

OAO Raspadskaya
Management's discussion and analysis
of financial condition and results of operations
for the six-month period ended 30 June 2012

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 2012 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 four mines in operation, a preparation plant, companies engaged in infrastructure development and transportation, a trading company and a managing company.

Overview of financial results

	1H2012	1H2011	Change	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Revenue	285,171	377,438	(92,267)	(24)%
Cost of sales	(211,529)	(178,876)	(32,653)	18%
Gross profit	73,642	198,562	(124,920)	(63)%
<i>margin</i>	<i>26%</i>	<i>53%</i>		
Selling and distribution costs	(2,143)	(2,542)	399	(16)%
General and administrative expenses	(30,506)	(30,683)	177	(1)%
Social expenses	(4,314)	(3,721)	(593)	16%
Loss on disposal of PP&E	(1,155)	(153)	(1,002)	655%
Foreign exchange gains/(losses)	(30,641)	13,860	(44,501)	n/a
Other operating income	2,590	1,317	1,273	97%
Other operating expenses	(11,777)	(44,264)	32,487	(73)%
Operating profit/(loss)	(4,304)	132,376	(136,680)	n/a
Dividend income	50	24	26	108%
Interest income	4,956	8,390	(3,434)	(41)%
Interest expense	(20,318)	(14,083)	(6,235)	44%
Profit/(loss) before income tax	(19,616)	126,707	(146,323)	n/a
Income tax	1,035	(27,661)	28,696	n/a
Profit/(loss) for the period	(18,581)	99,046	(117,627)	n/a
Earnings/(loss) per share, ¢	(2.52)	12.68		
Adjusted EBITDA	98,899	182,218	(83,319)	(46)%
<i>margin</i>	<i>35%</i>	<i>48%</i>		
Adjusted EBIT	30,677	120,379	(89,702)	(75)%
<i>margin</i>	<i>11%</i>	<i>32%</i>		
Capex	39,156	81,242	(42,086)	(52)%
	30/Jun/12	31/Dec/11		
Debt	554,328	305,270	249,058	82%

The loss for 1H2012 of US\$18.6m was significantly due to the foreign exchange loss of US\$30.6m.

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Mineral reserves and resources

Volumes of coking coal reserves and resources of our mines as at 31 December 2011 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
	<i>millions</i>	<i>millions</i>
	<i>of tonnes</i>	<i>of tonnes</i>
Semi-hard coking coal	1,178	1,576
Hard coking coal	136	233
	1,314	1,809

Semi-hard coking coal includes coal of GZh (gas fat), Zh (fat), and GZhO (gas fat semi-lean) grades under Russian classification. Hard coking coal includes coal of K (coking) and KO (coking semi-lean) grades, which are scarce in Russia and the most valuable coals for coking.

From 31 December 2011 to 30 June 2012, we extracted 3.4 million tonnes of these coking coal reserves.

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:

	1H2012	1H2011	Change
Average exchange rate, <i>RUB/US\$</i>	30.6390	28.6242	7%
	30/Jun/12	31/Dec/11	
Exchange rate, <i>RUB/US\$</i>	32.8169	32.1961	2%

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Production capacity

Production capacity of our mines is a factor that 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. Some mining conditions may cause significant disruptions in production process.

In May 2010 an accident occurred at Rеспадская mine resulting in deaths and injury to people. One of the negative effects of the accident was that the mine stopped its operations which severely cut our production capacity.

At present, we are reconstructing Rеспадская mine. The reconstruction process is being conducted in stages i.e. parts of the mine are put into operation before the whole mine has been reconstructed. The reconstruction expenditure includes compensatory social payments, costs of fire extinguishing and pumping the water out, project works, and purchase and repairs of property, plant and equipment and up to 30 June 2012 amounted to US\$190m. We believe that total expenditure on reconstruction of Rеспадская mine will not exceed US\$280m.

In December 2010 Rеспадская mine recommenced operation at one of its faces, in October 2011 a 2nd face was put in operation, and in May 2012 – a 3rd one.

