OAO Raspadskaya

Management's discussion and analysis of financial condition and results of operations *for the six-month period ended 30 June 2010*

This discussion and analysis should be read in conjunction with Raspadskaya's unaudited interim condensed consolidated financial statements for the six-month period ended 30 June 2010 prepared in accordance with International Financial Reporting Standard IAS 34 Interim Financial Reporting.

This discussion and analysis contains forward-looking statements that involve risks and uncertainties. The actual results could differ materially from those anticipated in the forward-looking statements under the influence of numerous factors.

We are a group of integrated companies that specializes in production and sales of coking coal and has leading market positions in Russia in the industry. The Group is located in Mezhdurechensk city in the Kemerovo region of Russia and includes mines in operation and under construction, a preparation plant, a trading company, a managing company and companies engaged in transportation and infrastructure development.

Overview of financial results

	1H2010	1H2009	Change	
	US$000	*US$000*	*US$000*	
Revenue	**466,039**	147,704	318,335	*216%*
Cost of sales	**(177,259)**	(85,317)	91,942	*108%*
Gross profit	**288,780**	62,387	**226,393**	***363%***
Gross profit margin	***62%***	*42%*		
Selling and distribution costs	**(20,143)**	(480)	19,663	*4096%*
General and administrative expenses	**(31,512)**	(20,215)	11,297	*56%*
Social expenses	**(3,282)**	(2,825)	457	*16%*
Loss on disposal of PP&E	**(45,106)**	(748)	44,358	*5930%*
Foreign exchange losses	**(847)**	(23,557)	(22,710)	*(96)%*
Other operating income	**1,616**	743	873	*117%*
Other operating expenses	**(27,511)**	(5,741)	21,770	*379%*
Operating profit	**161,995**	9,564	**152,431**	***1594%***
Dividend income	**2**	11	(9)	*(82)%*
Interest income	**7,992**	5,799	2,193	*38%*
Interest expense	**(13,709)**	(12,624)	1,085	*9%*
Gain from a bargain purchase	**103,872**	–	103,872	*n/a*
Profit before income tax	**260,152**	2,750	**257,402**	***9360%***
Income tax	**(32,603)**	(2,395)	30,208	*1261%*
Profit for the period	**227,549**	355	**227,194**	***63998%***
Earnings per share, *US¢*	**29.17**	0.03		
EBITDA	**259,199**	63,092	**196,107**	***311%***
EBITDA margin	***56%***	*43%*		
EBIT	**203,248**	33,280	**169,968**	***511%***
EBIT margin	***44%***	*23%*		
Cash Capex	**74,882**	74,016	**866**	***1%***
	30/Jun/10	**31/Dec/09**		
Net debt	**5,951**	**122,255**	**(116,304)**	***(95)%***

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Mineral reserves and resources

According to IMC Economic and Energy Consultants Limited, as at 30 June 2006, we had total measured and indicated resources of 1,461 million tonnes of coking coal, and proved and probable reserves of 781.5 million tonnes, of which 43.8 million tonnes were extracted in the period from 1 July 2006 to 30 June 2010. These resources and reserves were estimated in accordance with the requirements of the JORC Code.

Since 30 June 2006, more mining licenses have been acquired. In December 2006, we acquired a license for open-pit extraction of coking coal in Raspadsky IX-XI area with resources of approx. 122.1 million tonnes (based on our 2009 estimates). In 2H2009, we acquired licenses to develop Raspadskaya-3 area with resources of approx. 300.0 million tonnes of coking coal and Raspadskaya-4 area with resources of approx. 107.7 million tonnes. In April 2010, we acquired Koksovaya mine with resources of approx. 151.2 million tonnes of coking coal. To confirm our estimates, we intend to conduct audit of our mineral reserves and resources in accordance with the JORC Code in the near future.

Under Russian classification, our coking coals are mainly of the GZh (gas fat), Zh (fat), and GZhO (gas fat semi-lean) grades. In addition, under licenses held by Raspadskaya Koksovaya and Koksovaya mines, we have deposits of coking coal of the K (coking) and KO (coking semi-lean) grades, which are scarce in Russia and the most valuable coals for coking.

Our reserves will be available for extraction for at least the next 70 years.

Key factors affecting our results of operations

Certain factors relating to our business and industry, as well as the political, economic and legal environment in Russia, affect our results of operations. Such factors include, among others, exchange rates, production capacity, supply and demand of coking coal (and related prices and sales volumes), and production and other costs.

Exchange rates

In reading this discussion and analysis, an important issue of changes in the Russian ruble/US dollar exchange rate should be taken into consideration. Our performance may be significantly affected by these changes. Our functional currency is the Russian ruble, and our assets, revenues and expenses are mostly denominated in rubles whereas our presentation currency is the US dollar.

