# OAO Raspadskaya

## Management's discussion and analysis
## of financial condition and results of operations
## *for the year ended 31 December 2009*

*The following is a discussion and analysis of Raspadskaya's consolidated financial information for the year ended 31 December 2009. This discussion and analysis should be read in conjunction with Raspadskaya's consolidated financial statements for the year ended 31 December 2009 prepared in accordance with International Financial Reporting Standards. 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.*

**General overview**

We are a group of integrated companies located in Mezhdurechensk city in the Kemerovo region of Russia: three mines in operation, one mine under construction, a preparation plant, a trading company and companies engaged in transportation and infrastructure development – hereafter referred to collectively as "the Group". We have leading market positions in Russia with respect to production of coking coals of the GZh (gas fat) and GZhO (gas fat semi-lean) categories and sales of coal concentrate. According to IMC Economic and Energy Consultants Limited ("IMC"), as at 30 June 2006, we had total measured and indicated resources of 1,461 million tonnes, and proved and probable reserves of 781.5 million tonnes, of which 39.0 million tonnes were extracted in the period from 1 July 2006 to 31 December 2009. These resources and reserves were estimated in accordance with the requirements of the JORC Code and do not comprize licenses not audited according to international standards, including coal reserves under licenses acquired in 2009. In 2009 we acquired licenses to develop Raspadskaya-3 and Raspadskaya-4 coal deposits. Based on our estimates these deposits have reserves and indicated resources of approximately 520 million tonnes of coal. We plan to conduct audit of the mineral resources in accordance with the JORC Code in the near future to confirm our estimates. Our reserves will be available for extraction for at least the next 50 years.

**Overview of financial results**

| | 2009 | 2008 | Change |
|---|---|---|---|
| | *US$000* | *US$000* | |
| Revenue | 497,047 | 1,200,397 | (59)% |
| Cost of sales | (241,996) | (350,714) | (31)% |
| **Gross profit** | **255,051** | **849,683** | **(70)%** |
| ***Gross profit margin*** | ***51%*** | ***71%*** | |
| Selling and distribution costs | (11,434) | (5,060) | 126% |
| General and administrative expenses | (52,929) | (67,233) | (21)% |
| Social and social infrastructure maintenance expenses | (5,396) | (16,728) | (68)% |
| Loss on disposal of property, plant and equipment | (1,179) | (2,757) | (57)% |
| Foreign exchange gains/(losses) | (15,529) | (63,352) | (75)% |
| Other operating income | 1,553 | 2,391 | (35)% |
| Other operating expenses | (7,061) | (11,968) | (41)% |
| **Operating profit** | **163,076** | **684,976** | **(76)%** |
| ***Operating profit margin*** | ***33%*** | ***57%*** | |
| Dividend income | 12 | 14 | (14)% |
| Interest income | 12,322 | 12,813 | (4)% |
| Interest expense | (25,307) | (27,214) | (7)% |
| **Profit before income tax** | **150,103** | **670,589** | **(78)%** |
| ***Profit before income tax margin*** | ***30%*** | ***56%*** | |
| Income tax | (32,966) | (139,487) | (76)% |
| **Profit for the period** | **117,137** | **531,102** | **(78)%** |
| ***Profit for the period margin*** | ***24%*** | ***44%*** | |
| **Earnings per share, *US$*** | **0.15** | **0.68** | |
| **EBITDA** | **255,079** | **871,049** | **(71)%** |
| ***EBITDA margin*** | ***51%*** | ***73%*** | |

### 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, the supply and demand of coking coal, coking coal prices, and production and other costs.

#### *Exchange rates*

In reading this discussion and analysis, fluctuations of the Russian ruble/US dollar exchange rate should be taken into consideration. Our performance is significantly affected by these fluctuations. Our functional currency is the Russian ruble, and our assets, revenues and expenses are mostly nominated in rubles whereas our presentation currency is the US dollar. The devaluation of the Russian ruble in the second half of 2008 and the first quarter of 2009 had a material effect on our financial position and results of operations.

| | **2009** | **2008** | **Change** |
|---|---|---|---|
| Average exchange rate, *ruble/US$* | 31.7231 | 24.8553 | 27.6% |
| | **31 December 2009** | **31 December 2008** | |
| Exchange rate, *ruble/US$* | 30.2442 | 29.3804 | 2.9% |

#### *Supply and demand of coking coal*

Our operating results are significantly influenced by the balance of supply and demand of different types of coking coal on the domestic and international markets, which is primarily influenced by fluctuations in the volume of production of steel and coke, by changes in coal production capacity and other related factors. The consumers of our coking coal 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.

