Open Joint Stock Company Magnitogorsk Iron & Steel Works and subsidiaries

Consolidated Financial Statements

(prepared in accordance with US GAAP)

As of and for the years ended December 31, 2005 and 2004

Contents

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Independent Auditors' Report

The Board of Directors
Open Joint Stock Company Magnitogorsk Iron & Steel Works

We have audited the accompanying consolidated balance sheets of Open Joint Stock Company Magnitogorsk Iron & Steel Works and its subsidiaries (the "Group") as of December 31, 2005 and 2004 and the related consolidated statements of income, stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Group as of December 31, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

KPMG Limited
March 17, 2006

KPMG Limited, a company incorporated under the Guernsey Companies
Act, is a member firm of KPMG International, a Swiss cooperative.

Open Joint Stock Company Magnitogorsk Iron & Steel Works and subsidiaries

Consolidated Balance Sheets

(In millions of US dollars)

	Note	December 31, 2005	December 31, 2004
Assets			
Cash and cash equivalents	6	1,138	1,884
Bank deposits		-	209
Accounts receivable from third parties, less allowance for doubtful trade accounts of USD 20 million in 2005 and USD 23 million in 2004	7	569	734
Accounts receivable from affiliates and other related parties		3	23
Prepaid expenses		12	15
Inventories	8	568	455
Other investments	11	13	53
Current deferred income tax asset	16	26	24
Total current assets		**2,329**	**3,397**
Property, plant and equipment	9	2,288	1,883
Intangible assets	10	28	17
Investments in affiliates	24	90	7
Other investments	11	1	1
Bank deposits	18	99	103
Non-current deferred income tax asset	16	2	3
Other non-current assets	12	17	5
Total assets		**4,854**	**5,416**
Liabilities and Stockholders' Equity			
Short-term borrowings and current portion of long-term debt	13	171	847
Accounts and notes payable	17	460	403
Accounts payable to affiliates and other related parties		9	1
Current deferred income tax liability	16	26	11
Total current liabilities		**666**	**1,262**
Non-current portion of long-term debt	13	468	388
Employee benefits	15	26	23
Non-current deferred income tax liability	16	5	3
Other non-current liabilities		1	1
Total liabilities		**1,166**	**1,677**
Minority interest		**11**	**11**
Common stock (2005: 10,630,222 thousand stock of par value of 1 Russian ruble each, authorized and issued, 2004: 7,972,666 thousand stock of par value of 1 Russian ruble each, authorized and issued)		363	272
Preferred stock (2004: 2,657,556 thousand stock of par value of 1 Russian ruble each, authorized and issued)		-	91
Treasury stock at cost (common stock totaling, 472,832 thousand shares and 401,345 thousand shares at December 31, 2005 and 2004, respectively)		(64)	(30)
Additional paid-in capital		247	247
Retained earnings		3,131	3,148
Total stockholders' equity	19	**3,677**	**3,728**
Commitments and contingencies (notes 26 and 27)			
Total liabilities and stockholders' equity		**4,854**	**5,416**

The consolidated financial statements were approved on March, 17 2006 and signed by:

G.S.Senichev
General Director

A.S.Batrutdinov
Deputy Chief Accountant

The accompanying notes to financial statements set out on pages 7 to 25 are an integral part of these statements

Open Joint Stock Company Magnitogorsk Iron & Steel Works and subsidiaries

Consolidated Statements of Income

(In millions of US dollars except earnings per share)

	Note	Year ended December 31, 2005	2004
Gross revenue	5	5,380	4,829
Cost of products sold (exclusive of depreciation and amortization shown separately below)		(3,274)	(2,712)
Depreciation and amortization		(173)	(169)
Selling and distribution expenses		(237)	(128)
Administrative expenses		(262)	(213)
Social costs			
Social asset construction		-	(1)
Operation and maintenance expenses		(56)	(33)
Taxes other than income taxes		(59)	(48)
Change in allowance for doubtful accounts receivable and other provisions		11	10
Loss on disposal of property, plant and equipment		(15)	(28)
Other operating income		8	31
Income from operating activities		**1,323**	**1,538**
Equity in income from affiliates		-	1
Interest expense		(64)	(65)
Net foreign exchange (loss)/gain		(39)	78
Interest income		97	69
Income before tax and minority interest		**1,317**	**1,621**
Income taxes	16	(372)	(389)
Income before minority interest		**945**	**1,232**
Minority interest		2	-
Net income		**947**	**1,232**
Basic and fully diluted earnings per common share (USD)	20	**0.095**	**0.125**
Basic and fully diluted earnings per preferred share (USD)	20	**0.095**	**0.125**

The accompanying notes to financial statements set out on pages 7 to 25 are an integral part of these statements.