Some exchange rates used in preparation of our consolidated financial information are presented in the following table:

	1H2010	**1H2009**	**Change**
Average exchange rate, *RUB/US$*	**30.0676**	33.0679	*(9)%*
	30/Jun/10	**31/Dec/09**	
Exchange rate, *RUB/US$*	**31.1954**	30.2442	*3%*

Production capacity

Production capacity of our mines sets a ceiling on our production volumes and, consequently, on sales volumes. Many factors affect our production capacity, among which are equipment capacity and mining conditions.

Our underground mining operations are affected by mining conditions, some of which may cause significant disruptions in production process.

On 9 May 2010, an accident occurred at Raspadskaya mine resulting in deaths and injury to people and heavy damage to property, plant and equipment. One of the negative effects of the accident was that Raspadskaya mine has stopped its operations which severely cut our production capacity.

After liquidation of the consequences of the accident, we plan to reconstruct Raspadskaya mine. The reconstruction process will be conducted in stages i.e. parts of the mine will recommence operation before the whole mine will be reconstructed. According to preliminary estimations, the total expenditure on the reconstruction of Raspadskaya mine will be about US$280m. This amount includes compensatory social payments, costs of fire extinguishing and pumping the water out, project works, purchase and repairs of property, plant and equipment, and preparation of coal faces. A plan containing timing and expenditures of the reconstruction will be announced after working all the details out.

On 28 April 2010, we acquired from Evraz a 100% ownership interest in ZAO Koksovaya, a mining company located in Mezhdurechensk, Russia, for a cash consideration of US$40.0m. Koksovaya mine extracts coking coal of the K and KO grades.

Koksovaya mine is developing the same coal seams as Raspadskaya-Koksovaya, our mine under construction, because both mines are located in neighboring subsoil areas – Coal Deposit #1 and Coal Deposit #2 of Olzherasskoe coalfield in Mezhdurechensk. Prospective development of Koksovaya mine cannot be considered separately from Raspadskaya-Koksovaya because both subsoil areas of the integrated coal deposit will be developed under the most optimal mining plan that implies a consecutive mining of upper seams ready for extraction by using infrastructure of Raspadskaya-Koksovaya mine. In future, we plan to merge Koksovaya with Raspadskaya-Koksovaya.

Under the deal, in May 2010 we signed a 10-year contract for delivery of a part of coal produced by Koksovaya and Raspadskaya-Koksovaya mines to Evraz at market price and in accordance with existing commercial practice.

Our activities depend on our ability to maintain steady production levels. Therefore, the availability and development of mineral reserves, maintenance of our mining equipment and overall facilities, as well as ensuring safe working conditions for our personnel are crucial for the results of our operations. We plan to increase expenditure on safety and improve safety systems as an absolute priority.

Supply and demand of coking coal

Our operating results are profoundly influenced by the balance of supply and demand of different types of coking coal on domestic and international markets. The balance determines prices of coking coal and drives sales volumes. The balance is primarily influenced by fluctuations in the volume of production of steel and coke, by changes in coal production capacity and other related factors which in their turn are driven by the condition of the Russian and global economies.

Our customers are large domestic and foreign steel and coke producers. Therefore, our results are influenced by trends in the Russian and international steel markets. Cyclical fluctuations in the steel industry will continue to affect our future sales of coking coal.

After a big drop in demand caused by the global economy recession, during 2009 and 1H2010 the demand in Russia and the world for metallurgical products and, consequently, for coking coal has been gradually restoring which affected positively our sales and production volumes.

Our results can be indirectly affected by the situation with the coal production capacities and the sales volumes of our competitors. We believe that there will be no significant increase of the Russian coking coal capacity in the short- to medium-term mainly due to the following factors: prevailing difficult geological and mining conditions that are likely to further aggravate as the mining is forced to go to deeper levels; and significant lead times and investments to a production launch at green-field underground mines.

We intend to sustain our competitiveness based primarily on an optimal price/quality balance and relatively low cost of our products.

Prices of coking coal

Both domestic and export prices of coking coal have a crucial impact on our revenue and therefore results of operations.

With the coking coal market, there are no accepted reference to posted prices and a very limited futures market outside of Europe. Coal is sold under term contracts or on the spot market and, in term of pricing differentials, coking coal is priced according to its coking characteristics because coking coal is a product with significant quality differentiations. Coal quality is therefore the major criteria for customer selection before price considerations.

During 2009 and 1H2010, we operated in the frames of long-term contracts with our major Russian customers and negotiated the volumes and prices on the quarterly basis. In contracts, our domestic sales prices are set in rubles, and export prices are set in US dollars.

We made all our domestic sales and sales to Ukraine and Hungary under FCA Mezhdurechensk terms because the terms involve fewer risks for the seller. In 2010 and 1H2009, all sales to Asia were made under FOB Shipping point delivery terms, in which case transportation and other related costs were included in the contract price.