At 30 June 2012, our coal extraction capacity was 885 thousand tonnes per month, including 805 thousand tonnes of coal that we use in coal concentrate production.

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 and financial results are profoundly influenced by the balance of supply and demand 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 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 situation in the Russian and international steel markets.

As we sell mainly in Russia, fluctuations of demand for coking coal in the domestic market have a strong effect on us. If demand slackens, the negative effect on our sales volumes is particularly great because some of our customers have their own coking coal mines, and we are by far the largest independent coking coal producer in Russia.

Another important factor that affects long-term balance of supply and demand is a widening use of the PCI technology in steel making process. The technology allows injecting coal directly into the converter reducing coking coal consumption and allowing the use of coal of a lower quality.

After a big drop in demand caused by the global economy recession of 2008-9, the demand in Russia and the world for steel products and, consequently, for coking coal was gradually growing up to 4Q2011 which affected positively our sales. Starting 4Q2011 demand has been gradually weakening, especially in Russia. In the summer of 2012, sales volumes to our key customers dropped by 20-30% compared to those in the fall of 2011. At present, we find it increasingly difficult to sell our coal products.

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 for production launch at green-field underground mines.

We intend to sustain our competitiveness based primarily on an optimal price/quality balance and balance between domestic and export sales.

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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 is 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 2011 and 1H2012, 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. Our export price depends on the market.

We made all domestic sales and sales to Evraz's plants in Ukraine under FCA Mezhdurechensk terms. All sales in Asia were made under CFR Port of destination and FOB Port of shipment delivery terms, sales in Ukraine (except for Evraz's plants) were made under DAP Border delivery terms. Under CFR, FOB and DAP, transportation and other related costs are included in the contract price.

Quarterly dynamics of weighted average prices of our coal concentrate restated under common delivery terms (FCA Mezhdurechensk) for 2011 and 1H2012 are set out in the following table:

	1Q2011	2Q2011	3Q2011	4Q2011	1Q2012	2Q2012
	<i>US\$ per tonne, except percentages</i>					
Russia	147.1	174.1	167.3	149.7	130.2	114.1
<i>QoQ change</i>	12%	18%	(4)%	(10)%	(13)%	(12)%
Ukraine	–	–	–	157.0	105.3	90.2
<i>QoQ change</i>	–	–	–	n/a	(33)%	(14)%
Asia	–	–	–	–	–	100.5
<i>QoQ change</i>	–	–	–	–	–	n/a

Since 4Q2011, weakening demand has been negatively affecting our sales prices. In July and August 2012, weighted average prices of our coal concentrate sold in Russia was US\$103.1 and US\$103.3 per tonne respectively.

Weighted average prices of our coal concentrate compared between 1H2012 and 1H2011 restated under common delivery terms (FCA Mezhdurechensk) are set out in the following table:

	1H2012	1H2011	Change
	<i>US\$ per tonne</i>		
Russia	122.1	160.2	(24)%
Ukraine	96.2	–	n/a
Asia	100.5	–	n/a

Weighted average prices of our coal concentrate compared between 1H2012 and 2H2011 restated under common delivery terms (FCA Mezhdurechensk) are set out in the following table:

	1H2012	2H2011	Change
	<i>US\$ per tonne</i>		
Russia	122.1	158.1	(23)%
Ukraine	96.2	162.8	(41)%
Asia	100.5	–	n/a

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Sales volumes

In 1H2011, our impaired production capacity kept our sales volumes in check. But since 4Q2011, weakening demand has been gradually becoming the main factor restraining our sales volumes, and at present our production capacity exceeds demand which leads to revision of our previously announced plans.