Up to the middle of 2008, the demand for metallurgical products and, as a result, for coking coal was constantly growing on both the domestic and international markets. In the fourth quarter of 2008 the demand sharply dropped as a result of the global economy crisis and the related drop in demand for the end products – coke and steel. The direct consequences of the fall were the decrease in sales, production volumes and prices of coking coal in Russia and globally. Having reached its minimum in November 2008, during 2009 the demand for our products has been gradually restoring, which affected positively both sales and production volumes.

Our results can be indirectly affected by the increase in the coal production capacities and the sales volumes of our competitors. We believe that there will be no significant increase in the Russian metallurgical coal capacity in the short- to medium-term mainly because the developing of new mining projects is still at early stages, and the companies lack the adequate finance required for development of those capacities.

We intend to sustain our competitiveness based on the quality of our products, reliability in delivery and stable relationships with our customers.

***Revenue***

The table below sets out our domestic and export sales by product types restated under common delivery terms (FCA Mezhdurechensk) by deducting transportation costs from revenues reported in the financial statements in respect of sales of coal and coal concentrate made under other types of delivery terms (FOB Shipping point and DAF Customer destination) for the years ended 31 December:

| | 2009 | | 2008 | | |
|---|---|---|---|---|---|
| | **Amount** | **Share** | **Amount** | **Share** | **Change** |
| | *US$000* | | *US$000* | | |
| Sales of coal concentrate – Russia | 347,932 | 76% | 918,581 | 78% | (62)% |
| Sales of coal concentrate – export | 111,659 | 24% | 240,958 | 20% | (54)% |
| | **459,591** | **100%** | **1,159,539** | **98%** | (60)% |
| Sales of raw coal – Russia | 681 | 0% | 20,073 | 2% | (97)% |
| **Total sales of coal concentrate and raw coal** | **460,272** | **100%** | **1,179,612** | **100%** | **(61)%** |
| Transportation costs included in sales price under delivery terms other than FCA Mezhdurechensk relating to: | | | | | |
| Sales of coal concentrate – Russia | – | | 1,659 | | (100)% |
| Sales of coal concentrate – export | 23,559 | | 12,191 | | 93% |
| Sales of other goods | 8,477 | | 1,230 | | 589% |
| Rendering of services | 4,739 | | 5,705 | | (17)% |
| **Total revenue** | **497,047** | | **1,200,397** | | **(59)%** |

In 2009, 97% of our total revenue was derived from sales of coal concentrate and raw coal (including transportation costs) as compared to 99% in 2008. The sales of raw coal occurred just occasionally.

In 2009, the total sales of coal concentrate decreased by 60% as compared to 2008 due to lower prices and the higher ruble/US dollar average exchange rate.

Growing demand and, starting the fourth quarter of 2009, increased sales prices drove our sales up in 2009. In this way, the total sales of coal concentrate increased from US$61m in the first quarter to US$217m in the fourth quarter.

The transportation costs, that were included in delivery prices increased due to an increase in sales volumes to South East Asia under FOB terms.

In 2009, the sales of other goods increased due to increased sales of steel products.

The rendering of services, which mainly included coal transportation services provided locally to other coal companies decreased due to decreased volumes of transported coal.

***Coking coal prices***

Both domestic and export prices for coking coal have a material impact on our results. In the first half of 2008, the major driving force of high coking coal prices was the strong demand for metallurgical and coal products on the domestic and export markets. From the fourth quarter of 2008 our coking coal prices have decreased as compared to the third quarter of 2008 as a result of the decrease in global demand for iron and steel. During the first 3 quarters of 2009, our sales prices were about flat and starting the fourth quarter there was a rise in prices – the average price of coal concentrate for 9 months was US$45.3 for domestic sales and US$43.3 for export sales whereas for the fourth quarter it was US$91.8 for domestic sales and US$72.2 for export sales.

The table below shows our weighted average coal concentrate prices on FCA Mezhdurechensk terms for the years ended 31 December:

| | **2009** | **2008** | **Change** |
|---|---|---|---|
| | *US$ per tonne* | | |
| Coal concentrate – Russia | 62.8 | 167.3 | (62)% |
| Coal concentrate – export | 51.2 | 156.4 | (67)% |
| **Coal concentrate – total** | **59.6** | **164.9** | **(64)%** |

In 2008, our one year coal sales contracts fixed sales prices for major customers. If market prices changed the contract prices might be changed with the mutual agreement between the parties. Starting 2009, we operate in the frames of long-term contracts with our major Russian customers and negotiate the volumes and prices on the quarterly basis.

