tax effects	(185)	(132)	(317)	(35)	(161)	(196)
Loss from discontinued operations, net of tax	136	(1,383)	(1,247)	(67)	(1,768)	(1,835)

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(n) Goodwill

Balance at January 1, 2001	
New acquisitions	
Balance at December 31, 2001	
Acquisition of additional shares in Uglemetbank	
Purchase of minority interest in SUNP and LM	
Impairment	
Balance at December 31, 2002	
Acquisition of Mechel Nemunas (Note 2(k))	
Balance at December 31, 2003	

As disclosed for each individual acquisition above, goodwill arising on acquis
appropriate business segment benefited by the acquisition of each subsidiary. C
acquisitions during 2001 was related to the acquisitions of SUNP ($6,325), LM
and was allocated to the Mining segment. Goodwill related to the acquisition o
2002 as management decided to suspend UM s operations for economic reaso
suspended in November 2002.

Goodwill arising from the acquisition of the 29.6% interest in Uglemetbank in
allocated to the Mining segment. Based on continuing losses in Uglemetbank,
impairment analysis later in 2002, which indicated the goodwill was fully imp

In January and December 2002, the Group purchased additional 23.3% and 0.
and LM, respectively; therefore, part of the share of minority interest in negati
recorded as goodwill of $4,220, was valued at zero upon acquisition of respect

Goodwill arising from the acquisition of Mechel Nemunas in 2003 of $2,073 v
segment.

The excess of the fair value of net assets acquired over the purchase price (afte
non-current assets to zero) in the amount of $11,431, which related to the acqu
2000 was recorded as a deferred credit and was being amortized over 20 years
141 and SFAS No. 142 on January 1, 2002, the Group wrote off the unamortiz
such negative goodwill in the amount of $10,859 and recognized it in the inco
December 31, 2002, as the effect of a change in accounting principle.

In accordance with SFAS No. 141 and SFAS No. 142, the excess of the fair va
the purchase price (after reducing the value of non-current assets to zero) in th
and $1,252, which related to the acquisitions of minority interests in Industria
subsidiaries in December 2002 and November 2001, respectively, was recorde
tax, in the consolidated income statements for the years ended December 31, 2
respectively.

The adoption of the provisions of SFAS No. 141 and 142 resulted in a gain of
unamortized deferred credit related to business combinations effected prior to
recorded as a change in accounting principle, net of tax, at January 1, 2002. Th

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

income and income before extraordinary items amounts for the years ended De
reflect the effect of the retroactive adoption of SFAS No. 142 as follows:

	December 31, 20
Net income, as reported	89,2
Amortization of deferred credit	
Unamortized deferred credit write off	(10,8
Adjusted net income	**78,3**
Adjusted income before extraordinary items	**77,0**
Adjusted earnings per share	**0.**

(o) Minority interest

The following table summarizes changes in minority interest for the years end
and 2001:

Balance at January 1, 2001
New acquisitions
Purchase of the minority interest in existing subsidiaries by the Group
Minority s share in subsidiaries income from continuing operations
Balance at December 31, 2001
New acquisitions
Purchase of the minority interest in existing subsidiaries by the Group
Minority s share in subsidiaries loss from continuing operations
Balance at December 31, 2002
New acquisitions
Purchase of the minority interest in existing subsidiaries by the Group

Reduction on disposal of discontinued operations	
Minority s share in subsidiaries loss from continuing operations	
Translation adjustment	
Balance at December 31, 2003	

Purchase of minority interests in subsidiaries

At various dates during 2003, 2002 and 2001, the Group purchased minority i
subsidiaries:

	Date of acquisition	M intere %
Uglekop Mine	November 23, 2001	13.00
Siberian Central Processing Plant	November 28, 2001	12.35
Kuzbass Central Processing Plant	December 31, 2001	30.33
Olzherassk Open Pit Mine	December 31, 2001	26.24
Tomusinsk Group Processing Plant	December 31, 2001	16.46

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

	Date of acquisition	Minority inte %
Uglemetbank	January 1, 2002	29.6
Vyartsilya Metal Products Plant	October 7, 2002	3.51
TAB (subsidiary of SKCC)	December 25, 2002	15.71
Krasnogorsk Open Pit Mine	December 31, 2002	3.61
Siberian Central Processing Plant	December 31, 2002	18.46
Tomusinsk Open Pit Mine	December 31, 2002	13.38

	Date of acquisition	Minority inte %
Tomusinsk Group Processing Plant	June 22, 2003	3.21
Siberian Central Processing Plant	June 27, 2003	6.12
Beloretsk Metallurgical Plant	November 5, 2003	29.38
Other individually insignificant purchases	July-September 2003	2%< each

The Group has accounted for the purchase of minority interest under the purch accordance with Accounting Principles Board (APB) Opinion No. 16 or SF

(p) Pro forma condensed consolidated income statement data (u

The following unaudited pro forma condensed consolidated income statement effect to the business combinations that occurred in 2003, as if they had occur (ii) 2002 gives effect to the business combinations that occurred in 2003 and 2 the beginning of 2002:

Revenue, net
Net income
Net income per share

The following unaudited pro forma condensed consolidated income statement
effect to the business combinations that occurred in 2002, as if they had occurr
(ii) 2001 gives effect to the business combinations that occurred in 2002 and 2
the beginning of 2001.

Revenue, net
Net income
Net income per share

These unaudited pro forma amounts are provided for informational purposes o
present the results of operations of the Group (including discontinued operatio
Company and Uglemetbank) had the transactions assumed therein occurred or
is it necessarily indicative of the results of operations which may be achieved

F-22

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of accounting

Russian affiliates and subsidiaries of the Group maintain their books and recor
prepare accounting reports in accordance with the accounting principles and p
Accounting Regulations (RAR). Certain other foreign subsidiaries and affil
records in different foreign currencies and prepare accounting reports in accor
accounting principles (GAAP) in various jurisdictions. The financial statem
Group and its subsidiaries and affiliates for the purposes of preparation of thes
statements in accordance with generally accepted accounting principles in the
GAAP) have been translated and adjusted on the basis of the respective stand
GAAP financial statements.

The accompanying consolidated financial statements differ from the financial
statutory and other GAAP purposes in that they reflect certain adjustments, no
books, which are appropriate to present the financial position, results of operat
accordance with U.S. GAAP. The principal adjustments relate to: (1) purchase
interest expense and certain operating expenses; (3) valuation and depreciation
equipment; (4) foreign currency translation; (5) deferred income taxes; (6) rev
(7) valuation allowances for unrecoverable assets.

(b) Basis of consolidation

The consolidated financial statements of the Group include the accounts of all
where no minority shareholder or group of minority shareholders exercises sub
Investments in companies that the Group does not control, but has the ability t
over their operating and financial policies, are accounted for under the equity r
Group s share of net earnings and losses from these companies is included in
statements as income from equity investments. All other investments in equity
Intercompany profits, transactions and balances have been eliminated in conso

(c) Goodwill and Negative Goodwill

Purchase price has been allocated to the fair value of net assets acquired. Purcl
value of identified assets and liabilities acquired was capitalized as goodwill. T
net assets acquired over costs is called negative goodwill, and was allocated to
assets, except for deferred taxes, if any, until they were reduced to zero.

The remaining negative goodwill was amortized to income over its related life
adoption of SFAS No. 142 on January 1, 2002. The remaining unamortized ne
2002, was recognized in the income statement as a change in accounting princ
accounted for under the equity method, the excess of cost of the stock of those
share of fair value of their net assets as of the acquisition date is treated as emb
consolidated subsidiaries, SFAS No. 142 requires that goodwill from equity m
amortized over its estimated useful life. Subsequent changes to the value of th
Group s share of income or losses including impairment of the embedded goo
consolidated income statements.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(d) Minority interests

Minority interests in the net assets and net results of consolidated subsidiaries
interests in the accompanying consolidated balance sheets and income staten
liabilities of acquired companies were recorded as additional goodwill, and wh
reversed. For majority-owned subsidiaries that incur losses, the Group s recog
first reducing the related minority interests balances to zero, unless minority
the losses.

Further, when a majority-owned subsidiary becomes profitable, the Group rec
such time as the excess losses previously recorded have been recovered. There
profits in accordance with the underlying ownership percentage.

(e) Reporting and functional currencies

The Group determined its reporting currency to be the U.S. dollar. The functio
Romanian subsidiaries of the Group are the ruble and the lei, respectively. As
Romania were considered highly inflationary through December 31, 2002 and
respectively, transactions and balances of respective domestic operations not a
were remeasured as if the functional currency were the U.S. dollar, in accorda
of SFAS No. 52, Foreign Currency Translation . The objective of this remea
same results that would have been reported if the accounting records had been
method, monetary assets and liabilities have been translated using the exchang
dates. Non-monetary assets and liabilities, including non-current non-monetar
shareholders equity, are stated at their actual dollar cost or are restated from
the historical exchange rate as at the date of the original transaction. Income a
applying the monthly average exchange rates. Items in the statement of cash fl
monthly average exchange rates and where applicable at the exchange rates or
Foreign currency differences arising from remeasurement of the local currenci
in the consolidated income statement as Foreign exchange gain (loss) .

The U.S. dollar is the functional currency of other international operations of t

Effective from January 1, 2003, Russia no longer meets the criteria for a highl
purposes of applying SFAS No. 52. Accordingly, for the periods starting Janu
Russian subsidiaries no longer remeasure transactions and balances from their

into reporting currency in U.S. dollars but translate rubles into U.S. dollars usi
prescribed by SFAS No. 52. The translation adjustments resulting from the pro
statements from the functional currency into the reporting currency are includ
comprehensive income.

(f) Management estimates

The preparation of the consolidated financial statements requires management
assumptions that affect the reported carrying amounts of assets and liabilities,
assets and liabilities as of the date of the financial statements, and the amounts
recognized during the reporting period. Actual results could differ from those

F-24

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(g) Property, plant and equipment

Property, plant and equipment is recorded at cost less accumulated depletion a and equipment acquired in business combinations are initially recorded at thei determined by independent appraisers in accordance with requirements of APl No. 141, as applicable.

For the purpose of determining the carrying amounts of the property, plant and interests of non-controlling shareholders in business combinations when less t the Group uses appraised fair values as of the acquisition dates in the absence historical cost bases for property, plant and equipment, which represents a dep portion of minority interest not related to property, plant and equipment is dete cost of assets and liabilities.

Mining assets and processing plant and equipment

Mineral exploration costs incurred prior to establishing proven and probable re expensed as incurred. Proven and probable reserves are established based on i and appraisals performed by independent mining engineers. No exploration co point when proven and probable reserves are established. Reserves are defined deposit, which could be economically and legally extracted or produced at the determination. Proven reserves are defined as reserves for which (a) quantity i revealed in outcrops, trenches, workings or drill holes; grade and/or quality are detailed sampling and (b) the sites for inspection, sampling and measurement a geologic character is so well defined that size, shape, depth and mineral conte well-established. Probable reserves are defined as reserves for which quantity computed from information similar to that used for proven reserves, but the sit measurement are farther apart or are otherwise less adequately spaced. Accord although lower than that for proven reserves, is high enough to assume continu observation. No exploration costs were capitalized during the years presented.

Development costs are capitalized beginning after proven and probable reserve Group s surface mines, these costs include costs to further delineate the mine the mineral deposits. Additionally, interest expense allocable to the cost of dev to constructing new facilities is capitalized until assets are ready for their inter

Expenditures for betterments are capitalized, while costs related to maintenanc
incurred. In addition, cost incurred to maintain current production capacity at a
expenditures are charged to expenses as incurred.

When mining assets and processing plant and equipment are placed in product
costs, including mine development costs, are depleted using the unit-of-produc
tonnes of minerals mined or processed to the estimated proven and probable m
expected to be mined during the estimated lives of the mines or license term, w
on a mine by mine basis as estimated with the assistance of independent minin

A decision to abandon, reduce or expand activity on a specific mine is based u
general and specific assessments of mineral reserves, anticipated future minera
developing and operating a producing mine, the expiration date of mineral lice
Group will continue exploration on the mine. Based on the results at the

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

conclusion of each phase of an exploration program, properties that are not ec production are re-evaluated to determine if future exploration is warranted and appropriate. The ultimate recovery of these costs depends on the discovery and reserves or the sale of the companies owning such mineral rights.

Other property, plant and equipment

Capitalized production costs for internally developed assets include material, d material and manufacturing overhead costs. When construction activities are p period, interest costs incurred during construction are capitalized. Constructio held for installation are not depreciated until the constructed or installed asset intended use.

The costs of planned major maintenance activities are recorded as the costs ar accrued in advance of the planned maintenance. Costs for activities that lead t or to expanded future use capabilities of an asset are capitalized. Maintenance as incurred.

Property, plant and equipment are depreciated using the straight-line method. acquisition or production cost and related accumulated depreciation are remov any gain or loss is included in the consolidated income statement.

The following useful lives are used as a basis for calculating depreciation:

Category of asset
Buildings
Land improvements
Operating machinery and equipment, including transfer devices
Transportation equipment and vehicles
Tools, furniture, fixtures and other

(h) Mineral licenses, net

Certain subsoil licenses from state authorities are required to develop mineral
types of such licenses: (1) an exploration license, which is a non-exclusive lic
geological exploration and assessment within the license area, and (2) a produ
licensee an exclusive right to produce minerals from the license area.

Mineral licenses, net, include capitalized costs incurred to develop mineral res
to develop mineral reserves acquired upon acquisition of certain Group subsid
amortization. Although immaterial to date since acquisition of the subsidiaries
capitalizes development costs incurred in relation to the development of new p
The mineral licenses acquired in business combinations are recorded with the
their fair values at the date of acquisition, based on the appraised fair value. Fa
licenses is based on independent mining engineer appraisals for proven and pr
license term.

Mineral licenses are amortized using the units-of-production method over the
the estimated proven and probable reserve depletion period. In March 2004, th
reached by the Emerging Issues Task Force on Issue No. 04-2, Whether Min
Intangible Assets, which resolves the inconsistency between the Task Force

F-26

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

mineral rights are tangible assets and the guidance in SFAS No. 141 that chara intangible assets. In that consensus, the EITF determined mineral rights or lice adoption of this consensus did not have a material impact on financial positior Group.

(i) Long-lived assets impairment, including definite-lived intangi

Effective January 1, 2002, the Group adopted SFAS No. 144, Accounting fo Long Lived Assets, which addresses financial accounting and reporting for th long-lived assets, and SFAS No. 142, with respect to impairment of goodwill. did not have a material impact on the Group s consolidated financial position

The Group reviews the carrying value of its long-lived assets, including prope investments, goodwill, mineral licenses, and intangible assets, for impairment circumstances indicate that the carrying amount of such assets may not be full long-lived assets, excluding goodwill, is assessed by a comparison of the carry group of assets, including the asset in question, that represents the lowest leve flows) to the total estimated undiscounted cash flows expected to be generated If the estimated future net undiscounted cash flows is less than the carrying an assets, the asset or group of assets is considered impaired and expense is recog required to reduce the carrying amount of the asset or group of assets to its the determined by discounting the cash flows expected to be generated by the asse prices are not available for the long-lived assets. For assets and groups of asse mineral licenses, future cash flows include estimates of recoverable minerals, current and historical prices, price trends and other factors), production levels, all based on the engineering life of mine plans. Recoverable minerals refer to t be obtained from proven and probable reserves. Estimated future cash flows ar subject to risk and uncertainty.

On January 1, 2002, the Group adopted SFAS No. 142, which prohibits the an negative goodwill. Instead, goodwill is tested for impairment at least annually an event occurs or circumstances change between annual tests that would mor impairment.

Under SFAS No. 142, goodwill is assessed for impairment by using the fair va determines fair value by utilizing discounted cash flows. The fair value test re goodwill includes a two-step approach. Under the first step, companies must c reporting unit to its carrying value. A reporting unit is the level at which go

and it is defined as an operating segment or one level below it if certain condit
the reporting unit is less than its carrying value, goodwill is impaired.

Under step two, the amount of goodwill impairment is measured by the amour
goodwill carrying value exceeds the implied fair value of goodwill. The im
only be determined by deducting the fair value of all tangible and intangible n
unrecognized intangible assets) of the reporting unit from the fair value of the
the first step). In this step, the fair value of the reporting unit is allocated to all
and liabilities (a hypothetical purchase price allocation). SFAS No. 142 requir
impairment test at least annually and also upon adoption.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Calendar year companies such as the Group adopted SFAS No. 142 as of Janu
negative goodwill arising from business combinations completed prior to July
applied SFAS No. 142 for goodwill and negative goodwill arising from busine
after June 30, 2001. Upon adoption of SFAS No. 142 the Group ceased amorti
goodwill (see Note 2(n)). The Group did not have any impairment loss as a res
and performing the required impairment test.

(j) Inventories

Inventories are stated at the lower of acquisition/manufacturing cost or market
weighted average basis and includes all costs in bringing the inventory to its p
The elements of costs include direct material, labor and allocable material and

Costs of production in process and finished goods include the purchase costs c
costs such as direct labor and an allocation of fixed and variable production ov
valued at invoice cost inclusive of freight and other shipping costs.

Coal, nickel and iron ore inventory costs include labor, supplies, depreciation
mining assets and amortization of mineral licenses, mine operating overheads

Market value is the estimated price at which inventories can be sold in the nor
allowing for the cost of completion and sale.

(k) Accounts receivable

Accounts receivable are stated at net realizable value. If receivables are deeme
and a corresponding allowance for doubtful accounts is recorded. If receivable
related receivable balance is charged off. Recoveries of receivables previously
received. Receivables that do not bear interest or bear below market interest ra
of more than one year are discounted with the discount subsequently amortize
term of the receivable.

The Group reviews the valuation of accounts receivable on a regular basis. Th
accounts is estimated based on historical experience of cash collections and fu
that might impact the collectibility of accounts.

(l) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and in transit, checks and de
other bank deposits with an original maturity of three months or less.

(m) Retirement benefit obligations

The Group s Russian subsidiaries are legally obligated to make defined contri
Fund, managed by the Russian Federation Social Security (a defined contribut
pay-as-you-go basis). As such, the Group has no legal obligation to pay and do
benefits to its Russian employees. The Group s only obligation is to pay the c
the Group ceases to employ members of the Russian State Social Security plan
pay the benefits earned by its own employees in previous years. The Group s
Pension Fund relating to defined contribution plans are charged to income in t

F-28

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Contribution to the Russian Pension Fund together with other social contributi
unified social tax (UST), which is calculated by the application of a regress
part of the annual gross salary below 100 thousand rubles or approximately $3
of the rubles to the U.S. dollar at December 31, 2003) to 5% (applied to the pa
above 600 thousand rubles or approximately $19 translated at the exchange ra
at December 31, 2003) to the annual gross remuneration of each employee. US
funds (including the Russian Pension Fund), where the rate of contributions to
varies from 28% to 5%, respectively, depending on the annual gross salary of

Contributions to the Russian Pension Fund for the years ended December 31, 2
$25,883, $30,301 and $22,912, respectively.

(n) Revenue recognition

Revenue is recognized on an accrual basis when earned and realizable, which
are delivered to customers. In some instances, while title of ownership has bee
recognition criteria are not met as the selling price is subject to adjustment bas

Accordingly, in those instances, revenue and the related cost of goods sold are
and deferred cost of inventory in transit in the consolidated balance sheets and
consolidated income statement until the price becomes fixed and determinable
the price is settled with the end-customer. Sales are recognized net of applicab
allowances and associated sales taxes (VAT) and export duties.

(o) Advertising costs

Advertising costs are expensed as incurred. During 2003, 2002, and 2001 adve

(p) Shipping and handling costs

The Group classifies all amounts billed to customers in a sale transaction and r
as part of sales revenue and all related shipping and handling costs as selling, g
expenses. These costs totaled to $206,564, $158,109 and $155,568 for the yea
2002 and 2001, respectively.

(q) Income taxes

Provision is made in the financial statements for taxation of profits in accordan
currently in force. The Group accounts for income taxes under the liability me
No. 109, Accounting for Income Taxes , and related interpretations. Under t
income taxes reflect the future tax consequences of temporary differences betw
statement bases of assets and liabilities and are measured using enacted tax rat
the years in which those temporary differences are expected to be recovered or
tax assets and liabilities of a change in the tax rates is recognized in income in
enactment date. A valuation allowance is provided when it is more likely than
deferred tax assets will not be realized in the future. These evaluations are bas
taxable income and reversals of the various taxable temporary differences.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Prior to January 1, 2003, when Russia was deemed to be hyper-inflationary an financial statements the Group did not recognize deferred tax liabilities or asse to assets and liabilities of its Russian subsidiaries that, under SFAS No. 52, are currency into the functional currency using historical exchange rates and that r rates or indexing for tax purposes.

The deferred tax effect associated with the temporary differences that arose fro currency of the Group s Russian subsidiaries (from U.S. dollar to ruble) when highly inflationary on January 1, 2003, was reflected as an adjustment to the c adjustment component of accumulated other comprehensive income on Januar

The Group does not recognize deferred tax liabilities or assets for those differe liabilities of its Romanian subsidiaries that, under SFAS No. 52, are re-measur the functional currency using historical exchange rates and that result from cha indexing for tax purposes as Romanian economy is considered highly inflation

(r) Comprehensive income

SFAS No. 130, Reporting Comprehensive Income , requires the reporting o addition to net income. Accumulated other comprehensive income includes fo adjustments, unrealized holding gains and losses on available-for-sale securiti instruments, as well as additional pension liabilities not yet recognized as net p year ended December 31, 2003, as a result of the change in functional currency addition to the net income, total comprehensive income included the effect of statements denominated in currencies other than the reporting currency, in acc During the years ended December 31, 2002 and 2001 total comprehensive inc

(s) Stock-based compensation

The Group follows the provisions of SFAS No. 123, Accounting for Stock-B stock-based compensation arrangement with one of its executives. SFAS No. to either account for stock-based compensation under the provisions of SFAS of APB Opinion No. 25, Accounting for Stock Issued to Employees , and to with the provisions of SFAS No. 148, Accounting for Stock-Based Compens amendment of SFAS No. 123 . Because the fair value accounting requires use not developed for use in valuing employee stock awards, the Group has electe compensation in accordance with the Provisions of APB Opinion No. 25 and r

Accordingly, the compensation cost was recognized based on the excess, if an
Group s shares on the measurement date (July 1, 2003) over the amount an ex
shares. The Group recognizes compensation expense on a straight-line basis o
of the award through April 15, 2004.

The Group does not present pro forma disclosures of results of operations as i
applied, as the result would be substantially the same compared to intrinsic me
with APB Opinion No. 25.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(t) Segment reporting

According to SFAS No. 131, Disclosures about Segments of an Enterprise ar
reporting follows the internal organizational and reporting structure of the Gro
products and services the Group s organization comprises two business segme

- Steel segment, comprising production and sales of semi-finished steel p long products, carbon and stainless flat products, value-added downstre forgings, stampings, hardware and tubes and coke products.

- Mining segment, comprising production and sales of coal (coking and s which supplies raw materials to the steel segment and also sells substan third parties.

(u) Financial instruments

The carrying amount of the Group s financial instruments, which include cas securities, non-marketable debt securities, cost method investments, accounts approximates their fair value at December 31, 2003, 2002, and 2001. For long difference between the fair value and carrying value was not material. The Gr information and appropriate valuation methodologies, such as discounted cash estimated fair values of financial instruments. Since different entities are locat regions of Russia and elsewhere with different business and financial market c generally very limited or no comparable market values available to assess the and other financial instruments. The cost method investments are shares of Ru publicly traded and their market value is not available. It is not practicable for value of these investments for which a quoted market price is not available be developed the valuation model necessary to make the estimate, and the cost of valuation would be excessive. Therefore, such investments are recorded at cos

The Group reviews the carrying value of its cost method investments for impa certain events and circumstances indicate that the carrying amount of such inv recoverable. Since the fair value of the Group s cost method investments is no fair value of these investments, if indicators of impairment exist and are consi Group would obtain an independent valuation of the fair value of the particula amount, if any, by which the investment should be adjusted.

The Group did not have any impairment loss related to its cost method investm
December 31, 2003, 2002 and 2001.

(v) Derivative instruments and hedging activities

The Group recognizes all its derivative instruments as either assets or liabilitie
with SFAS No. 133, Accounting for Derivative instruments and Hedging Ac
interpretations. The accounting for changes in the fair value of a derivative ins
has been designated and qualifies as an accounting hedge and further, on the ty
the years ended December 31, 2003, 2002, and 2001, the Group did not have a
hedging instruments. Therefore, the gain or loss on a derivative instruments he
recognized currently in income. The net loss of $447 and gain of $296 and $ni

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

related to the change in the fair value of the derivative instruments was includ
gain in the accompanying consolidated income statements for the years ended
2001, respectively.

(w) Concentration of credit and other risks

Financial instruments, which potentially expose the Group to concentrations o
of cash and cash equivalents, short-term and long-term investments, trade acc
receivables. Generally, the Group does not require any collateral to be pledged
investments in the above financial instruments.

Approximately 92% (at December 31, 2003) of the Group s workforce is repr
covered by a one to three year collective agreements. These collective agreem
These collective agreements provide for minimum salary levels, bonus plans,
employee protection rights, but relationships of the Group with its employees
contracts with them. Management of the Group subsidiaries routinely interacts
ensure the appropriate treatment of the employees and the stability of the Grou

The following table presents the exchange rates for the functional and operati
subsidiaries, other than the reporting currency:

		Year end rates*		
	At June 30,	at December 31,		
Currency	2004	2003	2002	2001
Russian ruble	29.03	29.45	31.78	30.14
Swiss franc	1.25	1.25	1.36	1.66
Euro	0.82	0.79	0.95	1.12
Romanian lei (in thousand)	33.50	32.60	33.47	31.39
Croatian kuna	6.06	6.12	7.15	8.36
Lithuania lit	2.84	2.76	3.31	4.00
Kazakhstan tenge	136.40	143.95	155.86	150.93

* *-Exchange rates shown in local currency units for one U.S. dollar.*

The majority of the balances and operations not already denominated in the re
denominated in Russian ruble, Romanian lei, Swiss frank and euro.

The Russian ruble is not a convertible currency outside the territory of Russia.
determined daily by the Central Bank of Russia (CBR) and are generally co
approximation of market rates.

The Russian ruble has historically been devaluing against the U.S. dollar due t
as well as other factors. But during 2003 the Russian ruble appreciated in norm
U.S. dollar (versus depreciation in 2002 - 5.7%; 2001 - 7.2%) while official R
(2002 - 15.1%; 2001 - 18.8%).

Additionally, significant currency restrictions and controls exist related to con
currencies. As of June 30, 2004 the Russian ruble was not convertible outside
furthermore, all transactions within Russia must be settled in Russian ruble. Fu
exchange rate between the Russian ruble and the U.S. dollar will affect the car
Russian ruble-denominated monetary assets and liabilities. Such movements m
ability to realize non-monetary assets represented in U.S. dollars in these cons

F-32

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(x) Recently issued accounting pronouncements

Asset Retirement Obligations

Effective January 1, 2003, the Group adopted SFAS No. 143, Accounting fo
which applies to legal obligations associated with the retirement and removal
143 requires entities to record the fair value of an asset retirement obligation (
when it is incurred (typically when the asset is installed at the production loca
recorded, the entity capitalizes the cost by increasing the carrying amount of t
equipment. Over time, the liability is increased for the change in its present va
capitalized cost is depreciated over the useful life of the related asset.

If the accounting change we implemented during 2003 for asset retirement ob
2002 and 2001, the impact on income before cumulative effective changes in
earnings per share would have been as follows:

	Ye	
	December 31, 2003	**Dec**
Net income, as reported	143,508	
Adoption of SFAS No. 143, net of tax	3,788	
Depreciation of assets retirement cost and accretion expense of assets retirement obligation		
Adjusted net income	**147,296**	
Adjusted income before extraordinary items	**145,344**	
Adjusted earnings per share	**0.40**	

Upon adoption of SFAS No. 143 on January 1, 2003, the Group recorded $3,7
cumulative effect of changes in accounting principles. Application of this new
an increase in property, plant and equipment of $5,474 and an asset retirement
The application of SFAS No. 143 reduced income from continuing operations
$6,375 (after income taxes of $nil), or $0.02 per basic and diluted share, for th

2003. The following table summarized the balance sheet impact of our initial a
January 1, 2002, computed on a pro forma basis as if the provisions of SFAS N
all periods affected:

Asset retirement cost included in the related mining assets	
Accumulated depreciation of capitalized asset retirement costs	
Assets retirement cost, included in mining assets, net	
Asset retirement obligation	

The Group has numerous asset removal obligations that it is required to perfor
an asset is permanently taken out of service. Most of these obligations are not
years into the future and will be funded from general Group resources at the ti
asset retirement obligations primarily relate to its steel and mining production

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

related landfills and dump areas and its mines. The following table presents th
year ending December 31, 2003.

Asset retirement obligation
Balance at beginning of year
Liabilities incurred in the current period
Liabilities settled in the current period
Accretion expense
Revision in estimated cash flow
Translation and other
Balance at end of year

Guarantees

In November 2002, the Financial Accounting Standards Board issued Interpre
Accounting and Disclosure Requirements for Guarantees, Including Indirect G
Others. FIN No. 45 requires that upon issuance of certain types of guarantees,
account for the fair value of the guarantee as a liability. The initial recognition
FIN No. 45 should be applied on a prospective basis for guarantees issued or m
2002. The disclosure requirements of FIN No. 45 are effective for financial sta
annual periods ending after December 15, 2002. The adoption of FIN No. 45 b
2003, did not have a material impact on its financial position and results of ope

Consolidation of Variable Interest Entities

In December 2003, the FASB issued Interpretation No. 46R, Consolidation of
Interpretation of ARB No. 51 (the Interpretation), which revised Interpretat
2003. The Interpretation addresses the consolidation of business enterprises (v
which the usual condition (ownership of a majority voting interest) of consolid
Interpretation focuses on financial interests that indicate control. It concludes t
control through voting interests, a company s exposure (variable interest) to t
rewards from the variable interest entity s assets and activities are the best evi
interests are rights and obligations that convey economic gains or losses from
variable interest entity s assets and liabilities.

Variable interests may arise from financial instruments, service contracts, and
enterprise holds a majority of the variable interests of an entity, it would be co
beneficiary. The primary beneficiary would be required to include assets, liabi
operations of the variable interests entity in its financial statements.

The Group will adopt the Interpretation in 2004. Management has not determi
Interpretation will have on our financial position or results from operations.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are comprised of:

	Dec
Russian ruble bank deposits	
Other bank deposits	
Total cash and cash equivalents	

5. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net are comprised of:

	Dec
Domestic customers	
Foreign customers	
Total accounts receivable	
Less allowance for doubtful accounts	
Total accounts receivable, net	

The following summarizes the changes in the allowance for doubtful accounts
31, 2003, 2002 and 2001:

	December 31, 2003	Dec
Balance at the beginning of the year	(21,942)	
Provision for doubtful accounts receivable	(10,011)	

Accounts receivable written off	14,390
Provision for doubtful accounts of acquired entities	(5,749)
Balance at the end of the year	**(23,312)**

6. INVENTORIES

Inventories are comprised of:

	D
Finished goods	
Raw materials and purchased parts	
Work in process	
Total inventories	

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

7. PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments and other current assets are comprised of:

	De
VAT and other taxes recoverable	
Prepayments and advances for materials	
Other current assets	
Total other current assets	

Generally in Russia, VAT related to sales are payable to the tax authorities on
invoices issued to the customer. VAT incurred for purchases may be reclaimed
against VAT related to sales. VAT related to purchase transactions, which is n
related to sales as of the balance sheet dates, is recognized in the balance sheet
current assets and taxes and social charges payable.

8. LONG-TERM INVESTMENTS

Long-term investments are comprised of:

	De
Korshunov Mining Plant	
Equity method investments	
Magnitogorsk Metallurgical Kombinat	
Total investments in related parties	
Cost method investments	
Other	
Total other long-term investments	

Total long-term investments

(a) Investment in Korshunov Mining Plant

On December 25, 2002, the Group acquired 62.5% of the common shares of K
of $34,498 in cash. The shares, however, lacked any voting rights as KMP wa
and, accordingly, the Group s investment in KMP was carried at cost. On Oct
emerged from bankruptcy and the Group obtained full control over KMP. On
longer classified as a cost method investment and the Group began to consolid

F-36

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(b) Equity method investments

Equity method investments are comprised of:

	Percent v shares h Decemb
Investee	**2003**
Conares Eagle ltd (Mining segment)	50%
Mechel Energy AG (Mining segment)	50%
UMS America (Steel segment)	
Belkord (Steel segment)	100%
TRMZ (Mining segment)	25%
TPTU (Mining segment)	29%
Other	29-37%
Total equity method investments	

Conares Eagle ltd was a joint venture with English trading partners of the Gro
with its European sales. In 2003, Conares Eagle ltd ceased its operations and t
Swiss-based Mechel Energy AG, in which the Group also owns 50%. In 2003
of its investment in UMS America, a trading venture with U.S. partners aimed
products to the U.S. market. Belkord, a small hardware workshop that produce
sourced from BMP, became a subsidiary during 2003. Other equity method in
in equity of insignificant entities whose operations are supplementary to the G
primarily made before the acquisition of a respective sub-holding parent entity

The following table shows movements in the equity method investments:

Capital investment

January 1, 2002	12,157
Investments	1,413
Additions through business combinations	1,615
Share in net income (loss)	
Reclassification upon consolidation	(11,322
December 31, 2002	**3,863**
Investments	598
Additions through business combinations	
Share in net income (loss)	
Disposals through sales and write off	(490
Reclassification upon consolidation	(2,073
December 31, 2003	**1,898**

Reclassifications upon consolidation represent the carrying value of equity inv
purchase price at the dates of acquisition that consisted of BMP in 2002 for $8
$2,073.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(c) Investments in Magnitogorsk Metallurgical Kombinat (MMK)

Included in investments in other non-marketable securities is the Group s inve
preferred shares of Magnitogorsk Metallurgical Kombinat, a related party (see
$49,145, which comprised 16.9% and 16.7% of the voting shares and 12% of
of MMK, as of December 31, 2003 and 2002, respectively. As described in No
customer of the Group. As MMK shares are not publicly traded, their market v
not practicable to determine the fair value of this investment as management b
prohibitive to obtain an independent evaluation and that insufficient public inf
Therefore the Group s investment in MMK is recorded at cost. If MMK share
Group would classify its investment in MMK as available for sale with respec
recorded as part of comprehensive income.