Quarterly dynamics of sales volumes of our coal concentrate for 1H2011 and 1H2012 are set out in the following table:

	1Q2011	2Q2011	3Q2011	4Q2011	1Q2012	2Q2012
	<i>thousands of tonnes, except percentages</i>					
Russia	935	904	926	936	864	866
<i>QoQ change</i>	4%	(3)%	2%	1%	(8)%	0%
Ukraine	–	–	–	33	71	116
<i>QoQ change</i>	–	–	–	n/a	115%	63%
Asia	–	–	–	–	–	88
<i>QoQ change</i>	–	–	–	–	–	n/a
Export – Total	–	–	–	33	71	204
Total	935	904	926	969	935	1,070
<i>QoQ change</i>	4%	(3)%	2%	5%	(4)%	14%

In July and August 2012, our total sales volume of coal concentrate amounted to 352 and 306 thousand tonnes respectively.

Sales volumes of our coal concentrate and raw coal by markets and major customers compared between 1H2012 and 1H2011 are set out in the following table:

	1H2012		1H2011		Change	
	Volume	Portion	Volume	Portion		
	<i>thousands of tonnes</i>		<i>thousands of tonnes</i>		<i>thousands of tonnes</i>	
Coal concentrate – Russia						
MMK	531	26%	560	30%	(29)	(5)%
Kemerovo-Koks	412	21%	520	28%	(108)	(21)%
NLMK (including Altai-Koks)	300	15%	202	11%	98	48%
Mechel	189	9%	169	9%	20	12%
Evrz	115	6%	286	16%	(171)	(60)%
Other	183	9%	102	6%	81	79%
	1,730	86%	1,839	100%	(109)	(6)%
Coal concentrate – export						
Ukraine ⁽¹⁾	187	10%	–	–	187	n/a
China	66	3%	–	–	66	n/a
Republic of Korea	22	1%	–	–	22	n/a
	275	14%	–	–	275	n/a
Coal concentrate – total	2,005	100%	1,839	100%	166	9%
Raw coal – Russia (Evrz)	327		608		(281)	(46)%
Coal concentrate and raw coal	2,332		2,447		(115)	(5)%

(1) Including sales to Evraz's plants in the volume of 139 thousand tonnes in 1H2012.

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Sales volumes of our coal concentrate and raw coal by markets and major customers compared between 1H2012 and 2H2011 are set out in the following table:

	1H2012		2H2011		Change	
	Volume	Portion	Volume	Portion	Change	
	<i>thousands of tonnes</i>		<i>thousands of tonnes</i>		<i>thousands of tonnes</i>	
Coal concentrate – Russia						
MMK	531	26%	573	30%	(42)	(7)%
Kemerovo-Koks	412	21%	486	26%	(74)	(15)%
NLMK (including Altai-Koks)	300	15%	271	14%	29	11%
Mechel	189	9%	145	8%	44	30%
Evraz	115	6%	234	12%	(119)	(51)%
Other	183	9%	154	8%	29	19%
	1,730	86%	1,863	98%	(133)	(7)%
Coal concentrate – export						
Ukraine ⁽¹⁾	187	10%	33	2%	154	467%
China	66	3%	–	–	66	n/a
Republic of Korea	22	1%	–	–	22	n/a
	275	14%	33	2%	242	n/a
Coal concentrate – total	2,005	100%	1,896	100%	109	6%
Raw coal – Russia (Evraz)	327		344		(17)	(5)%
Coal concentrate and raw coal	2,332		2,240		92	4%

(1) Including sales to Evraz's plants in the volume of 139 thousand tonnes in 1H2012 and 33 thousand tonnes in 2H2011.

Despite a sharp decrease in sales volumes to our related party Evraz, it remained the largest customer – its share in total sales volume of our coal products was 25% in 1H2012 compared to 37% in 1H2011. The main reasons for the decrease in sales volumes to Evraz's plants are repairs of one of the converters and gradual implementation of the PCI technology. Nevertheless, all the hard coking coal is sold to Evraz under long-term contracts. Portion of raw coal in total sales volume of our coal products was 14% in 1H2012 compared to 25% in 1H2011.

Starting 4Q2011, as demand in the Russian market set to decline, we, in order to keep up and increase sales volumes, recommenced export – in October 2011 in Ukraine and in May 2012 in Asia. In future, we intend to expand export, especially in Asia, as a means to offset decreases of sales volumes in the domestic market. We expect that export expansion will allow us to reduce stockpiles and per tonne costs of mining, and utilize our production capacity more efficiently.