Starting 2Q2009, the recovering demand drove prices of our coal up.

Quarterly dynamics of weighted average prices of our coal concentrate on FCA Mezhdurechensk and FOB Shipping point terms for 2009 and 1H2010 are set out in the following table:

	1Q2009	**2Q2009**	**3Q2009**	**4Q2009**	**1Q2010**	**2Q2010**
	US$ per tonne					
Russia (FCA)	48.2	49.4	51.2	91.8	103.0	125.0
QoQ change	*(60)%*	*2%*	*4%*	*79%*	*12%*	*21%*
Export (FCA)	44.1	40.4	54.0	88.4	104.2	126.6
QoQ change	*n/a*	*(8)%*	*34%*	*64%*	*18%*	*22%*
Export (FOB)	–	81.6	94.7	100.0	136.4	164.6
QoQ change	*n/a*	*n/a*	*16%*	*6%*	*36%*	*21%*

In July and August 2010, the weighted average price of our coal concentrate on FCA Mezhdurechensk terms was US$123.3 per tonne, there were no export sales.

Weighted average prices of our coal concentrate are set out in the following table:

	1H2010	**1H2009**	**Change**
	US$ per tonne		
Russia (FCA)	**111.2**	48.8	*128%*
Export (FCA)	**109.6**	41.5	*164%*
Export (FOB)	**152.1**	81.6	*86%*

Our export prices differ depending on the market.

Sales volumes

The gradual recovery of demand for coking coal as well as our active export policy led to a growth in sales volumes. At present, although we see a significant demand for coking coal on both domestic and export markets, our impaired production capacity keeps our sales volumes in check since May 2010.

Quarterly dynamics of sales volumes of our coal concentrate for 2009 and 1H2010 are set out in the following table:

	1Q2009	2Q2009	3Q2009	4Q2009	1Q2010	2Q2010
			thousands of tonnes			
Russia	963	1,044	1,591	1,938	1,580	974
QoQ change	*20%*	*8%*	*52%*	*22%*	*(18)%*	*(38)%*
Export – West	337	606	419	330	258	88
QoQ change	*n/a*	*80%*	*(31)%*	*(21)%*	*(22)%*	*(66)%*
Export – Asia	–	36	245	206	395	482
QoQ change	*n/a*	*n/a*	*581%*	*(16)%*	*92%*	*22%*
Export – Total	337	642	664	536	653	570
Total	**1,300**	**1,686**	**2,255**	**2,474**	**2,233**	**1,544**
QoQ change	***63%***	***30%***	***34%***	***10%***	***(10)%***	***(31)%***

The decrease in domestic sales volumes in 1Q2010 by 18% QoQ was to a significant degree due to the anomalously low temperatures that set in for a long period of time and disruptions in the production process.

Sales volumes of our coal concentrate and raw coal by our markets and major customers are set out in the following table:

	1H2010		1H2009			
	Volume	Portion	Volume	Portion	Change	
	thousands of tonnes		*thousands of tonnes*		*thousands of tonnes*	
Coal concentrate – Russia						
Evraz	**706**	***19%***	420	*14%*	286	*68%*
Kemerovo-Koks	**619**	***16%***	289	*10%*	330	*114%*
NLMK (including Altay-Koks)	**398**	***10%***	329	*11%*	69	*21%*
MMK	**392**	***10%***	485	*16%*	(93)	*(19)%*
Mechel	**231**	***7%***	240	*8%*	(9)	*(4)%*
Urals Steel	**101**	***3%***	111	*4%*	(10)	*(9)%*
Other	**108**	***3%***	133	*4%*	(25)	*(19)%*
	2,555	***68%***	2,007	*67%*	**548**	***27%***
Coal concentrate – export						
China	**495**	***13%***	–	–	495	*n/a*
Republic of Korea	**381**	***10%***	–	–	381	*n/a*
Ukraine [(1)]	**346**	***9%***	872	*29%*	(526)	*(60)%*
Hungary	**–**	**–**	71	*2%*	(71)	*(100)%*
Japan	**–**	**–**	36	*1%*	(36)	*(100)%*
	1,222	***32%***	979	*32%*	**243**	***25%***
Coal concentrate – total	**3,777**	***100%***	2,986	*99%*	**791**	***26%***
Raw coal – Russia [(2)]	**21**	***0%***	26	*1%*	(5)	*(19)%*
Coal concentrate and raw coal [(3)]	**3,793**	***100%***	3,005	*100%*	**788**	***26%***

(1) Including sales to coke plants of Evraz in the volume of 318 thousand tonnes in 1H2010 and 372 thousand tonnes in 1H2009;
(2) Including sales to Evraz in the volume of 21 thousand tonnes in 1H2010;
(3) Raw coal has been restated in tonnes of coal concentrate at the output ratio of 75.9% for 1H2010 and 73.3% for 1H2009.