(d) Cost method investments

Cost method investments represent investments in equity securities of various
Group has less than 20% of equity interest and no significant influence. As sha
are not publicly traded, their market value is not available and the investment i

(e) Other investments

Other long-term investments comprise of available for sale securities of Chely
receivable of $2,569 and promissory notes.

9. RELATED PARTIES

During the three years ended December 31, 2003, 2002 and 2001, the Group h
with related parties:

	2003	2002

	Purchases	Sales	Financing provided (received), net	Purchases	Sales	Financing provided (received), net
Conares Holding	1,541	166	26,282			11,613
Uglemet Kooperatsia		177	4			10,508
KMP	45,661	5,720	23,128			5,266
MMK	154,041	162,809		105,303	90,670	
BMP				28,023	6,900	
Mechel Energy AG		37,210			32,850	
Methol			587			1,307
Uglemet	54	2				1,044
Other	11,195	5,859	(1,064)		4,545	
Total	**212,492**	**211,943**	**48,937**	**133,326**	**134,965**	**29,738**

F-38

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

At December 31, 2003 and 2002, the Group had the following balances in sett

	Balances at December 31, 2003			Bala
	Receivable from	Payable to	Total outstanding, net	Receiv fror
Conares Holding		(3,713)	(3,713)	14
Uglemet Kooperatsia	12,677	(207)	12,470	12
KMP				16
MMK	6,075	(7,877)	(1,802)	2
Mechel Energy AG	4,074		4,074	1
Methol	1,793	(6)	1,787	1
Uglemet	5	(47)	(42)	1
Other	3,906	(2,037)	1,869	1
Total	**28,530**	**(13,887)**	**14,643**	**50**
Presented on the balance sheets as:				
Current	28,530	(13,887)		49
Non-current				1

(a) Conares Holding

Conares Holding AG, a company associated with the Controlling Shareholders received financing from the Group during 2002 in the form of loans and advar certain of the Group s operating subsidiaries. The Group s debt instruments i denominated in U.S. dollars and were unsecured. Financing received during 20 interest at rates ranging from nil% to 11% p.a. Financing provided by the Grou 2002 totaled $14,075, was denominated in U.S. dollars, bore interest at rates ra of December 31, 2002) + 2% to 6% p.a. and was unsecured, with maturity in 2

During 2003, Conares Holding received dividends from the Group in the amou account payable to Conares Holding at December 31, 2003, amounts to $3,713 to the Group.

(b) Uglemet Kooperatsia

Uglemet Kooperatsia, a company affiliated with the Controlling Shareholders,
financing from the Group during 2002 in the form of loans and advance paym
Group s operating subsidiaries. The Group s debt instruments issued to Ugle
denominated in Russian rubles and were unsecured. Financing received by the
Kooperatsia during 2002 totaled $2,570, respectively, and was interest-free. Fi
to Uglemet Kooperatsia during 2002 totaled $12,151, was denominated in Rus
interest-free, maturing in 2003.

At December 31, 2003, the amount receivable from the company by the Grou
the amount of prior year financing by means of unsecured and interest free loa
the company is $207 resulting from the dividends accrued.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(c) Magnitogorsk Metallurgical Kombinat

The Group, in addition to an investment in MMK shares and participation in th
subsidiaries own 16.9% of ordinary shares), had significant purchase and sales
2002. The Group sold coal and coke to MMK, and purchased metal products f
channels.

During 2003 the Group had sales of coal and coke to MMK in the amount of $
$36,530, and purchases of metal products for resale by the Group were $153,9
$71. The balance receivable from MMK, and the balance payable to MMK rep
receivable and payable, respectively, resulting from the transactions stated abo

(d) Korshunov Mining Plant

On December 25, 2002, the Group acquired 62.5% of the common shares of K
of $34,498 in cash. The shares, however, lacked any voting rights as KMP wa
and accordingly, the Group s investment in KMP was carried at cost. On Octo
emerged from bankruptcy and the Group obtained full control over KMP. On
longer was classified as a cost method investment and the Group began to con
16, 2003, the Group considered KMP a related party and described its busines
below.

During 2002, the Group purchased iron ore from and sold miscellaneous good
balance receivable from KMP at December 31, 2002, includes a $10,920 amou
sales of raw materials and services to KMP. The remaining portion of the bala
provided to KMP in the form of loans and notes payable, which were unsecure

During the first nine month of 2003, the Group purchased iron ore in the total
purchases amounted to $358; sales of the Group to KMP amounted to $5,720.
long-term secured loan to KMP with 20% interest rate in the amount of $391 a
interest-free loan in the amount of $22,737.

(e) Mechel Energy AG

Mechel Energy AG, formerly named Conares Eagle AG, in which the Group c
purchased coal from the Group in 2003 in the amount of $37,210. The outstan
Mechel Energy AG to the Group in the amount of $4,074 results from these tr

(f) Uglemet

Uglemet, a company wholly owned by the Controlling Shareholders had no m
the Group throughout 2003. There were no significant balances at the end of 2

(g) Other related parties

Financing provided to other related parties, primarily shareholders of the Grou
consisted of short-term maturity, unsecured and interest-free instruments.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

10. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net are comprised of:

	Dec
Land improvements	
Buildings	
Transfer devices	
Operating machinery and equipment	
Transportation equipment and vehicles	
Tools, furniture, fixtures and other	
Less: accumulated depreciation	
Operating property, plant and equipment, net	
Mining, processing plant and equipment	
Less: accumulated depletion	
Mining, processing plant and equipment, net	
Construction-in-progress	
Property, plant and equipment, net	

Included within construction-in-progress are advances to suppliers of equipme
December 31, 2003 and 2002, respectively. Interest expense and interest capit
the cost of property, plant and equipment for the years ended December 31, 20
$52,936, $4,408, $37,652, $879, $14,526 and $nil, respectively.

11. MINERAL LICENSES, NET

Mineral licenses, net, are comprised of the following:

	Dec
Coal reserves	
Iron ore reserves	
Nickel reserves	
Limestone reserves	
Mineral reserves before depletion	
Accumulated depletion	
Mineral licenses, net	

Mineral licenses were recorded upon acquisition of mining subsidiaries (SKC
which held various mining and operating licenses relating to the mineral reserv
the acquisition of equity interest in those subsidiaries (see Note 2). Fair values
to the appraised proven and probable mineral reserves at the date of acquisitio
independent appraisals performed by independent mining engineers, for each a
values of the mineral licenses were reduced proportionate to the depletion of th
at each deposit related to mining and production of reserves adjusted for the re
purchase accounting effects. No residual value is assumed in the mineral right

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

In valuation of mineral reserves the Group used only quantities of proven and
expected to be produced within the term of the Group s current licenses.

The Group s mining segment production activities are located primarily withi
information provided in this note pertains to this region.

As disclosed in Note 2, the Group acquired all of its mining segment assets an
business combinations, at which dates substantially all of the acquired mining
the production stage; subsequent exploration and development costs to date w

The Group s mineral licenses are situated on land belonging to government a
Group obtains licenses from such authorities and pays certain taxes to explore
reserves. There are two major types of payments with respect to the developm
minerals: (1) periodic payments for the use of subsoil under the Subsoil Law a
tax under the Tax Code. Failure to make these payments could result in the su
subsoil licenses. The Subsoil Law-mandated payments are not material to the
results of operations. The minerals extraction tax is calculated as a percentage
extracted. Currently the tax rates are 4% for coal, 4.8% for iron ore and 8% fo
the minerals extraction tax in the amount of \$9,069, \$5,569 and \$8,336 for the
2003, 2002 and 2001, respectively.

The Group s licenses expire between 2005 and 2022, with the most significan
and 2022, and management believes that they may be extended at the initiativ
substantial cost. Management intends to extend such licenses for properties ex
subsequent to their license expiry dates.

12. DEBT

	Dece 2
Short-term borrowings and current portion of long-term debt:	**Amoun**
Russian ruble denominated:	
Banks and Financial Institutions	111,36

Corporate Lenders (including bonds)	45,03
Total	156,39
U.S. dollar denominated:	
Banks and Financial Institutions	110,72
Corporate Lenders	31,14
Total	141,87
Euro denominated:	
Banks and Financial Institutions	6,63
Total	6,63

F-42

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Short-term borrowings and current portion of long-term debt:	**December** **Amount**
Romanian lei denominated:	
Banks and Financial Institutions	4,070
Total	4,070
Short-term borrowings	308,969
Current portion of long-term debt	33,124
Total short-term borrowings and current portion of long-term debt	**342,093**

The weighted average interest rate of the ruble denominated short-term borrov and 2002 was 12.11% and 18.52%, respectively. The weighted average interes denominated short-term borrowings as of December 31, 2003 and 2002 was 5. The weighted average interest rate of the euro denominated short-term borrow and 2002 was 4.31% and 0% respectively. The weighted average interest rate denominated short-term borrowings as of December 31, 2003 and 2002 was 2

Long-term debt:	**Decembe** **Amount**
Russian ruble denominated:	
Banks and Financial Institutions	5,100
Bonds issue	101,852
Corporate Lenders	2,963
Total	109,915
U.S. dollar denominated:	
Banks and Financial Institutions	8,242
Corporate Lenders	380
Total	8,622
Romanian lei denominated:	
Corporate Lenders	36,898
Total long-term obligations	155,435
Less: current portion	(33,124)

Long-term portion	**122,311**

Aggregate scheduled maturities of the debt outstanding at December 31, 2003

Payable in:	
2004	
2005	
2006	
2007	
2008 and after	
Total	

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The most significant debt provided by banks included credit line facilities rece
Sberbank, UralSib, and Raiffeisenbank and loans from BNP Paribas and Alfa
the above credit line facilities as of December 31, 2003, and 2002, was $4,333
December 31, 2003, our credit facilities provided aggregated borrowing capac
$319,335 expires in 2004, $109,556 expires in 2006, $2,948 expires in 2008 a

During 2003, 2002, and 2001, Gazprombank provided ruble-denominated loan
for a total of $29,809, $12,817 and $3,818, respectively, bearing interest at the
respectively: from 13.5% to 14.3%, 20% and 21% p.a., secured by property an
balance as of December 31, 2003 is payable in 2004.

During 2003, 2002 and 2001, Sberbank provided a series of ruble-denominate
various Group subsidiaries for a total of $62,591, $43,856 and $9,627, bearing
respectively: from 9.5% to 14%, from 16% to 22%, and from 16% to 19% p.a
inventory and property and equipment. The balance outstanding of the above l
matures in 2004, 2005 and 2008. In addition, in 2003 Sberbank provided a $1,
short-term loan bearing interest at 9% p.a. and $2,209 U.S. dollar-denominated
interest at 11% p.a., secured by equipment, and maturing in 2004 and 2006.

During 2003, 2002 and 2001, UralSib provided a series of ruble-denominated
various Group subsidiaries for a total of $10,115, $28,377 and $3,337 bearing
11% to 13.5% p.a., from 12% to 23% p.a. and at 21% p.a., respectively, guara
subsidiaries and secured by their inventory, property and equipment and prom
balance of the above loans at December 31, 2003, matures in 2004. In additio
$1,155 U.S. dollar-denominated short-term loan bearing interest at 9% p.a.

During 2003, 2002 and 2001, Raiffeisenbank provided a $10,000 U.S. dollar-
line facility to the Group. Balances outstanding at December 31, 2003, 2002, a
and $7,004, respectively. Interest charged on the drawn credit line balances va
average 1.12% in 2003) plus 5% p.a., in 2002, LIBOR (on average 1.45% in 2
LIBOR (on average 2.44% in 2001) plus 6% p.a. The credit line was secured b
rights by CMP from Mechel Trading arising on export sales, plus a guarantee
2003, Raiffeisenbank provided $7,000 and $1,521 U.S. dollar-denominated sh
at LIBOR + 4.75% p.a. and 4.47% respectively, secured by inventory and equ
lei denominated loan at the interest rate from 19.5 to 21.25%, secured by inver
dollar-denominated short-term loan provided was bearing a LIBOR plus 5.5%

During 2003, Alfa bank provided U.S. dollar-denominated loans to Group con
bearing interest at rates from 9.5% to 11%, secured by property and equipmen

During 2003, 2002 and 2001, the Group utilized $52,768, $11,580 and $4,554
facility bearing interest from 3.06% to 3.19% in 2003 and interest-free in 2002
secured by Mechel Trading cash accounts.

During 2001, the Group obtained a series of short-term U.S. dollar-denominat
HillStreet Investments for the total amount of $27,821 and, during 2002, the G
short-term U.S. dollar-denominated loan from HillStreet Investments bearing
Total balances outstanding at December 31, 2003, 2002 and 2001 were $24,09
respectively.

F-44

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

During 2002 and 2001, Uraltransgas, a subsidiary of Gazprom, the Russian ga
a number of the Group s subsidiaries, provided long-term financing to the Gr
ruble-denominated non-interest bearing commercial notes payable for a total c
and 2001, respectively. These notes mature in January 2004. Total payable on
2003 and 2002 was $387 and $15,060, respectively.

During 2003, Group companies obtained short-term financing in form of ruble
bearing promissory notes, on which outstanding balance was $7,958 at Decem

Included within the corporate and other commercial debt at December 31, 200
U.S. dollar-denominated payable to Kilosa Enterprises and a $4,661 ruble-den
Holding, related to the purchase by the Group of KMP shares in December 20
and fully repaid at December 31, 2003.

During 2001, the Group issued ruble-denominated non-interest bearing notes p
supplier, with the face value of $7,677, which were repaid in 2002. During 20
ruble-denominated non-interest bearing notes payable with the face value of $
31, 2003. As of December 31, 2003 and December 31, 2002, the balance paya
respectively. The increase in the balance outstanding in 2003 is due to appreci
dollar (see Note 3(w)).

In connection with the acquisition of COST (see Note 2(f)), an agreement was
government that included the acknowledgement of debt for outstanding utility
the Romanian state energy corporations of approximately $44.8 million. This
connection with the purchase accounting for COST, this liability was recorded
million (based on a discount rate of 24%) and was recorded as debt to Romani
December 31, 2003 and 2002, the balance outstanding approximated $36.9 mi
respectively. If the Group meets all its obligations under the tax agreement wi
(see Note 13), $27.5 million of the debt can be forgiven.

Bonds

On February 4, 2003, CMP issued 1,000,000 ruble-denominated bonds in an a
billion rubles (approximately $31 million). The bonds were issued at 100% of
every six months in arrears. The interest rate for the first coupon period was d
based on the bids of buyers and comprised 16.85% p.a. The interest rate for th

coupon periods is set by the Group and is made public 10 days before the resp
Bondholders are entitled to early redemption of the bonds at face value before
coupon periods. The interest rate for the fourth and sixth coupon periods are s
immediately preceding coupon period. The bonds are guaranteed by SKCC. T
of the bonds is February 4, 2006. The total commission and issue costs amoun
outstanding at December 31, 2003 was $22,150.

On June 19, 2003, Mechel Trading House issued 3,000,000 ruble-denominated
principal amount of 3 billion rubles (approximately $98 million). The bonds w
value. Interest is payable every six months in arrears. The interest rate for the
determined upon the issuance based on the bids of buyers and comprised 11.7
second, third and fifth coupon periods is set by the Group and is made public
coupon period starts. The interest rate for the fourth and sixth coupon periods
the immediately preceding coupon period. The bondholders have an option to
starting June 19, 2006, with an obligatory redemption date on June 19, 2009.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The total commission and issue costs amounted to $4,295 and are amortized u
The balance outstanding at December 31, 2003 was $101,852. The increase in
2003 is due to appreciation of ruble against U.S. dollar (see Note 3(w)).

The bond issue costs are amortized to interest expense using the straight-line r
effective interest rate method. Carrying value of fixed assets pledged under loa
$177,982 and $91,986 as of December 31, 2003 and 2002, respectively. Carry
under loan agreements amounted to $51,027 and $23,574 as of December 31,
Carrying value of securities pledged under loan agreements amounted to $5,02
Accounts receivable pledged as of December 31, 2003 amounted to $25,066.

13. TAXES AND SOCIAL CHARGES PAYABLE

The balances of taxes, social charges and contributions to the Russian Pension
payments owed, including fines and penalties related thereto, are comprised of

	De
Current period taxes and social contributions	
Restructured prior period taxes and social charges, principal amount	
Restructured related fines and penalties	
Total taxes and social charges payable	

Taxes, social charges and contributions to the Russian Pension Fund and the A
Administration of Romania (APAPS), including restructured amounts with
December 31, 2003, mature as follows:

Payable in:	Restructured related fines and penalties
2004	11,685
2005	1,136
2006	1,654

2007	2,889
2008 and thereafter	43,537
Total	**60,901**

Included in current period taxes is the accrual for penalties and fines claimed b
tax liabilities in certain subsidiaries for the preceding periods allegedly undere
interpretations of the tax legislation existing during 1999-2002 and as a result
strategies in the amount of $25,717, 24,697 and $20,100 as of December 31, 2
respectively.

Restructured prior period taxes and social charges

Russia

The Group s subsidiaries entered into agreements with Russian tax and social
2002 to restructure the amounts and timing of payments of liabilities related to

F-46

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

income tax (i.e., value added tax and road users tax) and contributions due to t
Fund, both with related fines and penalties. Prior to the restructuring, a signific
including fines and penalties were overdue and payable with short maturities a
Upon conclusion of the restructuring agreements, overdue taxes and charges a
quarterly installments within six years; and related fines and penalties became
conditions were not met. Subject to timely payment of at least 50% of all the r
of taxes and charges within two years on schedule, and the full and timely pay
accrued, a 50%-portion of the restructured fines and penalties will be forgiven

Furthermore, subject to timely payment of the remaining restructured principa
within four years on schedule, and the full and timely payment of current taxes
50% of the restructured fines and penalties will be forgiven. Restructured prin
subject to interest of 5.5% p.a., payable in equal quarterly installments. Restru
not bear interest.

Contributions to the Russian Pension Fund and 15% of the related fines and pe
quarterly installments over five years. Subject to full repayment of the restruct
the Russian Pension Fund and payment of at least 15% of the fines and penalti
well as the full and timely payment of current contributions, the remaining 85
penalties related to the contributions to the Russian Pension Fund will be forgi
contributions to the Russian Pension Fund and the related fines and penalties c

Romania

Upon acquisition of COST and Industria Sarmei (see Note 2(f) and (i)), as par
APAPS agreed to restructure the liabilities of COST and Industria Sarmei rela
National Social Security Fund and Ministry of Labor and Social Security, alon
penalties. Prior to the restructuring, a significant portion of these liabilities inc
overdue and payable with short maturities. Restructured taxes, fines and penal
Restructured long-term liabilities of COST to state energy corporations, which
included in long-term debt (Note 12). Upon conclusion of the restructuring agr
payable as follows:

Payable in:
2004
2005
2006
2007

2008 and thereafter	
Total	

The amount payable in 2008 of $1,266, including primarily fines and penalties
forgiven if COST is in compliance with the current payments schedule for the

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

14. SHAREHOLDERS EQUITY

Capital stock

The capital stock of Mechel Steel Group OAO consists of 497,969,086 author
value of 10 Russian rubles (approximately $0.3), of which 366,178,815 comm
of December 31, 2003 and 2002. As disclosed in Note 1, in the context of the
control and based on the presentation of the Group as if it existed for all perio
the number of shares authorized and issued and earnings per share were based
Controlling Shareholders in connection with the formation of the Group in 20
(less treasury shares) has been treated as outstanding for all periods presented
contributions were made during 2002 and 2001 for which shares have been all
if issued at that time based upon the number of shares that were issued for the
companies in the common control reorganization as determined in accordance

Additional paid-in capital

The excess of the proceeds from contributions made by the Controlling Shareh
the form of the shares of various subsidiaries, which equity stakes accumulatin
in purchase business combinations as disclosed in Note 2, over the aggregate p
shares issued was allocated to additional paid-in capital.

Treasury shares

In connection with the reorganization described in Note 1, 16,790,271 commo
Trading, a Group subsidiary, in exchange for shares contributed by the Contro
Mechel Trading. Consistent with the presentation of common shares as descri
shares valued at their aggregate par value have been treated as held in treasury
2002, and 993,513 shares at December 31, 2001.

Stock-based compensation

During the year ended December 31, 2003, the Group recorded an issuance of
award pursuant to an employment contract with one of its executives. The stoc
entitles the executive to receive 0.6% (2,297,815 shares) of the issued shares o
held in treasury. The fair value of the award was estimated at approximately $
the award and the respective stock-based compensation expense commenced o
compensation recognized during the year ended December 31, 2003, was $2,2
expense.

Distribution of statutory earnings

In accordance with applicable legislation, Mechel and its subsidiaries can distr
transfer them to reserves. Dividends may only be declared from accumulated u
earnings as shown in the Russian statutory financial statements. Dividends are
tax in Russia, which can be reduced or eliminated if paid to foreign owners un
tax treaties. Approximately $338,158 was available for dividends as of Decem
December 31, 2002.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Earnings and dividends per share

Net income per common share for all periods presented was determined in acc
Earnings per Share , by dividing income available to shareholders by the we
outstanding during the years ended December 31:

	2003
Net income available to shareholders	143,
Total weighted average number of shares outstanding during the period	366,178,
Earnings per common share	0

Total weighted-average number of common shares outstanding during the peri

Dates outstanding	Shares outstanding
2001:	
Common shares: January 1-December 27	224,106,594
Issuance of common shares at December 27	107,281,213
Common shares: December 27-December 31	331,387,807
Treasury shares: December 27-December 31	(993,513)
Total weighted average shares outstanding during the period	
2002:	
Common shares: January 1-May 24	331,387,807
Issuance of common shares at May 24	162,729
Common shares: May 24-June 14	331,550,536
Issuance of common shares at June 14	4,099,903
Common shares: June 14-December 25	335,650,439
Issuance of common shares at December 25	47,318,647

Common shares: December 25-December 31	382,969,086
Treasury shares: January 1-May 24	(993,513)
Treasury shares acquired on May 24	(23,875)
Treasury shares: May 24-December 25	(1,017,388)
Treasury shares acquired on December 25	(15,772,883)
Treasury shares: December 25-December 31	(16,790,271)
Total weighted average shares outstanding during the period	
2003:	
Common shares: January 1-December 31	382,969,086
Treasury shares: January 1-December 31	(16,790,271)
Total weighted average shares outstanding during the period	**366,178,815**

There were no dilutive securities issued during and as of the ends of the years 2002 and 2001.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Dividends per common share for the years ended December 31, 2003, 2002 ar
$0.04, respectively.

Accumulated other comprehensive income

Included in accumulated other comprehensive income at December 31, 2003,
adjustment of $46,921 arising on the translation of the foreign currency financ
consolidated subsidiaries. For the years ended December 31, 2002, and 2001,
accumulated other comprehensive income.

Stock issued by a subsidiary

In an effort to consolidate outstanding minority interest in certain consolidated
Group exchanged 3.9% of their equity interest in SKCC for minority interest i
non-monetary exchange was accounted for using the purchase method of acco
value of the stock issued of $4,428, to acquire the minority interests was credi

15. INCOME TAXES

Income (loss) before income tax, minority interests, discontinued operations, e
accounting principle attributable to different jurisdictions was as follows:

Russia
Switzerland
Romania
Lithuania
Kazakhstan
Croatia

Total
Current income tax expense
Russia
Lithuania
Romania
Switzerland
Deferred income tax expense (benefit)
Russia
Switzerland
Lithuania
Kazakhstan
Romania
Total income tax expense

F-50

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Taxes represent the Group s provision for profit tax. Income tax of Russian su taxable profit in 2003 and 2002. Income tax of Swiss subsidiaries is calculated 2003 and 2002. Income tax of Romanian subsidiary is calculated at 25% of ta The Group s Liechtenstein subsidiary is exempt from income tax.

The reconciliation between the income tax expense computed by applying the rates (24% for 2003, 2002, and 35% for 2001) to the income before taxes, min items and change in accounting principle, to the income tax expense reported i follows:

Theoretical income tax expense computed on income before taxes at Russian statutory rates
Effects of other jurisdictions and permanent differences:
Investments incentive deductions
Property, plant and equipment basis difference
Non-deductible expenses and non-taxable income
Social expenditures
Change in valuation allowance
Other permanent differences
Different tax rates in foreign jurisdictions
Fines and penalties related to taxes
Change in tax rate
Income tax expense, as reported

The deferred tax balances were calculated by applying the currently enacted st jurisdiction applicable to the period in which the temporary differences betwe base (both in respective local currencies) of assets and liabilities are expected

The provisions of SFAS No. 109 prohibit recognition of a deferred tax asset fo that, under SFAS No. 52, are remeasured from the local currency into the func exchange rates and that result from (1) changes in exchange rates or (2) indexi property, plant and equipment basis difference reflected above for 2002 and 20 remeasurement and the related difference was recorded as a permanent item in reconciliation. The remeasurement was required during 2002 and 2001 becaus hyperinflationary economy and the functional currency was the U.S. dollar, th

were remeasured at historical exchange rates. The difference generated betwee
assets, as a result of changes in exchange rates or indexing for tax purposes, w
difference but rather as a permanent difference. Commencing on January 1, 20
considered a hyperinflationary economy and the ruble became the functional c
functional currency had the effect of removing this bases difference between t
property, plant and equipment and resulted in there being no permanent differe

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The amounts reported in the accompanying consolidated financial statements a
following:

Deferred tax assets, current:
Inventory and product related reserves
Bad debt allowance
Timing difference in cost recognition
Deferred revenue
Accrued liabilities
Vacation provision
Other
Total deferred tax asset, current
Deferred tax assets, non-current:
Net operating loss carry forward
Asset Retirement Obligation
Property, plant and equipment
Other
Total deferred tax assets, non-current
Valuation allowance for deferred tax assets
Total deferred tax asset, net

Deferred tax liabilities, current:
Timing difference in revenue recognition
Timing difference in cost recognition
Inventory and product related services
Bad debts provision
Other
Total deferred tax liabilities, current
Deferred tax liabilities, non-current:
Property, plant and equipment
Mineral reserves
Long-term debt
Investments
Other
Total deferred tax liabilities, non-current

Total deferred tax liability

For financial reporting purposes, a valuation allowance is recognized to reflec
realization of the deferred tax assets. Valuation allowances are provided when
some or all of the deferred tax assets will not be realized in the future. These e
expectations of future taxable income and reversals of the various taxable tem
income tax purposes, certain subsidiaries of the Group have accumulated tax l
2003, which may be carried forward for use against their future income

---

F-52

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

within 10 years. Their use is restricted to a maximum of 30% of taxable incom
of the Group. Tax loss carry forwards may be eroded by future devaluation of
2003, for Russian income tax purposes, the subsidiaries of the Group had tax l
of approximately $57,168, expiring as follows:

December 31, 2007
December 31, 2008
December 31, 2009
December 31, 2010
December 31, 2011
December 31, 2012
December 31, 2013
Total loss carry forward

16. TAXES OTHER THAN INCOME TAX

Taxes other than income tax included in the consolidated income statements c

Property and land tax
Road users tax
VAT
Other taxes and penalties
Total taxes other than income tax

17. GENERAL, ADMINISTRATIVE AND OTHER OPERATING EXP

General, administrative and other operating expenses comprise the following:

Personnel and social contributions	
Social expenses	
Fixed assets disposals	
Audit and consulting servises	
Depreciation	
Rent	
Banking charges and services	
Other	
Total general, administrative and other operating expenses	

Rent represents expenses related to the lease of premises. The Group has annu
of the premises.

18. SEGMENTAL INFORMATION

The Group has two reportable business segments: steel and mining. These se
subsidiaries and have separate management teams and offer different products

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

two segments meet criteria for reportable segments. Subsidiaries are consolida they belong based on their products and by which they are managed.

The Group s management evaluates performance of the segments based on se operating income and income before income taxes, minority interest and extra

Segmental information for the years ended December 31, 2003, 2002 and 200

	Steel	Mining	2003	Steel	Mining	2002
Revenues from external customers	1,636,145	413,943	2,050,088	1,011,537	302,612	1,314,149
Intersegment revenues	42,250	185,813	228,063	39,017	69,604	108,621
Gross margin	431,015	179,020	610,035	249,073	117,549	366,622
Gross margin*, %	25.7%	29.8%	26.8%	23.7%	31.6%	25.8
Depreciation, depletion and amortization	67,272	34,417	101,689	49,728	29,045	78,773
Operating income	129,326	63,450	192,776	54,732	34,412	89,144
Interest income	2,175	117	2,292	3,441	1,036	4,477
Interest expense	38,363	10,165	48,528	30,416	6,357	36,773
Segment assets	1,188,463	646,046	1,834,509	966,288	421,090	1,387,378
Capital expenditures	56,579	66,639	123,218	27,365	40,573	67,938
Income tax benefit (expense)	(26,186)	(21,573)	(47,759)	4,673	(7,328)	(2,655)
Extraordinary gain	5,740		5,740		1,388	1,388

* *Gross margin percentage is calculated as a function of total revenues for both from external customers and intersegment.*

The following table presents the Group s revenues segregated between domes represents sales by a production subsidiary in the country in which it is locate divided between subsidiaries located in Russia and other countries. Export rep subsidiary regardless of its location and sales.

	2
Domestic:	
Russia	1,0
Other	1
Total	1,1
Export	9
Total revenue, net	**2,0**

Allocation of total revenue by country is based on the location of the customer
from external customers by geographic area for the last three fiscal years were

	2
Russia	1,0
Europe	6
Asia	2
CIS	
Middle East	
USA	
Other Regions	
Total	**2,0**

F-54

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The majority of the Group s long-lived assets are located in Russia. The carry
assets/(liabilities) pertaining to the Group s major operation located outside R
follows:

Switzerland/Liechtenstain
Romania
Croatia

Due to the high number of customers there are no individual external custome
than 10% of the Group s consolidated total revenue, except for our sales to G
segment products), which comprised: 12%, 18% and 23% of our steel segmen
2001, respectively.

19. COMMITMENTS AND CONTINGENCIES

Commitments

In the course of carrying out its operations and other activities, the Group and
various agreements, which would require the Group to invest in or provide fin
undertakings. In management s opinion, these commitments are entered into u
representative of each specific project s potential and should not result in an u

In the course of acquisition of various subsidiaries (see Note 2), the Group und
respect of future capital expenditures connected with the development of prod
committed to make the investment for the development of the production facil
environmental compliance in Industria Sarmei, for the total of approximately S
years from the date of acquisition. The Group committed to make the investm
production facilities in COST, for the total of approximately $21,072, during a
date of acquisition. The Group committed to make the investment for the deve
facilities in Mechel Zeljezara, for the total of approximately $8,600, during a p
date of acquisition. As of December 31, 2003, the total of unfulfilled commitm
Also the Group committed to maintain workforce level at COST, Industria Sa
five years.

Contingencies

(a) General

The Russian economy continues to display certain traits consistent with that of
These characteristics include periods of high inflation, lack of liquidity in the c
existence of currency controls, which cause the national currency to be illiquid
continued success and stability of the Russian economy will be significantly a
continued actions with regard to administrative, legal, and economic reforms.

(b) Taxation

The Group is subject to taxation to the largest extent in Russia, and secondaril
Russian tax system continues to evolve. Applicable taxes include value-added
(profit tax), turnover-based taxes, payroll (social) taxes and others. Laws relat
adopted only recently, in contrast to more developed market economies; and i
often unclear or nonexistent. Many Russian tax laws and related regulations in

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

in 2002 and previous years were not always clearly drafted and their interpreta
of local tax authorities, the Central Bank and the Ministry of Finance. Instance
between local, regional and federal tax authorities and between the Central Ba
are not unusual, and few precedents with regard to issues have been establishe
with other legal compliance areas (for example, customs and currency control
and investigation by a number of authorities that are enabled by law to impose
interest charges. These facts create tax risks in Russia substantially more signi
countries with more developed tax systems. In Russia, generally, tax declaratio
inspection for a period of three years. The fact that a year has been reviewed d
tax declaration applicable to that year, from further review during the three-ye

Management believes that it has paid or accrued all taxes that are applicable. V
Group has accrued tax liabilities based on management s best estimate.