Revenue

Domestic and export sales by type of our products compared between 1H2012 and 1H2011 are set out in the following table:

	1H2012		1H2011		Change	
	Amount	Portion	Amount	Portion	Change	
	<i>US\$000</i>		<i>US\$000</i>		<i>US\$000</i>	
Coal concentrate – Russia	211,173	78%	294,673	80%	(83,500)	(28)%
Coal concentrate – export	26,926	10%	–	–	26,926	n/a
	238,099	88%	294,673	80%	(56,574)	(19)%
Raw coal – Russia	31,239	12%	74,047	20%	(42,808)	(58)%
	269,338	100%	368,720	100%	(99,382)	(27)%
Transportation costs	8,863		–		8,863	n/a
Sales of other goods	3,715		4,787		(1,072)	(22)%
Rendering of services	3,255		3,931		(676)	(17)%
Revenue	285,171		377,438		(92,267)	(24)%

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Domestic and export sales by type of our products compared between 1H2012 and 2H2011 are set out in the following table:

	1H2012		2H2011		Change	
	<i>Amount</i>	<i>Portion</i>	<i>Amount</i>	<i>Portion</i>	<i>US\$000</i>	
	<i>US\$000</i>		<i>US\$000</i>		<i>US\$000</i>	
Coal concentrate – Russia	211,173	78%	294,604	86%	(83,431)	(28)%
Coal concentrate – export	26,926	10%	5,372	2%	21,554	x5
	238,099	88%	299,977	88%	(61,878)	(21)%
Raw coal – Russia	31,239	12%	40,160	12%	(8,921)	(22)%
	269,338	100%	340,136	100%	(70,798)	(21)%
Transportation	8,863		–		8,863	n/a
Sales of other goods	3,715		4,736		(1,021)	(22)%
Rendering of services	3,255		4,663		(1,408)	(30)%
Revenue	285,171		349,536		(64,365)	(18)%

Revenue decreased by US\$92.3m YoY mainly because of lower prices of our coal products.

In 1H2012, portion of revenue from export sales of coal concentrate in revenue from our sales of coal concentrate was 11%.

Transportation consists of transportation costs that are included in sales price of coal concentrate under CFR, FOB and DAP delivery terms.

In 2012 and 2011, all sales of other goods and rendering of services were made within Russia.

In 2012 and 2011, sales of other goods mainly consisted of resale of steel products bought from Evraz.

In 2012 and 2011, 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. At present, our mines have a large production potential that is being held back by the market conditions. Today, our business depends not on production capacities and possibilities but on the situation on the industry markets because since the end of last year the coal market has been a buyer market.

Production volumes of our raw coal and coal concentrate between 1H2012 and 1H2011 are set out in the following table:

	1H2012	1H2011	Change	
	<i>thousands of tonnes</i>	<i>thousands of tonnes</i>	<i>thousands of tonnes</i>	
Raw coal extraction	3,434	3,458	(24)	(1)%
Raw coal preparation	2,727	2,584	143	6%
Coal concentrate production	2,116	1,866	250	13%
Output ratio	77.6%	72.2%		

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Production volumes of our raw coal and coal concentrate between 1H2012 and 2H2011 are set out in the following table:

	1H2012	2H2011	Change	
	<i>thousands of tonnes</i>	<i>thousands of tonnes</i>	<i>thousands of tonnes</i>	
Raw coal extraction	3,434	2,793	641	23%
Raw coal preparation	2,727	2,556	171	7%
Coal concentrate production	2,116	1,899	217	11%
Output ratio	77.6%	74.3%		

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

Production volume is an important factor in determining our overall cost competitiveness because a substantial proportion of our costs are fixed which is typical for the extractive industries. Thus, when production volumes decrease production cost per tonne of coal increases.