Open Joint Stock Company Magnitogorsk Iron & Steel Works and subsidiaries

Consolidated Statements of Cash Flows

(In millions of US dollars)

	Year ended December 31,	
	2005	**2004**
Operating activities		
Net income	947	1,232
Adjustments for non-cash items:		
Depreciation and amortization	173	169
Loss on disposal of property, plant and equipment	15	28
Change in allowance for doubtful accounts receivable and other provisions	(11)	(10)
Gain on disposal of investments	(8)	(8)
Deferred tax expense	13	4
Equity in income of affiliate companies	-	(1)
Minority interest	(2)	-
Operating profit before changes in working capital	**1,127**	**1,414**
Changes in operating assets and liabilities:		
Increase in inventories	(109)	(144)
Decrease/(increase) in trade and other receivables	181	(389)
Increase in trade and other payables	49	122
Increase in income taxes payable	7	7
Net cash provided by operating activities	**1,255**	**1,010**
Investing activities		
Proceeds from sale of property, plant and equipment	16	3
Proceeds obtained from bank deposits	200	(312)
Acquisition of investments in affiliates	(44)	-
Acquisition of property, plant and equipment	(562)	(395)
Acquisition of intangible assets	(18)	(12)
Acquisition of subsidiaries and minority interest less cash acquired	(52)	(3)
Net cash flow from other investments	48	6
Net cash used for investing activities	**(412)**	**(713)**
Financing activities		
Proceeds from borrowings	1,319	1,357
Repayments of borrowings	(1,900)	(740)
Net repayment of bank overdrafts	-	(47)
Acquisition of treasury stock	(34)	(39)
Proceeds from re-issuance of treasury stock, net of tax paid	-	236
Payments made under capital lease	(25)	(10)
Dividends paid	(947)	(14)
Net cash (provided by)/from financing activities	**(1,587)**	**743**
Effect of exchange rate changes on cash and cash equivalents	(2)	20
Net (decrease)/increase in cash and cash equivalents	**(746)**	**1,060**
Cash and cash equivalents at beginning of year	**1,884**	**824**
Cash and cash equivalents at year end	**1,138**	**1,884**
Supplementary information		
Interest paid	61	45
Income tax paid	352	448

The accompanying notes to financial statements set out on pages 7 to 25 are an integral part of these statements.

Open Joint Stock Company Magnitogorsk Iron & Steel Works and subsidiaries

Consolidated Statements of Stockholders' Equity

(In millions of US dollars)

	Common stock	Preferred stock	Common treasury stock	Preferred treasury stock	Additional paid- in capital	Retained earnings	Total
Balance at January 1, 2004	272	91	(19)	-	39	1,930	2,313
Acquisition of treasury stock	-	-	(12)	(27)	-	-	(39)
Re-issuance of treasury stock, net of tax effect of USD 70 million	-	-	20	8	208	-	236
Dividends	-	-	-	-	-	(14)	(14)
Net income	-	-	-	-	-	1,232	1,232
Balance at December 31, 2004	**272**	**91**	**(11)**	**(19)**	**247**	**3,148**	**3,728**
Acquisition of treasury stock	-	-	(13)	(21)	-	-	(34)
Share conversion	91	(91)	(40)	40	-	-	-
Dividends	-	-	-	-	-	(964)	(964)
Net income	-	-	-	-	-	947	947
Balance at December 31, 2005	**363**	**-**	**(64)**	**-**	**247**	**3,131**	**3,677**

The accompanying notes to financial statements set out on pages 7 to 25 are an integral part of these statements.