In other tax jurisdictions where the Group conducts operations or holds shares
the income arising in that jurisdiction. In some jurisdictions agreements to avo
between different jurisdictions; however, the risk of additional taxation exists,
domiciles where some of the Group entities are located and which are conside

As of December 31, 2003, the Group does not believe that any other material r
Group, including current pending or future governmental claims and demands
adjustment to the accompanying financial statements in order for those statem
misstated or misleading.

(c) Litigation, claims and assessments

The Group is subject to various lawsuits, claims and proceedings related to ma
In the opinion of management, the Group s liability, if any, in all pending litig
other matters, other than those described in Note 13, would not have a materia
condition, results of operations or liquidity of the Group.

The Group operates in a number of different jurisdictions with varying legal sy
developing markets with evolving fiscal and regulatory environments.

The Russian legal system, which affects most of the Group s subsidiaries, is c
(1) inconsistencies between and among laws, presidential decrees, and Russian
local orders, decisions, and resolutions and other acts; (2) conflicting local, reg
regulations; (3) the lack of judicial and administrative guidance on interpreting
inexperience of judges and courts in interpreting legislation; and (5) a high deg
governmental authorities. Management is unable to estimate what developmen
effect of any such developments on the Group s financial condition or future

The Group s operations and financial position will continue to be affected by
including the application of existing and future legislation and tax regulations.
occurrences and their effect on the Group could have a significant impact on th
operations.

F-56

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(d) Guarantees

The Group has guaranteed the fulfillment of obligations of third parties under
total amount of $4,034. The guarantees given for loans received by various en
the guarantees given for loans obtained by employees of the Group amounted
fails to fulfill its obligations under the loan agreement the Group repays the ou
debt agreement with all interests, fines and penalties due. Maximum potential
under the guarantees given amounted to $4,034.

(e) Environmental

In the course of the Group s operations, the Group may be subject to environ
proceedings. The quantification of environmental exposures requires an asses
including changing laws and regulations, improvements in environmental tech
information available related to specific sites, the assessment stage of each sit
findings and the length of time involved in remediation or settlement. Manage
pending environmental claims or proceedings will have a material adverse eff
results of operations.

20. SUBSEQUENT EVENTS

(a) Acquisitions

Port Posiet

On February 11, 2004, the Group acquired 80.0% of the common shares of Po
Russia s Far East on the Sea of Japan, for $30,000 in cash. The acquisition of
using the purchase method of accounting. The results of operations of Port Pos
consolidated financial statements from the date of acquisition of control, Febr
table summarizes on a preliminary basis the fair values of net assets acquired a

Cash and cash equivalents	
Other current assets	
Property, plant and equipment	
Current liabilities	
Long-term liabilities	
Deferred income taxes	
Fair value of net assets acquired	
Goodwill	
Minority s share in net assets	
Total investment	

As of June 30, 2004, the Group has not finalized its purchase price allocation f
Port Posiet.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Izhstal

In January-February 2004, the Group acquired a 15.35% interest in Izhstal, a p
products, carbon and specialty steel products and forgings, similar to those of
for $508 in cash. On May 14, 2004, the Group acquired an additional 26.9% i
$17,264 in cash, and a 17.17% interest from the management of Izhstal for $5
the Group acquired an additional 2.19% interest by buying shares on the open
Thus, by the end of May 2004, the Group had accumulated 61.61% of Izhstal
of $25,137 in cash.

The acquisition of Izhstal was accounted for using the purchase method of acc
value of the net assets acquired over the purchase price has been allocated as a
of the amounts that otherwise would have been assigned to property, plant and
SFAS No. 141, Business Combinations . The results of operations of Izhstal
consolidated financial statements from the date of acquisition of control, May

The following table summarizes on a preliminary basis the fair values of net a
assumed at the date of acquisition.

Cash and cash equivalents	
Other current assets	
Property, plant and equipment	
Current liabilities	
Long-term liabilities	
Deferred income taxes	
Fair value of net assets acquired	
Minority s share in net assets	
Total investment	

As of June 30, 2004, the Group has not finalized its purchase price allocation f

Gorbachev Mine

On May 7, 2004, the Group acquired the property complex of Gorbachev mine
operations for $1,600 in cash. Gorbachev mine is an underground coal mine c
located in Kazakhstan, neighboring to the recently acquired Mechel Coal Rese
subsidiary. The acquisition of Gorbachev mine was accounted for as an acquis
constitute a business.

Invest Coal

On June 17, 2004, the Group acquired 100% of Invest Coal for $3,275 in cash
mineral reserves extension, mostly in the area surrounding one of the Group s
Invest Coal facilitates the extraction of mineral reserves of that coal mine. The
accounted for as an acquisition of an asset as it did not constitute a business.

Table of Contents

Mechel Steel Group OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Mechel Energo

On February 3, 2004, the Group acquired the assets of REK Energosbyt, later
emerging energy trader in Siberia and Eastern Russia, whose primary asset wa
wholesale segments of the Russian electricity market, for $2,005, comprised o
notes and $270 paid in cash. The acquisition of Mechel Energo was accounted
as it did not constitute a business. The license was recorded as an intangible as
five years.

BMP

On March 19, 2004, the Group purchased an additional 10.77% of the commo
cash. As a result, the Group increased its interest in BMP to 90.24%. The purc
BMP will be accounted for using the purchase method of accounting and reco
financial statements for the year ended December 31, 2004. As of June 30, 20
its purchase price allocation for the acquisition of additional shares of BMP.

Chelyabenergo

From April through June 2004, the Group acquired 4.97% of Chelyabenergo, a
the Chelyabinsk region, for $9,314 in cash.

(b) Dividends

The Group declared a dividend of $5,200 on June 24, 2004.

Table of Contents

Mechel Steel Group OAO

INTERIM CONSOLIDATED BALANCE SHEETS

(in thousands of U.S. dollars, except share amounts)	Notes
ASSETS	
Cash and cash equivalents	
Accounts receivable, net of allowance for doubtful accounts of $21,922 as of June 30, 2004, and $23,312 as of December 31, 2003, respectively	
Due from related parties	
Inventories	3
Deferred cost of inventory in transit	
Deferred income taxes	
Prepayments and other current assets	
Total current assets	
Long-term investments in related parties	
Other long-term investments	
Due from related parties	
Intangible assets	2
Property, plant and equipment, net	
Mineral licenses, net	
Deferred income taxes	
Goodwill	2
Total assets	
LIABILITIES AND SHAREHOLDERS EQUITY	
Short-term borrowings and current maturities of long-term debt	5
Accounts payable and accrued expenses:	
Advances received	
Accrued expenses and other current liabilities	
Taxes and social charges payable	
Trade payable to vendors of goods and services	
Due to related parties	
Asset retirement obligation	4
Deferred income taxes	
Deferred revenue	
Total current liabilities	
Restructured taxes and social charges payable, net of current portion	
Long-term debt, net of current portion	5
Asset retirement obligations, net of current portion	4
Deferred income taxes	
Other long-term liabilities	
Commitments and contingencies	8
Minority interests	
SHAREHOLDERS EQUITY	
Common shares (10 Russian rubles par value; 497,969,086 shares authorized, 382,969,086 shares issued and 368,476,630 and 366,178,815 shares outstanding as of June 30, 2004 and December 31, 2003)	6
Treasury shares, at cost	

Additional paid-in capital	
Accumulated other comprehensive income	
Retained earnings	
Total shareholders equity	
Total liabilities and shareholders equity	

See accompanying notes to consolidated financial sta

F-60

Table of Contents

Mechel Steel Group OAO

INTERIM CONSOLIDATED INCOME STATEMENTS

(in thousands of U.S. dollars, except share and per share amounts)	**Notes**	**(u**
Revenue, net (including related party amounts of $33,950 and $99,540 during six months 2004 and 2003, respectively)	**7**	$
Cost of goods sold (including related party amounts of $ 6,279 and $106,697 during six months 2004 and 2003, respectively)		
Gross margin		
Selling, distribution and operating expenses:		
Selling and distribution expenses		
Taxes other than income tax		
Accretion expense		
Provision for doubtful accounts		
General, administrative and other operating expenses		
Total selling, distribution and operating expenses		
Operating income		
Other income and (expense):		
Income from equity investments		
Interest income		
Interest expense		
Other income, net		
Foreign exchange gain		
Total other income and (expense), net		
Income before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principles		
Income tax expense		
Minority interest in (income)/loss of subsidiaries		
Income from continuing operations		
Loss from discontinued operations, net of tax		
Extraordinary gain, net of tax		
Change in accounting principle, net of tax		
Net income		**$**
Currency translation adjustment		

Adjustment of available for sale securities			
Comprehensive income		**$**	
Basic and diluted earnings per share:			
Earnings per share from continuing operations		$	
(Loss) per share effect of discontinued operations			
Earnings per share effect of extraordinary gain			
Earnings per share effect of a change in accounting principle			
Net income per share		$	
Dividends declared per share		$	
Weighted average number of shares outstanding	**6**		3

See accompanying notes to consolidated financial sta

Table of Contents

Mechel Steel Group OAO

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of U.S. dollars)

Cash Flows from Operating Activities
Net income
Adjustments to reconcile net income to net cash provided by operating activities:
Depreciation
Depletion and amortization
Foreign exchange gain
Deferred income taxes
Provision for doubtful accounts
Inventory write down
Accretion expense
Minority interest
Effect of change in accounting principle
Income from equity investments
Non-cash interest on long-term tax liabilities
(Gain) loss on sale of property, plant and equipment
Loss (gain) on sale of short-term investments
Gain on forgiveness of fines and penalties
Stock based compensation expense
Amortization of capitalized costs on bonds issue
Extraordinary gain
Changes in current assets and liabilities, net of effects from acquisition of new subsidiaries:
Accounts receivable
Inventories
Trade payable to vendors of goods and services
Advances received
Accrued taxes and other liabilities
Settlements with related parties
Current assets and liabilities of discontinued operations
Deferred revenue and cost of inventory in transit, net
Other current assets
Net cash provided by operating activities
Cash Flows from Investing Activities
Acquisition of subsidiaries, less cash acquired
Acquisition of minority interest in subsidiaries
Investments in other non-marketable securities
Proceeds from disposal of long-term investments
Proceeds from disposals of property, plant and equipment
Purchases of property, plant and equipment
Net cash used in investing activities
Cash Flows from Financing Activities
Proceeds from short-term borrowings
Repayment of short-term borrowings
Dividends paid to minority interest
Proceeds from long-term debt

Repayment of long-term debt and long-term portion of restructured taxes and social charges payable
Net cash provided by financing activities
Effect of exchange rate changes on cash and cash equivalents
Net increase in cash and cash equivalents
Cash and cash equivalents at beginning of period
Cash and cash equivalents at end of period
Supplementary cash flow information:
Assumption of debt in business combination

See accompanying notes to consolidated financial sta

F-62

Table of Contents

Mechel Steel Group OAO

INTERIM CONSOLIDATED STATEMENT OF CHANGES IN SHAREH

(in thousands of U.S. dollars, except share amounts)	Common shares		Treasury shares			
						Ac
(unaudited)	Shares	Amount	Shares	Amount	Additional paid-in-capital	com
Balances as of December 31, 2003	382,969,086	$ 121,935	(16,790,271)	$ (5,346)	$ 92,659	$
Net income						
Dividends						
Cumulative translation adjustment						
Adjustment of available for sale securities						
Stock based compensation			2,297,815	732	668	
Balances as of June 30, 2004	**382,969,086**	**$ 121,935**	**(14,492,456)**	**$ (4,614)**	**$ 93,327**	**$**

See accompanying notes to consolidated financial sta

Table of Contents

Mechel Steel Group OAO

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (

As of June 30, 2004 and for the six months period then ended

(All amounts are in thousands of U.S. dollars, unless stated otherwise)

1. GENERAL

The accompanying unaudited interim consolidated financial statements have b
Group OAO (Mechel) and its subsidiaries (collectively, referred to herein a
and regulations of the United States Securities and Exchange Commission. Ce
disclosures normally included in the footnotes to annual consolidated financia
condensed or omitted pursuant to such rules and regulations, but resultant disc
accounting principles generally accepted in the United States of America (U.
interim reporting. The unaudited consolidated financial statements should be r
consolidated financial statements for the years ended December 31, 2003, 200
thereto. The balance sheet at December 31, 2003, has been derived from the au
that date, but does not include all of the information and footnotes required by
principles for complete annual financial statements. In the opinion of Mechel
accompanying unaudited interim consolidated financial statements contain all
present the consolidated financial position of the Group as of June 30, 2004, a
of income and cash flows for the six months ended June 30, 2004 and 2003. T
the six months ended June 30, 2004, are not necessary indicative of the incom
for the full year.

2. ACQUISITIONS, INVESTMENTS AND DISPOSALS

Port Posiet

On February 11, 2004, the Group acquired 80.04% of the common shares of P
in Russia s Far East on the Sea of Japan, for $30,000 in cash. The primary rea
intention to selectively expand our internal logistics capabilities, currently cen
forwarding company. Through the acquisition of Port Posiet, located on the Se
our transportation expenses. We intend to ship primarily our coking coal conc
products, to Asia through this port. No sea ports were readily available on the
because most of the ports in the area of Far East are controlled either by our co
transportation companies we had to pay a premium in order to acquire Port Po
in positive goodwill, none of which will be deductible for income tax purpose
the mining segment as the majority of its activity relate to movement of coal a

F-64

Table of Contents

Mechel Steel Group OAO

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (

The acquisition of Port Posiet was accounted for using the purchase method of operations of Port Posiet are included in the consolidated financial statements control, February 11, 2004. The following table summarizes the fair values of of acquisition of control.

Cash and cash equivalents	
Other current assets	
Property, plant and equipment	
Current liabilities	
Long-term liabilities	
Deferred income taxes	
Fair value of net assets acquired	
Goodwill	
Minority s share in net assets	
Total investment	

BMP

On March 19, 2004, the Group purchased an additional 10.77% of the commo cash. As a result, the Group increased its interest in BMP to 90.24%. The purc BMP is accounted for using the purchase method of accounting and recorded i statements for the period ended June 30, 2004.

Gorbachev Mine

On May 7, 2004, the Group acquired the property complex of Gorbachev min operations for $1,600 in cash. Gorbachev mine is an underground coal mine c located in Kazakhstan, neighboring to the recently acquired Mechel Coal Rese subsidiary. The acquisition of Gorbachev mine was accounted for as an acquis constitute a business.

Chelyabenergo

From April through June 2004, the Group acquired 4.97% of Chelyabenergo, a
the Chelyabinsk region, for $9,314 in cash. This investment is classified as ava

Izhstal

In January-February 2004, the Group acquired a 15.35% interest in Izhstal, a p
products, carbon and specialty steel products and forgings, similar to those of
May 14, 2004, the Group acquired an additional 26.9% interest from the gover
a 17.17% interest from the management of Izhstal for $5,671 in cash. During N
an additional 2.19% interest by buying shares on the open market for $1,694 in
2004 the Group had accumulated 61.61% of Izhstal voting stock and had paid
acquisition of Izhstal was accounted for using the purchase method of account
of the net assets acquired over the purchase price has been allocated as a pro ra
amounts that otherwise would have

Table of Contents

Mechel Steel Group OAO

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (

been assigned to property, plant and equipment, in accordance with SFAS No.
The results of operations of Izhstal are included in the consolidated financial s
acquisition of control, May 14, 2004. The following table summarizes the fair
the date of acquisition of control.

Cash and cash equivalents	
Other current assets	
Property, plant and equipment	
Current liabilities	
Long-term liabilities	
Deferred income taxes	
Fair value of net assets acquired	
Minority s share in net assets	
Total investment	

Invest Coal

On June 17, 2004, the Group acquired 100% of Invest Coal for $3,275 in cash
mineral reserves extension, mostly in the area surrounding one of the Group s
Invest Coal facilitates the extraction of mineral reserves of that coal mine. The
accounted for as an acquisition of an asset as it did not constitute a business.

Mechel Energo

On February 3, 2004, the Group acquired the assets of REK Energosbyt, later
emerging energy trader in Siberia and Eastern Russia, whose primary asset wa
wholesale segments of the Russian electricity market, for $2,005, comprised o
notes and $270 paid in cash. The acquisition of Mechel Energo was accounted
as it did not constitute a business. The license was recorded as an intangible as
five years.

Magnitogorsk Iron and Steel Works (MMK)

The Group has an investment in MMK shares and participates in the board of
increased its investment in MMK through acquisition of 0.21% of non-voting
common shares for the total of $4,054 during the six months ended June 30, 2
subsidiaries owned 16.95% of ordinary shares and 12.18% of preferred shares
of $53,697.

F-66

Table of Contents

Mechel Steel Group OAO

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (

Pro forma condensed consolidated income statement data

The following unaudited pro forma condensed consolidated income statement ended June 30, 2004, gives effect to the business combinations that occurred i at the beginning of 2004 and (ii) six months ended June 30, 2003, gives effect that occurred in 2004 and 2003, as if they had occurred at the beginning of 20

	Six months June 30, 2
Revenue, net	1,6
Income from continuing operations	2
Net income	2
Net income per share	

These unaudited pro forma amounts are provided for informational purposes o present the results of operations of the Group had the transactions assumed the date indicated, nor is it necessarily indicative of the results of operations whic

3. INVENTORIES

Inventories are comprised of:

	Ju (
Finished goods	
Raw materials and purchased parts	
Work in process	
Total inventories	

4. ASSET RETIREMENT OBLIGATIONS (ARO)

The following table presents the movements in ARO for the six months ended

Asset retirement obligation	Jun (ur
Balance at beginning of the period	
Liabilities incurred in the current period	
Liabilities settled in the current period	
Accretion expense	
Revision in estimated cash flow	
Translation and other	
Balance at end of the period	

Liabilities incurred in the six months ended June 30, 2004 arose from the acqu
property complex of Gorbachev mine of $2,492 and other operating assets.

Table of Contents

Mechel Steel Group OAO

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (

5. DEBT

The most significant changes in outstanding debt balances between December
were as follows:

During the six months ended June 30, 2004, Sberbank provided a series of rub
loans and credit facilities to various Group subsidiaries, bearing interest at rate
secured by inventory, property and equipment. At June 30, 2004 and Decembe
outstanding was $74,768 and $62,591, respectively. Sberbank also provided a
of $3,644 payable in 2006, secured by property and equipment and bearing int

During the six months ended June 30, 2004, UralSib provided a series of ruble
facilities to various Group subsidiaries, bearing interest at rates varying from 5
certain Group subsidiaries and secured by their property and equipment. At Ju
2003 the balance outstanding was $40,905 and $10,115, respectively.

During the six months ended June 30, 2004, Gazprombank provided a U.S. do
loan of $31,000, bearing interest at 8.9% p.a. and secured by inventory, plant a

During the six months ended June 30, 2004, the Group repaid its U.S. dollar-d
to Alfa bank in the total amount of $32,048.

During the six months ended June 30, 2004, the Group increased its bank over
$52,768 to $67,936. The facility opened at BNP Paribas bears interest at 3% p
secured by Mechel Trading cash accounts.

During the six months ended June 30, 2004, Cargill USA provided a U.S. doll
of $10,000, bearing interest at 7.25% p.a. and secured by inventory.

During the six months ended June 30, 2004 and the year ended December 31,
a $10,000 U.S. dollar-denominated revolving credit line facility to the Group.

30, 2004, and December 31, 2003 were $1,461 and $5,667, respectively. Inter
line balances varied: during six months of 2004 at 4.45% p.a., in 2003, LIBOR
plus 5% p.a. The credit line was secured by the pledge of the collection rights
Plant (CMP) from Mechel Trading arising on export sales.

6. SHAREHOLDERS EQUITY

Dividends

In accordance with applicable legislation, Mechel and its subsidiaries can distr
transfer them to reserves. Dividends may only be declared from accumulated u
earnings as shown in the Russian statutory financial statements. Dividends are
tax in Russia, which can be reduced or eliminated if paid to foreign owners un
tax treaties. Approximately $426,965 was available for dividends as of June 3

On June 24, 2004, Mechel declared a dividend of 149 million rubles (approxim
was paid as of September 20, 2004.

Stock based compensation

During the year ended December 31, 2003, the Group recorded an issuance of
award pursuant to an employment contract with one of its executives. The stoc

---

F-68

Table of Contents

Mechel Steel Group OAO

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (

compensation award entitles the executive to receive 0.6% (2,297,815 shares)
Group, out of the shares held in treasury. The fair value of the award was estin
The vesting period for the award and the respective stock based compensation
2003. The stock-based compensation recognized during the six months ended
recorded as an operating expense. On April 15, 2004, the stock option was exe
issuance of treasury stock.

The Group does not present pro forma disclosures of results of operations as if
applied, as the result would be substantially the same compared to intrinsic me
with APB Opinion No. 25.

Earnings per share

Net income per common share for all periods presented was determined in acc
Earnings per Share , by dividing income available to shareholders by the we
outstanding during the six months periods ended June 30, 2004 and 2003:

Net income available to shareholders	
Total weighted average number of shares outstanding during the period	
Earnings per common share	

7. INCOME TAXES

The provision for taxes based on income for the 2004 and 2003 interim period
with Interpretation No. 18 of APB Opinion No. 28 on reporting taxes for inter
projections of total year pretax income. The effective tax rate for the six montl
22%, compared to 27.7% for the same period in the prior year. In 2004, the pr
effective rate of 22% and the Russian statutory rate of 24% relates to recogniti
that is non-taxable and more income being generated in jurisdictions having a
between the effective and statutory tax rates for 2003 is the result of significan

8. SEGMENTAL INFORMATION

The Group has two reportable business segments: steel and mining. These se
subsidiaries and have separate management teams and offer different products
segments meet criteria for reportable segments. Subsidiaries are consolidated b
belong based on their products and by which they are managed.

The Group s management evaluates performance of the segments based on se
operating income and income before income taxes, minority interest and extra

Table of Contents

Mechel Steel Group OAO

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (

Segmental information for the six months ended June 30, 2004 and 2003 is as

	Steel	Mining	2004 (unaudited)	S
Revenues from external customers	1,267,754	362,309	1,630,063	7
Intersegment revenues	40,149	160,285	200,434	
Gross margin	343,785	300,908	644,693	2
Gross margin*, %	26	58	40	
Depreciation, depletion and amortization	36,574	25,666	62,240	
Operating income	163,714	185,392	349,106	
Interest income	677	448	1,125	
Interest expense	23,460	6,562	30,022	
Segment assets	1,567,578	768,655	2,336,233	1,1
Capital expenditures	90,447	35,420	125,867	
Income tax expense	55,163	18,937	74,100	
Extraordinary gain				

* *Gross margin percentage is calculated as a function of total revenues for both from external customers and intersegment.*

The following table presents the Group s revenues segregated between domes
represents sales by a production subsidiary in the country in which it is locate
divided between subsidiaries located in Russia and other countries. Export rep
subsidiary regardless of its location.

Domestic:	
Russia	
Other	
Total	
Export	
Total revenue, net	

Table of Contents

Mechel Steel Group OAO

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (

Allocation of total revenue by country is based on the location of the customer
from external customers by geographic area for the six months ended June 30,
follows:

Russia
Europe
Asia
CIS
Middle East
USA
Other Regions
Total

Due to the high number of customers there are no individual external custome
than 10% of the Group s consolidated total revenue, except for the Group s s
(steel segment products), which comprised 13% of the Group s total revenue
June 30, 2004 and 2003, respectively.

9. COMMITMENTS AND CONTINGENCIES

Commitments

In the course of carrying out its operations and other activities, the Group and
various agreements, which would require the Group to invest in or provide fin
undertakings. In management s opinion, these commitments are entered into
representative of each specific project s potential and should not result in an

In the course of acquisition of various subsidiaries in 2002 and 2003, the Grou
commitments in respect of future capital expenditures connected with the deve
facilities. The Group committed to make the investment for the development o
improvements of the environmental compliance in Industria Sarmei, for the to
during a period of five years from the date of acquisition. The Group committe
the development of the production facilities in COST, for the total of approxin
of five years from the date of acquisition. As of June 30, 2004, the total of unf
approximately $33,157. Also the Group committed to maintain workforce leve
for five years.

Contingencies

(a) Guarantees

The Group has guaranteed the fulfillment of obligations of third parties under
total amount of $4,376. The guarantees given for loans received by various en
the guarantees given for loans obtained by employees of the Group amounted
fails to fulfill its obligations under the loan agreement, the Group will have to
under the debt agreement with all interests, fines and penalties due. The maxin
payments under the guarantees given amounted to $4,376 at June 30, 2004.

Table of Contents

Mechel Steel Group OAO

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (

(b) Environmental

In the course of the Group s operations, the Group may be subject to environ
proceedings. The quantification of environmental exposures requires an assess
including changing laws and regulations, improvements in environmental tech
information available related to specific sites, the assessment stage of each site
findings and the length of time involved in remediation or settlement. Manage
pending environmental claims or proceedings will have a material adverse eff
results of operations.

(c) Taxation

Constitutional Court Resolution

In July 2004, Resolution No. 169-O of the Constitutional Court of the Russian
has become publicly available. The resolution has the possible effect of deferr
Company is able to offset input VAT to the extent the creation of such VAT is
the utilization of borrowed funds. In the event local taxing authorities would a
such an interpretation in arbitration courts, the result could have a material adv
financial condition. As of September 20, 2004, management is unable to predi
uncertainty.

10. SUBSEQUENT EVENTS

Mechel Zeljezara

On September 14, 2004, in connection with the decision of management of the
involvement in Croatia, Mechel Trading, Mechel Zeljezara, and Zeljezara Sisa
agreements relating to the assets and employees acquired by Mechel Zeljezara
to the first agreement, Zeljezara Sisak, the original seller of the assets to Mech
and obligations under the original asset purchase agreement to the Croatian Pr
the second agreement, all parties terminated the original purchase agreement,
conditions: (1) transfer by Mechel Zeljezara to the Croatian Privatization Fund
Mechel Zeljezara and the employees of the plant; (2) donation by Mechel Zelj
amount of $1,798 to the Croatian Privatization Fund; (3) the redemption by th

bank guarantee given to it pursuant to the original purchase agreement in the a
waiver of any and all claims against Mechel Trading and Mechel Zeljezara. M
liquidation, a process which is expected to be concluded in the first half of 200
account for Mechel Zeljezara as discontinued operations from the date of the a
As of June 30, 2004, total assets and total liabilities of Mechel Zeljezara were
respectively, resulting in net liabilities associated with Mechel Zeljezara of $5
ended June 30, 2004, Mechel Zeljezara had net sales of $23,283 and incurred a

Mechel Trading

On October 1, 2004, Mechel Trading, a 100% owned subsidiary of the Group,
and 268,078 of the Group s shares held by it to two employees of Mechel Me
Liechtenstein trading subsidiary, in return for 20% and 5%, respectively, of th
owned by these employees. The transaction will be accounted for as the purch
exchange for the issuance of treasury stock. The cost of the purchase will be b
treasury shares issued. The fair value of the treasury shares and the purchase p
be finalized before December 31, 2004.

F-72

Table of Contents

Chelyabinsk Metallurgical Plant OAO

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING

Shareholders and Board of Directors

Chelyabinsk Metallurgical Plant OAO

We have audited the accompanying consolidated balance sheet of Chelyabinsk open joint stock company, and its subsidiaries (hereinafter referred to as the 2001, and the related consolidated statements of income, cash flows and chang the year then ended. These financial statements are the responsibility of the Co responsibility is to express an opinion on these financial statements based on o

We conducted our audit in accordance with the standards of the Public Compa (United States). Those standards require that we plan and perform the audit to about whether the financial statements are free of material misstatement. An a test basis, evidence supporting the amounts and disclosures in the financial sta assessing the accounting principles used and significant estimates made by ma the overall financial statement presentation. We believe that our audit provides opinion.

As more fully described in Note 2(g) to the consolidated financial statements, equipment as of January 1, 2001, has been recorded at appraised values rather required by accounting principles generally accepted in the United States.

In our opinion, except for the effects of the matter discussed in the preceding p statements referred to above present fairly, in all material respects, the consoli Company at December 31, 2001, and the consolidated results of its operations then ended in conformity with accounting principles generally accepted in the

/s/ Ernst & Young (CIS) Limited

February 28, 2004

Moscow, Russia

[Table of Contents](#)

Chelyabinsk Metallurgical Plant OAO

CONSOLIDATED BALANCE SHEET

(in thousands of U.S. dollars, except share amounts)

Assets
Cash and cash equivalents
Accounts receivable, net of allowance for doubtful accounts of $2,539
Due from related parties
Inventories
Deferred income taxes
Prepayments and other current assets
Total current assets
Property, plant and equipment, net
Investments
Investments in affiliates
Other non-current assets
Total assets
Liabilities and Shareholders Equity
Short-term debt
Accounts payable and accrued expenses:
Trade accounts payable
Advances received
Accrued expenses and other current liabilities
Due to related parties
Total current liabilities
Restructured taxes and social charges payable, net of current portion
Deferred income taxes
Commitments and contingencies
Minority interest
Shareholders Equity
Common shares (1 Russian ruble par value); 3,161,965 shares authorized, issu and outstanding
Retained earnings
Total shareholders equity
Total liabilities and shareholders equity

See accompanying notes to consolidated financial sta

F-74

Table of Contents

Chelyabinsk Metallurgical Plant OAO

CONSOLIDATED INCOME STATEMENT

(in thousands of U.S. dollars, except share amounts)
Sales of goods:
Domestic
Export
Shipping and handling fees
Service revenue
Total revenue, net
Cost of goods sold
Cost of service revenues
Gross margin
Selling, distribution and operating expenses:
Selling and distribution expenses
Taxes other than income tax
Recovery of allowance for doubtful accounts receivable
General and administrative expenses
Other operating expenses, net
Total selling, distribution and operating expenses
Operating loss
Other income and expense:
Interest income
Interest expense
Other income, net
Foreign exchange gain, net
Total other income, net
Loss before income taxes and minority interest
Income tax benefit
Minority interest in income of subsidiaries
Net income
Basic and diluted earnings per share
Weighted average number of common shares used in computing basic and diluted earnings per share

See accompanying notes to consolidated financial sta

Table of Contents

Chelyabinsk Metallurgical Plant OAO

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands of U.S. dollars)

Cash Flows from Operating Activities
Net income
Adjustments to reconcile net income to net cash used in operating activities:
Depreciation of property, plant and equipment
Foreign exchange gain
Deferred tax benefit
Recovery of allowance for doubtful accounts receivable
Minority interest in income of subsidiaries
Gain on sale of property, plant and equipment
Loss on sale of short-term investments and other assets
Changes in assets and liabilities
Accounts receivable
Due from related parties
Inventories
Prepayments and other current assets
Other non-current assets
Trade accounts payable
Advances received
Accrued expenses and other current liabilities
Due to related parties
Restructured taxes and social charges
Net cash used in operating activities
Cash Flows from Investing Activities
Acquisition of interest in Beloretsk Metallurgical Plant
Acquisition of interest in Southern Urals Nickel Plant
Sales of investments in non-marketable securities
Purchases of property, plant and equipment
Proceeds from disposal of property, plant and equipment
Net cash used in investing activities
Cash Flows from Financing Activities
Proceeds from short-terms loans
Repayment of short-term loans
Proceeds from issuance of promissory notes, net of repayments
Net cash provided by financing activities
Effect of exchange rate changes on cash and cash equivalents
Net increase in cash and cash equivalents
Cash and cash equivalents at beginning of year
Cash and cash equivalents at end of year

Supplementary Cash Flow Information:	
Interest paid, net of capitalized	
Income taxes paid	
Non-cash Financing Activities:	
Capital leases	

See accompanying notes to consolidated financial sta

Table of Contents

Chelyabinsk Metallurgical Plant OAO

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS

	Common sha	
(in thousands of U.S. dollars, except share amounts)	Shares	Ar
Balances as of January 1, 2000	3,161,965	$
Net income		
Balances as of December 31, 2001	**3,161,965**	**$**

See accompanying notes to consolidated financial sta

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2001 and for the year then ended

(All amounts are in thousands of U.S. dollars, unless stated otherwise)

1. General Information and Business

Chelyabinsk Metallurgical Plant OAO (CMP , and together with its subsidia a subsidiary of Mechel Steel Group OAO on December 27, 2001, was incorpo upon privatization of Chelyabinsk Iron and Steel Works founded in 1943. CM subsidiaries involved in auxiliary activities.

The Company is an integrated plant, incorporating blast furnace and steel mill semi-finished steel products, carbon and specialty steel products and forgings. comprises production and sales of semi-finished steel products, carbon and sp and stainless flat products and forgings. In addition, the Company produces ch cutlery and construction materials. The Company sells its products within Rus foreign markets. Its customer base is largely comprised of steel producers and customers from the construction, engineering and ball-bearing industries.

Effective December 27, 2001, Mechel Steel Group completed the acquisition held by Glencore International AG, pursuant to the agreement dated October 3 interest of Mechel Steel Group in CMP to 82.38%.