A considerable part of our coal products was sold to large domestic steel and coke producers such as Evraz, Novolipetsk Iron and Steel Plant ("NLMK") including its subsidiary Altay-Koks, and Magnitogorsk Iron and Steel Plant ("MMK"). The portion of domestic sales volumes to these three companies accounted for 39% and 41% of our total coal concentrate and raw coal sales volume in 1H2010 and 1H2009, respectively.

Our related party, Evraz, remained our largest customer – its share in total coal concentrate and raw coal sales volume was 28% in 1H2010 and 26% in 1H2009.

Before May 2010, we diversified our Russian client base. In this way, we sold considerable volumes to such medium-sized companies as Mechel, Urals Steel (managing company Metalloinvest) and Kemerovo-Koks. The sales volume to Kemerovo-Koks increased by 114% YoY, thus making the company our second-largest Russian customer.

Before May 2010, we diversified and expanded our export sales. The most important feature of the diversification was the move toward the Asian export market which made Asia our largest export market in 1H2010 for the first time in our history. The portion of Asia in our export coal concentrate sales volume was 72% in 1H2010 and 4% in 1H2009. In future, in line with our market strategy to increase export sales in our total sales, we intend to get back to the Asian market because of its large potential for growth and our settled relations with the clients there.

Sales volume to Ukraine dropped by 60% YoY mainly because of a slowdown in the Ukrainian metallurgical industry.

After May 2010, in order to minimize the negative effects of the sudden drop in coking coal production for the Russian metallurgical industry, we supply Russian customers only. As our production volumes increase, we will supply other customers, both domestic and foreign.

Revenue

The following table sets out our domestic and export sales by product types restated under common delivery terms (FCA Mezhdurechensk) by deducting transportation costs from the revenue reported in the financial statements in respect of sales of coal concentrate made under other types of delivery terms (FOB Shipping point):

	1H2010		1H2009			
	Amount	**Portion**	**Amount**	**Portion**	**Change**	
	US$000		*US$000*		*US$000*	
Coal concentrate – Russia	**284,184**	***70%***	97,878	*70%*	186,306	*190%*
Coal concentrate – export	**122,468**	***30%***	40,416	*29%*	82,052	*203%*
	406,652	***100%***	138,294	*99%*	**268,358**	***194%***
Raw coal – Russia	**1,900**	***0%***	653	*1%*	1,247	*191%*
	408,552	***100%***	138,947	*100%*	**269,605**	***194%***
Transportation costs included in sales price under FOB delivery terms	**48,728**		1,533		47,195	*3079%*
Sales of other goods	**6,118**		5,788		330	*6%*
Rendering of services	**2,641**		1,436		1,205	*84%*
Revenue	**466,039**		147,704		**318,335**	***216%***

In 1H2010, 98% of our total revenue was derived from sales of coal concentrate and raw coal (including transportation costs) as compared to 95% in 1H2009. Starting May 2010, we sell raw coal of the K and KO grades extracted by Koksovaya mine.

Transportation costs included in sales price increased sharply because of the significant growth in sales volumes to South East Asia under FOB Far East terms.

Sales of other goods, which consist mainly of resale of steel products, were almost flat.

Rendering of services, which mainly included coal transportation services provided locally to other coal companies, increased by 84% YoY due to increased volumes of transported coal.

Production volumes

Our production volumes are driven by demand but also restricted by production capacity. A significant proportion of our costs can be classified as fixed costs which is typical for the extraction industry and therefore our production level is one of the key factors in determining our overall cost competitiveness.

Production volumes of our raw coal and coal concentrate are set out in the following table:

	1H2010	**1H2009**	**Change**	
	thousands of tonnes	*thousands of tonnes*	*thousands of tonnes*	
Raw coal production [1]	**4,778**	4,168	610	*15%*
Raw coal preparation	**4,822**	4,168	654	*16%*
Coal concentrate production	**3,659**	3,055	604	*20%*
Output ratio	***75.9%***	*73.3%*		

(1) Including preproduction extraction at Raspadskaya-Koksovaya in the volume of 30 thousand tonnes in 1H2010 and 3 thousand tonnes in 1H2009

The increase in the output ratio was a consequence of a decrease in ash content of raw coal.

The increase in raw coal production volume in 1H2010 as compared to 1H2009 was driven by the increased demand for coking coal. After May 2010, we extract as much coal as our decreased production capacity allows.

Production costs and efficiency

Our competitiveness and long-term profitability depend to a significant degree on our ability to maintain relatively low costs and high efficiency of our operations.

