OAO Raspadskaya

Management's discussion and analysis
of financial condition and results of operations
for the year ended 31 December 2010

This discussion and analysis should be read in conjunction with Raspadskaya's consolidated financial statements for the year ended 31 December 2010 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.

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

	2010	2009	Change	
	US$000	*US$000*	*US$000*	
Revenue	**705,606**	497,047	208,559	*42%*
Cost of sales	**(313,144)**	(250,847)	62,297	*25%*
Gross profit	**392,462**	246,200	146,262	*59%*
Gross profit margin	***56%***	*50%*		
Selling and distribution costs	**(3,504)**	(2,583)	921	*36%*
General and administrative expenses	**(63,890)**	(52,929)	10,961	*21%*
Social expenses	**(5,867)**	(5,396)	471	*9%*
Loss on disposal of PP&E	**(44,100)**	(1,179)	42,921	*3640%*
Foreign exchange losses	**1,826**	(15,529)	17,355	*n/a*
Other operating income	**5,075**	1,553	3,522	*227%*
Other operating expenses	**(92,653)**	(7,061)	85,592	*1212%*
Operating profit	**189,349**	163,076	25,273	*16%*
Dividend income	**3**	12	(9)	*(75)%*
Interest income	**16,519**	12,322	4,197	*34%*
Interest expense	**(26,500)**	(25,307)	1,193	*5%*
Gain from a bargain purchase	**104,735**	–	104,735	*n/a*
Profit before income tax	**284,106**	150,103	134,003	*89%*
Income tax	**(39,788)**	(32,966)	6,822	*21%*
Profit for the period	**244,318**	117,137	127,181	*109%*
Earnings per share, *US¢*	**31.35**	14.93		
EBITDA	**337,641**	255,079	82,562	*32%*
EBITDA margin	***48%***	*51%*		
EBIT	**227,078**	180,387	46,691	*26%*
EBIT margin	***32%***	*36%*		
Cash used in Capex	**137,570**	153,163	(15,593)	*(10)%*
	31/Dec/10	**31/Dec/09**		
Net debt/(Net cash position)	**(12,409)**	122,255	(134,664)	*n/a*

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Contents

Mineral reserves and resources

Volumes of our coking coal reserves and resources as at 31 December 2010 estimated by IMC Montan (International Economic and Energy Consulting) in accordance with the requirements of the JORC Code are set out in the following table:

	Reserves	Resources
	millions of tonnes	*millions of tonnes*
OAO Raspadskaya	617	1,258
OAO MUK-96	168	305
ZAO Razrez Raspadskiy	132	139
ZAO Raspadskaya-Koksovaya (1)	129	376
	1,046	**2,078**

(1) Including ZAO Koksovaya

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.

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:

	2010	2009	Change
Average exchange rate, *RUB/US$*	**30.3692**	31.7231	*(4)%*
	31/Dec/10	**31/Dec/09**	
Exchange rate, *RUB/US$*	**30.4769**	30.2442	*1%*

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.

In 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 stopped its operations which severely cut our production capacity.

At present, we are reconstructing Raspadskaya mine. The reconstruction process is being conducted in stages i.e. parts of the mine will be put into 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. The total expenditure 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. In 2010, these expenditures totaled US$99.8m.

On 16 December 2010, Raspadskaya mine recommenced operation – extraction started at face 4-9-21 bis (seam #9) with coal reserves about 600 thousand tonnes. In 2011, we plan to put into operation 4 faces more at Raspadskaya mine: the 1st – in 2Q2011, the 2nd – in 3Q2011, the 3rd and 4th – in 4Q2011.

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 was 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. On 1 February 2011, ZAO Koksovaya was merged with ZAO 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..

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 2010 the demand in Russia and the world for metallurgical products and, consequently, for coking coal has been gradually restoring which affected positively our sales.

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 2010, 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 2009, 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 2010 are set out in the following table:

	1Q2009	**2Q2009**	**3Q2009**	**4Q2009**	**1Q2010**	**2Q2010**	**3Q2010**	**4Q2010**
				US$ per tonne				
Russia (FCA)	48.2	49.4	51.2	91.8	103.0	125.0	122.8	131.2
QoQ change	*(60)%*	*2%*	*4%*	*79%*	*12%*	*21%*	*(2)%*	*7%*
Export (FCA) [(1)]	44.1	40.4	54.0	88.4	104.2	126.6	–	–
QoQ change	*n/a*	*(8)%*	*34%*	*64%*	*18%*	*22%*	*n/a*	*n/a*
Export (FOB)	–	81.6	94.7	100.0	136.4	164.6	–	–
QoQ change	*n/a*	*n/a*	*16%*	*6%*	*36%*	*21%*	*n/a*	*n/a*

(1) According to contracts to Ukraine and Hungary, all of which are on FCA basis

After the accident at Raspadskaya mine in May 2010, temporarily, there have been no export sales.