2. Summary of Significant Accounting Policies

(a) Basis of accounting

The accompanying consolidated financial statements have been prepared in ac principles generally accepted in the United States of America (U.S. GAAP)

CMP and its subsidiaries maintain their books and records in Russian rubles a
accordance with the accounting principles and practices mandated by Russian
accompanying consolidated financial statements are based on the underlying a
appropriately adjusted and reclassified for fair presentation in accordance with

The consolidated financial statements have been prepared using the historical
by the initial valuation of property, plant and equipment as further disclosed in
consolidated financial statements.

The accompanying consolidated financial statements differ from the financial
Russian statutory purposes in that they reflect certain adjustments, not recorde
appropriate to present the financial position, results of operations and cash flo
GAAP. The principal adjustments relate to: (1) consolidation of financial posi
subsidiaries; (2) recognition of interest expense and other operating expenses;
of property and equipment; (4) foreign currency translation; (5) deferred incor
allowances for unrecoverable assets.

(b) Management s plans

For the year ended December 31, 2001, the Company incurred operating loss
negative cash flows from operations of $11,286. In addition, at December 31,
negative working capital of $71,520. The Company may experience negative
future. Achieving positive cash flow depends on the Company s ability to ge

---

F-78

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

sufficient revenues from sales of steel products and raise additional capital anc
securities markets, respectively. There can be no assurances that the Company
sufficient revenues or raise additional capital and funds to achieve and sustain
flows in the future.

The Company has historically relied principally on financing and loans from r
its cash requirements.

As of December 31, 2001, the amount available to the Company under open c
$43,000. The lender s commitment to make available the unused amount tern

Effective from December 27, 2001, Mechel Steel Group acquired control of th
anticipates that its operations will benefit from integration into Mechel Steel C
ordinarily available to the members of integrated groups. These benefits are ex
in the form of efficiencies associated with the access to the established distribu
Mechel Steel Group.

Additionally, the Company plans to continue raising funds from new loans anc

Accordingly, the management of the Company believes that the Company wil
for the foreseeable future.

(c) Basis of consolidation

The accompanying consolidated financial statements of the Company include
majority owned subsidiaries where no minority shareholder or group of minor
substantive participating rights. A subsidiary is an entity that is controlled by t
ownership, directly or indirectly, of more than 50 percent of the voting share c
means. All significant inter-company balances and transactions have been elin

Minority interests in the net assets and net results of consolidated subsidiaries
interest in the accompanying consolidated balance sheet and income stateme
minority in a consolidated subsidiary may exceed the minority interest in the r
excess, and any further losses applicable to the minority, are charged against th
the extent that the minority has a binding obligation to, and is able to, make go
subsequently reports profits, the majority interest is allocated all such profits u
losses previously absorbed by the majority has been recovered.

(d) Reporting and functional currencies

The Company determined its reporting currency to be the U.S. dollar. The Co
the Russian ruble, as the majority of its revenues, expenses, property and equi
liabilities are either priced, incurred, payable or otherwise measured in Russia

As the economy of the Russian Federation was considered highly inflationary
transactions and balances not already measured in U.S. dollars were remeasur
were the U.S. dollar, in accordance with the relevant provisions of SFAS No.
Translation . The objective of this remeasurement process is to produce the sa
reported if the accounting records had been kept in U.S. dollars. Under this me
liabilities have been translated using the exchange rate as of the balance

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

sheet dates. Non-monetary assets and liabilities, including non-current assets a stated at their actual dollar cost or are restated from their historic cost, by appl rate as at the date of the original transaction. Income and expenses are restated average exchange rates. Items in the statement of cash flows are translated at t rates and where applicable at the exchange rates on the dates of the transaction arising from remeasurement of the local currencies to U.S. dollars are included statement as Foreign exchange gain .

The Russian ruble is not convertible outside the Russian Federation. Official e daily by the Central Bank of Russia and are generally considered to be a reaso rates. The translation of ruble-denominated assets and liabilities into U.S. doll consolidated financial statements does not indicate that the Company could re reported values of the assets and liabilities. Likewise, it does not indicate that distribute the reported U.S. dollar values of capital and retained earnings to its

The official exchange rates for one U.S. dollar were 30.14 and 28.16 Russian and 2000, respectively. The weighted average exchange rate of one U.S. dolla 31, 2001, was 29.17 Russian rubles.

(e) Devaluation, inflation, and currency restrictions and controls

The Russian ruble has historically been devaluing against the U.S. dollar due t Russian Federation as well as other factors. During 2001, for instance, the Rus against the U.S. dollar while official Russian ruble inflation was 18.8%. Addit currency restrictions and controls related to converting Russian rubles into oth Russian ruble is not convertible outside of the Russian Federation and, further Russian Federation must be settled in Russian rubles. Future movements in th Russian ruble and the U.S. dollar will affect the carrying values of the Compa monetary assets and liabilities. Such movements may also affect the Company non-monetary assets represented in U.S. dollars in these consolidated financial

(f) Management estimates

The preparation of the Company s consolidated financial statements requires and assumptions that affect the reported carrying amounts of assets and liabilit assets and liabilities as of the date of the financial statements, and the amounts recognized during the reporting period. Actual results could differ from those e

(g) Property, plant and equipment, net

For the purpose of determining the opening balance sheet on the first applicati
2001, the Company performed a valuation of the property, plant and equipmen
from U.S. GAAP, as reliable historical cost information and information regar
available.

Property, plant and equipment acquired subsequent to January 1, 2001 are valu
cost less accumulated depreciation. Capitalized production costs for internally
material, direct labor costs, and allocable material and manufacturing overhead

---

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

When production activities are performed over an extended period, interest co
are capitalized. The costs of planned major maintenance activities are recorded
incurred and are not accrued in advance of the planned maintenance. Planned
include the scheduled overhauls. Costs for activities that lead to the prolongati
future use capabilities of an asset are capitalized. Maintenance and repair costs
Depreciation is calculated on property, plant and equipment on a straight-line
are available for use, over their estimated useful lives as follows:

Category of asset
Buildings
Land improvements
Transfer devices
Machinery and equipment
Transportation equipment and vehicles
Tools, furniture, fixtures and other

Construction in progress and equipment held for installation are not depreciate
ready for its intended use.

Upon sale or retirement, the acquisition or production cost and related accumu
from the balance sheet and any gain or loss is included in the consolidated inc

(h) Impairment of long-lived assets

The carrying values of long-lived assets such as property, plant and equipment
reviewed for possible impairment whenever events or changes in circumstanc
amount of an asset may not be recoverable. In the event that facts and circums
amount of any long-lived asset may be impaired, an evaluation of recoverabili
estimated future undiscounted cash flows associated with the asset would be c
amount to determine if a write-down is required. The remaining useful life of
accordingly. An impairment loss is recognized to the extent that the carrying a
discounted cash flows. No impairment was recognized in the consolidated fina
December 31, 2001, and for the year then ended.

(i) Inventories

Inventories are stated at the lower of acquisition/manufacturing cost or market
weighted average basis and includes all costs in bringing the inventory to its p
The elements of costs include direct material, labor and allocable material and

Costs of production in process and finished goods include the purchase costs c
costs such as direct labor and an allocation of fixed and variable production ov
spare parts are valued at invoice cost inclusive of freight and other shipping co

Market value is the estimated price at which inventories can be sold in the nor
allowing for the cost of completion and sale.

(j) Accounts receivable

Accounts receivable are stated at net realizable value. If receivables are uncoll
corresponding allowance for doubtful accounts is recorded. If receivables are c

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

the related receivable balance is charged off. Recoveries of receivables previo when received. Receivables that do not bear interest or bear below market inte term of more than one year are discounted with the discount subsequently amo the term of the receivable.

The Company reviews the valuation of accounts receivable on a monthly basis accounts is estimated based on historical experience of cash collections and fu that might impact the collectibility of accounts.

(k) Investments

All investment in non-marketable equity securities of less than 20% owned en

The Company did not invest in debt and marketable equity securities for the y

(l) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and deposits with banks wit months or less.

(m) Retirement benefit obligations

The Company is legally obliged to make defined contributions to the Russian Russian Federation Social Security (a defined contribution plan financed on a the Company has no legal obligation to pay and does not guarantee any future employees. Its only obligation is to pay the contributions as they fall due. If th members of the Russian State Social Security plan, it will have no obligation t own employees in previous years. The Company s contributions relating to de charged to income in the year to which they relate.

Contribution to the Russian Pension Fund together with other social contributi
unified social tax (UST), which is calculated by the application of a regress
part of the annual gross salary below 100 thousand rubles or $3 translated at th
1 U.S. dollar at December 31, 2001) to 5% (applied to the part of the annual g
rubles or $20 translated at the exchange rate of the ruble to 1 U.S. dollar at De
gross remuneration of each employee. The Company allocates the UST to thre
Russian Pension Fund), where the rate of contributions to the Russian Pension
respectively, depending on the annual gross salary of each employee.

Contributions to the Russian Pension Fund for the year ended December 31, 2

(n) Revenue recognition

Revenue is recognized on an accrual basis when earned and realizable, which
of products and rendering of services.

Product revenue is represented by sales of steel products and coke. Service rev
services consisting primarily of coke processing, supply of heating and other r

---

F-82

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Both sales of products and services are recognized net of applicable provision
and turnover taxes charged on gross revenue, primarily value added tax and ex
realizable and earned. This is usually the case when there is clear evidence of a
ownership has been transferred or the service has been rendered, the price has
adequate assurance that collection will be made.

(o) Advertising costs

Advertising costs are expensed as incurred. These costs totalled $46 for the ye

(p) Shipping and handling fees and costs

In accordance with EITF 00-10, Accounting for Shipping and Handling Fees
classifies amounts billed to customers for shipping and handling as revenue ar
distribution and operating expenses. The amount of shipping and handling fee
$17,909 for the year ended December 31, 2001.

(q) Income taxes

Provision is made in the financial statements for taxation of profits in accordar
currently in force. The Company accounts for income taxes under the liability
SFAS No. 109, Accounting for Income Taxes . Under the liability method, d
future tax consequences of temporary differences between the tax and financia
liabilities and are measured using enacted tax rates to apply to taxable income
temporary differences are expected to be recovered or settled. The effect on de
of a change in the tax rates is recognized in income in the period that includes
allowance is provided when it is more likely than not that some or all of the de
realized in the future. These evaluations are based on the expectations of futur
of the various taxable temporary differences.

The Company does not recognize deferred tax liabilities or assets for those dif
liabilities that, under SFAS No. 52 are remeasured from the local currency into
historical exchange rates and that result from changes in exchange rates or ind

(r) Comprehensive income

SFAS No. 130, Reporting Comprehensive Income , requires the reporting o
addition to net income. Accumulated other comprehensive income includes fo
adjustments, unrealized holding gains and losses on available-for-sale securiti
instruments, as well as additional pension liabilities not yet recognized as net p
year ended December 31, 2001, comprehensive income for the Company equa

(s) Financial instruments

The carrying amounts of financial instruments, consisting of cash equivalents,
receivable, trade accounts payable and short-term debt approximate their fair v

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The Company, using available market information and appropriate valuation r
has determined the estimated fair values of financial instruments. Since Russia
markets for most of the financial instruments held by the Company, very limit
values are available to assess the fair value of the Company s financial instru

The cost method investments are shares of Russian companies that are not pub
value is not available. It is not be practicable for the Company to estimate the
for which a quoted market price is not available because it has not yet obtaine
model necessary to make the estimate, and the cost of obtaining an independe
considering the materiality of the instruments to the Company. Therefore, suc
cost (see also Note 7).

The Company does not use derivative financial instruments.

(t) Concentration of credit risk

Financial instruments, which potentially expose the Company to concentratio
primarily of cash and cash equivalents, short-term and long-term investments,
other receivables.

Revenue from sales to Mechel Trading House and Mechel Trading, affiliated
December 31, 2001, amounted to $63,337 and $136,584, or 11% and 23% of t
(see Note 8).

All of the Company s workforce is represented by trade union and is covered
is routinely renewed each year. The collective agreement provides for minimu
additional benefits and certain employee protection rights. Management of the
with trade union in order to ensure the appropriate treatment of the employees
Company s business.

(u) Earnings per share

In accordance with SFAS No. 128, Earnings per Share , basic earnings per s
the weighted average number of common shares outstanding during the period
dilutive securities outstanding during the period; therefore, diluted earnings pe
share.

(v) New accounting pronouncements

Business Combination, Goodwill and Other Intangible Assets

In June 2001, the Financial Accounting Standards Board (FASB) issued SF
Combinations and SFAS No. 142, Goodwill and Other Intangible Assets .
purchase method of accounting be used for all business combinations. SFAS N
intangible assets acquired in a business combination must meet to be recognize
goodwill. SFAS No. 142 requires that goodwill and intangible assets with inde
amortized, but instead tested for impairment at least annually in accordance w
142. SFAS No. 142 also requires that intangible assets with estimable useful li
respective estimated useful lives to their estimated residual values, and review
accordance with SFAS No. 144, Accounting for the Impairment or Disposal

---

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Upon adoption of SFAS No. 142, the Company will be required to reassess th
values of all intangible assets acquired, and make any necessary amortization
of the first interim period after adoption. For intangible assets identified as hav
Company will be required to test those intangible assets for impairment in acc
SFAS No. 142 and 144.

The Company adopted the provisions of SFAS No. 141 as of July 1, 2001, and
January 1, 2002. The adoption of the provisions of SFAS No. 141 and 142 did
the Company s results of operations, financial position or cash flows.

Assets Retirement Obligations

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirem
financial accounting and reporting for obligations associated with the retireme
and the associated asset retirement costs. SFAS No. 143 requires an enterprise
asset retirement obligation as a liability in the period in which it incurs a legal
retirement of a tangible long-lived asset. SFAS No. 143 also requires the enter
amount of the related long-lived asset (i.e., the associated asset retirement cost
over the remaining useful life of the asset. The liability is adjusted at the end o
passage of time (i.e., accretion expense) and changes in the estimated future ca
fair value measurement. Once the obligation is ultimately settled, any differen
the recorded liability is recognized as a gain or loss on disposition. SFAS No.
years beginning after June 15, 2002, with early adoption encouraged. Manager
evaluating the potential impact of the adoption of SFAS No.143 on the Compa
financial position or cash flow.

Impairment and Disposal of Long-Lived Assets

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impair
Assets , which addresses financial accounting and reporting for the impairme
assets. SFAS No. 144 supersedes both SFAS No. 121, and APB Opinion No. 3
Operations Reporting the Effects of Disposal of a Segment of a Business, and
Infrequently Occurring Events and Transactions . However, SFAS No. 144 re
provisions of SFAS No. 121 and retains the requirement in Opinion No. 30 to
operations and extends that reporting to a component of an entity that eithe
abandonment, or in a distribution to owners) or is classified as held for sale. T
144 as of January 1, 2002. The adoption of the provisions of SFAS No. 144 di
the Company s results of operations, financial position or cash flow.

Guarantees

In November 2002, the FASB issued Interpretation No. 45, Guarantor s Acc
Requirements for Guarantees, Including Indirect Guarantees of Indebtedness o
requires that upon issuance of certain types of guarantees, a guarantor recogni
value of the guarantee as a liability. The initial recognition and measurement p
applied on a prospective basis for guarantees issued or modified after Decemb
requirements of FIN 45 are effective for financial statements of both interim a
December 15, 2002. The adoption of the provisions of FIN No. 45 is not expec
on the Company s results of operations, financial position or cash flows.

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Consolidation of Variable Interest Entities

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Va
FIN 46 amended Accounting Research Bulletin No. 51, Consolidated Financia
established standards for determining under what circumstances a variable inte
consolidated with its primary beneficiary. FIN 46 also requires disclosures abo
required to consolidate but in which it has a significant variable interest. On D
deferred the effective date of FIN 46 to no later than the end of the first report
15, 2004, however, for special-purpose entities the public companies are requi
of the calendar year ending on December 31, 2003. The adoption of FIN No. 4
impact on the Company s results of operations, financial position or cash flow

3. Accounts Receivable, net

Accounts receivable, net are comprised of the following at December 31, 2001

Receivables for domestic sales
Receivables for export sales
Other receivables
Total accounts receivable
Less allowance for doubtful accounts
Total accounts receivable, net

The following summarizes the changes in the allowance for doubtful accounts
31, 2001:

Balance at the beginning of the year
Recovery of allowance
Exchange rate difference from remeasurement
Balance at the end of the year

4. Inventories

Inventories are comprised of the following at December 31, 2001:

Finished goods
Raw materials and purchased parts
Work in process
Total inventories

5. Prepayments and Other Current Assets

Prepayments and other current assets are comprised of the following at Decem

Input VAT and other taxes recoverable
Prepayments and advances for materials
Receivable on transportation
Receivable from tenants for rent of property
Other current assets
Total prepayments and other current assets

F-86

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The Company has the legal right to offset VAT paid on purchases, subject to c
charged to customers related to sales to the extent the Company disbursed casl
Company records VAT receivable in the balance sheet gross to the extent such
VAT received from customers.

6. Property, Plant and Equipment, net

Property, plant and equipment, net consisted of the following at December 31,

Land improvements
Buildings
Transfer devices
Machinery and equipment
Transport equipment
Tools, furniture, fixtures and other
Accumulated depreciation
Construction in progress
Total property, plant and equipment

As disclosed in Note 2(g) above, for the purpose of determining the opening b
and equipment on the first application of U.S. GAAP at January 1, 2001, the C
of the property, plant and equipment, as reliable historical cost information an
acquisition dates was not available.

The Company leases certain equipment under non-cancelable capital leases. A
obligations under capital leases amounted to $345 and were classified as curre
2001, the cost of leased equipment included in the carrying amount of property
related accumulated depreciation amounted to $711 and $21, respectively. Dep
and own assets are reported in the statement of operations in cost of sales and

Included in construction in progress are advances to suppliers of equipment of
December 31, 2001 and 2000, respectively.

Interest capitalized in the cost of property, plant and equipment during the yea
comprised $791.

7. Investments

Investments in non-marketable equity securities are comprised of the followin

Beloretsk Metallurgical Plant (BMP)	
Southern Urals Nickel Plant (SUNP)	
Other non-marketable equity securities	
Total long-term investments	

In August 2001, the Company acquired from related and unrelated parties 9.68
in BMP and SUNP for $1,731 and $1,742, respectively. Investments in BMP a
using the cost method.

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The fair values of the above listed investments are not presented in the accomp
statements as they are not readily determinable due to the fact that there is no a
Russian Federation and the information on pricing in single transactions is not
these transactions.

8. Related Party Transactions

During the year ended December 31, 2001, the Company had transactions or b
related parties:

- Ø BMP (an entity in which the Company had ownership interest of 9.68%
- Ø SUNP (an entity in which the Company had ownership interest of 10% Mechel Steel Group)
- Ø Arshan (an entity affiliated with Mechel Steel Group)
- Ø Omega-99 (an entity affiliated with Mechel Steel Group)
- Ø Mechel Trading House (an entity affiliated with Mechel Steel Group)
- Ø Uglemetbank (an entity affiliated with Mechel Steel Group)
- Ø Southern Kuzbass Coal Company (an entity affiliated with Mechel Stee
- Ø Mechel Trading AG (an entity affiliated with Mechel Steel Group)
- Ø Belsize (an entity affiliated with Mechel Steel Group)
- Ø Gordia (an entity affiliated with Mechel Steel Group)

- Ø Inter-Rail (an entity affiliated with Mechel Steel Group)

Amounts due from related parties consisted of the following at December 31,

Trade receivables:
BMP
SUNP
Arshan
Mechel Trading House
Mechel Trading
Advances issued to:
BMP
Mechel Trading House
Uglemetbank
Total due from related parties

The amounts due from BMP of $8 and $697 represented its obligations to the
and advances issued by the Company for producing hardware products from s
respectively. Sales to BMP amounted to $228 in 2001.

The amount due from SUNP of $14 represented its obligations to the Compan
amounted to $15 in 2001.

F-88

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The amount due from Arshan of $4,609 represented its obligations to the Com
Sales to Arshan amounted to $13,697 in 2001.

The amounts due from Mechel Trading House of $3,449 and $11,448 represen
Company for steel products and coke sold and advances issued by the Compar
respectively. Sales to Mechel Trading House amounted to $63,337 in 2001.

The amount due from Uglemetbank of $1,759 represented cash in transit paid
Trading House as a prepaid of raw materials, coal and other supplies.

Sales to Southern Kuzbass Coal Company amounted to $106 in 2001. The amo
Kuzbass Coal Company was zero at December 31, 2001.

The amount due from Mechel Trading of $2,796 represented its obligations to
sold. Sales to Mechel Trading amounted to $136,584 in 2001.

Amounts due to related parties consisted of the following at December 31, 200

Trade payables:
BMP
Arshan
Mechel Trading House
Mechel Trading
Omega-99
Inter-Rail
Advances received from:
BMP
Arshan
Mechel Trading House
Mechel Trading
Loans received from:

Uglemetbank	
Belsize	
Gordia	
Total due to related parties	

The amount due to BMP of $576 and $1 represented the Company s obligatio
products from steel billets provided and advances received for steel billets, res
amounted to $2,133 in 2001, of which $2,133 were included in cost of sales in
consolidated financial statements.

The amounts due to Arshan of $27,052 and $230 represented the Company s
coal and other supplies and advances received for steel products, respectively.
amounted to $68,215 in 2001, of which $68,215 were included in cost of sales
consolidated financial statements.

The amounts due to Mechel Trading House of $29,648 and $265 represented t
purchase of 9% ownership interest in SUNP, raw materials, coal and other sup

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

received for steel products, respectively. Purchases from Mechel Trading Hou
2001, of which $90,301 were included in cost of sales in the accompanying co
The Company purchased 54,000 shares of SUNP from Mechel Trading House

The amounts due to Mechel Trading of $399 and $401 represented the Compa
and advances received for steel products, respectively. Purchases from Meche
2001, of which $3,872 were included in cost of sales in the accompanying con

The amount due to Omega-99 of $169 represented the Company s obligations
interest in SUNP. There were no other transactions with Omega-99 during 200

The amounts due to Uglemetbank of $560 represented short-term Russian rub
annual interest rate of 22% and maturing at different dates throughout 2002. D
recognized interest expense of $40 in respect to the loans received from Uglen

At December 31, 2001, the Company owed $29,726 and $17,726 in zero inter
payable on demand to Belsize and Gordia, respectively. These instruments we
Group from predecessor owner as a result of acquisition of control of the Com

At December 31, 2001, the Company owed $6,164 in accounts payable to Inte
were acquired by Mechel Steel Group from predecessor owner as a result of ac
Company in December 2001.

9. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following at De

Taxes and social charges on payroll payable
Current portion of restructured taxes and contributions to the Russian Pension Note 10)
Accrued expenses

Other accounts payable

Total accrued expenses and other current liabilities

10. Restructured Taxes and Social Charges Payable

During 2000 through 2001, the Company entered into agreements with tax and restructure the amounts and timing of payments of liabilities related to taxes o added tax and road users tax) and contributions due to the Russian National Pe fines and penalties. Prior to the restructuring, a significant portion of these liab penalties were overdue and payable with short maturities and were accrued by conclusion of the restructuring agreements, overdue taxes and charges accrued quarterly installments within six years; and related fines and penalties became conditions were not met. Subject to timely payment of at least 50% of all the r of taxes and charges within two years on schedule, and the full and timely pay accrued, a 50%-portion of the restructured fines and penalties will be forgiven payment of the remaining restructured principal amounts of taxes and charges and the full and timely payment of current taxes being

F-90

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

accrued, the remaining 50% of the restructured fines and penalties will be forg
taxes and charges are subject to interest of 5.5% p.a., payable in equal quarterl
fines and penalties do not bear interest.

Contributions to the Russian Pension Fund and 15% of the related fines and pe
quarterly installments over five years. Subject to full repayment of the restruct
the Russian Pension fund and payment of at least 15% of the fines and penaltie
well as the full and timely payment of current contributions, the remaining 85
penalties related to the contributions to the Russian Pension Fund will be forgi
contributions to the Russian Pension Fund, fines and penalties related thereto,

Restructured taxes, contributions to the Russian Pension Fund and fines and pe
follows at December 31, 2001:

Restructured taxes
Restructured fines and penalties on tax delinquencies
Restructured contributions to the Russian Pension Fund
Restructured fines and penalties on Russian Pension Fund contributions delinc
Total
Less current portion
Non-current portion

Restructured taxes, contributions to the Russian Pension Fund and fines and pe
repayments over the five-year period beginning on January 1, 2002 are as follo

2002
2003
2004
2005
2006
2007 and thereafter
Total

11. SHORT-TERM DEBT

Short-term debt is comprised of the following at December 31, 2001:

Russian ruble denominated:
Banks and Financial Institutions
Corporate Lenders
U.S. dollar denominated:
Banks and Financial Institutions
Total

* *Based on the year-end balances and year-end interest rates*

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The loans from financial institutions are collateralized by raw materials, finish
and equipment.

In October 2001, the Company entered into a credit line agreement with a lenc
activities in the amount of $50,000. Amounts drawn under the facility bear an
annum and mature in October 2002. As of December 31, 2001, the amount ava
this credit line approximated $43,000. The lender s commitment to make avai
terminates in October 2002.

Amounts owed to corporate lenders are represented by no interest bearing pror
Company which are payable on demand.

12. Shareholders Equity

Capital stock

The capital stock of CMP consists of 3,161,965 common shares with par value
have been authorized and issued in 1993.

Distribution of statutory earnings

In accordance with Russian legislation, the Company and its subsidiaries can c
or transfer them to reserves. Dividends may only be declared from accumulate
earnings as shown in the Russian statutory financial statements. Dividends are
withholding tax, which can be reduced or eliminated if paid to foreign owners
tax treaties.

At December 31, 2001, no amounts were available for dividends as CMP had
million Russian rubles (or $101,000) in accordance with Russian statutory fina
subsidiaries had 18,990 thousand Russian rubles (or $630) available for distrib

13. Income Taxes

The income tax benefit consisted of the following for the year ended Decembe

Current income taxes	
Deferred income taxes	
Total provision for income taxes	

Income tax is calculated at 30% of taxable profit in 2001 in accordance with th
Federation. Effective January 1, 2002, the Russian Federation profit tax rate w
was enacted in August 2001 and taken into account when computing tax effec
December 31, 2001. A reconciliation between the income tax benefit compute
tax rate to the pre tax loss presented in the accompanying financial statements
taxes reported in the accompanying financial statements is as follows:

Income tax benefit computed on pre-tax loss at statutory tax rate of 30%	
Tax effect of permanent differences:	
U.S. GAAP currency translation gain not income for statutory tax purposes	
The benefit from operating loss carryforward	
Non-deductible expenses	
Other permanent differences	
Tax effect of the change in tax rate	
Income tax benefit reported in the financial statements	

F-92

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The deferred tax balances were calculated by applying the presently enacted st
jurisdiction applicable to the period in which the temporary differences betwe
base of assets and liabilities are expected to reverse. The amounts reported in t
financial statements at December 31, 2001, consisted of the following:

Deferred tax assets current:
Inventory written off for U.S. GAAP purposes not taken as deductible expense purposes
Trade and other accounts receivable written off for U.S. GAAP purposes not t expense for income tax purposes
Loss available for carry-forward
Allowance for doubtful accounts receivable
Total current deferred tax assets
Deferred tax assets non-current:
Loss available for carry-forward
Capital leases and other
Total non-current deferred tax assets
Total deferred tax assets

Deferred tax liabilities current:
Accounts receivable
Other
Total current deferred tax liabilities
Deferred tax liabilities non-current:
Property, plant and equipment
Other
Total non-current deferred tax liabilities
Total deferred tax liabilities

For Russian income tax purposes, the Company has accumulated tax losses, w
use against future income within 10 years. Their use is restricted to a maximu
Tax loss carry forwards may be eroded by future devaluation of the ruble. As
Russian income tax purposes, the Company has tax losses available to carry f

expiring at December 31, 2008.

14. Taxes Other Than Income Tax

Taxes other than income tax for the year ended December 31, 2001, are compr

Property and land tax	
Road users tax	
Other taxes and penalties	
Total taxes other than on income	

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

15. Revenues

Domestic revenue includes shipments to customers domiciled in the Russian F
includes shipments made to customers located in foreign countries, including r
of Independent States, other than Russia. Revenues for the year ended Decemb
the following:

Metal products	
Coal and coke	
Sales of goods	
Shipping and handling fee	
Service revenue	
Total revenues	

16. Cost of Sales

Cost of sales for the year ended December 31, 2001, are comprised of the follo

Raw materials	
Salary and social charges	
Repair and maintenance	
Depreciation	
Other	
Total cost of sales	

17. Commitments and Contingencies

Commitments

As of December 31, 2001, the Company had a commitment of $642 under non term of which did not commence. As of December 31, 2001, the equipment su was not delivered to the Company.

Contingencies

(a) General

The Russian economy continues to display certain traits consistent with that of These characteristics include periods of high inflation, lack of liquidity in the c existence of currency controls, which cause the national currency to be illiquic continued success and stability of the Russian economy will be significantly a continued actions with regard to supervisory, legal, and economic reforms.

(b) Taxation

The Company is a subject to taxation in Russia. The Russian tax system contin include value added tax, corporate income tax (profit tax), turnover-based taxe others. Laws related to these taxes have been adopted only recently, in contras economies; and implementing regulations are often unclear or nonexistent. Ma regulations introduced in 2002 and previous years were not always clearly

---

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

drafted and their interpretation is subject to the opinions of local tax authoritie
Ministry of Finance. Instances of inconsistent opinions between local, regiona
between the Central Bank and the Ministry of Finance are not unusual, and fev
issues have been established. Tax declarations, together with other legal comp
customs and currency control matters) are subject to review and investigation
are enabled by law to impose severe fines, penalties and interest charges. Thes
substantially more significant than typically found in countries with more dev

In Russia, generally, tax declarations remain open and subject to inspection fo
fact that a year has been reviewed does not close that year, or any tax declarati
further review during the three year period.

Management believes that it has paid or accrued all taxes that are applicable. V
the amount, the Company has accrued tax liabilities based on management s l

As of December 31, 2001, the Company does not believe that any other mater
Company, including pending or future governmental claims and demands, whi
the accompanying financial statements in order for those statements not to be
misleading.

(c) Litigation, claims and assessments

The Company is subject to various lawsuits, claims and proceedings related to
business. In the opinion of management, the Company s liability, if any, in al
proceeding or other matters would not have a material effect upon the financia
operations or liquidity of the Company.

The Russian legal system, which regulates the Company s business, is charac
between and among laws, presidential decrees, and Russian governmental, mi
decisions, and resolutions and other acts; (2) conflicting local, regional and fec
the lack of judicial and administrative guidance on interpreting legislation; (4)
judges and courts in interpreting legislation; and (5) a high degree of discretion
authorities. Management is unable to estimate what developments may occur c
such developments on the Company s financial condition or future results of c

The Company s operations and financial position will continue to be affected
developments, including the application of existing and future legislation and
of such occurrences and their effect on the Company could have a significant i
to continue operations.

(d) Environmental

In the course of the Company s operations, the Company may be subject to en
proceedings. The quantification of environmental exposures requires an assess
including changing laws and regulations, improvements in environmental tech
information available related to specific sites, the assessment stage of each site
findings and the length of time involved in remediation or settlement. Manage
pending environmental claims or proceedings will significantly impair the Co
material adverse effect on its financial position.

Table of Contents

Chelyabinsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

18. Subsequent Events

On February 4, 2003, the Company issued 1,000,000 Ruble-denominated bonc
amount of 1 billion Rubles (approximately $31 million). The bonds were issue
Interest is payable every six months. The interest rate for the first coupon peri
issuance based on the bids of buyers and comprised 16.85% p.a. The interest r
fifth coupon periods is set by the Company and is made public 10 days before
starts. Bondholders are entitled to redeem the bonds at face value before the se
periods start if the interest rates announced are perceived to be low. The intere
coupon periods are set as equal to the rate for the immediately preceding coup
guaranteed by Southern Kuzbass Coal Company. The obligatory redemption d
2006. The total commission and issue costs amounted to $332.

Table of Contents

Beloretsk Metallurgical Plant OAO

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING

Shareholders and Board of Directors

Beloretsk Metallurgical Plant OAO

We have audited the accompanying consolidated balance sheet of Beloretsk M
open joint stock company, and its subsidiaries (hereinafter referred to as the
and the related consolidated statements of operations, cash flows and changes
period starting from January 1, 2002 through June 14,2002. These financial sta
of the Company s management. Our responsibility is to express an opinion or
on our audit.

We conducted our audit in accordance with the standards of the Public Compa
(United States). Those standards require that we plan and perform the audit to
about whether the financial statements are free of material misstatement. An a
test basis, evidence supporting the amounts and disclosures in the financial sta
assessing the accounting principles used and significant estimates made by ma
the overall financial statement presentation. We believe that our audit provides
opinion.

As more fully described in Note 2(g) to the consolidated financial statements,
equipment as of January 1, 2002, has been recorded at appraised values rather
required by accounting principles generally accepted in the United States.

In our opinion, except for the effects of the matter discussed in the preceding p
statements referred to above present fairly, in all material respects, the consoli
Company at June 14, 2002, and the consolidated results of its operations and i
starting from January 1, 2002 through June 14, 2002, in conformity with accou
accepted in the United States.