1. Background

(a) Organisation and operations

The consolidated financial statements of Open Joint Stock Company Magnitogorsk Iron & Steel Works and its subsidiaries ("the Group") comprise the parent company Open Joint Stock Company Magnitogorsk Iron & Steel Works ("MMK" or "the Parent Company") and its 61 subsidiaries. The Parent Company is an open joint stock company as defined in the Civil Code of the Russian Federation. The head office of the Group is located at:

Ulitsa Kirova 93
455002 Magnitogorsk,
Russia

The Parent Company was established as a state owned enterprise in 1932. It was incorporated as an open joint stock company on October 17, 1992 as part of the Russian Federation privatisation program. The principal activity of the Group is the production of ferrous metal products at the Parent Company's plant located in the city of Magnitogorsk in the Chelyabinsk region of the Russian Federation. The Group's products are sold in the Russian Federation and abroad. The subsidiaries are mainly involved in the various sub-processes within the production cycle of the ferrous metal products or in the distribution of the products.

(b) Russian business environment

The Russian Federation has been experiencing political and economic change which has affected, and may continue to affect, the activities of enterprises operating in this environment. Consequently, operations in the Russian Federation involve risks which do not typically exist in other markets. The accompanying financial statements reflect management's assessment of the impact of the Russian business environment on the operations and the financial position of the Group. The future business environment may differ from management's assessment.

2. Basis of preparation

(a) Statement of compliance

The accompanying financial statements have been prepared in compliance with accounting principles generally accepted in the United States of America ("US GAAP").

(b) Principles of consolidation

The consolidated financial statements include the financial statements of MMK, its subsidiaries and variable interest entities where the Group holds a controlling financial interest other than through voting rights.

(c) Historical cost basis

The consolidated financial statements are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, investments held-for-trading and investments available-for-sale.

(d) Foreign currency translation

The national currency of the Russian Federation is the Russian Rouble. The Group has assessed its operations in the Russian Federation and determined its functional currency to be US dollars for financial reporting. The US dollar is also the reporting currency for the Group under US GAAP.

Monetary assets and liabilities have been translated into US dollars at the rate prevailing at each balance sheet date. Non-monetary assets and liabilities have been translated into US dollars at historical rates. Revenues, expenses and cash flows have been translated into US dollars at rates which approximate actual rates at the date of the transaction. Translation differences resulting from the use of these rates are included in the consolidated statement of income.

As of December 31, 2005 and 2004, exchange rates of 28.78 and 27.75 Russian rubles to the US dollar, respectively, have been used for translation purposes. The annual weighted average exchange rate was 28.26 and 28.83 Russian rubles to the US dollar for the years ended December 31, 2005 and 2004, respectively.

The Russian ruble is not readily convertible outside the Russian Federation. Accordingly, the translation of amounts recorded in Russian rubles into US dollars should not be construed as a representation that the Russian ruble amounts have been, could be, or will in the future be converted into US dollars at the exchange rate shown or at any other exchange rate.

(e) Going concern

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The recoverability of the Group's assets, as well as the future operations of the Group, may be significantly affected by the current and future economic environment (refer note 1(b)). The accompanying financial statements do not include any adjustments should the Group be unable to continue as a going concern.

(f) Use of estimates

The preparation of the consolidated financial statements requires management of the Group to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant items subject to such estimates and assumptions include the carrying amount of property, plant and equipment, intangibles and goodwill; valuation allowances for receivables, inventories and deferred income tax assets. Actual results could differ from those estimates.

3. Significant accounting policies

The following significant accounting policies have been applied in the preparation of the consolidated financial statements. These accounting policies have been consistently applied.

(a) Property, plant and equipment

(i) Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses (refer accounting policy (c)). The historical cost and depreciated historical cost of property, plant and equipment acquired or constructed prior to 1992 was determined by an independent appraiser due to the absence of reliable US GAAP accounting records.

(ii) Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as capital leases. Plant and equipment acquired by way of capital lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses (refer accounting policy (c)).

(In millions of US dollars, unless otherwise stated)

(iii) Depreciation

Depreciation is charged to the statement of income on a straight line basis over the estimated useful lives of the individual assets. Depreciation commences on the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and ready for use. Land is not depreciated.

The following useful lives have been applied to depreciated assets:

■ buildings	33-44 years
■ machinery and equipment	17-32 years
■ transportation equipment	8-22 years
■ fixtures and fittings	8-14 years

(b) Goodwill and other intangible assets

Goodwill represents the excess of the costs over the fair value of the assets of the businesses acquired. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of FASB Statement No. 142, *Goodwill and Other Intangible Assets*. Intangible assets with finite useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with FASB Statement No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets* ("Statement 144").