In 1Q2011, the weighted average price of our coal concentrate on FCA Mezhdurechensk terms was US$147.1 per tonne.

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

	2010	**2009**	**Change**
	US$ per tonne		
Russia (FCA)	**117.3**	62.8	*87%*
Export (FCA) [(1)]	**108.5**	53.3	*104%*
Export (FOB)	**150.6**	92.5	*63%*

(1) According to contracts to Ukraine and Hungary, all of which are on FCA basis

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 before the accident at Raspadskaya mine in May 2010 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 2010 are set out in the following table:

	1Q2009	**2Q2009**	**3Q2009**	**4Q2009**	**1Q2010**	**2Q2010**	**3Q2010**	**4Q2010**
				thousands of tonnes				
Russia	963	1,044	1,591	1,938	1,580	974	676	902
QoQ change	*20%*	*8%*	*52%*	*22%*	*(18)%*	*(38)%*	*(31)%*	*33%*
Export – West	337	606	419	330	258	88	–	–
QoQ change	*n/a*	*80%*	*(31)%*	*(21)%*	*(22)%*	*(66)%*	*n/a*	*n/a*
Export – Asia	–	36	245	206	395	482	–	–
QoQ change	*n/a*	*n/a*	*581%*	*(16)%*	*92%*	*22%*	*n/a*	*n/a*
Export – Total	337	642	664	536	653	570	–	–
Total	**1,300**	**1,686**	**2,255**	**2,474**	**2,233**	**1,544**	**676**	**902**
QoQ change	***63%***	***30%***	***34%***	***10%***	***(10)%***	***(31)%***	***(56)%***	***33%***

The decrease in domestic sales volumes in 1Q2010 by 18% QoQ was to a large degree due to the anomalously low temperatures that set in for a long period of time and consequent 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:

	2010		2009			
	Volume	Portion	Volume	Portion	Change	
	thousands of tonnes		*thousands of tonnes*		*thousands of tonnes*	
Coal concentrate – Russia						
Kemerovo-Koks	**1,148**	***20%***	1,022	*13%*	126	*12%*
Evraz	**1,057**	***19%***	1,023	*13%*	34	*3%*
MMK	**750**	***13%***	1,115	*14%*	(365)	*(33)%*
NLMK (including Altay-Koks)	**587**	***10%***	1,053	*14%*	(466)	*(44)%*
Mechel	**318**	***6%***	732	*10%*	(414)	*(57)%*
Urals Steel	**101**	***2%***	351	*5%*	(250)	*(71)%*
Other	**171**	***3%***	240	*3%*	(69)	*(29)%*
	4,132	***73%***	5,536	*72%*	(1,404)	*(25)%*
Coal concentrate – export						
China	**756**	***14%***	210	*3%*	546	*260%*
Ukraine (1)	**346**	***6%***	1,579	*20%*	(1,233)	*(78)%*
Republic of Korea	**120**	***2%***	138	*2%*	(18)	*(13)%*
Japan	**–**	***–***	138	*2%*	(138)	*(100)%*
Hungary	**–**	***–***	114	*1%*	(114)	*(100)%*
	1,222	***22%***	2,179	*28%*	(957)	*(44)%*
Coal concentrate – total	**5,354**	***95%***	7,715	*100%*	(2,361)	*(31)%*
Raw coal – Russia (2)	**337**	***5%***	26	*0%*	311	*1196%*
Coal concentrate and raw coal (3)	**5,613**	***100%***	7,734	*100%*	(2,121)	*(27)%*

(1) Including sales to coke plants of Evraz in the volume of 318 thousand tonnes in 2010 and 698 thousand tonnes in 2009;
(2) Including sales to Evraz in the volume of 337 thousand tonnes in 2010;
(3) Raw coal has been restated in tonnes of coal concentrate at the output ratio of 76.9% for 2010 and 73.4% for 2009.