/s/ Ernst & Young (CIS) Limited

June 30, 2004

Moscow, Russia

Table of Contents

Beloretsk Metallurgical Plant OAO

CONSOLIDATED BALANCE SHEET

(in thousands of U.S. dollars, except share amounts)

ASSETS
Cash and cash equivalents
Accounts receivable, net of allowance for doubtful accounts of $2,496
Due from related parties
Inventories
Deferred income taxes
Prepayments and other current assets
Total current assets
Property, plant and equipment, net
Investments in affiliates
Total assets
LIABILITIES AND SHAREHOLDERS EQUITY
Short-term debt
Accounts payable and accrued expenses:
Trade accounts payable
Advances received
Accrued expenses and other current liabilities
Due to related parties
Total current liabilities
Restructured taxes and social charges payable, net of current portion
Deferred income taxes
Commitments and contingencies
SHAREHOLDERS EQUITY
Common shares (1 Russian ruble par value); 1,209,978,307 shares authorized; shares issued and outstanding
Preferred shares (1 Russian ruble par value); 90,743,507 shares authorised, 56 shares issued and outstanding
Retained earnings
Total shareholders equity
Total liabilities and shareholders equity

See accompanying notes to consolidated financial sta

F-98

Table of Contents

Beloretsk Metallurgical Plant OAO

CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands of U.S. dollars, except share amounts)	**N**
Sales of goods:	
Domestic	
Export	
Shipping and handling fees	
Service revenue	
Total revenue, net	
Cost of goods sold	
Cost of service revenue	
Selling, distribution and operating expenses:	
Selling and distribution expenses	
Taxes other than income tax	
General and administrative expenses	
Other operating expenses, net	
Total selling, distribution and operating expenses	
Operating loss	
Other income and expense:	
Interest expense	
Other income, net	
Foreign exchange gain, net	
Total other income, net	
Loss before income taxes	
Income tax benefit	
Net loss	
Basic and diluted loss per share	
Weighted average number of common shares used in computing basic and diluted loss per share	

See accompanying notes to consolidated financial sta

Table of Contents

Beloretsk Metallurgical Plant OAO

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands of U.S. dollars)

Cash Flows from Operating Activities	
Net loss	
Adjustments to reconcile net loss to net cash provided by operating activities:	
Depreciation of property, plant and equipment	
Foreign exchange gain	
Deferred tax benefit	
Provision for doubtful accounts receivable	
Changes in assets and liabilities	
Accounts receivable	
Due from related parties	
Inventories	
Prepayments and other current assets	
Trade accounts payable	
Due to related parties	
Taxes and social charges	
Net cash provided by operating activities	
Cash Flows from Investing Activities	
Sales of investments in non-marketable securities	
Purchases of property, plant and equipment	
Net cash used in investing activities	
Cash Flows from Financing Activities	
Proceeds from short-term loans	
Repayment of short-term loans	
Net cash used in financing activities	
Effect of exchange rate changes on cash and cash equivalents	
Net increase in cash and cash equivalents	
Cash and cash equivalents at beginning of the period	
Cash and cash equivalents at end of the period	
Supplementary Cash Flow Information:	
Interest paid	
Income taxes paid	

See accompanying notes to consolidated financial sta

F-100

Table of Contents

Beloretsk Metallurgical Plant OAO

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS

(in thousands of U.S. dollars, except share amounts)	Common shares		Preferre
	shares	amount	shares
Balances as of January 1, 2002	7,466,842	$ 3,995	562,305
Net loss			
Balances as of June 14, 2002	**7,466,842**	**$ 3,995**	**562,305**

See accompanying notes to consolidated financial sta

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of June 14, 2002 and for the period starting from January 1, 2002 th

(All amounts are in thousand of U.S. dollars, unless stated otherwise)

1. General Information and Business

Beloretsk Metallurgical Plant OAO (BMP , and together with its subsidiarie subsidiary of Mechel Steel Group OAO on June 14, 2002, was incorporated or privatisation of this formerly state-owned entity. BMP has a number of subsid activities.

The Company is a hardware plant located in the southern Ural mountains in R wire rod and a broad range of hardware. The Company sells its products withi CIS and Baltics (2%) and other foreign markets (2%). The Company s custon different manufacturing companies and customers from the construction and e Company has license for mining operations at Pugachev limestone mineral de mine was developed to support Company s iron and steel plant in 1951. In 20 mining operations and during the period starting from January 1, 2002 through limestone were insignificant.

At different dates through June 14, 2002, Mechel Steel Group acquired a total of BMP. Prior to June 14, 2002, Mechel Steel Group did not have control over influence through its ownership of 33.3% of the voting shares, which were acc December 27, 2001. Subsequently in December 2002, Mechel Steel Group acc voting shares of BMP. On November 5, 2003, Mechel Steel Group purchased common shares of BMP. As a result, Mechel Steel Group increased its interest

2. Summary of Significant Accounting Policies

(a) Basis of accounting

The accompanying consolidated financial statements have been prepared in ac principles generally accepted in the United States of America (U.S. GAAP)

BMP and its subsidiaries maintain their books and records in Russian rubles ar
accordance with the accounting principles and practices mandated by Russian
accompanying consolidated financial statements are based on the underlying a
appropriately adjusted and reclassified for fair presentation in accordance with

The consolidated financial statements have been prepared using the historical
by the initial valuation of property, plant and equipment as further disclosed in
consolidated financial statements.

The accompanying consolidated financial statements differ from the financial
Russian statutory purposes in that they reflect certain adjustments, not recorde
appropriate to present the financial position, results of operations and cash flo
GAAP. The principal adjustments relate to: (1) consolidation of financial posi
subsidiaries; (2) recognition of interest expense and other operating expenses;
of property and equipment; (4) foreign currency translation; (5) deferred incon
allowances for unrecoverable assets.

F-102

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(b) Management s plans

For the period starting from January 1, 2002 through June 14, 2002, the Comp
of $10,248 and experienced positive cash flows from operations of $2,671. In
Company had negative working capital of $30,783. The Company may experi
operations in the future. Achieving positive cash flow depends on the Compan
revenues from sales of wire rod and hardware products and raise additional ca
debt securities markets, respectively. There can be no assurance that the Comp
sufficient revenues or raise additional capital and funds to achieve and sustain
flows in the future.

Effective from June 14, 2002, Mechel Steel Group OAO acquired control of th
anticipates that its operations will benefit from integration into Mechel Steel G
ordinarily available to the members of integrated groups. These benefits are ex
in the form of efficiencies associated with the access to the established distribu
Mechel Steel Group.

Accordingly, the management of the Company believes that the Company wil
for the foreseeable future.

(c) Basis of consolidation

The accompanying consolidated financial statements of the Company include
majority owned subsidiaries where no minority shareholder or group of minor
substantive participating rights. A subsidiary is an entity that is controlled by t
ownership, directly or indirectly, of more than 50 percent of the voting share c
means. All significant inter-company balances and transactions have been elin

(d) Reporting and functional currencies

The Company has determined its reporting currency to be the U.S. dollar. The
is the Russian ruble, as the majority of its revenues, expenses, property and eq
trade liabilities are either priced, incurred, payable or otherwise measured in R

As the economy of the Russian Federation was considered highly inflationary
transactions and balances not already measured in U.S. dollars were remeasur
were the U.S. dollar, in accordance with the relevant provisions of Statement o
Standards (SFAS) No. 52, Foreign Currency Translation . The objective of t
produce the same results that would have been reported if the accounting reco
dollars. Under this method, monetary assets and liabilities have been translate
the balance sheet date. Non-monetary assets and liabilities, including non-curr
equity, are stated at their actual dollar cost or are restated from their historic c
exchange rate as at the date of the original transaction. Income and expenses a
monthly average exchange rates. Items in the statement of cash flows are trans
exchange rates and where applicable at the exchange rates on the dates of the t
differences arising from remeasurement of the local currencies to U.S. dollars
statement of operations as Foreign exchange gain .

The Russian ruble is not convertible outside the Russian Federation. Official e
daily by the Central Bank of Russia and are generally considered to be a reaso

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

approximation of market rates. The translation of ruble-denominated assets an the purpose of these consolidated financial statements does not indicate that th settle in U.S. dollars the reported values of the assets and liabilities. Likewise, Company could return or distribute the reported U.S. dollar values of capital a shareholders.

The official exchange rates for one U.S. dollar were 31.31 and 30.14 Russian r January 1, 2002, respectively. The weighted average exchange rate of one U.S from January 1, 2002 through June 14, 2002, was 30.94 Russian rubles.

(e) Devaluation, inflation, and currency restrictions and controls

The Russian ruble has historically been devaluing against the U.S. dollar due t Russian Federation as well as other factors. During the period starting from Ja 2002, for instance, the Russian ruble devalued by 3.9% against the U.S. dollar inflation was 8.6%. But during 2003 the Russian ruble appreciated in normal t dollar (versus depreciation in 2002 5.7%) while official Russian ruble inflatio exchange rate as of June 30, 2004 is 29.03 Russian rubles for one U.S. dollar.

Additionally, there are significant currency restrictions and controls related to other currencies. As of June 30, 2004, the Russian ruble is not convertible outs and, furthermore, all transactions within the Russian Federation must be settle movements in the exchange rate between the Russian ruble and the U.S. dollar of the Company s Russian ruble-denominated monetary assets and liabilities. the Company s ability to realize non-monetary assets represented in U.S. doll financial statements.

(f) Management estimates

The preparation of the Company s consolidated financial statements requires and assumptions that affect the reported carrying amounts of assets and liabilit assets and liabilities as of the date of the financial statements, and the amounts recognized during the reporting period. Actual results could differ from those

(g) Property, plant and equipment, net

For the purpose of determining the opening balance sheet on the first applicati
2002, the Company performed a valuation of the property, plant and equipmen
from U.S. GAAP, as reliable historical cost information and information regar
available.

Property, plant and equipment acquired subsequent to January 1, 2002 are valu
cost less accumulated depreciation. Capitalized production costs for internally
material, direct labor costs, and allocable material and manufacturing overhea
activities are performed over an extended period, interest costs incurred during
The costs of planned major maintenance activities are recorded as the costs ar
accrued in advance of the planned maintenance. Planned major maintenance a
overhauls. Costs for activities that lead to the prolongation of useful life or to
of an asset are capitalized. Maintenance and repair costs are expensed as incur

F-104

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Depreciation is calculated on property, plant and equipment on a straight-line
are available for use, over their estimated useful lives as follows:

Category of asset
Buildings
Land improvements
Transfer devices
Machinery and equipment
Transportation equipment and vehicles
Tools, furniture, fixtures and other

Construction in progress and equipment held for installation are not depreciate
ready for its intended use.

Upon sale or retirement, the acquisition or production cost and related accumu
from the balance sheet and any gain or loss is included in the consolidated inc

(h) Impairment of long-lived assets

The carrying values of long-lived assets such as property, plant and equipment
reviewed for possible impairment whenever events or changes in circumstance
amount of an asset may not be recoverable. In the event that facts and circums
amount of any long-lived asset may be impaired, an evaluation of recoverabili
estimated future undiscounted cash flows associated with the asset would be c
amount to determine if a write-down is required. The remaining useful life of
accordingly. An impairment loss is recognized to the extent that the carrying a
discounted cash flows. No impairment was recognized in the consolidated fina
2002, and for the period starting January 1, 2002 through June 14, 2002.

(i) Inventories

Inventories are stated at the lower of acquisition/manufacturing cost or market
weighted average basis and includes all costs in bringing the inventory to its p

The elements of costs include direct material, labor and allocable material and

Costs of production in process and finished goods include the purchase costs c
costs such as direct labor and an allocation of fixed and variable production ov
spare parts are valued at invoice cost inclusive of freight and other shipping co

Lime stone inventory costs include labor, supplies, depreciation of equipment,
other related costs.

Market value is the estimated price at which inventories can be sold in the nor
allowing for the cost of completion and sale.

(j) Accounts receivable

Accounts receivable are receivables for production and services sold to custon
activity. Accounts receivable are stated at net realizable value. If receivables a

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

bad debt expense and a corresponding allowance for doubtful accounts is reco
uncollectible the related receivable balance is charged off. Recoveries of recei
are recorded when received. Receivables that do not bear interest or bear belov
an expected term of more than one year are discounted with the discount subse
income over the term of the receivable.

The Company reviews the valuation of accounts receivable on a regular basis.
accounts is estimated based on historical experience of cash collections and fu
that might impact the collectibility of accounts.

(k) Investments

All investments in non-marketable equity securities of less than 20% owned er
The Company did not invest in debt and marketable equity securities for the p
2002 through June 14, 2002.

(l) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and deposits with banks wit
months or less.

(m) Retirement benefit obligations

The Company is legally obliged to make defined contributions to the Russian
Russian Federation Social Security (a defined contribution plan financed on a
the Company has no legal obligation to pay and does not guarantee any future
only obligation is to pay the contributions as they fall due. If the Company cea
State Social Security plan, it will have no obligation to pay the benefits earned
previous years. The Company s contributions to the Russian Pension Fund rel
plans are charged to income in the year to which they relate.

Contribution to the Russian Pension Fund together with other social contributi
unified social tax (UST), which is calculated by the application of a regress
part of the annual gross salary below 100 thousand Rubles or approximately $
of the Ruble to the U.S. dollar at June 14, 2002) to 5% (applied to the part of t
600 thousand Rubles or approximately $19 translated at the exchange rate of t
June 14, 2002) to the annual gross remuneration of each employee. The Comp
social funds (including the Russian Pension Fund), where the rate of contribut
Fund varies from 28% to 5%, respectively, depending on the annual gross sala
Contributions to the Russian Pension Fund for the period starting from Januar
2002, were $2,077.

(n) Revenue recognition

Revenue is recognized on an accrual basis when earned and realizable, which
of products and rendering of services.

Sales of wire rod and a broad range of hardware represent product revenue. Se
of services consisting primarily of steel processing and other minor services.

Both sales of products and services are recognized net of applicable provision
and turnover taxes charged on gross revenue, primarily value added tax and ex

---

F-106

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

when realized or realizable and earned. This is usually the case when there is c the risk of ownership has been transferred or the service has been rendered, th and there is adequate assurance that collection will be made.

(o) Shipping and handling fees and costs

In accordance with EITF 00-10, Accounting for Shipping and Handling Fees classifies amounts billed to customers for shipping and handling as revenue an distribution and operating expenses. The amount of shipping and handling fee $1,006 for the period starting from January 1, 2002 through June 14, 2002.

(p) Income taxes

A provision is made in the financial statements for taxation of profits in accord currently in force. The Company accounts for income taxes under the liability SFAS No. 109, Accounting for Income Taxes . Under the liability method, d future tax consequences of temporary differences between the tax and financia liabilities and are measured using enacted tax rates to apply to taxable income temporary differences are expected to be recovered or settled. The effect on de of a change in the tax rate is recognized in income in the period that includes t allowance is provided when it is more likely than not that some or all of the de realized in the future. These evaluations are based on the expectations of futur of the various taxable temporary differences.

The Company does not recognize deferred tax liabilities or assets for those dif liabilities that, under SFAS No. 52 are remeasured from the local currency into historical exchange rates and that result from changes in exchange rates or ind

(q) Comprehensive income

SFAS No. 130, Reporting Comprehensive Income , requires the reporting o addition to net income. Accumulated other comprehensive income includes fo adjustments, unrealised holding gains and losses on available-for-sale securiti

instruments, as well as additional pension liabilities not yet recognized as net p
period starting from January 1, 2002 through June 14, 2002, comprehensive lo
the net loss.

(r) Financial instruments

The carrying amounts of financial instruments, consisting of cash equivalents,
receivable, trade accounts payable and short-term debt approximate their fair v

The Company, using available market information and appropriate valuation m
has determined the estimated fair values of financial instruments. Since the Ru
markets for most of the financial instruments held by the Company, very limit
values are available to assess the fair value of the Company s financial instrur

The cost method investments are shares of Russian companies that are not pub
value is not available. It is not practicable for the Company to estimate the fair

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

investments for which a quoted market price is not available because it has no valuation model necessary to make the estimate, and the cost of obtaining an i excessive considering the materiality of the instruments to the Company. Ther recorded at cost.

The Company does not use derivative financial instruments.

(s) Concentration of credit risk

Financial instruments, which potentially expose the Company to concentration primarily of cash and cash equivalents, trade accounts receivable, taxes recove

All of the Company s workforce is represented by a trade union and is covere is routinely renewed each year. The collective agreement provides for minimu additional benefits and certain employee protection rights. Management of the with trade unions to ensure the appropriate treatment of the employees and the business.

Revenue from sales to Mechel Trading House OOO, Chelyabinsk Metallurgic Trading AG, affiliated companies, for the period starting from January 1, 200 amounted to $13,640, $3,470 and $1,150, or 40%, 10% and 3% of the total re

(t) Earnings per share

In accordance with SFAS No. 128, Earnings per Share , basic earnings per s the weighted average number of common shares outstanding during the perio dilutive securities outstanding during the period; therefore, diluted earnings pe share.

(u) New accounting pronouncements

Business Combination, Goodwill and Other Intangible Assets

In June 2001, the Financial Accounting Standards Board (FASB) issued SF Combinations and SFAS No. 142, Goodwill and Other Intangible Assets . purchase method of accounting be used for all business combinations. SFAS N intangible assets acquired in a business combination must meet to be recogniz goodwill. SFAS No. 142 requires that goodwill and intangible assets with inde amortized, but instead tested for impairment at least annually in accordance w 142. SFAS No. 142 also requires that intangible assets with estimable useful li respective estimated useful lives to their estimated residual values, and review accordance with SFAS No. 144, Accounting for the Impairment or Disposal

The Company adopted the provisions of SFAS No. 141 as of July 1, 2001, and January 1, 2002. The adoption of the provisions of SFAS No. 141 and 142 did the Company s results of operations, financial position or cash flows.

Assets Retirement Obligations

In June 2001, the FASB issued SFAS No. 143, Accounting for Asset Retirem financial accounting and reporting for obligations associated with the retireme

---

F-108

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

long-lived assets and the associated asset retirement costs. SFAS No. 143 requ
fair value of an asset retirement obligation as a liability in the period in which
associated with the retirement of a tangible long-lived asset. SFAS No. 143 als
increase the carrying amount of the related long-lived asset (i.e., the associated
depreciate that cost over the remaining useful life of the asset. The liability is a
period to reflect the passage of time (i.e., accretion expense) and changes in th
underlying the initial fair value measurement. Once the obligation is ultimately
between the final cost and the recorded liability is recognized as a gain or loss
SFAS No. 143 by the Company on January 1, 2003, did not have a material in
and results of operations.

Impairment and Disposal of Long-Lived Assets

In August 2001, the FASB issued SFAS No. 144, Accounting for the Impair
Assets , which addresses financial accounting and reporting for the impairme
assets. SFAS No. 144 supersedes both SFAS No. 121, and APB Opinion No. 3
Operations Reporting the Effects of Disposal of a Segment of a Business, and
Infrequently Occurring Events and Transactions . However, SFAS No. 144 re
provisions of SFAS No. 121 and retains the requirement in Opinion No. 30 to
operations and extends that reporting to a component of an entity that either
abandonment, or in a distribution to owners) or is classified as held for sale. T
144 as of January 1, 2002. The adoption of the provisions of SFAS No. 144 di
the Company s results of operations, financial position or cash flow.

Guarantees

In November 2002, the FASB issued Interpretation No. 45, Guarantor s Acc
Requirements for Guarantees, Including Indirect Guarantees of Indebtedness o
requires that upon issuance of certain types of guarantees, a guarantor recogni
value of the guarantee as a liability. The initial recognition and measurement p
applied on a prospective basis for guarantees issued or modified after Decemb
requirements of FIN 45 are effective for financial statements of both interim a
December 15, 2002. The adoption of the provisions of FIN No. 45 did not hav
Company s results of operations, financial position or cash flows.

Consolidation of Variable Interest Entities

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Va
FIN 46 amended Accounting Research Bulletin No. 51, Consolidated Financia
established standards for determining under what circumstances a variable inte
consolidated with its primary beneficiary. FIN 46 also requires disclosures abo
required to consolidate but in which it has a significant variable interest. On D
deferred the effective date of FIN 46 to no later than the end of the first reporti
15, 2004, however, for special-purpose entities the public companies are requi
of the calendar year ending on December 31, 2003. The adoption of FIN No. 4
impact on the Company s results of operations, financial position or cash flow

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

3. Accounts receivable

Accounts receivable, net are comprised the following at June 14, 2002

Receivables for domestic sales	
Receivables for export sales	
Less allowance for doubtful accounts	
Total accounts receivable, net	

The following summarizes the changes in the allowance for doubtful accounts
January 1, 2002 through June 14, 2002:

Balance at the beginning of the period	
Provision for doubtful accounts receivable	
Exchange rate difference from remeasurment	
Balance at the end of the period	

4. Inventories

Inventories are comprised of the following at June 14, 2002:

Raw materials and purchased parts	
Work in process	
Finished goods	
Total	

5. Prepayments and Other Current Assets

Prepayments and other current assets are comprised of the following at June 1

Input VAT and other taxes receivable	
Prepayments and advances for materials	
Other current assets	
Total	

Generally in Russia, VAT related to sales are payable to the tax authorities on invoices issued to the customer. VAT incurred for purchases may be reclaimed against VAT related to sales. VAT related to purchase transactions, which is n related to sales as of the balance sheet dates, is recognized in the balance sheet current assets and taxes and social charges payable.

F-110

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

6. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net consisted of the following at June 14, 2002

Land improvements
Buildings
Transfer devices
Machinery and equipment
Transport equipment
Tools, furniture, fixture and other
Accumulated depreciation
Construction in progress
Total property, plant and equipment

As disclosed in Note 2(g) above, for the purpose of determining the opening b
and equipment on the first application of U.S. GAAP at January 1, 2002, the C
independent valuation of the property, plant and equipment, as reliable historic
information regarding acquisition dates was not available.

Included in construction in progress at June 14, 2002 are advances to suppliers

Interest capitalized in the cost of property, plant and equipment during the per
2002 through June 14, 2002, comprised $830.

7. INVESTMENTS

Investments in non-marketable equity and debt instruments are comprised of t

Belcord OOO	
Beloretsk Travel Agency OOO	
Other non-marketable equity securities	
Total	

The fair values of the above listed investments are not presented in the accomp statements as they are not readily determinable due to the fact that there is no a Russian Federation and the information on pricing in single transactions is not these transactions. Investments in Belcord OOO and Beloretsk Travel Agency cost method.

8. Related Party Transactions

During the period starting from January 1, 2002 through June 14, 2002, the Co balances with the following related parties:

- Mechel Trading AG (an entity affiliated with Mechel Steel Group)
- Mechel Trading House OOO (an entity affiliated with Mechel Steel Gro
- Chelyabinsk Metallurgical Plant OAO (an entity affiliated with Mechel
- Arshan OOO (an entity affiliated with Mechel Steel Group)

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

- Ø South Ural Nickel Plant OAO (an entity affiliated with Mechel Steel Gr

- Ø Magnitogorsk Metallurgical Plant OAO (an entity affiliated with Mech

Amounts due from related parties consisted of the following at June 14, 2002:

Trade receivables:
Mechel Trading AG
Mechel Trading House OOO
Chelyabinsk Metallurgical Plant OAO
Arshan OOO
SUNP OAO
Total due from related parties

The amount due from Mechel Trading AG of $272 represented its obligations products. Sales to Mechel Trading AG amounted to $1,150 for the period start June 14, 2002.

The amount due from Mechel Trading House OOO of $231 represented its ob by-products. Sales of metal products to Mechel Trading House OOO amounte products and services amounted to $390 and shipping and handling fees amou starting January 1, 2002 through June 14, 2002.

The amount due from Chelyabinsk Metallurgical Plant OAO of $121 represen Company for metal products. Sales of metal products to Chelyabinsk Metallur $3,319 and shipping and handling fees amounted to $151 for the period startin 14, 2002.

The amount due from Arshan OOO of $47 represented its obligations to the C products to Arshan OOO amounted to $31 for the period starting January 1, 20

Amounts due to related parties consisted of the following at June 14, 2002:

Debt:
Uglemetbank
Trade payables:
Chelyabinsk Metallurgical Plant OAO
Mechel Trading House OAO
Arshan OAO
SUNP OAO
Advances received from:
Mechel Trading House OOO
Magnitogorsk Metallurgical Plant OAO
Chelyabinsk Metallurgical Plant OAO
Total due to related parties

F-112

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The amounts due to Uglemetbank of $415 represented a short-term Russian ru
working capital financing, bearing an annual interest rate of 22% repayable in
starting from January 1, 2002 through June 14, 2002, the Company recognized
respect to the loans received from Uglemetbank.

The amount due to Chelyabinsk Metallurgical Plant OAO of $2,641 represent
steel, semi-products and wire rods. Purchases from Chelyabinsk Metallurgical
$4,064, of which $4,064 were included in cost of sales in the accompanying co

The amount due to Mechel Trading House OOO of $2,631 represented the Co
raw materials. Purchases from Mechel Trading House OOO amounted to $2,5
included in cost of sales in the accompanying consolidated financial statement
Mechel Trading House OOO represented the advance received for future meta

The amount due to Arshan OOO of $1,569 represented the Company s obliga
Arshan OOO amounted to $1,306, of which $1,306 were included in cost of sa
consolidated financial statements.

The amount due to Magnitogorsk Metallurgical Plant OAO of $92 represented
products.

9. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following at Ju

Taxes and social charges on payroll payable
Current portion of restructured taxes and contributions to the Russian Pension Note 10)
Accrued expenses
Notes payable
Other accounts payable
Total

10. Restructured Taxes and Social Charges Payable

During 2000 through 2002, the Company entered into agreements with tax and
restructure the amounts and timing of payments of liabilities related to taxes a
Russian National Pension Fund, both with related fines and penalties. Prior to
portion of these liabilities including fines and penalties were overdue and paya
were accrued by the Company. Upon conclusion of the restructuring agreeme
with related fines and penalties accrued became payable in equal quarterly ins

Related fines and penalties became payable only if certain conditions were no
of at least 50% of all the restructured principal amounts of taxes and charges v
and the full and timely payment of current taxes being accrued, a 50%-portion
penalties will be forgiven. Furthermore, subject to timely payment of the rema
amounts of taxes and charges within four years on schedule, and the full and ti
being accrued, the remaining 50% of the restructured fines and penalties will b
principal of taxes and charges (except for Road users tax, charges to regional f
subject to interest of 5.5% p.a., payable in equal quarterly instalments. Restruc
bear interest.

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Contributions to the Russian Pension Fund and 15% of the related fines and pe
quarterly instalments over five years. Subject to full repayment of the restructu
the Russian Pension fund and payment of at least 15% of the fines and penalti
well as the full and timely payment of current contributions, the remaining 85
penalties related to the contributions to the Russian Pension Fund will be forgi
contributions to the Russian Pension Fund, fines and penalties related thereto,

Restructured taxes, contributions to the Russian Pension Fund and fines and p
follows at June 14, 2002:

Restructured taxes
Restructured fines and penalties on tax delinquencies
Restructured contributions to social funds
Restructured fines and penalties on social funds contributions delinquencies
Total
Less current portion
Non-current portion

Restructured taxes, contributions to the Russian Pension Fund and fines and p
repayments over the five-year period beginning June 14, 2002 are as follows:

Repayable in year ended June 14:
2003
2004
2005
2006
2007
2008 and thereafter
Total

11. SHORT-TERM DEBT

Short-term debt is comprised of the following at June 14, 2002:

Russian ruble denominated:	
Banks and financial institutions	
Corporate lenders	
U.S. dollar denominated:	
Banks and financial institutions	
Euro denominated:	
Banks and financial institutions	
Total	

* *Based on the weighted average interest rates for the period from January*

F-114

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The most significant debt provided by banks included loans and a credit line fa
UralSib (formerly, known as Bashcreditbank) and Alfa Bank. The loans from
collateralised by raw materials, finished goods and property, plant and equipm

During 2002, Sberbank provided a series of Ruble-denominated loans and cre
activities in the amount of $10,151, bearing interest at rates varying from 20%
property, plant and equipment.

During 2002, UralSib provided a series of Ruble-denominated loans and credi
total of $4,211 bearing interest at rates from 23% to 24% p.a. guaranteed by C
OAO and secured by BMP s production in process. In addition, in 1999 Urals
denominated short-term loan and bearing interest at rate from 14 to 15% p.a. a
production (wire rods), which is outstanding as at June 14, 2002.

During 2002 and 2001, Alfa bank provided a series of Ruble denominated loa
secured by BMP s goods. The balance outstanding as at June 14, 2002 is $1,4
bank provided the Company by US dollar-denominated loan amounting to $86
13.75%, secured by equipment and goods.

12. Shareholders Equity

Capital stock

The capital stock of the Company consists of 1,209,978,307 and 90,743,507 a
preferred shares with par value of 1 Russian ruble (approximately $0.03), of w
common and preferred shares, respectively, were outstanding as of June 14, 20

In accordance with the Russian legislation and the Company s Charter, when
any given year were not accrued dividends such preferred shares receive the v
dividends have been paid in full. The minimum dividends preferred sharehold
least 10% of their par value. Should the dividends declared on common shares
preferred share dividends referred to above, the preferred shareholders are enti
payable on top of the minimum dividends so the total dividend per one prefer

declared per one common share. Preferred shares have a liquidation preferenc
accordance with the Company s Charter, the preferred shares are not converti
however, preferred shareholders are also entitled to a proportionate share in th
Company, thus making them participatory shares.

Distribution of statutory earnings

In accordance with Russian legislation, the Company and its subsidiaries can d
or transfer them to reserves. Dividends may only be declared from accumulate
earnings as shown in the Russian statutory financial statements. Dividends are
withholding tax, which can be reduced or eliminated if paid to foreign owners
tax treaties.

At June 14, 2002, no amounts were available for dividends as BMP had accum
Russian rubles (or $27.6 million) in accordance with Russian statutory financi

---

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

13. Income Taxes

The income tax benefit consisted of the following for the period starting Janua
2002:

Current income tax expense	
Deferred income tax benefit	
Total income tax benefit	

Income tax is calculated at 20% of taxable profit for the period starting from J
2002 in accordance with the rules of the Russian Federation. A reconciliation
computed by applying the 20% statutory tax rate to the pre tax loss presented i
consolidated financial statements, to the provision for income taxes reported in
consolidated financial statements, is as follows:

Income tax benefit computed on pre tax loss, at statutory tax rate of 20%	
Tax effect of permanent differences:	
Effect of indexation of property, plant and equipment basis	
Fines and penalties related to tax	
Social expenditures	
Non-deductible expenses and non-taxable income	
Other permanent differences	
Income tax benefit as reported	

The deferred tax balances were calculated by applying the presently enacted st
the period in which the temporary differences between the carrying amounts a
liabilities are expected to reverse. The amounts reported in the accompanying
statements at June 14, 2002, consist of the following:

Deferred tax assets current	
Inventory valuation differences	
Timing differences in cost recognition	

Allowance for doubtful accounts receivable	
Loss carry forward	
Total current deferred tax assets	
Total deferred tax assets	
Deferred tax liabilities current	
Accounts payable written off	
Deferred tax liabilities non-current	
Property, plant and equipment	
Total deferred tax liabilities	

For Russian income tax purposes, the Company has accumulated tax losses, w
use against future income within 10 years. Their use is restricted to a maximur
each year. Tax loss carry forwards may be eroded by future devaluation of the
Russian income tax purposes, the Company had tax losses available to carry fo
that expire in 2012.

F-116

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

14. Revenues

Domestic revenue includes shipments to customers domiciled in the Russian F
includes shipments made to customers located in foreign countries, including r
of Independent States, other than Russia. Revenues for the period starting from
14, 2002, are comprised of the following:

Metal products	
Sales of other goods and services	
Shipping and handling fees	
Service revenue	
Total revenues	

15. Taxes Other than Income Tax

Taxes other than income tax for the period starting from January 1, 2002 throu
comprised of the following:

Property and land tax	
Road users tax	
Other taxes and penalties	
Total taxes other than on income	

16. Commitments and Contingencies

Contingencies

(a) General

The Russian economy continues to display certain traits consistent with that of
These characteristics include periods of high inflation, lack of liquidity in the
existence of currency controls, which cause the national currency to be illiqui
continued success and stability of the Russian economy will be significantly a
continued actions with regard to supervisory, legal, and economic reforms.

(b) Taxation

The Company is a subject to taxation in Russia. The Russian tax system conti
include value added tax, corporate income tax (profit tax), turnover-based tax
others. Laws related to these taxes have been adopted only recently, in contras
economies; and implementing regulations are often unclear or nonexistent. Ma
regulations introduced in 2002 and previous years were not always clearly dra
subject to the opinions of local tax authorities, the Central Bank and the Minis
inconsistent opinions between local, regional and federal tax authorities and b
Ministry of Finance are not unusual, and few precedents with regard to issues
declarations, together with other legal compliance areas (for example, customs
are subject to review and investigation by a number of authorities that are enal
fines, penalties and interest charges. These facts create tax risks in Russia subs
typically found in countries with more developed tax systems.

Table of Contents

Beloretsk Metallurgical Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

In Russia, generally, tax declarations remain open and subject to inspection fo
fact that a year has been reviewed does not close that year, or any tax declarati
further review during the three year period. Management believes that it has pa
applicable. Where uncertainty exists as to the amount, the Company has accru
management s best estimate.