(c) Impairment of long lived assets

In accordance with Statement 144, long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of the asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds its fair value.

(d) Trade and other receivables

Trade accounts receivable are recorded at invoiced amounts and do not bear interest. The allowance for doubtful accounts is the Group's best estimate of the amount of probable credit losses in the Group's existing accounts receivable balances. The Group reviews its allowance for doubtful accounts monthly. Account balances are charged against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Group does not have any off-balance-sheet credit exposure related to its customers.

(e) Inventories

Inventories are stated at the lower of cost or market value. The cost of inventories is based on the weighted average principle and includes expenditure incurred in acquiring inventories and bringing them to their existing location and condition.

(f) Cash and cash equivalents

Cash and cash equivalents comprise cash balances, call deposits and liquid promissory notes with original maturities of less than three months. Cash funds which are subject to restrictions on their immediate use are not considered cash equivalents.

(g) Investment securities

The Group classifies its debt securities in one of three categories: trading, available-for-sale or held-to-maturity and its equity securities as trading or available-for-sale. Trading securities are bought and held principally for the purpose of selling them in the short term. Held-to-maturity debt securities are those securities in which the Group has the ability and intent to hold the security until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Held-to-maturity debt securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses on trading securities are included in earnings. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of other comprehensive income until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific-identification basis.

A decline in the market value of any available-for-sale or held-to-maturity security below cost that is deemed to be other-than-temporary results in a reduction in the carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether an impairment is other-than-temporary, the Group considers whether it has the ability and intent to hold the investment until the market price recovers and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to year-end, and forecasted performance of the investee.

Premiums and discounts are amortized or accreted over the life of the related held-to-maturity or available-for-sale security as an adjustment to yield using the effective-interest method. Dividend and interest income are recognized when earned.

(h) Short-term borrowings and long-term debt

Short-term borrowings and long-term debt are initially recorded at the value of the net proceeds received. Any difference between the net proceeds and the redemption value is recognised in the consolidated income statement over the term of the borrowing on an effective interest basis.

(i) Employee benefits

(i) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognized as an expense in the consolidated statement of income as incurred.

(ii) Defined benefit plans

The Group's net obligations in respect of defined benefit pension and healthcare plans are calculated separately for each defined benefit plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. These benefits are discounted to determine the present value, and the fair values of any plan assets are deducted. The discount rate is the yield on government bonds that have maturity dates approximating the terms of the Group's obligations. The calculation is performed annually by a suitably qualified expert using the projected unit credit method.

(j) Accrued and contingent liabilities

Liabilities for loss contingencies, arising from claims, assessments, litigation, fines, and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment can be reasonably estimated.

(k) Trade and other payables

Trade and other payables are stated at their cost.

(l) Revenue recognition

(i) Goods sold

The Group recognizes revenue when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, pervasive evidence of an arrangement exists and the sales price is fixed or determinable.

(ii) Interest income

Interest income is recognized in the consolidated statement of income as earned.

(m) Social costs

(i) Social construction costs

Capital expenditure of a social nature which benefits the community as a whole and is not expected to bring significant future economic benefits to the Group is recognized in the consolidated statement of income as incurred.

(ii) Operation and maintenance expenses

Expenditure related to the operation and maintenance of sports complexes, holiday and recreational facilities, medical centres, public housing, kindergartens and restaurants are recognized in the consolidated statement of income as incurred.

(n) Income tax

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

In accordance with SFAS No. 52 and SFAS No. 109 *Accounting for Income Taxes*, deferred tax assets and liabilities are not recognized for temporary differences arising from the re-measurement of the local currency into the functional currency using historical exchange rates. Also, in accordance with SFAS No. 109, no deferred tax assets or liabilities are recognized for the effects of tax indexation of property, plant and equipment. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the consolidated statement of income in the reporting period that includes the enactment date. Deferred income tax assets and liabilities arising in different tax jurisdictions are not offset.

The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income in the reporting periods in which the originating expenditure becomes deductible. In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that the deferred income tax assets will be realized. In making this assessment, management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies.