Stockpiles of our coal products are set out in the following table:

	30/06/12	31/12/11
	<i>thousands of tonnes</i>	<i>thousands of tonnes</i>
Raw coal	591	213
Coal concentrate (including concentrate at ports)	116	32

Cost of production and cost of sales

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.

Cash cost of extraction of coal increased mainly because of an increase in expenses included in production costs and associated with the disposing of the accident and reconstruction of Rospadskaya mine. The expenses increased because the main stage of disposing of the accident and reconstruction of Rospadskaya mine was completed. In addition, the volume of development at the mine also increased.

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

	1H2012		1H2011		Change	
	Amount	Portion	Amount	Portion	Change	
	<i>US\$000</i>		<i>US\$000</i>		<i>US\$000</i>	
Payroll	49,943	22%	38,337	21%	11,606	30%
Payroll taxes	20,771	9%	16,117	9%	4,654	29%
Other taxes	11,671	5%	10,947	6%	724	7%
Materials	50,703	23%	35,312	20%	15,391	44%
Electricity	8,831	4%	7,701	4%	1,130	15%
Other costs and expenses	17,312	8%	15,206	9%	2,106	14%
Cash cost of production	159,231	71%	123,620	69%	35,611	29%
Depreciation, depletion (excluding mineral reserve) and amortization	48,094	21%	38,525	21%	9,569	25%
Depletion of mineral reserve	17,126	8%	17,784	10%	(658)	(4)%
Cost of production	224,451	100%	179,929	100%	44,522	25%
Transportation	8,863		-		8,863	n/a
Cost of resold goods	3,640		4,753		(1,113)	(23)%
Cost of rendering of services	2,752		3,174		(422)	(13)%
Change in finished goods	(28,177)		(8,980)		(19,197)	214%
Cost of sales	211,529		178,876		32,653	18%

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

	1H2012	1H2011	Change	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Cash cost of extraction of coal	155,955	112,164	43,791	39%
	<i>US\$</i>	<i>US\$</i>	<i>US\$</i>	
Cash cost of extraction of 1t of coal	45.4	32.4	13.0	40%

In 1H2012, given that extraction volume did not materially change, the higher cash cost of extraction of 1t of coal was due to higher payroll and payroll taxes, cost of materials and electricity, and services.

Estimated cash costs of our coal concentrate preparation are set out in the following table:

	1H2012	1H2011	Change	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Estimated cash cost of coal used in concentrate preparation ⁽¹⁾	120,741	82,493	38,248	46%
Cash cost of preparation	8,610	9,168	(558)	(6)%
Cash cost of production transportation of coal concentrate	1,844	1,535	309	20%
Estimated cash cost of coal concentrate	131,195	93,196	37,999	41%
	<i>US\$</i>	<i>US\$</i>	<i>US\$</i>	
Estimated cash cost of 1t of coal used in concentrate preparation	44.3	31.9	12.4	39%
Cash cost of preparation of 1t of coal used	3.2	3.5	(0.3)	(9)%
Cash cost of production transportation of 1t of coal concentrate	0.9	0.8	0.1	13%
Estimated cash cost of 1t of concentrate ⁽²⁾	62.0	49.9	12.1	24%

(1) Estimated cash cost of coal used in concentrate preparation is calculated by multiplying volume of coal used in concentrate preparation by cash cost of extraction of 1t of coal intended for preparation;

(2) Raw coal has been restated in tonnes of coal concentrate at the output ratio of 77.6% for 1H2012 and 72.2% for 1H2011.

If sales and production volumes had reached the planned levels, cash cost of 1 t of coal concentrate would have been no less than 30% lower than the actual one in 1H2012.

We expect that the ruble-denominated estimated cash cost of production of 1t of concentrate will decrease as production volumes increase.

Payroll and payroll taxes

Payroll and payroll taxes constitute the largest item of our production cash costs – 31% and 30% in 1H2012 and in 1H2011 respectively.

The increase in production payroll by 30% YoY came about because in 1H2011 payroll of many miners who took part in the reconstruction of Rospadskaya mine was included in other operating expenses. As the mine completed the main stage of reconstruction, the payroll is included in production costs.