***Sales volumes***

The global financial crisis and a drop in the output of the Russian steel industry materially depressed our sales. A gradual recovery of the metallurgical production and demand in Russia as well as our active export policy have led to a retrieval of our sales volumes in 2009. During 2009, the total sales volume of coal concentrate were on a steady rise and increased from 276 thousand tonnes in January to 843 thousand tonnes in December, having totaled 7,715 thousand tonnes in 2009. Whereas in January 2009 there were no export sales, in December they were 172 thousand tonnes. In the second half of 2009, sales volumes grew by 58% as compared to the previous half of the year. At present, we see a significant growth in demand for coking coal on both domestic and export markets.

Quarterly dynamics of sales volumes of coal concentrate for 2009 are set out in the table below:

| | **1Q2009** | **2Q2009** | **3Q2009** | **4Q2009** |
|---|---|---|---|---|
| | *thousand tonnes, unless stated otherwise* | | | |
| Russia | 963 | 1,044 | 1,591 | 1,938 |
| *Change to the previous quarter* | *20%* | *8%* | *52%* | *22%* |
| Export | 337 | 641 | 664 | 537 |
| *Change to the previous quarter* | *n/a* | *90%* | *4%* | *(19)%* |
| **Total** | **1,300** | **1,685** | **2,255** | **2,475** |
| *Change to the previous quarter* | *63%* | *30%* | *34%* | *10%* |

The table below sets out the sales volumes of our coal concentrate and raw coal by location of our major customers for the years ended 31 December:

| | 2009 | | 2008 | | |
|---|---|---|---|---|---|
| | **Volume** | **Share** | **Volume** | **Share** | **Change** |
| | *thousands of tonnes* | | *thousands of tonnes* | | |
| **Coal concentrate – Russia** | | | | | |
| MMK | 1,115 | 14% | 1,667 | 23% | (33)% |
| Evraz | 1,023 | 13% | 1,330 | 18% | (23)% |
| NLMK | 1,053 | 14% | 1,264 | 17% | (17)% |
| Kemerovo-Koks | 1,022 | 13% | 574 | 8% | 78% |
| Mechel | 732 | 10% | 203 | 3% | 261% |
| Urals Steel | 351 | 5% | 176 | 2% | 99% |
| Other | 240 | 3% | 275 | 4% | (13)% |
| | **5,536** | **72%** | **5,489** | **75%** | **1%** |
| **Coal concentrate – export** | | | | | |
| Ukraine(1) | 1,579 | 20% | 1,315 | 18% | 20% |
| Asia | 486 | 6% | – | 0% | n/a |
| Eastern Europe(2) | 114 | 2% | 226 | 3% | (50)% |
| | **2,179** | **28%** | **1,541** | **21%** | **41%** |
| **Coal concentrate – total** | **7,715** | **100%** | **7,030** | **96%** | **10%** |
| Raw coal – Russia | 26 | 0% | 280 | 4% | (91)% |
| **Coal concentrate and raw coal(3)** | **7,734** | **100%** | **7,244** | **100%** | **7%** |

(1) Including sales to three coke plants of Evraz in the amount of 698 thousand tonnes in 2009 and 624 thousand tonnes in 2008;

(2) Including sales to Evraz in the amount of 93 thousand tonnes in 2008;

(3) Raw coal restated in tonnes of coal concentrate at output ratio of 73.4% and 76.3% for the years ended 31 December 2009 and 2008, respectively.

A considerable part of our coal products is sold to domestic steel mills and coke producers such as Magnitogorsk Iron and Steel Plant (”MMK”), Evraz Group (“Evraz”), Novolipetsk Iron and Steel Plant including its subsidiary Altay-Koks (”NLMK”). The share of domestic sales volumes to these three companies accounted for 41% and 59% of our total coal concentrate and raw coal sales volume in 2009 and 2008, respectively.

In 2009, our domestic sales volumes of coal concentrate increased by 1% as compared to 2008. Despite the decrease in sales to our three major customers we managed to increase sales volumes to Mechel, Kemerovo-Koks and Urals Steel (managing company Metalloinvest) in line with our policy on diversification of our client base.