4. Segment information

The Group predominantly produces iron and steel products. The revenues from the sale of these products constitute more than 95% of the total revenues. An analysis of sales by product and the location of the end customers is included in note 5. Geographically, all significant assets, production and management/administrative facilities are located in Magnitogorsk.

(In millions of US dollars, unless otherwise stated)

5. Gross revenue

	Year ended December 31,	
	2005	**2004**
Rolled steel	3,165	2,853
Assorted rolled products	341	365
Galvanized steel	338	322
Tin plated steel	295	217
Band	274	251
Galvanized steel whith polymeric coating	148	50
Slabs	140	258
Formed section	112	73
Metae	117	121
Coking production	102	66
Wire, sling, bracing	71	80
Tubes	39	45
Other	238	128
	5,380	**4,829**

Percentage of total revenue by location of the end customer

	Year ended December 31,	
	2005	**2004**
Russia and CIS	61%	55%
China	8%	6%
Italy	3%	6%
Turkey	6%	5%
Taiwan	1%	4%
India	4%	3%
USA	1%	3%
Iran	4%	2%
Vietnam	-	-
Other (countries each representing less than 2% of total revenue)	12%	16%
	100%	**100%**

6. Cash and cash equivalents

Cash and cash equivalents comprise local and foreign currency bank balances, call deposits and bank promissory notes.

	December 31,	
	2005	**2004**
RUR denominated Russian bank deposits	898	1,619
RUR bank accounts	140	142
USD bank deposits	41	61
EUR bank deposits	20	-
USD bank accounts	23	29
CHF bank accounts	2	-
EUR denominated liquid bank promissory notes	-	14
USD denominated liquid bank promissory notes	4	-
Other RUR denominated cash equivalents	6	14
EUR bank accounts	4	5
Cash and cash equivalents per balance sheet	**1,138**	**1,884**

(In millions of US dollars, unless otherwise stated)

7. Accounts receivable from third parties

	December 31, 2005	December 31, 2004
Trade accounts receivable	247	470
VAT receivable	201	184
Advances paid	45	59
Interest receivable	67	15
Other receivables	29	29
	589	757
Allowance for doubtful trade accounts receivable	(20)	(23)
	569	**734**

8. Inventories

	December 31, 2005	December 31, 2004
Raw materials and consumables	302	319
Work in progress	112	118
Finished goods and goods for resale	164	31
	578	468
Provision for inventory obsolescence	(10)	(13)
	568	**455**

9. Property, plant and equipment

	Cost	Accumulated depreciation	Carrying Value
Land and buildings	1,276	(686)	590
Machinery and equipment	3,059	(1,875)	1,184
Transportation equipment	165	(105)	60
Fixtures and fittings	85	(31)	54
Assets under construction	400	-	400
Balance at December 31, 2005	**4,985**	**(2,697)**	**2,288**
Land and buildings	1,230	(662)	568
Machinery and equipment	2,828	(1,800)	1,028
Transportation equipment	152	(97)	55
Fixtures and fittings	60	(24)	36
Assets under construction	196	-	196
Balance at December 31, 2004	**4,466**	**(2,583)**	**1,883**

In 2005 the depreciation of property, plant and equipment amounted to USD 165 million (2004: USD 152 million), of which USD 159 million (2004: USD 146 million) related to productive assets.

Borrowing costs
In 2005 USD 3 million of borrowing costs were capitalised as part of the cost of qualifying assets (2004: USD 1 million).

(In millions of US dollars, unless otherwise stated)

10. Intangible assets

	Cost	Accumulated amortization	Carrying value
Licenses and other intangibles	49	(23)	26
Goodwill	2	-	2
Balance at December 31, 2005	**51**	**(23)**	**28**
Licenses and other intangibles	31	(15)	16
Goodwill	1	-	1
Balance at December 31, 2004	**32**	**(15)**	**17**

11. Other investments

	December 31,	
	2005	2004
Current investments		
Equity securities held for trading	3	2
Debt securities held for trading	9	16
Promissory notes held to maturity	1	35
	13	**53**
Non-current investments		
Equity securities available-for-sale	**1**	**1**

Net realised gains on trading securities during the year ended December 31, 2005 were USD 8 million (2004: USD 8 million) and are included in other operating income in the consolidated statement of income. Debt securities held for trading are subject to the price volatility associated with any interest bearing instrument.