A breakdown of our costs of production and sales is set out in the following table:

	1H2010		1H2009			
	Amount	Portion	Amount	Portion	Change	
	US$000		*US$000*		*US$000*	
Payroll	**28,650**	***21%***	19,550	*25%*	9,100	*47%*
Payroll taxes	**8,830**	***6%***	6,164	*8%*	2,666	*43%*
Other taxes	**11,477**	***8%***	5,571	*7%*	5,906	*106%*
Materials	**22,331**	***16%***	10,964	*14%*	11,367	*104%*
Electricity	**7,408**	***5%***	5,257	*7%*	2,151	*41%*
Other costs and expenses	**8,150**	***6%***	3,057	*4%*	5,093	*167%*
Cash cost of production (1)	**86,846**	***62%***	50,563	*65%*	**36,283**	***72%***
Depreciation, depletion (excluding mineral reserve) and amortization	**34,366**	***25%***	16,670	*21%*	17,696	*106%*
Depletion of mineral reserve	**18,324**	***13%***	10,812	*14%*	7,512	*69%*
Cost of production	**139,536**	***100%***	78,045	*100%*	**61,491**	***79%***
Railroad costs	**31,813**		1,533		30,280	*1975%*
Cost of resold goods	**5,883**		5,644		239	*4%*
Change in finished goods	**27**		95		(68)	*(72)%*
Cost of sales	**177,259**		85,317		**91,942**	***108%***

(1) Cash cost of production represents cost of sales before railroad costs, cost of resold goods, changes in finished goods and depreciation, depletion and amortization. We present cash cost of production and other measures calculated using cash cost of production because we consider them important supplemental measures of our operating performance and believe they are frequently used in the evaluation of companies in our industry. Cash cost of production and other measures calculated using cash cost of production have limitations as analytical tools, and should not be considered in isolation, or as a substitute for analysis of our operating results as reported under IFRS. We compensate for these limitations by relying primarily on our IFRS operating results and using cash cost measures only as supplemental. Cash cost of production and other measures calculated using cash cost of production are measures of our operating performance that is not required by, or presented in accordance with, IFRS. Cash cost of production and other measures calculated using cash cost of production are not measurement of our operating performance under IFRS and should not be considered as an alternative to net income, operating income or any other performance measures derived in accordance with IFRS.

Cash costs of our coal concentrate production are set out in the following table:

	1H2010	1H2009	Change	
	US$000	*US$000*	*US$000*	
Estimated cash cost of raw coal used in concentrate preparation (1)	**77,614**	45,548	32,066	70%
Cash cost of preparation	**9,940**	5,015	4,925	98%
Total cash cost of coal concentrate production	**87,554**	50,563	**36,991**	**73%**
	US$	*US$*		
Cash cost per tonne of raw coal produced	**16.1**	10.9		*48%*
Preparation cash cost per tonne of raw coal used	**2.1**	1.2		*75%*
Total cash cost per tonne of coal concentrate production (2)	**23.9**	16.6		***44%***

(1) Estimated cash cost per tonne of raw coal used in concentrate preparation is a computed value calculated based on the volumes of raw coal used in concentrate preparation and the average cash cost per tonne of raw coal produced;

(2) Raw coal has been restated in tonnes of coal concentrate at the output ratio of 75.9% for 1H2010 and 73.3% for 1H2009.

The increase in our cash cost of coal concentrate production by 72% YoY was driven mainly by industry inflation, return of certain expenses to pre-crisis levels, and the growth in production volumes by 20%. The lower average RUB/US$ exchange rate also contributed to the increase in cash cost of production. Thus, the ruble denominated total cash cost per tonne of coal concentrate produced increased by 31% YoY.

In 2H2010, because Raspadskaya mine stopped operation, we expect an increase in the ruble denominated cash cost per tonne of coal concentrate produced.

Payroll and payroll taxes

Payroll and payroll taxes (labor costs) constitute the largest item of our production cash costs – their portion in cash cost of production was 43% in 1H2010 and 51% in 1H2009.

Before 1 January 2010, payroll taxes were represented by the unified social tax ("UST") that mainly included regular mandatory contributions to the state Pension Fund of Russia. UST included also contributions to medical insurance funds and mandatory industrial accident and occupational disease insurance charges. Since 1 January 2010, UST has been abolished and insurance contributions are paid to the funds separately. We have no legal or constructive obligation to pay further contributions in respect of the State benefits.

Information on our overall labor force and costs (including production, general and administrative, and construction) is summarized in the following table:

	1H2010	**1H2009**	**Change**	
Average total number of employees	**7,787**	7,498	289	*4%*
Total payroll, *US$000*	**52,811**	31,217	21,594	*69%*
Total payroll taxes, *US$000*	**14,797**	9,076	5,721	*63%*
Average annual pay per employee, *US$*	**13,564**	8,327	5,237	*63%*
Effective payroll tax rate	***28%***	*29%*		

The increase in the overall labor costs by 68% YoY reflected a return to pre-crisis levels of pay and the labor costs inflation. In June 2010, we increased miners' average pay. Consequently, we expect that the ruble denominated labor costs will increase in 2H2010 as compared to 1H2010.