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 43% and 41% of our total coal concentrate and raw coal sales volume in 2010 and 2009, respectively.

Our related party, Evraz, remained our largest customer – its share in total coal concentrate and raw coal sales volume was 30% in 2010 and 22% in 2009.

Before May 2010, we diversified our Russian client base. In this way, we sold considerable volumes to such medium-sized companies as Kemerovo-Koks, Mechel and Urals Steel (managing company Metalloinvest). The sales volume to Kemerovo-Koks increased by 12% YoY, thus making the company our 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 2010 for the first time in our history. The portion of Asia in our export coal concentrate sales volume was 72% in 2010 and 22% in 2009. 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. In the medium term, we plan to export no less than 35% of our total coal concentrate and raw coal sales volume.

A slowdown in the Ukrainian metallurgical industry was partially responsible for a 78% decrease in sales volume to the country.

Starting May 2010, we sell raw coal of the K and KO grades extracted by Koksovaya mine which accounts for a sharp increase in the sales volumes of raw coal. All the raw coal we sold in 2010 was of the K and KO grades, until then we sold raw coal of other, less expensive, grades.

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 a limited number of 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:

	2010		2009			
	Amount	**Portion**	**Amount**	**Portion**	**Change**	
	US$000		*US$000*		*US$000*	
Coal concentrate – Russia	**484,653**	***70%***	347,932	*76%*	136,721	*39%*
Coal concentrate – export	**169,497**	***25%***	111,659	*24%*	34,279	*25%*
	654,150	***95%***	459,591	*100%*	171,000	*35%*
Raw coal – Russia	**32,193**	***5%***	681	*0%*	31,512	*4627%*
	686,343	***100%***	460,272	*100%*	202,512	*42%*
Sales of other goods	**13,498**		8,477		5,021	*59%*
Rendering of services	**5,765**		4,739		1,026	*22%*
Revenue	**705,606**		497,047		208,559	*42%*

Both in 2010 and 2009, 97% of our total revenue was derived from sales of coal concentrate and raw coal (including transportation costs).

Sales of other goods increased by US$5.0m (59%) because of an increased volume of resold steel products, which constituted the main portion of other goods.

Rendering of services mainly included coal transportation services provided locally to other coal companies.

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:

	2010	2009	Change	
	thousands of tonnes	*thousands of tonnes*	*thousands of tonnes*	
Raw coal production (1)	**7,160**	10,560	(3,400)	*(32)%*
Raw coal preparation	**6,818**	10,642	(3,824)	*(36)%*
Coal concentrate production	**5,246**	7,810	(2,564)	*(33)%*
Output ratio	***76.9%***	*73.4%*		

(1) Including preproduction extraction at Raspadskaya-Koksovaya in the volume of 57 thousand tonnes in 2010 and 22 thousand tonnes in 2009

The increase in the output ratio was mainly due to a decrease in ash content of raw coal.

Despite a strong demand for coking coal in 2010, because of the May accident, production volumes decreased as compared to 2009. After May 2010, we extract as much coal as our existing production capacity allows.

In 4Q2010, production volumes of coal concentrate increased by 15% QoQ due to the recommencement of extraction at Raspadskaya mine, increase of extraction volumes at our other mines, and a high output ratio in 4Q2010 (79.1%).

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:

	2010		2009			
	Amount	Portion	Amount	Portion	Change	
	US$000		*US$000*		*US$000*	
Payroll	**46,580**	***18%***	48,139	*23%*	(1,559)	*(3)%*
Payroll taxes	**13,490**	***5%***	13,302	*6%*	188	*1%*
Other taxes	**16,247**	***6%***	14,625	*7%*	1,622	*11%*
Materials	**50,287**	***20%***	41,350	*19%*	8,937	*22%*
Electricity	**11,368**	***4%***	12,771	*6%*	(1,403)	*(11)%*
Other costs and expenses	**19,911**	***8%***	12,585	*6%*	7,326	*58%*
Cash cost of production (1)	**157,883**	***61%***	142,772	*67%*	15,111	*11%*
Depreciation, depletion (excluding mineral reserve) and amortization	**65,347**	***26%***	36,370	*17%*	28,977	*80%*
Depletion of mineral reserve	**31,208**	***13%***	34,510	*16%*	(3,302)	*(10)%*
Cost of production	**254,438**	***100%***	213,652	*100%*	40,786	*19%*
Transportation costs	**48,328**		23,656		24,672	*104%*
Cost of resold goods	**13,398**		8,123		5,275	*65%*
Change in finished goods	**(3,020)**		5,416		8,436	*n/a*
Cost of sales	**313,144**		250,847		62,297	*25%*

(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. Cash cost of production is not required by IFRS. We present cash cost of production because we consider it an important supplemental measure of our operating performance. Cash cost of production should not be considered in isolation from or as an alternative to our operating results as reported under IFRS.