Export sales volumes of coal concentrate by countries for the years ended 31 December are set out in the table below:

| | 2009 | | 2008 | | |
|---|---|---|---|---|---|
| | **Volume** | **Share** | **Volume** | **Share** | **Change** |
| | *thousands of tonnes* | | *thousands of tonnes* | | |
| Ukraine | 1,579 | 73% | 1,315 | 85% | 20% |
| China | 210 | 10% | – | 0% | n/a |
| Republic of Korea | 138 | 6% | – | 0% | n/a |
| Japan | 138 | 6% | – | 0% | n/a |
| Hungary | 114 | 5% | 124 | 8% | n/a |
| Romania | – | 0% | 93 | 6% | (100)% |
| Bulgaria | – | 0% | 9 | 1% | (100)% |
| **Coal concentrate – export** | **2,179** | **100%** | **1,541** | **100%** | **41%** |

In 2009, our share of export sales volume of coal concentrate in the total sales volume of our products increased to 28% as compared to 21% in 2008 due to the total increase in export sales.

Our sales to Ukraine ceased in the fourth quarter of 2008 as a result of a sharp decrease in Ukrainian steel production; however, sales to Ukraine were recommenced in early 2009. At present, we supply major Ukrainian coke plants with our coal concentrate. Ukraine remained our main export market, its share in export sales volumes was 73% and 85% in 2009 and 2008, respectively.

Evraz's portion in the total sales volume of coal concentrate and raw coal was 22% in 2009 and 28% in 2008.

The main contribution to the increase by 10% of the sales volumes of coal concentrate was export, which grew by 41%. The increase in export, in its turn, was driven mainly by sales on Asian markets.

In 2008, because of the favorable conditions in the Russian and Ukrainian markets, we did not export to Asia. Since 2009 we have made a move toward Asian export markets: have started to carry out contracts with large metallurgical companies JFE Holding (Japan) and POSCO (Republic of Korea) and has signed contracts for supply on the Chinese market. As a result, Asia is our second largest export market for the first time in our history. In the future, we intend to strengthen our relations with Asian customers in line with our medium-term market strategy on expansion of export sales in total sales of our products by both executing existing contracts and signing new ones.

***Production volumes***

Our revenue as well as our production costs and costs per tonne are significantly affected by the changes in production volumes, which in their turn depend on sales volumes. During the period of decline in demand for coal products, we minimized the extraction of raw coal not covered by existing contracts and orders. A significant proportion of our costs is fixed which is typical for the extraction industry and, therefore, our production level is one of the key factors in determining our overall cost competitiveness.

The table below sets out our raw coal and coal concentrate production volumes for the years ended 31 December:

| | **2009** | **2008** | **Change** |
|---|---|---|---|
| | *thousands of tonnes* | | |
| Raw coal production | 10,560 | 9,409 | 12% |
| Raw coal preparation | 10,642 | 9,220 | 15% |
| Coal concentrate production | 7,810 | 7,033 | 11% |
| Output ratio | 73.4% | 76.3% | |

The increase in raw coal production volume in 2009 as compared to 2008 was influenced mainly by the increase in demand for coking coal in both the Russian and export markets.

As compared to the first half of 2009, in the second half of 2009 raw coal production grew by 53% – from 4,168 thousand tonnes to 6,392 thousand tonnes.

The decrease in the output ratio was a consequence of an increase in ash content of raw coal as coal was extracted in a geologically disturbed area. In the first quarter of 2010, output ratio was 76.1%.

***Production costs and efficiency***

Our competitiveness and long-term profitability are, to a significant degree, dependent upon our ability to maintain relatively low costs and high efficiency of our operations.

Under the pressure of difficulties in the industry and the temporary decline in our sales, starting the fourth quarter of 2008 we took additional action on control over costs, financial risks and liquidity, in line with our complex anti-crisis program which includes a number of operating and financial measures.