12. Other non-current assets

	December 31,	
	2005	2004
Restricted cash	2	4
Loans to employees	1	1
Loan provided to affiliate	14	-
	17	**5**

Restricted cash comprises cash held in certain bank accounts of the Group, which has been pledged as collateral for letters of credit issued on the Group's behalf for the purpose of acquiring equipment.

(In millions of US dollars, unless otherwise stated)

13. Short-term borrowings and long-term debt

	Effective interest rate	2005	Effective interest rate	2004
Current liabilities				
Secured loans - RUR, fixed	11%	10	7%	150
- RUR, variable	-	-	11%	4
- USD, variable	5%	82	-	-
Unsecured loans - RUR, fixed	11%	1	7%	430
- USD, variable	-	-	4%	40
- RUR, variable	8%	9	-	-
Current portion of unsecured Russian bond issues - RUR, fixed	-	-	9%	28
Current portion of unsecured bond issues - EUR, fixed	-	-	11%	148
- USD, fixed	9%	4	9%	4
Current portion of secured loans - RUR, fixed	11%	4	12%	2
Current portion of secured loans - USD, variable	-	-	3%	3
Current portion of unsecured loans – USD, variable	5%	38	3%	16
- RUR, fixed	10%	3	11%	2
Current portion of capital lease liabilities – RUR, fixed	15%	20	16%	20
		171		**847**
Non-current liabilities				
Secured loans - RUR, fixed	11%	1	12%	3
- USD, variable	-	-	3%	24
Unsecured loans - USD, variable	5%	147	3%	39
- USD, fixed	24%	1	-	-
- EUR, fixed	6%	1	-	-
- RUR, fixed	11%	1	-	-
Unsecured bonds issues – USD, fixed	9%	297	9%	296
Capital lease liabilities - RUR, fixed	15%	20	15%	26
		468		**388**
Unused available borrowing facilities - USD, variable		224		92

The weighted average interest rate on short-term borrowings outstanding as at the balance sheet date was 7% (2004: 8%).

(In millions of US dollars, unless otherwise stated)

Long-term debt repayment schedule

		Total	Current portion	2007	2008	2009	2010	>2010
Secured bank loans	– RUR, fixed	5	4	1	-	-	-	-
Unsecured loans	– USD, variable	185	38	45	40	31	28	3
	– USD, fixed	1	-	-	1	-	-	-
	– EUR, fixed	1	-	-	1	-	-	-
	– RUR, fixed	4	3	1	-	-	-	-
Unsecured bond issues	– USD, fixed	301	4	-	297	-	-	-
Capital lease liabilities	– RUR, fixed	40	20	13	4	3	-	-
		537	**69**	**60**	**343**	**34**	**28**	**3**

Capital lease assets and liabilities

Capital lease liabilities are payable as follows:

	2005			2004		
	Payments	Interest	Principal	Payments	Interest	Principal
Less than one year	24	4	20	25	5	20
Between one and five years	23	3	20	30	4	26
	47	**7**	**40**	**55**	**9**	**46**

Leased assets with a carrying amount of USD 57 million (2004: USD 54 million) were included in property, plant and equipment as follows:

	Cost	Accumulated depreciation	Carrying value
Machinery and equipment	59	(9)	50
Assets under construction	7	-	7
Balance at December 31, 2005	**66**	**(9)**	**57**
Balance at December 31, 2004	**60**	**(6)**	**54**

14. Pledges provided by the Group

As at the balance date the Group had pledged property, plant and equipment of USD 27 million and USD 8 million of inventory (2004: USD 241 million of property, plant and equipment and USD 6 million of inventory).

The Group is subject to the following pledges as at December 31, 2005:

	December 31,	
	2005	2004
Short-term		
Pledges provided for the debt of the Group	30	202
Long-term		
Pledges provided for the debt of related parties	-	-
Pledges provided for the debt of the Group	5	45
	35	**247**

(In millions of US dollars, unless otherwise stated)

15. Employee benefits

Defined contribution obligations

The Group makes monthly contributions to a non-government pension fund "Sotsialnaya Zashchita Starosti" where the employee has an individual accumulation agreement with the fund.