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 staff and related costs is summarized in the following table:

	1H2012	1H2011	Change	
Average total number of employees	8,356	8,116	240	3%
Total payroll, <i>US\$000</i>	66,079	66,948	(869)	(1)%
Total payroll taxes, <i>US\$000</i>	25,687	26,971	(1,284)	(5)%
Effective payroll tax rate	39%	40%		

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Overall, in 2011-2, total payroll did not materially change.

The increase in average total number of employees by 3% YoY was principally due to requirements of supervisory authorities on safe mining conditions.

As payroll taxes rate was reduced from 34% to 30% starting 1 January 2012, total payroll taxes decreased by 5% YoY.

Other taxes

Other taxes included in production costs consist primarily of the mineral extraction tax (MET) and the land lease rental. The increase in other taxes by 7% YoY was mainly due to an increase in land rent.

Materials and electricity

The increase in materials cost by 44% YoY was, apart from increased prices, mainly due to increases in mine development by 19%, overburden removal by 22%, overburden transportation distances by 27%, diesel price by 17%, and materials used in repairs by 75%.

Electricity cost increased by 15% YoY principally because of an increase of the tariff by 13% and commencement of new faces and longwall panels at Rеспдская mine.

Other costs and expenses

Other costs and expenses increased by 14% YoY mainly due to an increase in mining equipment repairs services by 46% and volumes of drilling and blasting work by 27% and 24% respectively.

Depreciation, depletion and amortization

Depreciation, depletion and amortization comprise a significant portion in our cost of production – 29% and 31% in 1H2012 and in 1H2011 respectively.

Depreciation, depletion (excluding mineral reserve) and amortization increased by 25% YoY mainly because of large additions of property, plant and equipment in 2011.

Depletion of mineral reserves is directly proportional to extraction volumes. Mineral reserves represent tangible assets acquired in business combinations which concerns 3 of our mines. The decrease in depletion charge was due to a slight decrease in total extraction by these companies.

Transportation

Transportation consists of transportation costs that are included in sales price of our coal concentrate under CFR, FOB and DAP delivery terms – railroad costs and loading services in ports as well as freight. In 2011, there were no transportation costs because all our sales were made under FCA terms.

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. Railroad tariffs increased by 6% in 1H2012.

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Other income and expenses

Selling and distribution costs

Selling and distribution costs consist of agent fee for the supply of railroad trucks, 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:

	1H2012		1H2011		Change	
	Amount	Portion	Amount	Portion	US\$000	
	US\$000		US\$000		US\$000	
Payroll	12,877	42%	12,830	42%	47	0%
Payroll taxes	3,690	12%	3,660	12%	30	1%
Other taxes	4,872	16%	4,778	16%	94	2%
Materials	945	3%	892	3%	53	6%
Other costs and expenses	6,272	21%	6,088	20%	184	3%
Depreciation and amortization	1,850	6%	2,435	7%	(585)	(24)%
	30,506	100%	30,683	100%	(177)	(1)%

The most material part of our general and administrative expenses is payroll and payroll taxes – 54% in both 1H2012 and 1H2011.

Other taxes are represented mainly by property tax.

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

Social expenses

As is the case with many large Russian production companies, we have certain social expenses that are primarily in the form of donations and social sphere infrastructure maintenance.

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 there is any, and the carrying amount of the items.

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 1H2012, the depreciation of the ruble resulted in a loss of US\$55.0m on US\$ loans and a gain of US\$22.7m from cash and deposits. Besides, exchange rate differences on sales and purchase of foreign currencies represented a gain of US\$1.7m. The resulting foreign exchange loss of US\$30.6m played a significant part in making the negative financial result for the period.

Other operating income and expenses

Other operating income and expenses consist of non-recurring income and expenses. Other operating expenses were 73% lower YoY mainly because of a decrease in expenses associated with the completion of the main stage of disposing of the accident and reconstruction of Rospadskaya mine.