The table below sets out the breakdown of costs of production and sales by major categories for the years ended 31 December:

| | 2009 | | 2008 | | |
|---|---|---|---|---|---|
| | **Amount** | **Share** | **Amount** | **Share** | **Change** |
| | *US$000* | | *US$000* | | |
| Payroll | 48,139 | 23% | 68,086 | 20% | (29)% |
| Materials | 41,350 | 19% | 52,922 | 16% | (22)% |
| Other taxes | 14,625 | 7% | 22,866 | 7% | (36)% |
| Payroll taxes | 13,302 | 6% | 19,574 | 6% | (32)% |
| Electricity | 12,771 | 6% | 16,296 | 5% | (22)% |
| Other costs and expenses | 12,585 | 6% | 41,321 | 12% | (70)% |
| **Cash cost of production**(1) | **142,772** | | **221,065** | | **(35)%** |
| Depreciation, depletion (excluding mineral reserve) and amortization | 36,370 | 17% | 75,915 | 22% | (52)% |
| Depletion of mineral reserves | 34,510 | 16% | 41,890 | 12% | (18)% |
| **Cost of production** | **213,652** | **100%** | **338,870** | **100%** | **(37)%** |
| Transportation costs | 14,805 | | 12,191 | | 21% |
| Cost of resold goods | 8,123 | | 1,088 | | 647% |
| Change in finished goods | 5,416 | | (1,435) | | n/a |
| **Cost of sales** | **242,996** | | **350,714** | | **(31)%** |

(1) Cash cost of production represents cost of sales before railway tariff, 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 by securities analysts, investors and other interested parties in the evaluation of companies in coal industry. Cash cost of production and other measures calculated using cash cost of production have limitations as analytical tools, and you should not consider them 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.

The table below sets out our cash costs of coal concentrate production for the years ended 31 December:

| | **2009** | **2008** | **Change** |
|---|---|---|---|
| | *US$000* | *US$000* | |
| Estimated cash cost of raw coal used in concentrate preparation(1) | 128,180 | 197,986 | (35)% |
| Cash cost of preparation | 15,580 | 19,020 | (18)% |
| **Total cash cost of coal concentrate produced** | **143,760** | **217,006** | **(34)%** |
| | *US$ per tonne* | | |
| Cash cost per tonne of raw coal produced | 12.0 | 21.5 | (44)% |
| Preparation cash cost per tonne of raw coal used | 1.5 | 2.1 | (29)% |
| **Total cash cost per tonne of coal concentrate produced**(2) | **18.4** | **30.9** | (40)% |

(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 restated in tonnes of coal concentrate at output ratio of 73.4% and 76.3% for the years ended 31 December 2009 and 2008, respectively.

The decrease in our cash cost per tonne of coal concentrate produced in 2009 as compared to 2008 was affected by the 28% increase in the average ruble/dollar exchange rate as well as by the 44% decrease in the cash cost per tonne of raw coal produced, the 12% growth in raw coal production volumes, the decrease in preparation cash cost per tonne of coal used, and the 11% increase in the coal concentrate preparation volumes. The decrease in the ruble denominated cash cost of production reflects a stricter cost control introduced by management.

The decrease in our cash cost of raw coal production was driven by a decrease in underground development, overburden removal and major repairs, and by a decrease in materials prices (including steel products and fuel and grease).

As compared to the first half of 2009, in the second half of 2009 the cash cost per tonne of raw coal produced increased by 17% – from US$10.9 to US$12.8 per tonne. The increase was affected by a 39% increase in underground development and a 20% increase in overburden removal, both of which were driven by the 53% increase in raw coal production.

In 2010, as a consequence of a growth in sales and production volumes, we expect a certain increase in the costs of underground development, overburden removal, major repairs and labor costs.

*Payroll and payroll taxes*

The table below sets out our overall payroll costs and related payroll taxes for the years ended 31 December:

| | **2009** | **2008** | **Change** |
|---|---|---|---|
| Average total number of employees | 7,474 | 7,863 | (5)% |
| Total net payroll, *US$000* | 80,161 | 108,263 | (26)% |
| Total payroll taxes, *US$000* | 19,202 | 28,080 | (32)% |
| Average annual payroll per employee, net, *US$* | 10,725 | 13,769 | (22)% |
| Effective payroll tax rate | 24% | 26% | |

The decrease in the overall payroll costs in 2009 as compared to 2008 reflected the decrease in the headcount number and the reduction of the average annual payroll per employee which was a temporary anti-crisis measure. In 2010, average annual payroll per employee in ruble terms will increase as compared to 2009.

The payroll taxes contain the unified social tax ("UST") and mandatory industrial accident and occupational disease insurance charges. UST includes our regular contributions to the State Pension Fund of Russia in accordance with the Russian legislation. We have no legal or constructive obligation to pay further contributions in respect of the State benefits.