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

	2010	2009	Change	
	US$000	*US$000*	*US$000*	
Estimated cash cost of raw coal used in concentrate preparation (1)	**124,949**	128,180	(3,231)	*(3)%*
Cash cost of preparation	**16,837**	15,580	1,257	*8%*
Cash cost of coal concentrate production	**141,786**	143,760	(1,974)	*(1)%*
	US$	*US$*		
Cash cost per tonne of raw coal produced	**18.3**	12.0		*53%*
Preparation cash cost per tonne of raw coal used	**2.5**	1.5		*67%*
Cash cost per tonne of coal concentrate production (2)	**27.0**	18.4		*47%*

(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 76.9% for 2010 and 73.4% for 2009.

The decrease in production volume had a double-edged effect on our cash costs of production – it drove cash cost of coal concentrate production down, and cash cost per tonne of coal concentrate production up.

We expect the ruble denominated cash cost per tonne of coal concentrate production will decrease as Raspadskaya mine increases its production volume.

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 38% in 2010 and 43% in 2009.

Payroll taxes consist of regular mandatory contributions to the state Pension Fund of Russia, contributions to medical insurance funds, and mandatory industrial accident and occupational disease insurance charges. 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:

	2010	**2009**	**Change**	
Average total number of employees	**7,879**	7,474	405	*5%*
Total payroll, *US$000*	**103,149**	80,161	22,988	*29%*
Total payroll taxes, *US$000*	**25,909**	19,202	6,707	*35%*
Average annual pay per employee, *US$*	**13,092**	10,725	2,367	*22%*
Effective payroll tax rate	***25%***	*24%*		

The increase in the overall labor costs by 30% YoY reflected a return to pre-crisis levels of pay and the labor costs inflation. In June 2010, we increased miners' average pay.

The increase in average total number of employees by 5% YoY was mainly due to the acquisition of Koksovaya mine.

As we are socially responsible before our employees, we retained all Raspadskaya's permanent staff after the mine stopped operation.

Other taxes

Other taxes included in production costs consist primarily of the mineral extraction tax (MET) and the ground rent. The increase in other taxes by 11% YoY was mainly due to a higher ground rent.

Starting 1 April 2011, a new scheme of MET calculation for coal industry is in place – MET is calculated based on actual extraction volumes and a fixed rate set by the Government of Russia depending on changes in coal prices. Moreover, MET can be decreased by qualified expenses incurred in connection with enhancement of work safety.

Materials and electricity

The increase in materials cost by 22% YoY was mainly due to a significant decrease of overburden removal and repairs of mining equipment. Despite an increase of the tariff by 22%, electricity cost decreased by 11% because of the drop in production volumes

Depreciation, depletion and amortization

Depreciation, depletion and amortization comprise a significant portion in our cost of production (39% in 2010 and 33% in 2009). Depreciation, depletion (excluding mineral reserve) and amortization increased by 80% YoY mainly because of large additions of property, plant and equipment at the end of 2009 and the acquisition of ZAO Koksovaya in April 2010. The lower average RUB/US$ exchange rate also affected the amount – the ruble denominated charge increased by 72%.

Depletion of mineral reserves is directly proportional to extraction volumes. Mineral reserves represent tangible assets acquired in business combinations (MUK-96, Razrez Raspadsky and Koksovaya). The decrease in depletion charge by 10% YoY was mainly due to the revision and change of mineral reserves at 31 December 2010.

Other costs and expenses

Other costs and expenses increased by 58% due to an increase in drilling and blasting services (a consequence of a 23% increase in overburden removal at Razrez Raspadskiy), an increase in mining equipment repairs at MUK-96 mine, and an increase in equipment and property repairs at the newly acquired Koksovaya mine.