As of June 14, 2002, the Company does not believe that any other material ma
Company, including pending or future governmental claims and demands, wh
the accompanying financial statements in order for those statements not to be
misleading.

(c) Litigation, claims and assessments

The Company is subject to various lawsuits, claims and proceedings related to
business. In the opinion of management, the Company s liability, if any, in al
proceeding or other matters would not have a material effect upon the financia
operations or liquidity of the Company.

The Russian legal system, which regulates the Company s business, is charac
between and among laws, presidential decrees, and Russian governmental, mi
decisions, and resolutions and other acts; (2) conflicting local, regional and fe
the lack of judicial and administrative guidance on interpreting legislation; (4)
judges and courts in interpreting legislation; and (5) a high degree of discretio
authorities. Management is unable to estimate what developments may occur
such developments on the Company s financial condition or future results of

The Company s operations and financial position will continue to be affected
developments, including the application of existing and future legislation and
of such occurrences and their effect on the Company could have a significant
to continue operations.

(d) Environmental

In the course of the Company s operations, the Company may be subject to en
proceedings. The quantification of environmental exposures requires an assess
including changing laws and regulations, improvements in environmental tech
information available related to specific sites, the assessment stage of each site
findings and the length of time involved in remediation or settlement. Manage
pending environmental claims or proceedings will significantly impair the Co
material adverse effect on its financial position.

17. Subsequent events

On June 14, 2002, Mechel Steel Group acquired 50.7% of voting shares of the
November 2003 and March 2004, Mechel Steel Group acquired additional 0.4
respectively, of the voting shares of the Company. As a result, Mechel Steel G
Company to 91.3% as of June 30, 2004.

In 2003, the Company received long-term loan of $17,770 from Mechel Trade
interest at 12.5% p.a. The loan is payable in 2006.

F-118

Table of Contents

Korshunov Mining Plant OAO

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING

Shareholders and the Board of Directors

Korshunov Mining Plant OAO

We have audited the accompanying consolidated balance sheet of Korshunov joint stock company (hereinafter referred to as the KMP), as of October 16, statements of operations, cash flows and changes in shareholders deficit for t through October 16, 2003. These consolidated financial statements are the resp management. Our responsibility is to express an opinion on these financial sta

We conducted our audit in accordance with the standards of the Public Compa (United States). Those standards require that we plan and perform the audit to about whether the financial statements are free of material misstatement. An a test basis, evidence supporting the amounts and disclosures in the financial sta assessing the accounting principles used and significant estimates made by ma the overall financial statement presentation. We believe that our audit provides opinion.

As more fully described in Note 2(f) to the consolidated financial statements, t equipment as of January 1, 2002, has been recorded at appraised values rather required by accounting principles generally accepted in the United States.

In our opinion, except for the effects of the matter discussed in the preceding p statements referred to above present fairly, in all material respects, the consoli at October 16, 2003, and the consolidated results of its operations and its cash January 1, 2003 through October 16, 2003, in conformity with accounting prin United States.

/s/ Ernst & Young (CIS) Limited

June 30, 2004

Moscow, Russia

Table of Contents

Korshunov Mining Plant OAO

CONSOLIDATED BALANCE SHEETS

(in thousands of U.S. dollars, except share amounts)
ASSETS
Cash and cash equivalents
Accounts receivable, net of allowance for doubtful accounts of $1,028
Inventories
Due from related parties
Deferred tax asset
Prepayments and other current assets
Total current assets
Property, plant and equipment, net
Mining assets, net
Other non-current assets
Total non-current assets
Total assets
LIABILITIES AND SHAREHOLDERS DEFICIT
Accounts payable and accrued expenses:
Accrued expenses and other current liabilities
Taxes and other obligatory payments payables
Trade accounts payable
Advances received
Capital lease obligation
Due to related parties
Total current liabilities
Long-term debt
Deferred income taxes
Asset retirement obligations
Total non-current liabilities
Total liability
SHAREHOLDERS DEFICIT
Common shares (1 Russian ruble par value); 250,216 shares authorized, issued and outstanding
Additional paid-in capital
Accumulated other comprehensive loss
Accumulated deficit

Total shareholders deficit

Total liabilities and shareholders deficit

See accompanying notes to consolidated financial sta

Table of Contents

Korshunov Mining Plant OAO

CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands of U.S. dollars)
Revenue (including related party amounts of $45,323)
Cost of goods sold and cost of service revenue (including related party amoun $39,418)
Gross margin
Selling, distribution and operating expenses:
Selling and distribution expenses
Taxes other than income tax
General and administrative expenses
Other operating expenses
Total selling, distribution and operating expenses
Operating loss
Other income and expense:
Interest expense
Other expense, net
Foreign exchange gain, net
Total other income and expense, net
Loss before income taxes and change in accounting principle
Income tax benefit
Loss before change in accounting principle
Change in accounting principle, net of taxes
Net loss
Cumulative translation adjustment on opening balances
Cumulative translation adjustment for 2003
Total comprehensive loss
Basic and diluted loss per share (in dollars):
Loss per share before effect of change in accounting principle
Loss per share effect of change in accounting principle
Net loss per share

Weighted average number of common shares used in computing basic and dilu
loss per share

See accompanying notes to consolidated financial sta

Table of Contents

Korshunov Mining Plant OAO

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands of U.S. dollars)
Cash Flows from Operating Activities:
Net loss
Adjustments to reconcile net loss to net cash used in operating activities:
Depreciation
Foreign exchange gain
Deferred tax benefit
Allowance for doubtful accounts receivable
Write off accounts payable
Loss on sale of property, plant and equipment
Non-cash interest on long-term debt
Loss on disposal of promissory notes
Accretion expense
Changes in working capital items:
Accounts receivable
Due from related parties
Due to related parties
Inventories
Prepayments and other current assets
Accounts payable, including trade payables, accrued expenses and advances re
Taxes and other obligatory payments payable
Net cash used in operating activities
Cash Flows from Investing Activities:
Purchases of property, plant and equipment
Proceeds from disposal of property, plant and equipment
Purchases of short-term investments
Net cash used in investing activities
Cash Flows from Financing Activities:
Proceeds from short-term related party debt
Net cash provided by financing activities
Effect of exchange rate changes on cash and cash equivalents
Net decrease in cash and cash equivalents
Cash and cash equivalents at beginning of year
Cash and cash equivalents at end of year

Supplementary Cash Flow Information:	
Income taxes paid	
Interest paid	

See accompanying notes to consolidated financial sta

F-122

Table of Contents

Korshunov Mining Plant OAO

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS

(in thousands of U.S. dollars, except share amounts)	Common shares: Shares	Common shares: Amount	Additional paid-in capital	Accumulated deficit
Balances as of December 31, 2002	250,126	$ 269	$ 786	$ (27,534)
Cumulative translation adjustment on opening balances				
Cumulative translation adjustment				
Net loss				(2,800)
Balances as of October 16, 2003	**250,126**	**$ 269**	**$ 786**	**$ (30,334)**

See accompanying notes to consolidated financial sta

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of October 16, 2003 and for the period from January 1 through Octo

(All amounts are in thousand of U.S. dollars, unless stated otherwise)

1. Business and Going concern

Business and formation

Korshunov Mining Plant OAO (KMP and, together with its subsidiaries, th joint-stock company in Russia, as a successor company to the formerly state-o Mining and Dressing Plant (also known as Korshunovsky GOK) upon its is located in Zheleznogorsk-Ilimsky, Irkutsk region (Far-Eastern part of Russi mining and production of iron ore concentrate as its primary product. KMP op mines and one iron ore processing plant. The Company sells its products prim number of majority-owned insignificant subsidiaries involved in auxiliary serv and non-core to the main business of KMP.

Going concern

As a result of the general economic crisis developing in Russia since August 1 effects on the Company s business, in November 1998, the Company was for initiated by a group of external creditors. Under the rules of the bankruptcy pr management was introduced by the creditors committee and the government management, which overruled the voting authority of the shareholders of the C status. Under the bankruptcy laws, the creditors committee and the external m as opposed to the shareholders, had the ultimate authority and control over the decision of KMP.

Throughout most of the period ended October 16, 2003, the Company was stil September 29, 2003, when a court approved an Amicable Agreement and a de bankruptcy committee creditors, which ceased the bankruptcy proceedings. Du through October 16, 2003, the Company incurred a net loss of $2,800 and exp from operations of $39,114. In addition, at October 16, 2003, the Company ha $91,698. However, in addition to the majority interest in the Company s capit Group OAO (Mechel) by October 16, 2003, the date of acquisition of KMP by

capital to the Company in form of debt (see Note 6) and advances for product
January 1 through October 16, 2003, and committed to continue to provide cap
Company s continuing operations. As of October 16, 2003, the Company has
taxes, social charges with related interest and penalties, to the local and federa
Due to its financial position and the outstanding tax arrears to be repaid pursua
October 16, 2003, the Company is still dependent on the financing provided by

The Company may experience negative cash flows from operations in the futu
flow depends on the Company s ability to generate sufficient revenues from s
additional capital and attract funds in the form of debt. The Company anticipat
benefit from integration into Mechel s business and these benefits are expecte
form of efficiencies associated with the access to the established distribution a
and capital available to finance operations. Accordingly, management of the C
Company will continue as a going concern for the foreseeable future.

F-124

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

2. Summary of Significant Accounting Policies

(a) Basis of accounting and presentation

The accompanying consolidated financial statements have been prepared in ac
principles generally accepted in the United States of America (U.S. GAAP)
maintain their books and records in Russian rubles and prepare accounting rep
accounting principles and practices mandated by Russian Accounting Regulat
consolidated financial statements are based on the underlying accounting reco
reclassified for fair presentation in accordance with U.S. GAAP.

The accompanying consolidated financial statements have been prepared usin
and modified by the initial valuation of property, plant and equipment as furth
accompanying consolidated financial statements.

The accompanying consolidated financial statements differ from the financial
Russian statutory purposes in that they reflect certain adjustments, not recorde
appropriate to present the financial position, results of operations and cash flo
GAAP. The principal adjustments relate to: (1) consolidation of financial posi
subsidiaries; (2) recognition of interest expense and other operating expenses;
of property and equipment; (4) foreign currency translation; (5) deferred incor
allowances for unrecoverable assets.

(b) Basis of consolidation

The accompanying consolidated financial statements of the Company include
majority owned subsidiaries where no minority shareholder or group of minor
substantive participating rights. A subsidiary is an entity that is controlled by t
ownership, directly or indirectly, of more than 50 percent of the voting share c
means. All significant inter-company balances and transactions have been elin

(c) Reporting and functional currencies

The Company determined its reporting currency to be the U.S. dollar. The Co
the Russian ruble, as the majority of its revenues, expenses, property and equi
liabilities are either priced, incurred, payable or otherwise measured in Russia

As the economy of the Russian Federation was considered highly inflationary
transactions and balances not already measured in U.S. dollars were remeasur
were the U.S. dollar, in accordance with the relevant provisions of SFAS No.
Translation . The objective of this remeasurement process was to produce the
been reported if the accounting records had been kept in U.S. dollars. Under th
liabilities have been translated using the exchange rate as of the balance sheet
liabilities, including non-current assets and shareholders equity, are stated at
restated from their historic cost, by applying the historical exchange rate as at
transaction. Income and expenses are restated by applying the monthly averag
statement of cash flows are translated at the monthly average exchange rates a
exchange rates on the dates of the transactions. Foreign currency differences a
the local currencies to U.S. dollars were included in the consolidated statemen
exchange gain .

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Effective from January 1, 2003, Russia no longer meets the criteria for a highl
purposes of applying SFAS No. 52. Accordingly, for the periods starting Janu
its subsidiaries remeasure transactions and balances from their functional curr
currency in U.S. dollars using the current rate method as prescribed by SFAS
consolidated financial statements. The translation adjustments resulting from t
financial statements from the functional currency into the reporting currency a
other comprehensive income or loss.

The official exchange rates for one U.S. dollar were 30.23 and 31.78 Russian
and December 31, 2002, respectively. The weighted average exchange rate of
from January 1 through October 16, 2003, was 30.60 Russian rubles.

(d) Devaluation, inflation, and currency restrictions and controls

The Russian ruble has historically been devaluing against the U.S. dollar due t
Russian Federation as well as other factors. During 2003, however, the Russia
against the U.S. dollar while official Russian ruble inflation was 12%. Additio
currency restrictions and controls related to converting Russian rubles into oth
Russian ruble is not convertible outside of the Russian Federation and, further
Russian Federation must be settled in Russian rubles. Future movements in th
Russian ruble and the U.S. dollar will affect the carrying values of the Compa
monetary assets and liabilities. Such movements may also affect the Company
non-monetary assets represented in U.S. dollars in these consolidated financia
rates are determined daily by the Central Bank of Russia and are generally co
approximation of market rates. The translation of ruble-denominated assets an
the purpose of these consolidated financial statements does not indicate that th
settle in U.S. dollars the reported values of the assets and liabilities. Likewise,
Company could return or distribute the reported U.S. dollar values of capital a
shareholders.

(e) Management estimates

The preparation of the Company s consolidated financial statements requires
and assumptions that affect the reported carrying amounts of assets and liabilit
assets and liabilities as of the date of the financial statements, and the amounts
recognized during the reporting period. Actual results could differ from those

(f) Property, plant and equipment, net

As disclosed in the Company s consolidated financial statements for the year
first period when the Company prepared its U.S. GAAP financial statements, a
Company performed a valuation of the property, plant and equipment using th
by independent valuation experts and recorded it at the appraised value on its l
2002, which represents a departure from U.S. GAAP. The Company had to ca
equipment existing as of January 1, 2002 at its appraised value instead of the h
reliable historical cost information and information regarding acquisition dates
property, plant and equipment acquired subsequent to January 1, 2002 were va
production cost. In the accompanying consolidated balance sheet the carrying
equipment is shown net of accumulated depreciation.

F-126

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Mining assets and processing plant and equipment

Mineral exploration costs incurred prior to establishing proven and probable re expensed as incurred. Proven and probable reserves are established based on in and appraisals performed by independent mining engineers. No exploration co point when proven and probable reserves are established. Reserves are defined deposit, which could be economically and legally extracted or produced at the determination. Proven reserves are defined as reserves for which (a) quantity i revealed in outcrops, trenches, workings or drill holes; grade and/or quality are detailed sampling and (b) the sites for inspection, sampling and measurement a geologic character is so well defined that size, shape, depth and mineral conten well-established. Probable reserves are defined as reserves for which quantity computed from information similar to that used for proven reserves, but the sit measurement are farther apart or are otherwise less adequately spaced. Accord although lower than that for proven reserves, is high enough to assume continu observation.

Development costs are capitalized beginning after proven and probable reserve Company s surface mines, these costs include costs to further delineate the m expose the mineral deposits. Additionally, interest expense allocable to the cos properties and to constructing new facilities is capitalized until assets are ready

Exploration and development costs during the period from January 1 through (immaterial.

Expenditures for betterments are capitalized, while costs related to maintenanc incurred. In addition, cost incurred to maintain current production capacity at a expenditures are charged to expenses as incurred.

When mining assets and processing plant and equipment are placed in product costs, including mine development costs, are depleted using the unit-of-produc tones of minerals mined or processed to the estimated proven and probable mi to be mined during the estimated lives of the mines or license term, whichever mine by mine basis as estimated with the assistance of independent mining eng

A decision to abandon, reduce or expand activity on a specific mine is based u
general and specific assessments of mineral reserves, anticipated future minera
developing and operating a producing mine, the expiration date of mineral lice
Company will continue exploration on the mine. Based on the results at the co
exploration program, properties that are not economically feasible for producti
determine if future exploration is warranted and that carrying values are appro
these costs depends on the discovery and development of economic ore reserv
owning such mineral rights.

Other property, plant and equipment

Capitalized production costs for internally developed assets include material, c
material and manufacturing overhead costs. When production activities are pe
period, interest costs incurred during production are capitalized. The costs of p
activities are recorded as the costs are actually incurred and are not accrued in
maintenance. Planned major maintenance activities include the scheduled over

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

for activities that lead to the prolongation of useful life or to expanded future u
capitalized. Maintenance and repair costs are expensed as incurred. Depreciati
plant and equipment on a straight-line basis from the time the assets are availa
useful lives as follows:

Category of asset
Buildings
Land improvements
Transfer devices
Machinery and equipment
Transportation equipment and vehicles
Tools, furniture, fixtures and other

Construction in progress and equipment held for installation are not depreciate
ready for its intended use. Upon sale or retirement, the acquisition or productio
depreciation are removed from the balance sheet and any gain or loss is includ
of operations.

(g) Impairment of long-lived assets

The carrying values of long-lived assets such as property, plant and equipment
reviewed for possible impairment whenever events or changes in circumstance
amount of an asset may not be recoverable. In the event that facts and circums
amount of any long-lived asset may be impaired, an evaluation of recoverabili
estimated future undiscounted cash flows associated with the asset would be c
amount to determine if a write-down is required. The remaining useful life of t
accordingly. An impairment loss is recognized to the extent that the carrying a
discounted cash flows. No impairment was recognized in the consolidated fina
16, 2003 and for period from January 1 through October 16, 2003.

(h) Inventories

Inventories are stated at the lower of acquisition/manufacturing cost or market
weighted average basis and includes all costs in bringing the inventory to its p
The elements of costs include direct material, labor and allocable material and

of production in process and finished goods include the purchase costs of raw
such as direct labor and an allocation of fixed and variable production overhea
parts are valued at invoice cost inclusive of freight and other shipping costs. M
price at which inventories can be sold in the normal course of business after al
completion and sale.

(i) Accounts receivable

Accounts receivable are stated at net realizable value. If receivables are uncoll
corresponding allowance for doubtful accounts is recorded. If receivables are
receivable balance is charged off. Recoveries of receivables previously charge
received. Receivables that do not bear interest or bear below market interest ra
of more than one year are discounted with the discount subsequently amortized
term of the receivable.

F-128

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The Company reviews the valuation of accounts receivable on a regular basis. accounts is estimated based on historical experience of cash collections and fu that might impact the collectibility of accounts.

(j) Capital leases

The Company recognizes capital leases as assets and liabilities in the balance inception of the lease to the fair value of the leased property or, if lower, at the lease payments. In calculating the present value of the minimum lease paymen the interest rate implicit in the lease, when it is practicable to determine; other incremental borrowing rate is used. Initial direct costs incurred are included as

Lease payments are apportioned between the finance charge and the reduction finance charge is allocated to periods during the lease term so as to produce a on the remaining balance of the liability for each period. The depreciation poli consistent with that for depreciable assets that are owned.

(k) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and deposits with banks wit months or less.

(l) Retirement benefit obligations

The Company is legally obligated to make defined contributions to the Russia the Russian Federation Social Security (a defined contribution plan financed o such, the Company has no legal obligation to pay and does not guarantee any Its only obligation is to pay the contributions as they fall due. If the Company the State Social Security plan, it will have no obligation to pay the benefits ea previous years. The Company s contributions to the Russian Pension Fund re plans are charged to income in the year to which they relate.

Contribution to the Russian Pension Fund together with other social contributi unified social tax (UST), which is calculated by the application of a regress part of the annual gross salary below 100 thousand Rubles or approximately $ rate of the Ruble to the U.S. dollar at October 16, 2003) to 5% (applied to the above 600 thousand Rubles or approximately $20, translated at the exchange r dollar at October 16, 2003) to the annual gross remuneration of each employee social funds (including the Russian Pension Fund), where the rate of contribut Fund varies from 28% to 5%, respectively, depending on the annual gross sala

(m) Revenue recognition

Revenue is recognized on an accrual basis when earned and realizable, which of products and rendering of services. Product revenue is represented by sales revenue comprises sales of services consisting primarily of transportation and of products and services are recognized net of applicable provisions for discou turnover taxes charged on gross revenue, primarily value added tax and export realizable and earned. This is usually the case when there is clear evidence

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

of an agreement, the risk of ownership has been transferred or the service has
been agreed upon, and there is adequate assurance that collection will be made

(n) Shipping and handling fees and costs

In accordance with EITF 00-10, Accounting for Shipping and Handling Fees
classifies amounts billed to customers for shipping and handling as revenue an
distribution and operating expenses. These costs totaled to $85 for the period e

(o) Income taxes

Provision is made in the financial statements for taxation of profits in accordar
currently in force. The Company accounts for income taxes under the liability
SFAS No. 109, Accounting for Income Taxes . Under the liability method,
future tax consequences of temporary differences between the tax and financia
liabilities and are measured using enacted tax rates to apply to taxable income
temporary differences are expected to be recovered or settled. The effect on de
of a change in the tax rates is recognized in income in the period that includes
allowance is provided when it is more likely than not that some or all of the de
realized in the future. These evaluations are based on the expectations of futur
of the various taxable temporary differences.

Prior to January 1, 2003, when Russia was deemed to be hyper-inflationary an
financial statements the Company did not recognize deferred tax liabilities or
relating to assets and liabilities that, under SFAS No. 52, are re-measured fron
functional currency using historical exchange rates and that result from change
for tax purposes. The deferred tax affect associated with the temporary differe
in the Company s functional currency (from U.S. dollar to ruble) when Russia
inflationary on January 1, 2003, was reflected as an adjustment to the Compan
adjustment component of accumulated other comprehensive loss on January 1

(p) Total comprehensive loss

SFAS No. 130, Reporting Comprehensive Income , requires the reporting o
addition to net income. For the period ended October 16, 2003, total comprehe
apart from the net loss of $2,800, included a cumulative translation adjustmen
of the Russian ruble denominated financial statements in accordance with SFA
deferred tax effect of change in functional currency of KMP from US Dollar t
1, 2003, recorded in accordance with EITF 92-8 Accounting for the Income
Statement No. 109 of a Change in Functional Currency When an Economy Ce
Inflationary .

(q) Financial instruments

The carrying amounts of financial instruments, consisting of cash equivalents,
receivable, trade accounts payable and short-term debt approximate their fair v

The Company, using available market information and appropriate valuation r
has determined the estimated fair values of financial instruments. Since the Ru

---

F-130

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

active markets for most of the financial instruments held by the Company, ver
market values are available to assess the fair value of the Company s financia

The cost method investments are shares of Russian companies that are not pub
value is not available. It is not be practicable for the Company to estimate the
for which a quoted market price is not available because it has not yet obtained
model necessary to make the estimate, and the cost of obtaining an independen
considering the materiality of the instruments to the Company. Therefore, such
cost.

The Company does not use derivative financial instruments.

(r) Concentration of credit and other risk

Financial instruments, which potentially expose the Company to concentration
primarily of cash and cash equivalents, trade accounts receivable, taxes recove

All of the Company s workforce is represented by trade union and is covered
is routinely renewed each year. The collective agreement provides for minimu
additional benefits and certain employee protection rights. Management of the
with trade union in order to ensure the appropriate treatment of the employees
Company s business.

(s) Earnings per share

In accordance with SFAS No. 128, Earnings per Share , basic loss per share
weighted average number of common shares outstanding during the period. Th
securities outstanding during the period; therefore, diluted earnings per share e
share.

(t) Assets Retirement Obligations

Effective January 1, 2003, the Company adopted SFAS No. 143, Accounting
Obligations, which applies to legal obligations associated with the retirement
assets. SFAS No. 143 requires entities to record the fair value of an asset retire
liability in the period when it is incurred (typically when the asset is installed a
When the liability is recorded, the entity capitalizes the cost by increasing the
property, plant and equipment. Over time, the liability is increased for the cha
period, and the capitalized cost is depreciated over the useful life of the related
No. 143 on January 1, 2003, the Company recorded $1,671, as a result of a ch
Application of this new accounting principle resulted in an increase in propert
and an asset retirement obligation liability of $2,154. The application of SFAS
operations by $250 and net loss by $1,922, or $7.68 per basic and diluted shar
through October 16, 2003.

The Company has numerous asset removal obligations that we are required to
once an asset is permanently taken out of service. Most of these obligations ar
many years into the future and will be funded from general company resource
Company s asset retirement obligations primarily relate to the Company s su

---

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

areas, production facilities with related landfills and dump areas. The followin
in ARO for the year period from January 1 through October 16, 2003.

Balance at January 1, 2003 (adoption)	
Accretion expense	
Balance at end of period	

(v) New accounting pronouncements

Consolidation of Variable Interest Entities

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Va
FIN 46 amended Accounting Research Bulletin No. 51, Consolidated Financia
established standards for determining under what circumstances a variable inte
consolidated with its primary beneficiary. FIN 46 also requires disclosures abo
required to consolidate but in which it has a significant variable interest.

On December 17, 2003, the FASB deferred the effective date of FIN 46 to no
reporting period that ends after March 15, 2004, however, for special-purpose
are required to apply FIN 46 by the end of the calendar year ending on Decem
FIN No. 46 is not expected to have a material impact on the Company s resul
position or cash flows.

3. INVENTORIES

Inventories were comprised of the following:

Raw materials and purchased parts
Semi-finished goods
Work in process
Finished goods
Total inventories

4. Prepayments and Other Current Assets

Prepayments and other current assets were comprised of the following:

Prepayments and advances for materials
Deferred expenses
Input VAT and other taxes recoverable
Other current assets
Total prepayments and other current assets

The Company has the legal right to offset value added tax (VAT) paid on purc
restrictions, against VAT charged to customers related to sales to the extent th
VAT on purchases. The Company records VAT receivable in the balance shee
cannot be offset against VAT received from customers.

F-132

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

5. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net consisted of the following:

Land
Machinery and equipment
Buildings and constructions
Transport equipment and vehicles
Tools, furniture, fixtures and other
Total operating property, plant and equipment
less: accumulated depreciation
Mining, processing plant and equipment
Less: accumulated depletion
Total mining property, plant and equipment, net
Construction in progress
Total property, plant and equipment, net

As disclosed in Note 2(f) above, for the purpose of determining the opening ba
and equipment on the first application of U.S. GAAP at January 1, 2002, the C
of the property, plant and equipment existing at January 1, 2002 as reliable his
information regarding acquisition dates was not available.

The Company leases certain equipment under non-cancelable capital leases. A
under capital leases amounted to $1,747, which should be repaid during one y
cost of leased equipment included in the carrying amount of property, plant an
accumulated depreciation amounted to $1,682 and $473. Depreciation charge
reported in the statement of operations. Included in construction in progress at
to suppliers of equipment of $1,714.

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

6. Related Party Transactions

Amounts due to related parties consisted of the following:

Due from related parties:
Sual Ruda
Mechel Trading House
Total

Due to related parties:
Trade paybles:
Sual Ruda
Mechel Trading House
Other
Total trade payables
Other payables:
Mechel Trading House
Short-term loans:
Uglemetbank
Mechel Trading House (current portion of long-term debt)
Mechel Trading House (short-term loans)
Total short-term loans
Total due from related parties
Capital lease obligation:
Sual Ruda
Multigroup
Total capital lease obligation
Long-term debt
Mechel Trading House

(a) Sual Ruda

During the period from January 1 through October 16, 2003, the Company sol
Ruda, a subsidiary of Mechel, for a total of $7,038. The balance receivable fro
ore concentrate and other materials at October 16, 2003 was $791. During the
October 16, 2003, the Company purchased from Sual Ruda various raw mater
to Sual Ruda at October 16, 2003 for these transactions was $8,707. Also, at O
owed the outstanding balance of the interest-free long-term loan of $180 provi

---

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(b) Mechel Trading House

During the period from January 1 through October 16, 2003, the Company sol
Mechel Trading House, a subsidiary of Mechel, for a total of $37,882, includi
the amount of $85. The amount due from Mechel Trading House at October 1
and other sales was $5,135. Mechel Trading House was also selling various ra
Company during the period from January 1 through October 16, 2003, and the
transactions at October 16, 2003 was $5,260.

During the period from January 1 through October 16, 2003, Mechel Trading
Company s tax and social arrears owed to the state budgets and guaranteed a
the tax and social debt under the Amicable Agreement signed in August 2003
long-term loan of $4,991 previously due to Sual Ruda was reassigned to Mech
of debt outstanding under this loan at October 16, 2003, less unamortized disc
including current portion of $4,298. Also during 2003, Mechel Trading House
interest-free and uncollateralized Ruble-denominated loans, for a total of $23,
cover its working capital shortages.

(c) Uglemetbank

During the period from January 1 through October 16, 2003, Uglemetbank, an
provided a Ruble-denominated short-term loan at interest rate of 20% p.a. to t

7. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities

Accrued expenses and other current liabilities consisted of the following:

Payroll payable	
Other expenses accrued	
Total accrued expenses and other current liabilities	

Taxes and other obligatory payments payable

As disclosed in Note 1, due to the bankruptcy proceedings going on, the Comp
and unpaid social charges in arrears, and related interest and penalties relating
following was included in the amount of total debt owed to the different state l
including interest and penalties, at October 16, 2003:

Social and pension charges	
Value added tax	
Road users tax	
Income taxes payable	
Other taxes and obligatory payment arrears	
Total principal of taxes and other obligatory payment arrears	
Interest and penalties	
Total taxes and other obligatory payments payable	

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Upon signing the Amicable Agreement, the total tax and social charges arrears with the accumulated interest and penalties thereto were rescheduled to becom equal monthly installments, commencing from the date of signing the Amicab these debts were fully repaid.

8. Shareholders Deficit

Capital stock

The capital stock of the Company consists of 250,126 common shares with pa all of which have been authorized and issued since 1993.

Distribution of statutory earnings

In accordance with Russian legislation, the Company and its subsidiaries can c or transfer them to reserves. Dividends may only be declared from accumulate earnings as shown in the Russian statutory financial statements. Dividends are withholding tax, which can be reduced or eliminated if paid to foreign owners tax treaties.

At October 16, 2003, no amounts were available for dividends as KMP had ac million Russian rubles (or $12,900) in accordance with Russian statutory finan subsidiaries had 35.3 million Russian rubles (or $1) available for distribution t their Russian statutory accounting reports, however, the subsidiaries being lim have to distribute their earnings, unless the controlling shareholder (the Comp

9. Income Taxes

The income tax benefit consisted of the following, during the period from Janu 2003:

Current income taxes	
Deferred income taxes	
Total income tax benefit	

Income tax is calculated at 24% of taxable profit in accordance with the rules o
reconciliation between the theoretical income tax benefit computed by applyin
the pre tax loss presented in the accompanying consolidated financial statemen
taxes reported in the accompanying consolidated financial statements, is as fol

Theoretical income tax benefit computed on pre tax loss, at statutory tax rate o	
Tax effect of permanent differences:	
Effect of indexation of property, plant and equipment basis	
Non-deductible expenses	
Tax effect on currency translation gain	
Other permanent differences	
Income tax benefit as reported	

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The deferred tax balances were calculated by applying the presently enacted st
the period in which the temporary differences between the carrying amounts a
liabilities are expected to reverse. The amounts reported in the accompanying
statements consist of the following:

Deferred tax asset current:
Allowance for doubtful accounts receivable
Other accruals and asset write offs
Total deferred tax assets
Deferred tax liability current:
Inventory and other valuation differences
Net deferred tax asset current
Deferred tax asset non-current:
Loss available for carry-forward
Asset retirement obligation
Total deferred tax assets
Deferred tax liability non-current:
Property, plant and equipment
Net deferred tax asset non-current

For Russian income tax purposes, the Company has accumulated tax losses, w
use against future income within 10 years. Their use is restricted to a maximu
Tax loss carry forwards may be eroded by future devaluation of the ruble. As
Russian income tax purposes, the Company has tax losses available to carry fo
11,200 expiring at various dates in 2010-2011.

10. Revenue

Revenues for the period from January 1 through October 16, 2003, are compri

Iron ore concentrate

Sales of goods	
Shipping and handling fee	
Service revenue	
Total revenues	

11. Selling and Distribution and Operating Expenses

Operating expenses for the period from January 1 through October 16, 2003, a

Personnel expenses	
Social expenses	
Depreciation	
Audit and consulting	
Raw materials	
Rent and office expense	
Provision for doubtful debts	
Total other operating expenses	

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Taxes other than income tax for the period from January 1 through October 16
following:

Property and land tax	
Other taxes	
Total taxes other than on income	

12. Commitments and Contingencies

Contingencies

(a) General

The Russian economy continues to display certain traits consistent with that of
These characteristics include periods of high inflation, lack of liquidity in the c
existence of currency controls, which cause the national currency to be illiquid
continued success and stability of the Russian economy will be significantly a
continued actions with regard to supervisory, legal, and economic reforms.

(b) Taxation

The Company is a subject to taxation in Russia. The Russian tax system contin
include value added tax, corporate income tax (profit tax), turnover-based taxe
others. Laws related to these taxes have been adopted only recently, in contras
economies; and implementing regulations are often unclear or nonexistent. Ma
regulations introduced in 2002 and beyond and previous years were not alway
interpretation is subject to the opinions of local tax authorities, the Central Ba
Instances of inconsistent opinions between local, regional and federal tax auth
Bank and the Ministry of Finance are not unusual, and few precedents with reg
established. Tax declarations, together with other legal compliance areas (for e
control matters) are subject to review and investigation by a number of authori
impose severe fines, penalties and interest charges. These facts create tax risks

significant than typically found in countries with more developed tax systems.