As we are socially responsible before our employees, we retain all Raspadskaya's permanent staff after the mine stopped operation. As at 30 June 2010, the number of employees of Raspadskaya mine was 3,564, of whom 131 and 205 workers of Raspadskaya mine had been employed at our mines, MUK-96 and Raspadskaya-Koksovaya, respectively, and the rest were engaged in the reconstruction of the mine.

Other taxes

Other taxes included in production costs consist primarily of the mineral extraction tax. The increase in other taxes by 106% (US$5.9m) YoY was mainly due to the increase in coal prices and extraction volume.

Materials and electricity

The increase in materials cost by 104% (US$11.4m) YoY was mainly due to the increase in extraction and preparation volumes and to a significant increase of overburden removal. The increase in electricity cost by 41% (US$2.2m) was caused by the growth of production volumes and an increase of the tariff by 22%.

Depreciation, depletion and amortization

Depreciation, depletion and amortization comprise a significant portion in our cost of production (38% in 1H2010 and 35% in 1H2009). Depreciation, depletion (excluding mineral reserve) and amortization increased by 106% YoY mainly because of a large amount of additions of property, plant and equipment in 2009. The lower average RUB/US$ exchange rate also affected the amount – the ruble denominated charge increased by 87%.

Depletion of mineral reserves is directly proportional to extraction volumes. Mineral reserves represent tangible assets acquired in business combinations in 2006 (MUK-96 and Razrez Raspadsky). The increase in depletion charge was due to a significant increase of production by these two mines and to the lower average RUB/US$ exchange rate.

Other income and expenses

Railroad costs

All the coal products we sell are transported by railroad. We are among the few Russian coal producers who own and operate an integrated coal transportation network that is directly connected to the federal railroad system operated by the state monopoly OJSC Russian Railways. Our proprietary coal transportation network includes 15 km of railroad which connects our production facilities with the federal railroad station Mezhdurechensk.

Fluctuations of railroad tariffs affect the total cost paid by our customers, and as such, may impact demand for our coal from any customers located far from our production site. From 1 January 2010 railroad tariffs increased by 9.4% (in ruble terms).

Selling and distribution costs

Selling and distribution costs mainly include transportation and loading services in ports and customs fees pertaining to the export sales. Selling and distribution costs increased by US$19.7m YoY mainly because of the significant growth in sales volumes to Asia under FOB Far East terms. We expect that in 2H2010 selling and distribution costs will significantly drop because there will be no export sales.

General and administrative expenses

A breakdown of our general and administrative expenses is set out in the following table:

	1H2010		**1H2009**			
	Amount	**Portion**	**Amount**	**Portion**	**Change**	
	US$000		*US$000*		*US$000*	
Payroll	**15,842**	***50%***	9,278	*46%*	6,564	*71%*
Payroll taxes	**3,579**	***11%***	2,296	*11%*	1,283	*56%*
Other taxes	**5,483**	***17%***	3,468	*17%*	2,015	*58%*
Materials	**768**	***2%***	296	*1%*	472	*159%*
Depreciation and amortization	**1,573**	***5%***	1,205	*6%*	368	*31%*
Other costs and expenses	**4,267**	***15%***	3,672	*19%*	595	*16%*
	31,512	***100%***	20,215	*100%*	**11,297**	***56%***

The increase in general and administrative expenses by 56% YoY was mainly a result of a return to normal, pre-crisis levels of expenditure. More than half of our general and administrative expenses are labor costs – 61% in 1H2010 and 57% in 1H2009. The increase in labor costs by 68% YoY was primarily a consequence of a return to the normal workday hours after a 30% reduction in 1H2009.

Property tax constitutes the core of other taxes. The increase in property tax expenses was primarily due to mining equipment and the 2nd stage of the preparation plant put into operation in 2H2009.

Other costs and expenses include insurance, bank, information, communication, consulting, audit and other services.

Social expenses

As is the case for many of large Russian production companies, we bear certain social costs and social infrastructure maintenance expenses which are primarily in the form of donations and assistance to social sphere infrastructure. The increase in social expenses by 16% YoY (US$0.5m) reflects a return to pre-crisis levels of these expenses after reductions implemented in 1H2009.

Loss on disposal of property, plant and equipment

The profit (loss) arising from the disposal (derecognition) of items of property, plant and equipment is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the items. The amount of the loss on disposal of property, plant and equipment in 1H2010 (US$45.1m) was mainly due to damage from the accident at Raspadskaya mine.

Foreign exchange gains/(losses)

Foreign exchange gains and losses relate to the differences arising from revaluation of assets and liabilities in foreign currencies (primarily US dollars) and exchange rate differences on sales and purchase of foreign currencies. In 1H2010, RUB/US$ exchange rate went up 3% therefore the revaluation of our dollar debt brought about an exchange loss of US$9.8m. But revaluation of our Euro debt and dollar deposits partially compensated for the loss, so that the resulting loss was US$0.8m.