Other income and expenses

Transportation costs

Transportation costs mainly consist of railroad costs and loading services in ports. Transportation costs increased by 104% YoY mainly because of the significant growth in sales volumes to Asia under FOB Far East terms (80%).

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. In 2010 railroad tariff increased by 9.4% YoY, from 1 January 2011 – by 8.0% more (in ruble terms).

Selling and distribution costs

Selling and distribution costs consist of customs fees pertaining to export sales, insurance and other services.

General and administrative expenses

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

	2010		**2009**			
	Amount	**Portion**	**Amount**	**Portion**	**Change**	
	US$000		*US$000*		*US$000*	
Payroll	**31,473**	***49%***	26,844	*51%*	4,629	*17%*
Payroll taxes	**6,281**	***10%***	4,676	*9%*	1,605	*34%*
Other taxes	**10,543**	***17%***	9,134	*17%*	1,409	*15%*
Materials	**1,425**	***2%***	875	*2%*	550	*63%*
Depreciation and amortization	**3,584**	***6%***	2,456	*5%*	1,128	*46%*
Other costs and expenses	**10,584**	***16%***	8,944	*16%*	1,640	*18%*
	63,890	***100%***	52,929	*100%*	10,961	*21%*

The increase in general and administrative expenses by 21% 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 – 59% in 2010 and 60% in 2009. The increase in labor costs by 20% YoY was primarily a consequence of a return to the normal workday hours after a 30% reduction in place during most part of 2009.

Property tax is the main part of other taxes. The increase in property tax expenses was primarily due to new mining equipment, the 2nd stage of the preparation plant put into operation in 2H2009, and the acquisition of Koksovaya mine.

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. Because we did not significantly reduce social expenses during the recession, there was no material increase in them in 2010.

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 large amount of loss on disposal of property, plant and equipment in 2010 (US$44.1m) was mainly due to damage from the accident at Raspadskaya mine (US$39.4m). The disposal was estimated based on inspections conducted by management. As at 31 December 2010, the carrying value of all the items located in the disaster area, was US$81.0m. Disposals and carrying values of the items of property, plant and equipment located in the disaster area will be reassessed upon getting access to the disaster area.

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.

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 because we incurred certain expenses associated with the liquidation of the consequences of the accident at Raspadskaya mine.

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, compensatory 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 2010, expenses associated with the liquidation of the consequences of the accident were US$79.8m, 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 34% (US$4.2m) was mainly due to a larger amount of bank deposits held in 2010 as compared to 2009.

The core of interest expense is the 7.5% coupon on our eurobonds – we pay US$22.5m per annum. In addition, in 2010, there was interest cost on benefit obligation in the amount of US$2.5m.

Gain from a bargain purchase of subsidiary

Gain from a bargain purchase of subsidiary (US$104.7m) is the difference between the provisional fair value of net assets of the acquired entity, Koksovaya, (US$144.7m) and the cash fair value of transferred consideration (US$40.0m). (For detailed information on the acquisition refer to Note 4 in Consolidated financial statements of OAO Raspadskaya for the year ended 31 December 2010.)

Income tax

In 2010, the amount of income tax expense (US$39.8m) represents the difference between the tax accrued (US$71.4m) and the change in the amount of the deferred income tax liability and asset (US$31.6m).

EBITDA and indebtedness

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

	2010	2009	Change	
	US$000	*US$000*	*US$000*	
Profit for the period	**244,318**	117,137	127,181	*109%*
Adjusted for:				
Foreign exchange (gains)/losses, net	**(1,826)**	15,529	17,355	*(112)%*
Change in bad debt allowance	**(815)**	623	1,438	*n/a*
Consolidated Profit	**241,677**	133,289	108,388	*81%*
Adjusted for:				
Dividend income	**(3)**	(12)	(9)	*(75)%*
Interest income	**(16,519)**	(12,322)	4,197	*34%*
Interest expense	**26,500**	25,307	1,193	*5%*
Capitalized interest	**1,394**	1,560	(166)	*(11)%*
Amortization of debt issuance cost	**(419)**	(401)	18	*4%*
Gain from a bargain purchase of subsidiary	**(104,735)**	–	104,735	*n/a*
Extraordinary loss on disposal of PP&E	**39,395**	–	39,395	*n/a*
Income tax	**39,788**	32,966	6,822	*21%*
EBIT	**227,078**	180,387	46,691	*26%*
Adjusted for:				
Depreciation, depletion and amortization	**114,211**	79,325	34,886	*44%*
Capitalized depreciation	**(3,648)**	(4,633)	(985)	*(21)%*
Consolidated EBITDA	**337,641**	255,079	82,562	*32%*
EBITDA margin	***48%***	*51%*		