In Russia, generally, tax declarations remain open and subject to inspection fo
fact that a year has been reviewed does not close that year, or any tax declarati
further review during the three year period. Management believes that it has pa
applicable. Where uncertainty exists as to the amount, the Company has accru
management s best estimate.

As of October 16, 2003, the Company management believe that all material m
future governmental claims and demands or other claims, which would require
accompanying financial statements in order for those statements not to be mate
have been properly accrued or disclosed.

(c) Litigation, claims and assessments

The Company is subject to various lawsuits, claims and proceedings related to
business. In the opinion of management, the Company s liability, if any, in al
proceeding or other matters would not have a material effect upon the financia
operations or liquidity of the Company.

F-138

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

The Russian legal system, which regulates the Company s business, is charac
between and among laws, presidential decrees, and Russian governmental, mi
decisions, and resolutions and other acts; (2) conflicting local, regional and fe
the lack of judicial and administrative guidance on interpreting legislation; (4)
judges and courts in interpreting legislation; and (5) a high degree of discretio
authorities. Management is unable to estimate what developments may occur
such developments on the Company s financial condition or future results of

The Company s operations and financial position will continue to be affected
developments, including the application of existing and future legislation and
of such occurrences and their effect on the Company could have a significant
to continue operations.

(d) Environmental

In the course of the Company s operations, the Company may be subject to e
proceedings. The quantification of environmental exposures requires an asses
including changing laws and regulations, improvements in environmental tec
information available related to specific sites, the assessment stage of each sit
findings and the length of time involved in remediation or settlement. Manage
pending environmental claims or proceedings will significantly impair the Co
material adverse effect on its financial position.

13. Subsequent Events

On April 25, 2004, the Company has fully repaid its tax and social arrears und
Agreement.

Table of Contents

Korshunov Mining Plant OAO

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING

Shareholders and the Board of Directors

Korshunov Mining Plant OAO

We have audited the accompanying consolidated balance sheet of Korshunov
joint stock company (hereinafter referred to as the KMP), as of December 3
consolidated statements of operations, cash flows and changes in shareholders
These consolidated financial statements are the responsibility of KMP s mana
express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Compa
(United States). Those standards require that we plan and perform the audit to
about whether the financial statements are free of material misstatement. An a
test basis, evidence supporting the amounts and disclosures in the financial sta
assessing the accounting principles used and significant estimates made by ma
the overall financial statement presentation. We believe that our audit provides
opinion.

As more fully described in Note 2(f) to the consolidated financial statements, t
equipment as of January 1, 2002, has been recorded at appraised values rather
required by accounting principles generally accepted in the United States.

In our opinion, except for the effects of the matter discussed in the preceding p
statements referred to above present fairly, in all material respects, the consoli
at December 31, 2002, and the consolidated results of its operations and its cas
in conformity with accounting principles generally accepted in the United Stat

/s/ Ernst & Young (CIS) Limited

June 30, 2004

Moscow, Russia

F-140

Table of Contents

Korshunov Mining Plant OAO

CONSOLIDATED BALANCE SHEET

(in thousands of U.S. dollars, except share amounts)

ASSETS
Cash and cash equivalents
Accounts receivable, net of allowance for doubtful accounts of $1,030
Inventories
Due from related parties
Deferred tax asset
Prepayments and other current assets
Total current assets
Property, plant and equipment, net
Mining assets, net
Other non-current assets
Total non-current assets
Total assets
LIABILITIES AND SHAREHOLDERS DEFICIT
Accounts payable and accrued expenses:
Accrued expenses and other current liabilities
Taxes and other obligatory payments payable
Trade accounts payable
Advances received
Capital lease obligations, current portion
Due to related parties
Total current liabilities
Due to related parties
Deferred income taxes
Capital lease obligations, net of current portion
Total non-current liabilities
Total liability
SHAREHOLDERS DEFICIT
Common shares (1 Russian ruble par value); 250,126 shares authorized, issued and outstanding
Additional paid-in capital
Accumulated deficit
Total shareholders deficit

Total liabilities and shareholders deficit

See accompanying notes to consolidated financial sta

Table of Contents

Korshunov Mining Plant OAO

CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands of U.S. dollars, except share amounts)
Revenue (including related party amounts of $ 18,499)
Cost of goods sold and cost of service revenue (including related party amoun of $ 20,490)
Gross margin
Selling, distribution and operating expenses:
Selling and distribution expenses
Taxes other than income tax
General and administrative expenses
Other operating expenses
Total selling, distribution and operating expenses
Operating loss
Other income and expense:
Foreign exchange gain, net
Other expense, net
Total other income and expense, net
Loss before income taxes
Income tax benefit
Net loss
Basic and diluted loss per share (in dollars):
Net loss per share
Weighted average number of common shares used in computing basic and diluted loss per share

See accompanying notes to consolidated financial sta

F-142

Table of Contents

Korshunov Mining Plant OAO

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands of U.S. dollars)

Cash Flows from Operating Activities:
Net loss
Adjustments to reconcile net loss to net cash used in operating activities:
Depreciation
Foreign exchange gain
Deferred tax benefit
Provision for doubtful accounts receivable
Write off accounts payable
Loss on sale of property, plant and equipment
Loss on disposal of promissory notes
Changes in working capital items:
Accounts receivable
Due from related parties
Due to related parties
Inventories
Prepayments and other current assets
Accounts payable, including trade payables, accrued expenses and advances re
Taxes and other obligatory payments payable

Net cash used in operating activities

Cash Flows from Investing Activities:
Purchases of property, plant and equipment
Proceeds from disposal of property, plant and equipment
Purchases of short-term investments

Net cash used in investing activities

Cash Flows from Financing Activities:
Proceeds from short-term related party debt

Net cash provided by financing activities

Effect of exchange rate changes on cash and cash equivalents

Net decrease in cash and cash equivalents

Cash and cash equivalents at beginning of year

Cash and cash equivalents at end of year

Supplementary Cash Flow Information:
Income taxes paid
Interest paid

Non-cash Activities
Capital contribution related to imputed interest on non-interest bearing loan (N

See accompanying notes to consolidated financial sta

Table of Contents

Korshunov Mining Plant OAO

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS

(in thousands of U.S. dollars, except share amounts)	Common shares		Additio paid-i capita
	Shares	Amount	
Balances as of January 1, 2002	250,126	$ 269	$
Capital contribution related to imputed interest on non-interest bearing loan (Note 6)			7
Net loss			
Balances as of December 31, 2002	**250,126**	**$ 269**	**$ 7**

See accompanying notes to consolidated financial sta

F-144

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2002 and for the year then ended

(All amounts are in thousand of U.S. dollars, unless stated otherwise)

1. Business and Going concern

Business and formation

Korshunov Mining Plant OAO (KMP and, together with its subsidiaries, th joint-stock company in Russia, as a successor company to the formerly state-o Mining and Dressing Plant (also known as Korshunovsky GOK) upon its is located in Zheleznogorsk-Ilimsky, Irkutsk region (Far-Eastern part of Russi mining and production of iron ore concentrate as its primary product. KMP op mines and one iron ore processing plant. The Company sells its products prim number of majority-owned insignificant subsidiaries involved in auxiliary serv and non-core to the main business of KMP.

Bankruptcy proceeding and going concern

As a result of the general economic crisis developing in Russia since August 1 effects on the Company s business, in November 1998, the Company was for initiated by a group of external creditors. Under the rules of the bankruptcy pr management was introduced by the creditors committee and the government management, which overruled the voting authority of the shareholders of the C status.

As of December 31, 2002, the Company had $78,632 payable in arrears for ta interest and penalties, to the local and federal state budgets. In addition, includ proceedings debt outstanding were trade payable balances to various suppliers purchased and accumulated by the entities affiliated with Mechel Steel Group payables at December 31, 2002. Under the bankruptcy laws, the creditors com appointed by the court, as opposed to the controlling shareholders, had the ulti the key financial and economic decision of KMP.

For the year ended December 31, 2002, the Company incurred a net loss of $1
cash flows from operations of $7,055. In addition, at December 31, 2002, the C
capital of $88,028. Due to its financial position and the continuing bankruptcy
operation the Company was dependent on the external financing and restructu
disclosed in Note 13, in December 2002, the majority of the Company s share
Steel Group OAO (Mechel). Due to the reasons above, Mechel did not control
became part of Mechel Group only in October 2003, when, as disclosed in No
restrictions were removed. However, subsequent to December 31, 2002, Mech
Company in the form of short-term interest-free debt and guarantees of repaym
related penalties and interest.

The Company may experience negative cash flows from operations in the futu
flow depends on the Company s ability to generate sufficient revenues from s
additional capital and attract funds in the form of debt. The Company anticipat
benefit from integration into Mechel s business and these benefits are expecte
form of efficiencies associated with the access to the established distribution a
and capital available to finance operations. Accordingly, management of the C
Company will continue as a going concern for the foreseeable future.

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

2. Summary of Significant Accounting Policies

(a) Basis of accounting

The accompanying consolidated financial statements have been prepared in ac
principles generally accepted in the United States of America (U.S. GAAP)
maintain their books and records in Russian rubles and prepare accounting rep
accounting principles and practices mandated by Russian Accounting Regulat
consolidated financial statements are based on the underlying accounting reco
reclassified for fair presentation in accordance with U.S. GAAP.

The consolidated financial statements have been prepared using the historical
by the initial valuation of property, plant and equipment as further disclosed in
consolidated financial statements.

The accompanying consolidated financial statements differ from the financial
Russian statutory purposes in that they reflect certain adjustments, not recorde
appropriate to present the financial position, results of operations and cash flo
GAAP. The principal adjustments relate to: (1) consolidation of financial posi
subsidiaries; (2) recognition of interest expense and other operating expenses;
of property and equipment; (4) foreign currency translation; (5) deferred inco
allowances for unrecoverable assets.

(b) Basis of consolidation

The accompanying consolidated financial statements of the Company include
majority owned subsidiaries where no minority shareholder or group of mino
substantive participating rights. A subsidiary is an entity that is controlled by t
ownership, directly or indirectly, of more than 50 percent of the voting share c
means. All significant inter-company balances and transactions have been elim

(c) Reporting and functional currencies

The Company determined its reporting currency to be the U.S. dollar. The Cor the Russian ruble, as the majority of its revenues, expenses, property and equip liabilities are either priced, incurred, payable or otherwise measured in Russian Russian Federation was considered highly inflationary until January 1, 2003, t already measured in U.S. dollars were remeasured as if the functional currency accordance with the relevant provisions of SFAS No. 52, Foreign Currency T remeasurement process was to produce the same results that would have been records had been kept in U.S. dollars. Under this method, monetary assets and using the exchange rate as of the balance sheet dates. Non-monetary assets and non-current assets and shareholders equity, are stated at their actual dollar co historic cost, by applying the historical exchange rate as at the date of the orig expenses are restated by applying the monthly average exchange rates. Items i are translated at the monthly average exchange rates and where applicable at th of the transactions. Foreign currency differences arising from remeasurement o dollars are included in the consolidated statement of operations as Foreign ex

The Russian ruble is not convertible outside the Russian Federation. Official e daily by the Central Bank of Russia and are generally considered to be a reaso

---

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

approximation of market rates. The translation of ruble-denominated assets an the purpose of these consolidated financial statements does not indicate that th settle in U.S. dollars the reported values of the assets and liabilities. Likewise, Company could return or distribute the reported U.S. dollar values of capital a shareholders.

The official exchange rate for one U.S. dollar was 31.78 as of December 31, 2 exchange rate of one U.S. dollar for the year ended December 31, 2002 was 3

(d) Devaluation, inflation, and currency restrictions and controls

The Russian ruble has historically been devaluing against the U.S. dollar due t Russian Federation as well as other factors. During 2002, for instance, the Rus against the U.S. dollar while official Russian ruble inflation was 15.1%. Addit currency restrictions and controls related to converting Russian rubles into oth Russian ruble is not convertible outside of the Russian Federation and, further Russian Federation must be settled in Russian rubles. Future movements in th Russian ruble and the U.S. dollar will affect the carrying values of the Compa monetary assets and liabilities. Such movements may also affect the Company non-monetary assets represented in U.S. dollars in these consolidated financia

(e) Management estimates

The preparation of the Company s consolidated financial statements requires and assumptions that affect the reported carrying amounts of assets and liabilit assets and liabilities as of the date of the financial statements, and the amounts recognized during the reporting period. Actual results could differ from those

(f) Property, plant and equipment

For the purposes of determining the opening balance sheet on the first applica 2002, the Company performed a valuation of the property, plant and equipme performed by independent valuation experts and recorded it at the appraised v

January 1, 2002, which represents a departure from U.S. GAAP. The Compan
and equipment existing as of January 1, 2002 at its appraised value instead of
as reliable historical cost information and information regarding acquisition da
property, plant and equipment acquired subsequent to January 1, 2002 were va
production cost. In the accompanying consolidated balance sheet the carrying
equipment is shown net of accumulated depreciation.

Mining assets and processing plant and equipment

Mineral exploration costs incurred prior to establishing proven and probable re
expensed as incurred. Proven and probable reserves are established based on i
and appraisals performed by independent mining engineers. No exploration co
point when proven and probable reserves are established. Reserves are defined
deposit, which could be economically and legally extracted or produced at the
determination. Proven reserves are defined as reserves for which (a) quantity i

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

from dimensions revealed in outcrops, trenches, workings or drill holes; grade
from the results of detailed sampling and (b) the sites for inspection, sampling
closely and the geologic character is so well defined that size, shape, depth and
are well-established.

Probable reserves are defined as reserves for which quantity and grade and/or
information similar to that used for proven reserves, but the sites for inspection
are farther apart or are otherwise less adequately spaced. Accordingly, the deg
lower than that for proven reserves, is high enough to assume continuity betwe

Development costs are capitalized beginning after proven and probable reserve
Company s surface mines, these costs include costs to further delineate the m
expose the mineral deposits. Additionally, interest expense allocable to the cos
properties and to constructing new facilities is capitalized until assets are ready

Exploration and development costs during the year ended December 31, 2002

Expenditures for betterments are capitalized, while costs related to maintenanc
incurred. In addition, cost incurred to maintain current production capacity at a
expenditures are charged to expenses as incurred.

When mining assets and processing plant and equipment are placed in product
costs, including mine development costs, are depleted using the unit-of-produc
tones of minerals mined or processed to the estimated proven and probable mi
to be mined during the estimated lives of the mines or license term, whichever
mine by mine basis as estimated with the assistance of independent mining eng

A decision to abandon, reduce or expand activity on a specific mine is based u
general and specific assessments of mineral reserves, anticipated future minera
developing and operating a producing mine, the expiration date of mineral lice
Company will continue exploration on the mine. Based on the results at the co
exploration program, properties that are not economically feasible for producti
determine if future exploration is warranted and that carrying values are appro
these costs depends on the discovery and development of economic ore reserv
owning such mineral rights.

F-148

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Other property, plant and equipment

Capitalized production costs for internally developed assets include material, d
material and manufacturing overhead costs. When production activities are pe
period, interest costs incurred during production are capitalized. The costs of p
activities are recorded as the costs are actually incurred and are not accrued in
maintenance. Planned major maintenance activities include the scheduled over
lead to the prolongation of useful life or to expanded future use capabilities of
Maintenance and repair costs are expensed as incurred. Depreciation is calcula
equipment on a straight-line basis from the time the assets are available for use
lives as follows:

Category of asset
Buildings
Land improvements
Transfer devices
Machinery and equipment
Transportation equipment and vehicles
Tools, furniture, fixtures and other

Construction in progress and equipment held for installation are not depreciate
ready for its intended use. Upon sale or retirement, the acquisition or productio
depreciation are removed from the balance sheet and any gain or loss is includ
of operations.

(g) Impairment of long-lived assets

Effective January 1, 2002, the Group adopted SFAS No. 144, Accounting for
Long Lived Assets, which addresses financial accounting and reporting for th
long-lived assets. The adoption of this standard did not have a material impact
financial position or results of operations. The carrying values of long-lived as
equipment, and purchased intangibles are reviewed for possible impairment w
circumstance indicate that the carrying amount of an asset may not be recovera
circumstances indicate that the carrying amount of any long-lived asset may be
recoverability is performed whereby the estimated future undiscounted cash fl
would be compared to the asset s carrying amount to determine if a write-dow
useful life of the assets is evaluated accordingly. An impairment loss is recogn

carrying amount exceeds the asset s discounted cash flows. No impairment w
financial statements as of December 31, 2002, and for the year then ended.

(h) Inventories

Inventories are stated at the lower of acquisition/manufacturing cost or market
weighted average basis and includes all costs in bringing the inventory to its p
The elements of costs include direct material, labor and allocable material and

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Costs of production in process and finished goods include the purchase costs c
costs such as direct labor and an allocation of fixed and variable production ov
spare parts are valued at invoice cost inclusive of freight and other shipping co

Market value is the estimated price at which inventories can be sold in the nor
allowing for the cost of completion and sale.

(i) Accounts receivable

Accounts receivable are stated at net realizable value. If receivables are uncoll
corresponding allowance for doubtful accounts is recorded. If receivables are c
receivable balance is charged off. Recoveries of receivables previously charge
received. Receivables that do not bear interest or bear below market interest ra
of more than one year are discounted with the discount subsequently amortize
term of the receivable.

The Company reviews the valuation of accounts receivable on a monthly basis
accounts is estimated based on historical experience of cash collections and fu
that might impact the collectibility of accounts.

(j) Capital leases

The Company recognizes capital leases as assets and liabilities in the balance s
inception of the lease to the fair value of the leased property or, if lower, at the
lease payments. In calculating the present value of the minimum lease paymen
the interest rate implicit in the lease, when it is practicable to determine; other
incremental borrowing rate is used. Initial direct costs incurred are included as

Lease payments are apportioned between the finance charge and the reduction
finance charge is allocated to periods during the lease term so as to produce a c
on the remaining balance of the liability for each period. The depreciation poli
consistent with that for depreciable assets that are owned.

(k) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and deposits with banks wit
months or less.

(l) Retirement benefit obligations

The Company is legally obligated to make defined contributions to the Russia
the Russian Federation Social Security (a defined contribution plan financed o
such, the Company has no legal obligation to pay and does not guarantee any f
Its only obligation is to pay the contributions as they fall due. If the Company
the State Social Security plan, it will have no obligation to pay the benefits ear
previous years. The Company s contributions to the Russian Pension Fund rel
plans are charged to income in the year to which they relate.

Contribution to the Russian Pension Fund together with other social contributi
unified social tax (UST), which is calculated by the application of a regress
part of the annual gross salary below 100 thousand Rubles or approximately $
of the Ruble to the U.S. dollar at December 31, 2002) to 5% (applied to

---

F-150

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

the part of the annual gross salary above 600 thousand Rubles or approximatel exchange rate of the Ruble to the U.S. dollar at December 31, 2002) to the ann employee. UST is allocated to three social funds (including the Russian Pensio contributions to the Russian Pension Fund varies from 28% to 5%, respectivel gross salary of each employee.

(m) Revenue recognition

Revenue is recognized on an accrual basis when earned and realizable, which of products and rendering of services. Product revenue is represented by sales revenue comprises sales of services consisting primarily of transportation and of products and services are recognized net of applicable provisions for discou turnover taxes charged on gross revenue, primarily value added tax and export realizable and earned. This is usually the case when there is clear evidence of a ownership has been transferred or the service has been rendered, the price has adequate assurance that collection will be made.

(n) Shipping and handling fees and costs

In accordance with EITF 00-10, Accounting for Shipping and Handling Fees classifies amounts billed to customers for shipping and handling as revenue an distribution and operating expenses. These costs totaled to $1,133 for the year

(o) Income taxes

Provision is made in the financial statements for taxation of profits in accordan currently in force. The Company accounts for income taxes under the liability SFAS No. 109, Accounting for Income Taxes . Under the liability method, d future tax consequences of temporary differences between the tax and financia liabilities and are measured using enacted tax rates to apply to taxable income temporary differences are expected to be recovered or settled.

The effect on deferred tax assets and liabilities of a change in the tax rates is r
period that includes the enactment date. A valuation allowance is provided wh
some or all of the deferred tax assets will not be realized in the future. These e
expectations of future taxable income and reversals of the various taxable tem

The Company does not recognize deferred tax liabilities or assets for those dif
liabilities that, under SFAS No. 52 are remeasured from the local currency int
historical exchange rates and that result from changes in exchange rates or ind

(p) Comprehensive income

SFAS No. 130, Reporting Comprehensive Income , requires the reporting o
addition to net income or loss. Accumulated other comprehensive income or l
translation adjustments, unrealized holding gains and losses on available-for-s
financial instruments, as well as additional pension liabilities not yet recogniz
For the year ended December 31, 2002, comprehensive loss for the Company

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(q) Financial instruments

The carrying amounts of financial instruments, consisting of cash equivalents, receivable, trade accounts payable and short-term debt approximate their fair v

The Company, using available market information and appropriate valuation n has determined the estimated fair values of financial instruments. Since the Ru markets for most of the financial instruments held by the Company, very limit values are available to assess the fair value of the Company s financial instrur

The cost method investments are shares of Russian companies that are not pub value is not available. It is not be practicable for the Company to estimate the for which a quoted market price is not available because it has not yet obtained model necessary to make the estimate, and the cost of obtaining an independer considering the materiality of the instruments to the Company. Therefore, such cost.

The Company does not use derivative financial instruments.

(r) Concentration of credit and other risk

Financial instruments, which potentially expose the Company to concentratior primarily of cash and cash equivalents, trade accounts receivable, taxes recove

All of the Company s workforce is represented by trade union and is covered is routinely renewed each year. The collective agreement provides for minimu additional benefits and certain employee protection rights. Management of the with trade union in order to ensure the appropriate treatment of the employees Company s business.

(s) Earnings per share

In accordance with SFAS No. 128, Earnings per Share , basic loss per share
weighted average number of common shares outstanding during the period. Th
securities outstanding during the period; therefore, diluted earnings per share e
share.

(v) Recently issued accounting pronouncements

Business Combination, Goodwill and Other Intangible Assets

In June 2001, the Financial Accounting Standards Board (FASB) issued SF
Combinations and SFAS No. 142, Goodwill and Other Intangible Assets .
purchase method of accounting be used for all business combinations. SFAS N
intangible assets acquired in a business combination must meet to be recognize
goodwill. SFAS No. 142 requires that goodwill and intangible assets with inde
amortized, but instead tested for impairment at least annually in accordance w
142. SFAS No. 142 also requires that intangible assets with estimable useful li
respective estimated useful lives to their estimated residual values, and review
accordance with SFAS No. 144, Accounting for the Impairment or Disposal
accordance with SFAS No. 142, the Company is required to reassess

---

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

the useful lives and residual values of all intangible assets acquired, and make
period adjustments by the end of the first interim period after adoption. For int
having indefinite useful lives, the Company is required to test those intangible
accordance with the provisions of SFAS No. 142 and 144. The adoption of the
material impact on the results of the Company s operations or financial positi

Guarantees

In November 2002, the FASB issued Interpretation No. 45, Guarantor s Acc
Requirements for Guarantees, Including Indirect Guarantees of Indebtedness o
requires that upon issuance of certain types of guarantees, a guarantor recogni
value of the guarantee as a liability. The initial recognition and measurement p
applied on a prospective basis for guarantees issued or modified after Decemb
requirements of FIN 45 are effective for financial statements of both interim a
December 15, 2002. The adoption of the provisions of FIN No. 45 did not hav
Company s results of operations, financial position or cash flows.

Assets Retirement Obligations

Effective January 1, 2003, the Group adopted SFAS No. 143, Accounting fo
which applies to legal obligations associated with the retirement and removal o
143 requires entities to record the fair value of an asset retirement obligation (
when it is incurred (typically when the asset is installed at the production locat
recorded, the entity capitalizes the cost by increasing the carrying amount of th
equipment. Over time, the liability is increased for the change in its present va
capitalized cost is depreciated over the useful life of the related asset. The Co
143 as of January 1, 2003. Upon adoption of SFAS No. 143 on January 1, 200
of $1,671 as cumulative effect of change in accounting principle. Application
resulted in an increase in property, plant and equipment of $242 and an asset r
$1,913.

Consolidation of Variable Interest Entities

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Va
FIN 46 amended Accounting Research Bulletin No. 51, Consolidated Financia
established standards for determining under what circumstances a variable int

consolidated with its primary beneficiary. FIN 46 also requires disclosures abo
required to consolidate but in which it has a significant variable interest. On D
deferred the effective date of FIN 46 to no later than the end of the first reporti
15, 2004, however, for special-purpose entities the public companies are requi
of the calendar year ending on December 31, 2003. The adoption of FIN No. 4
material impact on the Company s results of operations, financial position or

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

3. Inventories

Inventories are comprised of the following at December 31, 2002:

Raw materials and purchased parts	
Semi-finished goods	
Work in process	
Finished goods	
Total inventories	

4. Prepayments and Other Current Assets

Prepayments and other current assets are comprised of the following at Decem

Prepayments and advances for materials	
Deferred production expenses	
Input VAT and other taxes recoverable	
Other current assets	
Total prepayments and other current assets	

The Company has the legal right to offset value added tax (VAT) paid on purc
restrictions, against VAT charged to customers related to sales to the extent th
VAT on purchases. The Company records VAT receivable in the balance shee
cannot be offset against VAT received from customers.

5. Property, Plant and Equipment, Net

Property, plant and equipment, net consisted of the following at December 31,

Land	
Machinery and equipment	
Buildings and constructions	
Transport equipment and vehicles	
Tools, furniture, fixtures and other	
Total operating property, plant and equipment	
less: accumulated depreciation	
Construction in progress	
Total property, plant and equipment, net	
Mining, processing plant and equipment	
Less: accumulated depletion	
Total mining property, plant and equipment, net	

As disclosed in Note 2(f) above, for the purpose of determining the opening ba
and equipment on the first application of U.S. GAAP at January 1, 2002, the C
of the property, plant and equipment existing at January 1, 2002 as reliable his
information regarding acquisition dates was not available.

The Company leases certain equipment under non-cancelable capital leases. A
of leased equipment included in the carrying amount of property, plant and eq

F-154

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

accumulated depreciation amounted to $1,651 and $320. Depreciation charges
reported in the statement of operations as depreciation expense. Included in co
December 31, 2002 are advances to suppliers of equipment of $39.

6. Related Party Transactions

Amounts due to related parties at December 31, 2002 consisted of the followi

Due from related parties:	
Sual Ruda	
Due to related parties:	
Sual Ruda	
Mechel Trading House	
Total	
Capital lease obligation:	
Sual Ruda	
Multigroup	
Total	
Less: current portion	
Net of current portion	
Long-term debt:	
Sual Ruda	

(a) Sual Ruda

During the year ended December 31, 2002, the Company sold iron ore concen
affiliated with Sual-Holding (a former beneficial owner of the Company until
subsidiary of Mechel Steel Group at December 31, 2002, for a total of $18,49
handling fees in the amount of $1,046. The balance receivable from Sual Ruda
December 31, 2002 was $3,642. During the year ended December 31, 2002, th
Sual Ruda various raw materials and parts for a total of $12,244. The balance
31, 2002 for these transactions was $3,722.

Also, during the year ended December 31, 2002, Sual Ruda provided financin
by KMP s short-term interest-free and uncollateralized promissory notes, for
December 31, 2002, included within the total current liability due to related pa

In addition, the Company received from Sual Ruda a series of Ruble-denomin
aimed to cover working capital shortages and repayable in April 2004, interest
Discounted at an imputed interest rate approximating the estimated weighted a
the balance of long-term debt outstanding under these loans at December 31, 2
of $786, was $4,205. The discount was recorded as contribution to the additio
imputed interest on non-interest bearing loan from a related party.

Sual Ruda also provided vehicles to the Company under capital lease agreeme
2001. At December 31, 2002, obligations under these capital leases amounted
current maturity payments, and $341 non-current.

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(b) Mechel Trading House

During the year ended December 31, 2002, the Company received a series of s
uncollateralized Ruble-denominated loans, for a total of $466, from Mechel Tr
affiliated with Mechel, as financial assistance to cover its working capital shor

(c) Multigroup

Multigroup provided vehicles to the Company under capital lease agreements
At December 31, 2002, obligations under these capital leases amounted to $68

7. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities

Accrued expenses and other current liabilities consisted of the following, at D

Payroll payable	
Other expenses accrued	
Total accrued expenses and other current liabilities	

Taxes and other obligatory payments payable

As disclosed in Note 1, due to the bankruptcy proceedings going on, the Comp
and unpaid social charges in arrears, and related interest and penalties relating
following was included in the amount of total debt owed to the different state
December 31, 2002, which were overdue:

Social and pension charges	
Value added tax	
Road users tax	
Income taxes payable	
Other taxes and obligatory payment arrears	
Total principal of taxes and other obligatory payment arrears	
Interest and penalties	
Total taxes and other obligatory payments payable	

As disclosed in Note 13, subsequently, during the period preceding the Compa
beyond, these debts were fully repaid.

8. Shareholders Deficit

Capital stock

The capital stock of the Company consists of 250,126 common shares with pa
all of which have been authorized and issued since 1993.

Distribution of statutory earnings

In accordance with Russian legislation, the Company and its subsidiaries can d
or transfer them to reserves. Dividends may only be declared from accumulate
earnings as shown in the Russian statutory financial statements. Dividends are

F-156

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

a 6% individual withholding tax, which can be reduced or eliminated if paid to
applicable double tax treaties. At December 31, 2002, no amounts were availa
Company had accumulated losses of 522.3 million Russian rubles (approxima
based on the Russian statutory accounting reports. The subsidiaries had 30.6 n
(approximately, $963) available for distribution as determined based on their I
reports, however, the subsidiaries being limited liability companies did not hav
unless the controlling shareholder (the Company) wished to do so.

9. Income Taxes

The income tax benefit consisted of the following for the year ended Decembe

Current income taxes
Deferred income taxes
Total income tax benefit

Income tax is calculated at 24% of taxable profit in 2002 in accordance with th
Federation. A reconciliation between the theoretical income tax benefit compu
statutory tax rate to the pre tax loss presented in the accompanying consolidate
provision for income taxes reported in the accompanying consolidated financi

Theoretical income tax benefit computed on pre tax loss, at statutory tax rate o
Tax effect of permanent differences:
Effect of indexation of property,plant and equipment basis
Non-deductible expenses
Currency translation gain
Other permanent differences
Income tax benefit as reported

The deferred tax balances were calculated by applying the presently enacted st
the period in which the temporary differences between the carrying amounts a
liabilities are expected to reverse.

The amounts reported in the accompanying consolidated financial statements a
of the following:

Deferred tax asset current:
Allowance for doubtful accounts receivable
Other accruals and asset write offs
Total deferred tax assets
Deferred tax liability current:
Inventory and other valuation differences
Net deferred tax asset current
Deferred tax asset non-current:
Loss available for carry-forward
Deferred tax liability non-current:
Property, plant and equipment
Net deferred tax asset non-current

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

For Russian income tax purposes, the Company has accumulated tax losses, w use against future income within 10 years. Their use is restricted to a maximu Tax loss carry forwards may be eroded by future devaluation of the ruble. As Russian income tax purposes, the Company has tax losses available to carry fo 13,137 expiring at various dates through 2010-2011.

10. Revenue

Revenues for the year ended December 31, 2002, are comprised of the followi

Iron ore concentrate
Shipping and handling fee
Service revenue
Other revenue
Total revenue

11. Selling and Distribution and Operating Expenses

Operating expenses for the year ended December 31, 2002, are comprised of t

Depreciation
Personnel expenses
Fines and penalties
Raw materials
Social expenses
Transportation cost
Reversal of allowance for doubtful acounts
Total other perating expenses

The reversal of allowance for doubtful accounts is due to the fact that certain c
the Company for over 2 years as of December 31, 2001 andwere considered as
subsequently repaid their amounts outstanding in 2002.

Taxes other than income tax for the year ended December 31, 2002, are compr

Property and land tax	
Other taxes and penalties	
Total taxes other than on income	

12. Commitments and Contingencies

Contingencies

(a) General

The Russian economy continues to display certain traits consistent with that of
These characteristics include periods of high inflation, lack of liquidity in the c
existence of currency controls, which cause the national currency to be illiquid
continued success and stability of the Russian economy will be significantly a
continued actions with regard to supervisory, legal, and economic reforms.

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(b) Taxation

The Company is a subject to taxation in Russia. The Russian tax system contin
include value added tax, corporate income tax (profit tax), turnover-based taxe
others. Laws related to these taxes have been adopted only recently, in contras
economies; and implementing regulations are often unclear or nonexistent. Ma
regulations introduced in 2002 and beyond and previous years were not alway
interpretation is subject to the opinions of local tax authorities, the Central Bar
Instances of inconsistent opinions between local, regional and federal tax auth
Bank and the Ministry of Finance are not unusual, and few precedents with reg
established. Tax declarations, together with other legal compliance areas (for e
control matters) are subject to review and investigation by a number of author
impose severe fines, penalties and interest charges. These facts create tax risks
significant than typically found in countries with more developed tax systems.

In Russia, generally, tax declarations remain open and subject to inspection fo
fact that a year has been reviewed does not close that year, or any tax declarati
further review during the three year period. Management believes that it has pa
applicable. Where uncertainty exists as to the amount, the Company has accru
management s best estimate.

