

SEVERSTAL

Condensed special purpose consolidated financial statements
for the six months ended June 30, 2003

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Independent Accountants' Review Report

The Board of Directors and Shareholders
OAO Severstal

Introduction

We have been engaged by the Company to review the accompanying condensed special purpose consolidated financial statements prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board set out on pages 3 to 9.

This report is made solely to the Company in accordance with the terms of our engagement. Our review has been undertaken so that we might state to the company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our review work, for this report, or for the conclusions we have reached.

Directors' responsibilities

The condensed special purpose consolidated financial statements are the responsibility of, and have been approved by, the directors.

Basis of preparation

The accompanying condensed special purpose consolidated financial statements have been prepared for the purpose of presenting the consolidated financial position, results of operations, changes in shareholders' equity and cash flows of the Company as of 30 June 2003 as if the Group structure that came in place on 16 September 2002 had been in place before 1 January 2002. The basis of preparation of the condensed special purpose consolidated financial statements is explained in note 2 to these condensed special purpose consolidated financial statements.

Review work performed

We conducted our review having regard to the guidance contained in Bulletin 1999/4: Review of interim financial information issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of group management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review is substantially less in scope than an audit performed in accordance with Auditing Standards and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the condensed special purpose consolidated financial statements.





Review conclusion

On the basis of our review, we are not aware of any material modifications that should be made to the condensed special purpose consolidated financial statements as presented for the six months ended 30 June 2003.

KPMG Limited

KPMG Limited
Moscow, Russian Federation
1 December 2003

Condensed special purpose consolidated balance sheet

June 30, 2003

(Amounts expressed in thousands of US dollars)

	<u>June 30, 2003</u>	<u>December 31, 2002</u>
Assets		
Current assets:		
Cash and cash equivalents	236,650	188,288
Reserves at Central Bank of Russia	6,366	2,520
Banking assets	94,812	39,058
Trade accounts receivable	155,765	123,970
Inventories	259,323	246,749
Amounts receivable from related parties	56,995	42,827
VAT recoverable	54,878	48,233
Income tax recoverable	7,138	1,506
Other current assets	82,350	93,248
Lease receivables	289	416
Financial assets	403,641	330,327
Total current assets	<u>1,358,207</u>	<u>1,117,142</u>
Non-current assets:		
Lease receivables	32	161
Financial assets	282,221	115,070
Property, plant & equipment	1,918,483	1,958,734
Intangible assets	(4,472)	(1,893)
Total non-current assets	<u>2,196,264</u>	<u>2,072,072</u>
Total assets	<u>3,554,471</u>	<u>3,189,214</u>
Liabilities and shareholders' equity		
Current liabilities:		
Trade accounts payable	140,145	117,059
Bank customer accounts	16,010	6,857
Amounts payable to related parties	33,732	35,715
Income taxes payable	1,752	8,466
Other taxes and social security payable	21,997	22,363
Deferred income	3,130	3,665
Debt finance	182,348	92,493
Lease liabilities	717	689
Dividends payable	185	564
Other current liabilities	114,194	84,398
Total current liabilities	<u>514,210</u>	<u>372,269</u>
Non-current liabilities:		
Debt finance	71,778	83,859
Lease liabilities	696	631
Deferred tax liabilities	280,302	287,526
Other non-current liabilities	45,179	35,863
Total non-current liabilities	<u>397,955</u>	<u>407,879</u>
Minority interest	<u>33,895</u>	<u>35,815</u>
Shareholders' equity:		
Share capital	3,311,129	3,311,129
Revaluation reserve	782,446	832,048
Accumulated deficit	(1,485,164)	(1,769,926)
Total shareholders' equity	<u>2,608,411</u>	<u>2,373,251</u>
Total liabilities and shareholders' equity	<u>3,554,471</u>	<u>3,189,214</u>

These financial statements were approved by the Board of Directors on December 1, 2003

Condensed special purpose consolidated statement of operations
Six months ended June 30, 2003

(Amounts expressed in thousands of US dollars, except shares and earnings per share)