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Interest income and interest expense

Interest income mainly related to deposits held in Russian banks. The decrease in interest income was mainly due to a lower amount of bank deposits held in 1H2012 compared to 1H2011.

In 2012 and 2011, the main part of interest expense was coupon on our Eurobonds. We have to pay on 7.75% Eurobonds due 2017 US\$15.5m each half year. In addition, we pay an interest on a loan from Raiffeisenbank we took in February 2012 to finance our operating activities.

Income tax

In 1H2012, the amount of income tax (US\$1.0m) represents the difference between tax accrued (US\$18.2m) and the change in the amount of the deferred income tax asset and liability (US\$19.2m). The main part of the change in the amount of the deferred income tax asset and liability was a tax benefit arising from loss carry forwards available for offset against future taxable profit.

Adjusted EBITDA

Our Adjusted EBITDA for 1H2012 and 1H2011 is calculated in the following table:

	1H2012	1H2011	Change	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Profit/(loss) for the period	(18,581)	99,046	(117,627)	<i>n/a</i>
<i>Adjusted for:</i>				
Foreign exchange (gains)/losses, net	30,641	(13,860)	44,501	<i>n/a</i>
Dividend income	(50)	(24)	(26)	<i>108%</i>
Interest income	(4,956)	(8,390)	(3,434)	<i>(41)%</i>
Interest expense	20,318	14,083	6,235	<i>44%</i>
Amortization of debt issuance cost	(308)	(222)	(86)	<i>39%</i>
Change in provisions	3,976	3,810	166	<i>4%</i>
Net employee benefit	96	(1,099)	1,195	<i>n/a</i>
Change in bad debt allowance	576	(626)	1,202	<i>n/a</i>
Income tax	(1,035)	27,661	(28,696)	<i>n/a</i>
Adjusted EBIT	30,677	120,379	(89,702)	<i>(75)%</i>
<i>Adjusted for:</i>				
Depreciation, depletion and amortization	70,911	64,821	6,090	<i>9%</i>
Capitalized depreciation	(2,689)	(2,982)	(293)	<i>(10)%</i>
Adjusted EBITDA	98,899	182,218	(83,319)	<i>(46)%</i>
Adjusted EBITDA margin	35%	48%		

Our Adjusted EBITDA for the 12-month period ended 30 June 2012 is calculated in the following table:

	<i>US\$000</i>
Adjusted EBITDA for 2011	318,295
<i>Less:</i>	
Adjusted EBITDA for 1H2011	(182,218)
Adjusted EBITDA for 2H2011	136,077
Adjusted EBITDA for 1H2012	98,899
Adjusted EBITDA for 12m ended 30/Jun/2012	234,976

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Indebtedness

Our indebtedness is calculated in the following table:

	30/Jun/12	31/Dec/11	Change	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Long-term loans	496,820	1,243	495,577	<i>x400</i>
Short-term loans and current portion of long-term loans	57,508	304,027	(246,519)	<i>(81)%</i>
Debt	554,328	305,270	249,058	<i>82%</i>
<i>Less:</i>				
Short-term bank deposits	(75,017)	(80,179)	(5,162)	<i>(6)%</i>
Cash and cash equivalents	(73,274)	(180,100)	(106,826)	<i>(59)%</i>
Net debt	406,037	44,991	361,046	<i>x9</i>

By issuing 7.75% five-year Eurobonds in the amount of US\$400m in April 2012, we refinanced our 7.5% Eurobonds in the amount of US\$300m due May 2012. The remaining amount of US\$100m was used to finance our operating activities.

At 30 June 2012, the new bonds and the loan from Raiffeisenbank in the amount of US\$150m together constituted the main component of our long-term debt.

One of the covenants stipulated in the Loan Agreement on 7.75% Eurobonds is Leverage Ratio which represents the ratio of Debt to 12-month Adjusted EBITDA. If the ratio exceeds 3, we may not incur indebtedness. As at 30 June 2012, Leverage Ratio equaled 2.36, nor was breached any of other covenants stipulated in the Loan Agreement on 7.75% Eurobonds.