*Other taxes*

Taxes included in production costs consist primarily of the mineral extraction tax. The decrease of US$8.2m in the tax amount was due to the decrease in coal prices.

*Materials and electricity*

The decrease in materials cost by US$11.6m and electricity cost by US$3.5m was primarily caused by the decrease in underground development and overburden removal in 2009 as compared to 2008.

*Other costs and expenses*

In 2009, as compared to 2008, other costs and expenses decreased by US$28.7m due to a decrease in mining equipment repairs.

*Depreciation, depletion and amortization*

Depreciation, depletion and amortization comprise a significant portion of our cost of production. Decrease in depreciation expense in 2009 as compared to 2008 comprised the decrease of depreciation charge in ruble terms by 41% mostly driven by reassessment of remaining useful lives of items of property, plant and equipment (remaining useful lives of such items were extended), enforced by the effect of changes in the ruble/US$ exchange rate. The decrease in depletion was due to the increase in the average ruble/dollar exchange rate.

***Railway costs***

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

Our coal concentrate and raw coal is delivered to customers by Russian Railways via the federal railway system. Fluctuations of the railway tariffs affect the total cost paid by our customers, and as such, may impact the demand for our coal from any customers located far from our production site. From 1 January 2009 the railway tariffs increased by 4.8%, from 1 July – by 5.7% and from 1 January 2010 – by 9.4% more (expressed in rubles).

***Production facilities maintenance***

Our activities are dependent upon 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 is crucial for the results of our operations. Our top priorities are keeping our mining equipment in very good condition and maintaining a healthy and safe working environment at each of our facilities through the implementation of stringent safety measures.

***Selling, general and administrative and other expenses***

*Selling and distribution costs*

Selling and distribution costs mainly included transportation and loading services in ports, customs fees pertaining to the export sales. The increase in selling and distribution costs by US$6.4m in 2009 as compared to 2008 was mainly due to the commencement of export sales to Asia under FOB Far East terms.

*General and administrative expenses*

The table below sets out the breakdown of general and administrative expenses by major categories for the years ended 31 December:

| | **2009** | | **2008** | | |
|---|---|---|---|---|---|
| | **Amount** | **Share** | **Amount** | **Share** | **Change** |
| | *US$000* | | *US$000* | | |
| Payroll | 26,844 | 51% | 28,394 | 42% | (5)% |
| Other taxes | 9,134 | 17% | 10,830 | 16% | (16)% |
| Payroll tax | 4,676 | 9% | 5,884 | 9% | (21)% |
| Raw materials | 875 | 2% | 2,451 | 4% | (64)% |
| Insurance | 316 | 1% | 751 | 1% | (58)% |
| Depreciation and amortization | 2,456 | 5% | 2,782 | 4% | (12)% |
| Other services and costs | 8,628 | 15% | 16,141 | 24% | (47)% |
| | **52,929** | **100%** | **67,233** | **100%** | **(21)%** |

In 2009, the decrease in general and administrative expenses by US$14.3m was a result of the growth in the ruble/dollar exchange rate. The ruble denominated general and administrative expenses did not change in 2009 as compared to 2008. Other taxes mainly consist of property tax, the increase in property tax was due to the commencement of operations of our preparation plant's second stage. Other services and costs include bank services, information, communication, consulting, audit and other fees.

*Social and social infrastructure maintenance 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 objects.

The decrease in social and social infrastructure maintenance expenses was due to the fact that in 2008 certain one-time payments for financing safety and environmental protection programs were made.

*Foreign exchange gains/(losses)*

Our revenues from domestic sales accounted for 73% and 79% of total revenue for the years ended 31 December 2009 and 2008, respectively. Prices for domestic sales are set in rubles. Most of our costs (except for certain equipment purchases) are also denominated in rubles.

Foreign exchange gains and losses relate to the difference arising from revaluation of assets and liabilities denominated in foreign currencies (primarily US dollars) and exchange rate differences on sales and purchase of foreign currencies. In the year ended 31 December 2009, the US dollar has appreciated by 2.9% against the Russian ruble. As a result, we incurred foreign exchange loss of US$15.5m for the period. The loss mainly resulted from the revaluation of our US dollar denominated borrowings.

***Interest income and interest expense***

Interest income mainly related to short-term deposits held in various Russian banks. In 2009, our interest expense of US$25.3m primarily related to the coupon payments on eurobonds due in May 2012.