	Six months June 30, 2003	Six months June 30, 2002
	<u> </u>	<u> </u>
Sales		
Sales - external	1,448,765	880,398
Sales - to related parties	84,478	89,284
	<u>1,533,243</u>	<u>969,682</u>
Cost of sales	(937,119)	(717,617)
	<u>596,124</u>	<u>252,065</u>
Gross profit		
Indirect taxes & contributions	(12,000)	(21,597)
Selling, general & administration expenses	(58,319)	(44,579)
Distribution expenses	(158,429)	(127,699)
Other operating income	10,925	2,548
Other operating expenses	(5,230)	(14,853)
Net expenses with insurance operations	(10,897)	(1,333)
Net income from banking operations	516	1,560
Net income/(expense) from securities operations	13,704	(7,789)
	<u>376,394</u>	<u>38,323</u>
Profit from operations		
Non-operating expenses	(16,110)	(17,051)
Impairment loss	(1,110)	(5,426)
Amortization of goodwill	83	223
Share of associates income	-	(522)
	<u>359,257</u>	<u>15,547</u>
Profit before financing and taxation		
Net financing expense	(2,083)	(8,395)
	<u>357,174</u>	<u>7,152</u>
Profit before income tax		
Income tax expense	(86,478)	(10,106)
	<u>270,696</u>	<u>(2,954)</u>
Profit/(loss) for the year		
Profit attributable to minorities	(1,096)	(535)
	<u>269,600</u>	<u>(3,489)</u>
Profit/(loss) attributable to shareholders		
Weighted average number of shares outstanding during the year	<u>22,074,192</u>	<u>22,074,192</u>
Basic and diluted earnings per share	<u>12.21</u>	<u>(0.16)</u>

Condensed special purpose consolidated statement of cash flows
Six months ended June 30, 2003

(Amounts expressed in thousands of US dollars)

	Six months June 30, 2003	Six months June 30, 2002
Operating activities:		
Profit before financing and taxation	359,257	15,547
Adjustments to reconcile profit to cash provided by operating activities:		
Depreciation of property, plant & equipment	111,211	100,598
Amortization of intangible assets	(52)	(189)
Asset impairment	1,110	5,506
Foreign exchange loss/(gain)	(33,881)	17,630
Loss on disposal of property, plant & equipment	4,251	14,524
Loss on disposal of intangible assets	8	67
Loss on deconsolidation of OAO Pensionat Sheksna	-	496
Profit on disposal of financial assets	(93)	(122)
Adjustment of financial assets to fair value	(13,944)	(5,097)
Share of associates income	-	522
Bank loan loss provisions	865	(179)
Provision for doubtful accounts receivable	35	(461)
Changes in operating assets and liabilities:		
Reserves at Central Bank of Russia	(3,846)	4,170
Banking assets	(56,619)	(578)
Trade accounts receivable	(28,252)	(3,665)
Amounts receivable from related parties	(14,168)	(43,444)
VAT recoverable	(4,464)	(34,169)
Inventories	(9,832)	30,493
Lease receivables	239	409
Other current assets	(5,652)	(1,912)
Short term bank deposits	(4,059)	(24,429)
Trade accounts payable	21,812	53,574
Bank customer accounts	9,153	1,013
Amounts payable to related parties	(1,983)	15,633
Other taxes and social security payable	19,446	14,485
Deferred income	(694)	(1,174)
Other current liabilities	29,160	9,044
Other non-current liabilities	10,256	(5,083)
Cash generated from operations	389,264	163,209
Interest received (excluding banking operations)	10,384	2,452
Interest paid (excluding banking operations)	(10,357)	(11,962)
Income tax paid	(106,048)	(30,000)
Net cash provided from operating activities	283,243	123,699
Investing activities:		
Additions to property, plant & equipment	(81,324)	(74,474)
Additions to financial assets	(494,720)	(183,535)
Buy-out of minority interests	(393)	(3,226)
Proceeds from disposal of property, plant & equipment	2,261	7,060
Proceeds from disposal of financial assets	291,823	107,530
Cash used for investing activities	(282,353)	(146,645)
Financing activities:		
Proceeds from debt finance	158,937	213,632
Repayment of debt finance	(84,311)	(180,263)
Proceeds from lease finance	93	-
Repayment of lease finance	-	(3)
Parent company dividends paid	(34,828)	(18,568)
Minority capital contributions	-	1,115
Cash provided from financing activities	39,891	15,913
Effect of exchange rates on cash and cash equivalents	7,581	(2,329)
Net increase/(decrease) in cash and cash equivalents	48,362	(9,362)
Cash and cash equivalents at beginning of period	188,288	100,796
Cash and cash equivalents at end of period	236,650	91,434