(1) EBITDA represents profit for the period before foreign exchange gains/(losses), change in bad debt allowance, 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. EBITDA is not required by IFRS. We present EBITDA because we consider it an important supplemental measure of our operating performance. EBITDA should not be considered in isolation from or as an alternative to 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 [(1)] is calculated in the following table:

	31/Dec/10	31/Dec/09	Change	
	US$000	*US$000*	*US$000*	
Long-term loans	**304,104**	303,343	761	*0%*
Short-term loans and current portion of long-term loans	**6,499**	28,384	(21,885)	*(77)%*
Less:				
Long-term bank deposits	**–**	(31,242)	(31,242)	*(100)%*
Short-term bank deposits	**(158,384)**	(149,953)	8,431	*6%*
Cash and cash equivalents	**(164,628)**	(28,277)	136,351	*482%*
Consolidated Net Indebtedness/(Net cash position)	**(12,409)**	122,255	134,664	*n/a*

(1) Consolidated Net Indebtedness represents loans less deposits and cash and cash equivalents. Consolidated Net Indebtedness is not required by IFRS. We present Consolidated Net Indebtedness because we consider it an important supplemental measure of our financial position. Consolidated Net Indebtedness should not be considered in isolation from or as a substitute for our financial position as reported under IFRS.

As at 31 December 2010, cash and cash equivalents, short- and long-term bank deposits increased by US$113.5m YoY and were US$323.0m.

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 Consolidated EBITDA.

Net Leverage Ratio may not exceed 3. As at 31 December 2010, none of the covenants stipulated in the Loan Agreement on the eurobonds was breached. We believe none of the covenants will be breached in the future.

Working capital

Our working capital is calculated in the following table:

	31/Dec/10	31/Dec/09	Change	
	US$000	*US$000*	*US$000*	
Taxes recoverable	**23,672**	14,542	9,130	*63%*
Receivables	**79,950**	147,355	(67,405)	*(46)%*
Prepayments	**12,749**	17,800	(5,051)	*(28)%*
Inventories	**77,199**	44,274	32,925	*74%*
Less:				
Taxes payable	**(30,259)**	(33,904)	(3,645)	*(11)%*
Advances	**(19)**	(3,095)	(3,076)	*(99)%*
Payables	**(43,770)**	(44,962)	(1,192)	*(3)%*
Working capital	**119,522**	142,010	(22,488)	*(16)%*

Working capital decreased by 16%. Receivables decreased by 46% (US$67.4m) mainly due to decreased sales volumes in 2Q2010. The increase in inventories by 47% (US$329.7m) was to a large degree due to the disruption of production process at Raspadskaya mine, when the stock could not be consumed as intended, and to an increase in spare parts stock. Taxes recoverable (mainly income tax and VAT) increased by 63% (US$67.4m) because Raspadskaya mine showed tax loss in 2H2010.

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:

	2010	2009	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	**307,905**	221,621	86,284	*39%*
Net cash used in investing activities	**(128,746)**	(209,603)	(80,857)	*(39)%*
Net cash used in financing activities	**(42,892)**	(49,538)	(6,646)	*(13)%*
Effect of foreign exchange rate changes on cash and cash equivalents	**84**	(5,758)	5,842	*n/a*
Cash and cash equivalents at 31 December	**164,628**	28,277	136,351	*482%*

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:

	2010		2009			
	Amount	Portion	Amount	Portion	Change	
	US$000		*US$000*		*US$000*	
Mines in operation	**101,865**	***74%***	107,542	*70%*	(5,677)	*(5)%*
Mine under construction	**31,974**	***23%***	28,292	*18%*	3,682	*13%*
Mining licenses	**317**	***0%***	14,656	*10%*	(14,339)	*(98)%*
Other	**3,414**	***3%***	2,673	*2%*	741	*28%*
	137,570	***100%***	153,163	*100%*	(15,593)	*(10)%*

The amount of cash used in capital expenditures decreased mainly because we spent on mining licenses in 2010 much less than in 2009.

The amount of cash used in capital expenditures to reconstruct Raspadskaya mine was US$20.0m.

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.