***Income tax expense***

In 2009, the amount of income tax represented the tax accrued in the amount of US$34.0m. The effective income tax rate was 22% in 2009, and was consistent with the prior year.

**Liquidity, capital resources and capital expenditures**

Our primary sources of liquidity are cash generated from operating activities, debt financing and access to equity capital markets. We plan to finance our capital expenditures, interest expenses and dividends primarily out of our operating cash flows.

The table below summarizes our IFRS cash flow statement for the years ended 31 December:

| | **2009** | **2008** | **Change** |
|---|---|---|---|
| | *US$000* | *US$000* | |
| Cash and cash equivalents at 1 January | 71,555 | 82,311 | (13)% |
| Net cash from operating activities | 220,666 | 585,257 | (62)% |
| Net cash used in investing activities | (208,648) | (405,107) | (48)% |
| Net cash used in financing activities | (49,538) | (176,396) | (72)% |
| Effect of foreign exchange rate changes on cash and cash equivalents | (5,758) | (14,510) | (60)% |
| **Cash and cash equivalents at 31 December** | **28,277** | **71,555** | **(60)%** |

As at 31 December, cash and cash equivalents and bank deposits were US$209.5m in 2009 and US$186.6m in 2008.

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

Capital expenditures represented the major part of the cash used in our investing activities. The following table sets out our capital expenditures by business activities for the years ended 31 December:

| | 2009 | | 2008 | | |
|---|---|---|---|---|---|
| | **Amount** | **Share** | **Amount** | **Share** | **Change** |
| | *US$000* | | *US$000* | | |
| Mines in operation | 117,656 | 72% | 208,805 | 73% | (44)% |
| Mine under construction | 30,075 | 18% | 60,409 | 21% | (50)% |
| Mining licenses | 14,656 | 9% | – | – | n/a |
| Preparation plant | 66 | 0% | 6,491 | 2% | (99)% |
| Other | 2,206 | 1% | 9,869 | 4% | (78)% |
| | **164,659** | **100%** | **285,574** | **100%** | **(42)%** |

The following table sets out the calculation of our Consolidated EBITDA,[(1)] as stipulated in the Loan Agreement on the eurobonds, for the years ended 31 December:

| | 2009 | 2008 | Change |
|---|---|---|---|
| | *US$000* | *US$000* | |
| **Profit for the period** | **117,137** | **531,117** | **(78)%** |
| Adjusted for: | | | |
| Foreign exchange gains/(losses), net | 15,529 | 63,352 | (75)% |
| Gain/(loss) on net monetary position | 623 | 110 | 466% |
| **Consolidated Profit** | **133,289** | **594,579** | **(78)%** |
| Adjusted for: | | | |
| Depreciation, depletion and amortization | 79,325 | 123,210 | (36)% |
| Capitalized depreciation | (4,633) | (1,588) | 192% |
| Dividend income | (12) | (14) | (14)% |
| Interest income | (12,322) | (12,813) | (4)% |
| Interest expense | 25,307 | 27,214 | (7)% |
| Amortization of debt issuance cost | (401) | (512) | (22)% |
| Capitalized interest | 1,560 | 989 | 58% |
| Income tax | 32,966 | 139,472 | (76)% |
| **Consolidated EBITDA** | **255,079** | **870,537** | **(71)%** |

(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, capitalized interest 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 by securities analysts, investors and other interested parties in the evaluation of companies in our industry. EBITDA has limitations as an analytical tool, and you should not consider it 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.

The following table sets out our Consolidated Net Indebtedness as at 31 December:

| | 2009 | 2008 | Change |
|---|---|---|---|
| | *US$000* | *US$000* | |
| Loans (including interest) | 331,727 | 351,147 | (6)% |
| Adjusted for: | | | |
| Bank deposits | (181,195) | (115,045) | 57% |
| Cash and cash equivalents | (28,277) | (71,555) | (60)% |
| **Consolidated Net Indebtedness** | **122,255** | **164,547** | **(26)%** |

In 2009, our long-term debt included primarily 7.5% eurobonds in amount of US$300m due 2012.

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. Net Leverage Ratio may not exceed 3. As at 31 December 2009, Net Leverage Ratio was 0.48.

As at 31 December 2009, none of the covenants stipulated in the Loan Agreement on the eurobonds was infringed. We believe none of the covenants will be infringed in the foreseeable future.

**Off-balance sheet arrangements**

We do not have off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, revenues and expenses, results of operations, liquidity, capital expenditures, or capital resources.