One of the covenants stipulated in the Loan Agreement with Raiffeisenbank is Net Leverage Ratio which represents the ratio of Net debt to 12-month Adjusted EBITDA. As at 30 June 2012, Leverage Ratio equaled 1.73, nor was breached any of other covenants stipulated in the Loan Agreement with Raiffeisenbank.

Our short-term loans were mainly represented by the short-term portion (US\$50m) of the loan from Raiffeisenbank.

Liquidity

At 30 June 2012, cash and cash equivalents, short- and long-term bank deposits totaled US\$148.3m, having decreased by US\$112.0m from US\$260.3m at 31 December 2011.

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:

	1H2012	1H2011	Change	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Cash and cash equivalents at 1 January	180,100	164,628	15,472	<i>9%</i>
Net cash from operating activities	73,140	159,636	(86,496)	<i>(54)%</i>
Net cash used in investing activities	(25,599)	(66,553)	40,954	<i>(62)%</i>
Net cash used in financing activities	(196,190)	(15,961)	(180,229)	<i>x12</i>
Effect of forex rate changes on cash and cash equivalents	41,823	15,112	26,711	<i>177%</i>
Cash and cash equivalents at 30 June	73,274	256,862	(183,588)	<i>(71)%</i>

In 1H2012, a large amount of cash of 11,641,254,900 rubles (US\$396.4m at exchange rates at the date of each transaction) was used in payments in agreement with shareholders under share buyback program announced at the end of 2011.

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In November 2011 the Board of Directors decided to buy back up to 78,079,980 shares (up to 10% of issued capital). The purchase price of 150 rubles per share was set based on the average market price for 6 months.

On 27 August 2012 the Board of Directors recommended an Extraordinary General Meeting on 23 October 2012 reduces issued capital of OAO Rospadskaya by canceling the treasury shares.

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

Working capital

Our working capital is calculated in the following table:

	<u>30/Jun/12</u>	<u>31/Dec/11</u>	<u>Change</u>	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Inventories	113,792	84,046	29,746	35%
Receivables	89,244	99,818	(10,574)	(11)%
Prepayments	6,293	4,614	1,679	36%
Taxes recoverable	7,418	13,124	(5,706)	(43)%
<i>Less:</i>				
Payables	(63,519)	(48,250)	(15,269)	32%
Taxes payable	(25,357)	(29,661)	4,304	(15)%
Advances	(700)	(49)	(651)	x14
Working capital	<u>127,171</u>	<u>123,642</u>	<u>3,529</u>	<u>3%</u>

In 1H2012, slackening demand and sales volumes led to a significant increase of stockpile of raw coal and coal concentrate. This, coupled with a higher cost of our coal, was the main reason for the significant growth of inventories.

This growth of inventories by US\$29.7m could have led to a substantial increase of working capital. However, some other changes in it partially offset its increase. These changes include an increase in payables by US\$15.3m, a decrease in receivables by US\$10.6m, and a decrease in taxes recoverable by US\$5.7m.

Payables increased mainly because we negotiated delaying payments to some of our creditors.

Receivables decreased mainly due to lower prices of coking coal.

Taxes recoverable (mainly income tax and VAT) decreased due to a partial recovery of taxes previously overpaid.

Capital expenditure

Our capital expenditure is set out in the following table:

	<u>1H2012</u>		<u>1H2011</u>		<u>Change</u>	
	<u>Amount</u>	<u>Portion</u>	<u>Amount</u>	<u>Portion</u>	<u>US\$000</u>	
	<i>US\$000</i>		<i>US\$000</i>		<i>US\$000</i>	
Mines	35,961	92%	75,878	93%	(39,917)	(53)%
Other	3,195	8%	5,364	7%	(2,169)	(40)%
	<u>39,156</u>	<u>100%</u>	<u>81,242</u>	<u>100%</u>	<u>(42,086)</u>	<u>(52)%</u>

The significant decrease in capex took place mainly because the production program was not fulfilled which brought about a decrease in investments on production capacity maintenance.

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.