Condensed special purpose consolidated statement of changes in shareholders' equity
Six months ended June 30, 2003

(Amounts expressed in thousands of US dollars)

	<u>Share capital</u>	<u>Revaluation reserve</u>	<u>Accumulated deficit</u>	<u>Total</u>
Balances at December 31, 2001	3,311,129	949,245	(2,076,114)	2,184,260
Realization of revaluation reserve:				
Disposals	-	(20,589)	20,589	-
Depreciation	-	(64,597)	64,597	-
Deferred tax on realization	-	20,444	(20,444)	-
Loss attributable to shareholders	-	-	(3,489)	(3,489)
Balances at June 30, 2002	<u>3,311,129</u>	<u>884,503</u>	<u>(2,014,861)</u>	<u>2,180,771</u>
Balances at December 31, 2002	3,311,129	832,048	(1,769,926)	2,373,251
Dividends in respect of 2002	-	-	(34,440)	(34,440)
Realization of revaluation reserve:				
Disposals	-	(2,826)	2,826	-
Depreciation	-	(62,272)	62,272	-
Deferred tax on realization	-	15,496	(15,496)	-
Profit attributable to shareholders	-	-	269,600	269,600
Balances at June 30, 2003	<u>3,311,129</u>	<u>782,446</u>	<u>(1,485,164)</u>	<u>2,608,411</u>

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Notes to the condensed special purpose consolidated financial statements for the six months ended June 30, 2003

(Amounts expressed in thousands of US dollars)

1. Commentary on results

The results of the six months ended June 30, 2003 reflect a significant increase in general steel prices around the world and Russia especially. Prices have risen by up to US\$ 100 per tonne compared with those during the six months ended June 30, 2002. This increase started in the third quarter of 2002 and has continued throughout 2003.

During the six months ended June 30, 2003 Severstal shipped more value added products at the expense of shipping basic products (such as slabs) and continued to develop the Russian market. As a result, during the six months ended June 30, 2003 Severstal shipped 2.5 million tonnes of rolled products to Russian customers (six months ended June 30, 2002: 2 million tonnes), and 1.8 million tonnes to international customers (six months ended June 30, 2002: 2.1 million tonnes).

The change in distribution expenses represents the combined effects of increased rail tariffs and the weakening of the US dollar against the rouble. The higher expenses from insurance operations represent the extension of the Group's insurance cover to more of its assets and operations, which are re-insured in the international markets through the Group's own insurance company.

Although steel prices have increased, Severstal has continued to control its primary cost base, hence, the increased sales prices have resulted in additional profits that have been used to continue the modernization of the Group's facilities; invest in the development of the Group's activities; pay dividends; and invest in securing supplies of raw materials.

The increase in income from securities operations reflects the weakening of the US dollar against the rouble during the six months ended June 30, 2003.

2. Accounting policies

The accounting conventions and accounting policies used in these financial statements are the same as those used to prepare the consolidated financial statements for the year ended December 31, 2002. The special purpose basis reflects the Group structure that came into place on September 16, 2002 when the subsidiaries OAO Severstal Resource and OAO Severstal Avto were spun off by way of dividend payment. Consequently, the results for the six months ended June 30, 2002 in these special purpose consolidated financial statements present only the results of the new Group structure as if it had been in place from January 1, 2002. Accordingly, the results presented in these special purpose consolidated financial statements for the six months ended June 30, 2002 are not necessarily indicative of the results or related effects on the financial position as at that date that might have been attained had the new Group structure actually been in place before January 1, 2002.