Other operating income and expenses

Other operating income and expenses consist of various untypical for our business, non-recurring income and expenses. Other operating expenses significantly increased by 379% (US$21.8m) YoY because we incurred certain expenses associated with the liquidation of the consequences of the accident at Raspadskaya mine in May 2010.

Expenses associated with the liquidation of the consequences of the accident included payroll and payroll taxes, cost of materials, electricity, services, drilling, reconstruction of coal faces, compensation social payments and other expenses. In addition, after Raspadskaya mine stopped operation in May 2010, depreciation and amortization of its production property, plant and equipment has been included in other operating expenses. In 1H2010, expenses associated with the liquidation of the consequences of the accident were US$20.2m, including payments and accruals to the families of the killed and to the injured in the amount of US$6.3m.

Interest income and interest expense

Interest income mainly related to deposits held in Russian banks. The increase in interest income by 38% (US$2.2m) was mainly due to a larger amount of bank deposits held in 1H2010 as compared to 1H2009.

The core of interest expense is the 7.5% coupon on our eurobonds – every half year we pay US$11.25m. In addition, in 1H2010, there was interest cost on benefit obligation in the amount of US$1.3m.

Gain from a bargain purchase of subsidiary

Gain from a bargain purchase of subsidiary (US$103.9m) is the difference between the provisional fair value of net assets of the acquired entity, Koksovaya, (US$143.9m) and the cash fair value of transferred consideration (US$40.0m).

Income tax

In 1H2010, the amount of income tax expense (US$32.6m) represents the difference between the tax accrued (US$44.3m) and the change in the amount of the deferred income tax liability and asset (US$11.7m).

EBITDA and indebtedness

Consolidated EBITDA [(1)], as stipulated in the Loan Agreement on the eurobonds, is calculated in the following table:

	1H2010	1H2009	Change	
	US$000	*US$000*	*US$000*	
Profit/(loss) for the period	**227,549**	355	227,194	*63998%*
Adjusted for:				
Foreign exchange (gains)/losses, net	**847**	23,557	(22,710)	*(96)%*
(Gain)/loss on net monetary position	**(658)**	87	745	*n/a*
Consolidated Profit	**227,738**	23,999	**203,739**	***849%***
Adjusted for:				
Dividend income	**(2)**	(11)	(9)	*(82)%*
Interest income	**(7,992)**	(5,799)	2,193	*38%*
Interest expense	**13,709**	12,624	1,085	*9%*
Capitalized interest	**–**	264	(264)	*(100)%*
Amortization of debt issuance cost	**(212)**	(192)	20	*10%*
Gain from a bargain purchase of subsidiary	**(103,872)**	–	103,872	*n/a*
Extraordinary loss on disposal of PP&E	**41,276**	–	41,276	*n/a*
Income tax	**32,603**	2,395	30,208	*1261%*
EBIT	**203,248**	33,280	**169,968**	***511%***
Adjusted for:				
Depreciation, depletion and amortization	**58,026**	30,375	27,651	*91%*
Capitalized depreciation	**(2,075)**	(563)	1,512	*269%*
Consolidated EBITDA	**259,199**	63,092	**196,107**	***311%***

(1) EBITDA represents profit for the period before foreign exchange gains/(losses), gain/(loss) on net monetary position, depreciation, depletion and amortization, dividend income, interest income and expense, gain from a bargain purchase of subsidiary, extraordinary loss on disposal of property, plant and equipment, and income tax expense. We present EBITDA because we consider it an important supplemental measure of our operating performance and believe it is frequently used in the evaluation of companies in our industry. EBITDA has limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our operating results as reported under consolidated IFRS financial statements. We compensate for these limitations by relying primarily on our consolidated IFRS operating results and are using EBITDA only as a supplement. EBITDA is a measure of our operating performance that is not required by or presented in accordance with IFRS. EBITDA is not a measurement of our operating performance under IFRS and should not be considered as an alternative to profit for the period, profit before income tax or any other performance measures derived in accordance with IFRS or as an alternative to cash flow from operating activities or as a measure of our liquidity. In particular, EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business.

Consolidated Net Indebtedness [(2)] is calculated in the following table:

	30/Jun/10	31/Dec/09	Change	
	US$000	*US$000*	*US$000*	
Long-term loans	**299,252**	303,343	(4,091)	*(1)%*
Short-term loans and current portion of long-term loans	**13,619**	28,384	(14,765)	*(52)%*
Less:				
Long-term bank deposits	**(21,000)**	(31,242)	(10,242)	*(33)%*
Short-term bank deposits	**(195,517)**	(149,953)	45,564	*30%*
Cash and cash equivalents	**(90,403)**	(28,277)	62,126	*220%*
Consolidated Net Indebtedness	**5,951**	122,255	**(116,304)**	***(95)%***

(1) Consolidated Net Indebtedness (Net debt) represents loans less deposits and cash and cash equivalents. We present Net debt because it is stipulated in the Loan Agreement on the eurobonds and we consider it an important supplemental measure of our financial position and believe it is frequently used in the evaluation of companies in our industry. Net debt has limitations as an analytical tool, and should not considered in isolation, or as a substitute for analysis of our financial position as reported under consolidated IFRS financial statements. We compensate for these limitations by relying primarily on our consolidated IFRS financial position and are using Net debt only as a supplement. Net debt is a measure of our financial position that is not required by or presented in accordance with IFRS.