As the Company was in bankruptcy until late in 2003 (see Note 1 and Note 13
related interest and penalties was made. In the accompanying financial statem
current and in arrears with the related interest and penalties were accrued as ex

As of December 31, 2002, management of the Company does not believe that
relating to the Company, including pending or future governmental claims and
adjustment to the accompanying financial statements in order for those statem
misstated or misleading.

(c) Litigation, claims and assessments

The Company is subject to various lawsuits, claims and proceedings related to
business. In the opinion of management, the Company s liability, if any, in al
proceeding or other matters would not have a material effect upon the financia
operations or liquidity of the Company.

The Russian legal system, which regulates the Company s business, is charac between and among laws, presidential decrees, and Russian governmental, mi decisions, and resolutions and other acts; (2) conflicting local, regional and fe (3) the lack of judicial and administrative guidance on interpreting legislation; judges and courts in interpreting legislation; and (5) a high degree of discretio authorities. Management is unable to estimate what developments may occur such developments on the Company s financial condition or future results of

The Company s operations and financial position will continue to be affected developments, including the application of existing and future legislation and of such occurrences and their effect on the Company could have a significant to continue operations.

Table of Contents

Korshunov Mining Plant OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(d) Environmental

In the course of the Company s operations, the Company may be subject to en
proceedings. The quantification of environmental exposures requires an assess
including changing laws and regulations, improvements in environmental tech
information available related to specific sites, the assessment stage of each site
findings and the length of time involved in remediation or settlement. Manage
pending environmental claims or proceedings will significantly impair the Co
material adverse effect on its financial position.

13. Subsequent Events

a) Financing received and acquisition by Mechel

During the period ending October 15, 2003, the period preceding the acquisitio
the latter provided a Ruble-denominated short-term secured loan to KMP in th
rate of 20% p.a., a series of interest-free unsecured short-term financing disbur
$28,028, and an interest-free unsecured long-term debt for a total of $180, to f
operations. In addition, as of October 15, 2003, Mechel repaid $17,025 of the
arrears and guaranteed the repayment of the remainder of the bankruptcy debts

On October 16, 2003, Mechel obtained control over the Company upon its exi
and removal of external manager.

b) End of bankruptcy proceedings

On September 29, 2003, a court approved an Amicable Agreement and a debt
bankruptcy committee creditors, which ceased the bankruptcy proceedings. Su
Mechel repaid the outstanding tax debts restructured under the terms of the Am
30, 2004, all of the tax and social charges arrears with the related interest and
Amicable Agreement and relating to the bankruptcy period, were fully paid.

F-160

Table of Contents

Izhstal OAO

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING

Shareholders and the Board of Directors

Izhstal OAO

We have audited the accompanying consolidated balance sheet of Izhstal OAO (hereinafter referred to as the Izhstal), as of December 31, 2003, and the rel operations, cash flows and changes in shareholders equity for the year then e are the responsibility of Izhstal s management. Our responsibility is to expres statements based on our audit.

We conducted our audit in accordance with the standards of the Public Compa (United States). Those standards require that we plan and perform the audit to about whether the financial statements are free of material misstatement. An a test basis, evidence supporting the amounts and disclosures in the financial sta assessing the accounting principles used and significant estimates made by ma the overall financial statement presentation. We believe that our audit provides opinion.

As more fully described in Note 2(g) to the consolidated financial statements, equipment as of January 1, 2003, has been recorded at appraised values rather required by accounting principles generally accepted in the United States.

In our opinion, except for the effects of the matter discussed in the preceding p statements referred to above present fairly, in all material respects, the consoli Izhstal at December 31, 2003 and the consolidated results of its operations and ended in conformity with accounting principles generally accepted in the Unit

/s/ Ernst & Young (CIS) Limited

June 25, 2004

Moscow, Russia

Table of Contents

Izhstal OAO

CONSOLIDATED BALANCE SHEET

(in thousands of U.S. dollars, except share amounts)
Assets
Cash and cash equivalents (including $69 held at related party, Note 8)
Accounts receivable, net of allowance for doubtful accounts of $292
Inventories
Short-term investments
Prepayments and other current assets
Deferred taxes
Total current assets
Property, plant and equipment, net
Long-term investments and other assets
Total assets
Liabilities and Shareholders Equity
Short-term debt
Accounts payable and accrued expenses:
Trade accounts payable
Advances received
Taxes and social charges payable
Accrued expenses and other current liabilities
Deferred income taxes
Total current liabilities
Asset retirement obligations
Deferred income taxes
Total liabilities
Shareholders Equity
Common shares (1,000 Russian ruble par value); 750 million shares authorized; 800,729 shares issued and 739,760 shares outstanding
Preferred Type A shares (1,000 Russian ruble par value); 250 million shares authorized; 266,910 shares issued and 251,382 shares outstanding
Treasury shares, at cost
Accumulated other comprehensive income
Accumulated deficit
Total shareholders equity
Total liabilities and shareholders equity

See accompanying notes to consolidated financial sta

F-162

Table of Contents

Izhstal OAO

CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands of U.S. dollars, except share and per share amounts)	**N**
Revenue, net (including related party amounts of $138, Note 8)	
Cost of goods sold (including related party amounts of $121, Note 8)	
Gross margin	
Selling, distribution and operating expenses:	
Selling and distribution expenses	
General, administrative and other operating expenses	
Total selling, distribution and operating expenses	
Operating loss	
Other income and expense:	
Interest income	
Interest expense (including related party amounts of $22, Note 8)	
Foreign exchange gain, net	
Other income, net	
Total other expense, net	
Loss before income taxes and change in accounting principle	
Income tax benefit	
Loss before cumulative effect of change in accounting principle	
Change in accounting principle, net of tax	
Net loss	
Cumulative translation adjustment on opening balances	
Cumulative translation adjustment for 2003	
Total comprehensive income	
Basic and diluted loss per share:	
Loss per share before effect of change in accounting principle	
Loss per share effect of change in accounting principle	
Net loss per share	
Weighted average number of common shares used in computing basic and diluted loss per share	

See accompanying notes to consolidated financial sta

Table of Contents

Izhstal OAO

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands of U.S. dollars)
Cash Flows from Operating Activities
Net loss
Adjustments to reconcile net loss to net cash used in operating activities:
Depreciation
Foreign exchange gain
Change in deferred tax
Change in accounting principle
Allowance for doubtful accounts
Accretion expense
Loss on disposal of property, plant and equipment
Changes in assets and liabilities:
Accounts receivable
Inventories
Prepayments and other current assets
Trade accounts payable
Advances received
Accrued expenses and other current liabilities
Net cash used in operating activities
Cash Flows from Investing Activities
Purchases of property, plant and equipment
Proceeds from disposal of property, plant and equipment and other assets
Net cash used in investing activities
Cash Flows from Financing Activities
Proceeds from short-terms debt (including loans provided by related party of $
Repayment of short-term debt (including loans repaid to related party of $600)
Purchases of treasury shares
Net cash provided by financing activities
Effect of exchange rate changes on cash and cash equivalents
Net decrease in cash and cash equivalents
Cash and cash equivalents at beginning of year
Cash and cash equivalents at end of year
Supplemental non-cash flow information
Income taxes paid

Interest paid

See accompanying notes to consolidated financial sta

Table of Contents

Izhstal OAO

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS

(in thousands of U.S. dollars, except share amounts)	Common shares		Preferred shares		Treasury shares		Ac
	shares	amount	shares	amount	shares	amount	
Balances as of January 1, 2003	800,729	$ 132,352	266,910	$ 44,117	(70,556)	$ (192)	$
Net loss							
Purchase of treasury shares					(6,048)	(60)	
Cumulative translation adjustment on opening balances (see note 2(d))							
Cumulative translation adjustment for 2003							
Balances as of December 31, 2003	800,729	$ 132,352	266,910	$ 44,117	(76,604)	$ (252)	$

See accompanying notes to consolidated financial sta

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of December 31, 2003 and for the year then ended

(All amounts are in thousands of U.S. dollars, unless stated otherwise)

1. General Information and Business

Izhstal OAO (Izhstal , and together with its subsidiaries, the Company), v
upon privatization of state-owned Proizvodstvennoye Objedineniye (productio
in the eighteenth century. IZHSTAL has four insignificant subsidiaries involv

The Company is a metal processing plant producing a range of carbon and spe
Company sells its products within Russia and exports to different foreign mar
comprised of steel product manufacturers and metal trading companies.

2. Summary of Significant Accounting Policies

(a) Basis of accounting

The accompanying consolidated financial statements have been prepared in ac
principles generally accepted in the United States of America (U.S. GAAP)

Izhstal and its subsidiaries maintain their books and records in Russian rubles
in accordance with the accounting principles and practices mandated by Russi
accompanying consolidated financial statements are based on the underlying a
appropriately adjusted and reclassified for fair presentation in accordance with

The consolidated financial statements have been prepared using the historical c
by the initial valuation of property, plant and equipment as further disclosed in
consolidated financial statements.

The accompanying consolidated financial statements differ from the financial
Russian statutory purposes in that they reflect certain adjustments, not recorde
appropriate to present the financial position, results of operations and cash flov
GAAP. The principal adjustments relate to: (1) consolidation of financial posit
subsidiaries; (2) recognition of interest expense and other operating expenses;
of property and equipment; (4) foreign currency translation; (5) deferred incor
allowances for unrecoverable assets.

(b) Management plans

For the year ended December 31, 2003, the Company incurred net loss of $12,
cash flows from operations of $2,933. In addition, at December 31, 2003, the C
capital of $11,739. The Company may experience negative cash flow from ope
positive cash flow depends on the Company s ability to generate sufficient re
products and raise additional capital and funds in equity and debt securities ma

As disclosed in Note 13, on May 14, 2004, Mechel Steel Group OAO acquired
Company anticipates that its operations will benefit from integration into Mech
leverage ordinarily available to the members of integrated groups. These benef
Company in the form of efficiencies associated with the access to the establish
channels of Mechel Steel Group. Accordingly, management of the Company b
continue as a going concern for the foreseeable future.

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(c) Basis of consolidation

The accompanying consolidated financial statements of the Company include
its majority owned subsidiaries where no minority shareholder or group of mi
substantive participating rights. A subsidiary is an entity that is controlled by t
ownership, directly or indirectly, of more than 50 percent of the voting share c
means. All significant inter-company balances and transactions have been elin

The losses applicable to the minority in a consolidated subsidiary may exceed
assets of the subsidiary. The excess, and any further losses applicable to the m
majority interest except to the extent that the minority has a binding obligation
the losses. If the subsidiary subsequently reports profits, the majority interest i
the minority s share of losses previously absorbed by the majority has been re

(d) Reporting and functional currencies

The Company determined its reporting currency to be the U.S. dollar. The Co
the Russian ruble, as the majority of its revenues, expenses, property and equi
liabilities are either priced, incurred, payable or otherwise measured in Russia

As the economy of the Russian Federation was considered highly inflationary
transactions and balances not already measured in U.S. dollars were remeasur
were the U.S. dollar, in accordance with the relevant provisions of SFAS No.
Translation . The objective of this remeasurement process was to produce the
been reported if the accounting records had been kept in U.S. dollars. Under th
liabilities have been translated using the exchange rate as of the balance sheet
liabilities, including non-current assets and shareholders equity, are stated at
restated from their historic cost, by applying the historical exchange rate as at
transaction. Income and expenses are restated by applying the monthly averag
statement of cash flows are translated at the monthly average exchange rates a
exchange rates on the dates of the transactions. Foreign currency differences a
the local currencies to U.S. dollars are included in the consolidated income sta
gain .

Effective from January 1, 2003, Russia no longer meets the criteria for a highl
purposes of applying SFAS No. 52. Accordingly, for the periods starting Janu

its subsidiaries remeasure transactions and balances from their functional curr
currency in U.S. dollars using the current rate method as prescribed by SFAS
consolidated financial statements. The translation adjustments resulting from t
financial statements from the functional currency into the reporting currency a
other comprehensive income.

The official exchange rates for one U.S. dollar were 29.45 and 31.78 Russian
and 2002, respectively. The weighted average exchange rate of one U.S. dolla
31, 2003, was 30.69 Russian rubles.

(e) Devaluation, inflation, and currency restrictions and controls

The Russian ruble has historically been devaluing against the U.S. dollar due t
Russian Federation as well as other factors. During 2003, however, the Russia

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

7.4% against the U.S. dollar while official Russian ruble inflation was 12%. A
currency restrictions and controls related to converting Russian rubles into oth

At present, the Russian ruble is not convertible outside of the Russian Federati
transactions within the Russian Federation must be settled in Russian rubles. F
exchange rate between the Russian ruble and the U.S. dollar will affect the car
Russian ruble-denominated monetary assets and liabilities. Such movements n
ability to realize non-monetary assets represented in U.S. dollars in these cons
Official exchange rates are determined daily by the Central Bank of Russia an
a reasonable approximation of market rates. The translation of ruble-denomina
U.S. dollars for the purpose of these consolidated financial statements does no
could realize or settle in U.S. dollars the reported values of the assets and liabi
indicate that the Company could return or distribute the reported U.S. dollar va
earnings to its shareholders.

(f) Management estimates

The preparation of the Company s consolidated financial statements requires
and assumptions that affect the reported carrying amounts of assets and liabilit
assets and liabilities as of the date of the financial statements, and the amounts
recognized during the reporting period. Actual results could differ from those

(g) Property, plant and equipment

For the purpose of determining the opening balance sheet on the first applicati
2003, the Company performed a valuation of the property, plant and equipmen
from U.S. GAAP, as reliable historical cost information and information regar
available.

Property, plant and equipment acquired subsequent to January 1, 2003 are valu
cost less accumulated depreciation. Capitalized production costs for internally
material, direct labor costs, and allocable material and manufacturing overhea
activities are performed over an extended period, interest costs incurred during
The costs of planned major maintenance activities are recorded as the costs are
accrued in advance of the planned maintenance. Planned major maintenance a
overhauls. Costs for activities that lead to the prolongation of useful life or to c

of an asset are capitalized. Maintenance and repair costs are expensed as incur
on property, plant and equipment on a straight-line basis from the time the ass
their estimated useful lives as follows:

Category of asset
Buildings and structures
Transfer devices
Machinery and equipment
Transportation equipment and vehicles
Tools, furniture, fixtures and other

F-168

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Construction in progress and equipment held for installation are not depreciate
ready for its intended use. Upon sale or retirement, the acquisition or productio
depreciation are removed from the balance sheet and any gain or loss is includ
of operations.

(h) Impairment of long-lived assets

The carrying values of long-lived assets such as property, plant and equipment
reviewed for possible impairment whenever events or changes in circumstance
amount of an asset may not be recoverable. In the event that facts and circums
amount of any long-lived asset may be impaired, an evaluation of recoverabili
estimated future undiscounted cash flows associated with the asset would be c
amount to determine if a write-down is required. The remaining useful life of t
accordingly. An impairment loss is recognized to the extent that the carrying a
discounted cash flows. No impairment was recognized in the consolidated fina
December 31, 2003, and for the year then ended.

(i) Inventories

Inventories are stated at the lower of acquisition/manufacturing cost or market
weighted average basis and includes all costs in bringing the inventory to its p
The elements of costs include direct material, labor and allocable material and

Costs of production in process and finished goods include the purchase costs o
costs such as direct labor and an allocation of fixed and variable production ov
spare parts are valued at invoice cost inclusive of freight and other shipping co

Market value is the estimated price at which inventories can be sold in the nor
allowing for the cost of completion and sale.

(j) Accounts receivable

Accounts receivable are stated at net realizable value. If receivables are uncoll
corresponding allowance for doubtful accounts is recorded. If receivables are
receivable balance is charged off. Recoveries of receivables previously charge
received. Receivables that do not bear interest or bear below market interest ra
of more than one year are discounted with the discount subsequently amortize
term of the receivable. The Company reviews the valuation of accounts receiv
allowance for doubtful accounts is estimated based on historical experience of
expectations of conditions that might impact the collectibility of accounts.

(k) Investments

All investments in non-marketable equity securities of less than 20% owned e
Investments into debt instruments are accounted for as available for sale secur

(l) Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and deposits with banks wit
months or less.

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(m) Retirement benefit obligations

The Company is legally obligated to make defined contributions to the Russia
the Russian Federation Social Security (a defined contribution plan financed o
such, the Company has no legal obligation to pay and does not guarantee any f

Its only obligation is to pay the contributions as they fall due. If the Company
the State Social Security plan, it will have no obligation to pay the benefits ea
previous years. The Company s contributions to the Russian Pension Fund re
plans are charged to income in the year to which they relate.

Contribution to the Russian Pension Fund together with other social contributi
unified social tax (UST), which is calculated by the application of a regress
part of the annual gross salary below 100 thousand Rubles or approximately $
rate of the Ruble to the U.S. dollar at December 31, 2003) to 5% (applied to th
above 600 thousand Rubles or approximately $20, translated at the exchange r
dollar at December 31, 2003) to the annual gross remuneration of each employ
social funds (including the Russian Pension Fund), where the rate of contribut
Fund varies from 28% to 5%, respectively, depending on the annual gross sala

(n) Revenue recognition

Revenue is recognized on an accrual basis when earned and realizable, which
of products and rendering of services. Product revenue is represented by sales
services so far were immaterial. Both sales of products and services are recog
provisions for discounts and allowances and turnover taxes charged on gross r
tax and export duties, when realized or realizable and earned. This is usually t
evidence of an agreement, the risk of ownership has been transferred or the se
price has been agreed upon, and there is adequate assurance that collection wi

(o) Shipping and handling fees and costs

In accordance with EITF 00-10, Accounting for Shipping and Handling Fees classifies amounts billed to customers for shipping and handling as revenue an distribution and operating expenses. Shipping and handling costs for the year amounted to $2,056 and were included in selling and distribution expenses lin of operations.

(p) Income taxes

Provision is made in the financial statements for taxation of profits in accordar currently in force. The Company accounts for income taxes under the liability SFAS No. 109, Accounting for Income Taxes . Under the liability method, future tax consequences of temporary differences between the tax and financia liabilities and are measured using enacted tax rates to apply to taxable income temporary differences are expected to be recovered or settled. The effect on de of a change in the tax rates is recognized in income in the period that includes allowance is provided when it is more likely than

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

not that some or all of the deferred tax assets will not be realized in the future.
the expectations of future taxable income and reversals of the various taxable t

Prior to January 1, 2003, when Russia was deemed to be hyper-inflationary an
financial statements the Company did not recognize deferred tax liabilities or a
relating to assets and liabilities that, under SFAS No. 52, are re-measured from
functional currency using historical exchange rates and that result from change
for tax purposes.

The deferred tax affect associated with the temporary differences that arose fro
functional currency (from U.S. dollar to ruble) when Russia ceased to be consi
January 1, 2003, was reflected as an adjustment to the Company s cumulative
component of accumulated other comprehensive income on January 1, 2003.

(q) Total comprehensive income (loss)

SFAS No. 130, Reporting Comprehensive Income , requires the reporting o
addition to net income. For the year ended December 31, 2003, total comprehe
apart from the net loss of $12,696, included a cumulative translation adjustme
of the Russian ruble denominated financial statements in accordance with SFA
tax effect of change in functional currency of Izhstal from US Dollar to Russia
recorded in accordance with EITF 92-8 Accounting for the Income Tax Effe
109 of a Change in Functional Currency When an Economy Ceases to Be Con

(r) Financial instruments

The carrying amounts of financial instruments, consisting of cash equivalents,
receivable, trade accounts payable and short-term debt approximate their fair v

The Company, using available market information and appropriate valuation m
determined the estimated fair values of financial instruments. Since the Russia
for most of the financial instruments held by the Company, very limited or no
available to assess the fair value of the Company s financial instruments.

The cost method investments are shares of Russian companies that are not pub
value is not available. It is not practicable for the Company to estimate the fai
which a quoted market price is not available because it has not yet obtained or
necessary to make the estimate, and the cost of obtaining an independent valu
considering the materiality of the instruments to the Company. Therefore, such
cost. The Company does not use derivative financial instruments.

(s) Concentration of credit and other risks

Financial instruments, which potentially expose the Company to concentration
primarily of cash and cash equivalents, trade accounts receivable, taxes recove
Generally, the Company does not require any collateral to be pledged in conne
the above financial instruments. All of the Company s workforce is represent
covered by collective agreement, which is routinely renewed each year. The co
minimum salary levels, bonus plans, additional benefits and certain employee

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

protection rights. Management of the Company routinely interacts with trade u appropriate treatment of the employees and the stability of the Company s bu

(t) Earnings per share

In accordance with SFAS No. 128, Earnings per Share , basic loss per share weighted average number of common shares outstanding during the period. Th securities outstanding during the period; therefore, diluted earnings per share e share.

(u) Advertising costs

Advertising costs are expensed as incurred. During 2003 advertising costs wer

(v) Recently issued accounting pronouncements

Assets Retirement Obligations

Effective January 1, 2003, the Group adopted SFAS No. 143, Accounting fo which applies to legal obligations associated with the retirement and removal o 143 requires entities to record the fair value of an asset retirement obligation (when it is incurred (typically when the asset is installed at the production locat recorded, the entity capitalizes the cost by increasing the carrying amount of th equipment. Over time, the liability is increased for the change in its present va capitalized cost is depreciated over the useful life of the related asset. The Con 143 as of January 1, 2003. Upon adoption of SFAS No. 143 on January 1, 200 including tax benefit, as a result of a change in accounting principle. Applicati principle resulted in an increase in property, plant and equipment of $82 and a liability of $233. The application of SFAS No. 143 increased loss from contin $143, or $0.19 per basic and diluted share, for the year ended December 31, 20 numerous asset removal obligations that we are required to perform under law permanently taken out of service. Most of these obligations are not expected to the future and will be funded from general company resources at the time of re

retirement obligations primarily relate to the Company s production facilities
areas. The following table presents the movements in ARO for the year ending

Balance at January 1, 2003 (adoption)	
Liabilities incurred in the current period	
Liabilities settled in the current period	
Accretion expense	
Balance at end of year	

Consolidation of Variable Interest Entities

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Va
FIN 46 amended Accounting Research Bulletin No. 51, Consolidated Financia
established standards for determining under what circumstances a variable inte
consolidated with its primary beneficiary. FIN 46 also requires disclosures abo
required to consolidate but in which it has a significant variable interest.

F-172

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

On December 17, 2003, the FASB deferred the effective date of FIN 46 to no
reporting period that ends after March 15, 2004, however, for special-purpose
are required to apply FIN 46 by the end of the calendar year ending on Decem
FIN No. 46 is not expected to have a material impact on the Company s resul
position or cash flows.

3. Inventories

At December 31, 2003, inventories are comprised of the following:

Raw materials and purchased parts
Finished goods
Work in process
Total inventories

4. Prepayments and Other current assets

At December 31, 2003, prepayments and other current assets are comprised of

Input VAT recoverable
Other taxes recoverable
Prepayments, advances for materials and services
Total prepayments and other current assets

The Company has the legal right to offset VAT paid on purchases, subject to c
charged to customers related to sales to the extent the Company disbursed cas
Company records VAT receivable in the balance sheet gross to the extent such
VAT received from customers.

5. Property, plant and equipment

Property, plant and equipment consisted of the following at December 31, 200

Machinery and equipment	
Buildings and structures	
Vehicles and transportation equipment	
Transfer devices	
Tools, furniture, fixtures and other	
Accumulated depreciation	
Construction in progress	
Total property, plant and equipment, net	

As disclosed in Note 2(g) above, for the purpose of determining the opening b
equipment on the first application of U.S. GAAP at January 1, 2003, the Comp
the property, plant and equipment, as reliable historical cost information and i
acquisition dates was not available.

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

6. Short-term debt

Short-term debt at December 31, 2003 is comprised of the following:

Banks and Financial Institutions:
Ruble-denominated
US Dollar-denominated
Total

* *Based on the year-end balances and year-end interest rates weighted-ave*

The loans are collateralized by raw materials and finished goods (approximate
and equipment (approximately $38,352), at December 31, 2003.

In November to December 2003, the Company drew on its ruble credit facility
Bank to finance its operating activities, for a total amount of $3,565. Amounts
bear interest ranging from 12.5% to 14% per annum and mature from January
December 31, 2003, the amount available to the Company under this credit fac

In addition, from April to October 2003, the Company financed its capital exp
Dollar-denominated loans provided by International Moscow Bank and matur
in total, at LIBOR plus 7% per annum. As of December 31, 2003, the amount
this credit facility approximated $318.

In August to December 2003, the Company drew on its ruble credit facility op
operating activities for a total amount of $4,563. Amounts drawn under this fa
from 6% to 16% per annum and mature from January to November 2004. As o
amount available to the Company under this credit facility approximated $3,2

In August to December 2003, the Company drew on its ruble credit facility op
finance its operating activities in the total amount of $3,497. Amounts drawn o
interest rates ranging from 6% to 18% per annum and mature from January to
31, 2003, the amount available to the Company under this credit facility appro

7. Income Taxes

The income tax benefit consisted of the following for the year ended Decembe

Current income tax expense	
Deferred income tax benefit	
Total provision for income taxes (benefit)	

F-174

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

Income tax is calculated at a 24% nominal rate applied to taxable profit in 200
of the Russian Federation. A reconciliation between the theoretical income tax
the 24% statutory tax rate to the pre tax loss presented in the accompanying co
to the provision for income taxes reported in the accompanying consolidated f
follows:

Theoretical income tax benefit computed on pre tax loss, at statutory nominal
Tax effect of permanent differences:
Non-deductable social expenditures according to collective labor agreement
Other non-deductable expenses
Income tax benefit, as reported

The deferred tax balances were calculated by applying the presently enacted st
the period in which the temporary differences between the carrying amounts a
liabilities are expected to reverse. The amounts reported in the accompanying
statements for deferred taxes at December 31, 2003, consist of the following:

Deferred tax assets current:
Prepayment and other current assets
Trade and other accounts receivable valuation differences
Total current deferred tax assets
Deferred tax liabilities non-current:
Property, plant and equipment
Deferred tax liabilities current:
Inventory valuation differences
Total deferred tax liabilities, net

8. Related party

During the year ended December 31, 2003, the Company received $400 of sho
financing from Izhkombank, an affiliate, where the Company held an 8% inter

represented on its Board of directors by a member of Izhstal top-management,
debt, including the amounts outstanding at the beginning of the year. Interest c
the year and included in the consolidated statement of operations totaled $22.
Company also held $69 in current accounts and deposits at Izhkombank, at ma

During the year ended December 31, 2003, the Company had sales to and purc
from various affiliates on an aggregate basis totaling to $138 and $121, respec
individual entities were immaterial.

9. Shareholders Equity

Capital stock

Common shares

The capital stock of IZHSTAL consists of 750 million of authorized for issuar
value of 1,000 ruble each, of which 800,729 shares have been issued in 1998.

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

privatization of IZHSTAL, the regional government of the Republic of Udmur received a single share with special perpetual rights (the golden share) in IZ shareholder and board decisions. Decisions subject to veto include: increases a amendments to the charter, liquidation and reorganization of IZHSTAL or its s investment in other legal entities and disposal or encumbrance of subsidiaries total assets).

Preferred shares

The Company has 250 million of authorized for issuance non-cumulative prefe value of 1,000 ruble each, of which 266,910 shares have been issued in 1998. legislation and the Company s Charter, when the preferred shares in respect to declared or accrued dividends such preferred shares receive the voting rights a or until the time the dividends have been paid in full. The minimum dividends entitled to should comprise at least 10% of the net profit determined in accorda accounting rules; should the dividends declared on common shares be higher t share dividends referred to above, the preferred shareholders are entitled to the top of the minimum amount so the total dividend per one preferred share equa common share. In accordance with the Company s Charter, the preferred shar common shares, however, preferred shareholders are also entitled to a proporti between the Company s liquidation value and the redemption value of the pre participatory shares.

Treasury shares

During 2003 and earlier, a Company s subsidiary purchased approximately 6 and 15,500 of preferred shares in the open market, for $252 in total, which we Under the Russian law, treasury shares held by the issuer are neither entitled to meetings, nor entitled to dividends. However, as prescribed by the Russian law subsidiary are not restricted of their otherwise attaching voting rights and the r purchased by the issuer itself regardless of the fact of control over the subsidia upon the acquisition of the Company in May 2004 by Mechel Steel Group, the treasury shares.

Distribution of statutory earnings

In accordance with Russian legislation, the Company and its subsidiaries can d
or transfer them to reserves. Dividends may only be declared from accumulate
earnings as shown in the Russian statutory financial statements. Dividends are
withholding tax, which can be reduced or eliminated if paid to foreign owners
tax treaties.

At December 31, 2003, no amounts were available for dividends as the Compa
121 million rubles (or approximately $4,100) in accordance with the Russian s
The Company s subsidiaries are not open joint-stock companies and are not re

F-176

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

10. Revenues

Revenues for the year ended December 31, 2003 are comprised of the followi

by product group:	
Metal products	
Service and other revenue	
Total revenues	
by region of sale:	
Domestic	
Export	
Total revenues	

Domestic revenue includes shipments to customers domiciled in the Russian F
includes shipments made to customers located in foreign countries, including
of Independent States, other than Russia. The Company s total revenue by ge
December 31, 2003 was as follows:

Region	
Russia	
Europe	
Asia	
CIS	
Middle East	
USA	
Others	
Total	

11. Administrative and Other Operating Expenses

Major categories of administrative and other operating expenses during the ye
were as follows:

Personnel expenses with related taxes and social charges	
Taxes other than on income	
Social infrastructure maintenance costs	
Depreciation and amortization	
Other	
Total general, administrative and other operating expenses	

12. Commitments and Contingencies

Contingencies

(a) General

The Russian economy continues to display certain traits consistent with that of
These characteristics include periods of high inflation, lack of liquidity in the c
existence of currency controls, which cause the national currency to be illiquic

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

continued success and stability of the Russian economy will be significantly a
continued actions with regard to supervisory, legal, and economic reforms.

(b) Taxation

The Company is a subject to taxation in Russia. The Russian tax system conti
include value added tax, corporate income tax (profit tax), turnover-based taxe
others. Laws related to these taxes have been adopted only recently, in contras
economies; and implementing regulations are often unclear or nonexistent. Ma
regulations introduced in 2003 and previous years were not always clearly dra
subject to the opinions of local tax authorities, the Central Bank and the Minis
inconsistent opinions between local, regional and federal tax authorities and be
Ministry of Finance are not unusual, and few precedents with regard to issues

Tax declarations, together with other legal compliance areas (for example, cus
matters) are subject to review and investigation by a number of authorities tha
severe fines, penalties and interest charges. These facts create tax risks in Rus
significant than typically found in countries with more developed tax systems.

In Russia, generally, tax declarations remain open and subject to inspection fo
fact that a year has been reviewed does not close that year, or any tax declarati
further review during the three year period. Management believes that it has p
applicable. Where uncertainty exists as to the amount, the Company has accru
management s best estimate.

As of December 31, 2003, the Company does not believe that any other mater
Company, including pending or future governmental claims and demands, wh
the accompanying financial statements in order for those statements not to be
misleading.

(c) Litigation, claims and assessments

The Company is subject to various lawsuits, claims and proceedings related to
business. In the opinion of management, the Company s liability, if any, in al
proceeding or other matters would not have a material effect upon the financia
operations or liquidity of the Company.

The Russian legal system, which regulates the Company s business, is charac
between and among laws, presidential decrees, and Russian governmental, mi
decisions, and resolutions and other acts; (2) conflicting local, regional and fe
the lack of judicial and administrative guidance on interpreting legislation; (4)
judges and courts in interpreting legislation; and (5) a high degree of discretio
authorities. Management is unable to estimate what developments may occur
such developments on the Company s financial condition or future results of

The Company s operations and financial position will continue to be affected
developments, including the application of existing and future legislation and
of such occurrences and their effect on the Company could have a significant
to continue operations.

F-178

Table of Contents

Izhstal OAO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continu

(d) Environmental

In the course of the Company s operations, the Company may be subject to er
proceedings. The quantification of environmental exposures requires an assess
including changing laws and regulations, improvements in environmental tech
information available related to specific sites, the assessment stage of each site
findings and the length of time involved in remediation or settlement. Manage
pending environmental claims or proceedings will significantly impair the Cor
material adverse effect on its financial position.

13. Subsequent Events

On May 14, 2004, Mechel Steel Group (Mechel) won an auction held by the g
Udmurtia and purchased 27% of common shares previously held by the gover
already owned by Mechel purchased in the open market and from the Compan
shares, the total voting interest at the date of the auction comprised 58.4% and
interest in the Company. Shortly after the auction, Mechel increased its holdin
to 60.8%, at June 30, 2004, through continuing to purchase shares in the open

Table of Contents

Dealer Prospectus Delivery Obligation

Until the later of (1) 25 days after the date of this prospectus and (2) 60 days a
earlier, the date of registration by the Russian Federal Service for the Financia
report for the shares underlying the ADSs, as described in this prospectus, all
in these securities in the United States, whether or not participating in this offe
deliver a prospectus. This is in addition to the dealers obligation to deliver a
underwriters and with respect to their unsold allotments or subscriptions.

Sole Global Coordinator and Sole Bookrunne

UBS Investment Bank

Co-Lead Managers

JPMorgan Morgan Stanley

Co-Manager

Troika Dialog