3. Seasonality

There are no material seasonal effects in the business activities of the company.

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Notes to the condensed special purpose consolidated financial statements for the six months ended June 30, 2003 (Amounts expressed in thousands of US dollars)

4. Related party balances

	June 30, 2003	December 31, 2002
Amounts receivable from related parties:		
Advances paid	10,172	8,441
Trade accounts receivable	41,963	33,436
Other receivables	4,860	950
	<u>56,995</u>	<u>42,827</u>
Banking assets include loans to related party customers of	20,284	8,069
Current financial assets include the following balances with related parties:		
Originated loans	133,506	129,759
Trading securities – promissory notes	79,073	64,734
Non-current financial assets include the following balances with related parties:		
Originated loans	189,074	29,539
Held-to-maturity securities – promissory notes	202	477
Amounts payable to related parties:		
Advances received	1,255	1,021
Trade accounts payable	12,563	10,905
Other accounts payable	18,995	22,786
Bank demand deposits	194	307
Bank term deposits	725	696
	<u>33,732</u>	<u>35,715</u>
Debt finance includes loans received from related parties of	32,190	-

5. Related party transactions

	Six months June 30, 2003	Six months June 30, 2002
Sales	84,478	89,284
Purchases – non capital	240,158	134,560
Purchases – capital	1,374	385
Bank expenses	65	-
Insurance claims	324	212

6. Commitments and Contingents

The Group has provided for all significant contingent liabilities which are probable of assertion and success.

As at June 30, 2003 the Group had capital commitments of US\$ 133.9 million (December 31, 2002: US\$ 133.7 million).

At June 30, 2003 the Group had given US\$ 105.4 million (December 31, 2002: US\$ 50.3 million) of guarantees for bank borrowings, of which US\$ 11.0 million (December 31, 2002: US\$ 16.9 million) were in respect of related parties. All these guarantees mature within one year.

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Notes to the condensed special purpose consolidated financial statements for the six months ended June 30, 2003

(Amounts expressed in thousands of US dollars)

7. Segmental information – Statement of operations

	Metallurgical	Banking	Insurance	Inter segment transactions	Total
Six months ended June 30, 2003:					
Net sales	1,533,243	-	-	-	1,533,243
Profit before financing and taxation	349,378	1,866	7,775	238	359,257
Six months ended June 30, 2002:					
Net sales	969,682	-	-	-	969,682
Profit before financing and taxation	9,709	593	4,210	1,035	15,547

8. Post balance sheet events

On November 12, 2003 ZAO Severstal received the first tranche (US\$ 10 million) of the US\$ 90 million loan agreed in February 2003 with the European Bank for Reconstruction and Development to finance its production equipment construction. The loan is fully repayable in 2011 and carries an interest of 4.25% plus margin estimated on the basis of market indices. The effective interest rate is expected to be between 7% and 8% per annum. This loan is guaranteed by Severstal and the minority shareholder of ZAO Severstal.

On July 3, 2003 Severstal issued three million four year interest-bearing non-convertible Rouble bonds with a nominal value of Rbs 1,000 each. The bonds, issued on the Moscow International Currency Exchange (MICEX), carry a coupon of 9.75% payable twice a year. The interest rate for the first four coupons was determined by auction on the day of issue, and the interest rate for the last four coupons will be determined by Severstal based on prevailing market conditions.

On September 15, 2003, Severstal's shareholders approved the payment of an interim dividend of Rbs 194.00 per share in respect the results of the first half of 2003.

During September and October 2003 OAO Ulyanovski Automotive Plant, a related party, repaid to Severstal loans and promissory notes totaling US\$ 65.2 million.

In October 2003, Severstal's Board of Directors proposed the payment of an interim dividend of Rbs 205.00 per share in respect the results of the third quarter of 2003.

In October 2003, the Group purchased 100% of the share capital of OOO UralMash-Metallurgical Oborudovanie for US\$ 14 million.

* * *