Our long-term debt was represented primarily by 7.5% eurobonds in the amount of US$300m due 22 May 2012. Short-term loans were mainly letters of credit we open to buy imported equipment.

One of the covenants stipulated in the Loan Agreement on the eurobonds is Net Leverage Ratio which represents the ratio of Consolidated Net Indebtedness to 12-month Consolidated EBITDA.

12-month Consolidated EBITDA for 1H2010 is calculated in the following table:

	US$000
EBITDA for 2009	255,079
Less:	
EBITDA for 1H2009	(63,092)
Add:	
EBITDA for 1H2010	259,199
12-month Consolidated EBITDA	**451,186**

Net Leverage Ratio may not exceed 3. As at 30 June 2010, Net Leverage Ratio was 0.01. As at 30 June 2010, none of the covenants stipulated in the Loan Agreement on the eurobonds was breached. We believe none of the covenants will be breached.

Working capital

Our working capital is calculated in the following table:

	30/Jun/10	**31/Dec/09**	**Change**	
	US$000	*US$000*	*US$000*	
Taxes recoverable	**30,765**	14,542	16,223	*112%*
Receivables	**117,501**	147,355	(29,854)	*(20)%*
Prepayments	**13,319**	17,800	(4,481)	*(25)%*
Inventories	**52,933**	44,274	8,659	*20%*
Less:				
Taxes payable	**(24,567)**	(33,904)	(9,337)	*(28)%*
Advances	**(278)**	(3,095)	(2,817)	*(91)%*
Payables	**(47,420)**	(44,962)	2,458	*5%*
Working capital	**142,253**	142,010	**243**	***0%***

Working capital did not change materially. Receivables decreased by 20% (US$29.9m) mainly due to decreased sales volumes in 2Q2010. The increase in inventories by 20% (US$8.7m) was to a large degree due to the disruption of production process at Raspadskaya mine, when the stock could not be consumed as intended.

Liquidity, capital resources and expenditures

Our primary source of liquidity is cash generated from operating activities. In addition, we use debt financing and have access to capital markets. Our policy is to finance our capital expenditures, interest expenses and dividends primarily out of our operating cash flows.

Our cash flow statement is summarized in the following table:

	1H2010	**1H2009**	**Change**	
	US$000	*US$000*	*US$000*	
Cash and cash equivalents at 1 January	**28,277**	71,555	(43,278)	*(60)%*
Net cash from operating activities	**232,054**	63,545	168,509	*265%*
Net cash used in investing activities	**(140,027)**	(51,378)	88,649	*173%*
Net cash used in financing activities	**(28,221)**	(16,256)	11,965	*74%*
Effect of foreign exchange rate changes on cash and cash equivalents	**(1,680)**	(3,933)	(2,253)	*(57)%*
Cash and cash equivalents at 30 June	**90,403**	63,533	**26,870**	***42%***

As at 30 June 2010, cash and cash equivalents, short- and long-term bank deposits increased by US$97.4m and were US$306.9m.

We intend to maintain a sufficient level of liquidity to continue our business in changing economic environment.

The cash used in our investing activities was used in capital expenditures, the acquisition of Koksovaya mine, and to increase short-term bank deposits.

Cash used in capital expenditures by our business activities are set out in the following table:

	1H2010		**1H2009**			
	Amount	**Portion**	**Amount**	**Portion**	**Change**	
	US$000		*US$000*		*US$000*	
Mines in operation [(1)]	**48,949**	***65%***	61,508	*83%*	(12,559)	*(20)%*
Mine under construction	**22,598**	***30%***	11,364	*15%*	11,234	*99%*
Other	**3,335**	***5%***	1,144	*2%*	2,191	*192%*
	74,882	***100%***	74,016	*100%*	**866**	***1%***

(1) Including Raspadskaya mine

In 1H2010, cash used in capital expenditures did not increase materially. The amount of cash used in capital expenditures of mines in operation decreased because we signed fewer equipment purchase contracts in 1H2010 whereas contracts signed in 2008 were executed in 1H2009. The amount of cash used in capital expenditures of the mine under construction decreased because of a return to pre-crisis levels of financing.

Off-balance sheet arrangements

We do not have any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition or results of operations.