The Group has the ability to exercise significant influence over the financial and operating policy decisions of the fund through positions that certain directors of the Group have on the board of directors of the fund.

The monthly contribution made by the Group is equal to the employee's contribution, unless the employee is a male aged between 55 and 60, or a female aged between 50 and 55, in which case the contribution will be 1.5 times the employee's contribution. The monthly contribution by the Group may not exceed RUR 4,000 (USD 141) per employee (2004: RUR 4,000 (USD 144) per employee). In 2005 contributions made by the Group to the fund were USD 2.9 million (2004: USD 2.7 million).

Russian Federation State Pension Fund

The Group pays into the Russian Federation State Pension Fund a percentage of each employee's wage based on a scale as established by the Russian Tax Code. In 2005 total payments made to the state pension fund totalled USD 51 million (2004: USD 38 million). These amounts are expensed when incurred and are recorded in taxes related to personnel expenses.

Defined benefit obligations

The Group also has a defined benefit plan in favour of employees who retired prior to 1 April 2000. Pensions from this defined benefit plan are administered by the independent charity fund, "BOF Metallurg".

The Group makes monthly payments to the fund of RUR 327 (USD 11.56) per retiree every month (2004: RUR 276 (USD 9.58), which are then distributed by the fund to retirees. The fund does not hold any assets set aside for the benefit of retirees under this plan.

	December 31,	
	2005	**2004**
Liability for defined benefit obligations	**26**	**23**

Benefit obligations recognized in the balance sheet:

	December 31,	
	2005	**2004**
Net benefit obligations at January 1, 2005	23	22
Payments made during the year	(3)	(3)
Expenses recognized in the statement of income	6	4
Net benefit obligations at December 31, 2005	**26**	**23**

The pension related expenses were as follows:

	December 31,	
	2005	**2004**
Interest costs	3	3
Actuarial loss/(gain)	4	(1)
Foreign exchange (gain)/loss	(1)	2
Total pension related expense	**6**	**4**

(In millions of US dollars, unless otherwise stated)

Current service costs and actuarial gains and losses are recognized in administrative expenses in the consolidated statement of income.

The principal actuarial assumptions used to calculate the retirement benefit liabilities at the balance sheet date were are follows:

	December 31, 2005	December 31, 2004
Discount rate at December 31,	9.1%	10.6%
Future retirement benefit increases (based on RUR amounts)	8.5%	8.7%

Cash Flows

The benefits expected to be paid from the pension plan in 2006 are USD 3 million and in each year from 2007-2010 are USD 2 million per annum. The aggregate benefits expected to be paid during the five years from 2011-2015 are USD 7 million. The aggregate of the benefits expected to be paid after 2015 are USD 8 million. The expected benefits are based on the same assumptions used to measure the Group's benefit obligation at December 31, 2005.

16. Taxes

	December 31, 2005	December 31, 2004
Current tax expense		
Current year expense	359	385
	359	385
Deferred tax expense		
Origination and reversal of temporary differences	13	4
	372	**389**

In 2005 deferred tax originating from the acquisition of subsidiaries amounted to USD 3 million (2004: 0).

The following table is a reconciliation of the notional income tax at the Russian statutory tax rate applied to income before income taxes to total income taxes:

	December 31, 2005	December 31, 2004
Income before income taxes	1,317	1,621
Notional income tax at Russian statutory rate	316	389
Increase in income tax due to non-deductible items	56	1
Overprovided in prior years	-	(1)
Total income taxes	**372**	**389**

(In millions of US dollars, unless otherwise stated)

Deferred income tax assets and liabilities were comprised of differences arising between the carrying values of the following assets and liabilities:

	December 31,	
	2005	**2004**
Inventories - cash basis tax accounting, provisions	5	1
Investments	2	3
Loans and borrowings	4	7
Trade and other accounts receivable	2	5
Trade and other accounts payable	15	10
Tax loss carryforwards	-	1
Gross deferred income tax assets	28	27
Property, plant and equipment - depreciation	(5)	(2)
Investments	(2)	(1)
Inventories	(16)	(9)
Trade and other accounts receivable - cash basis tax accounting	(7)	(2)
Loans and borrowings	(1)	-
Gross deferred income tax liabilities	(31)	(14)
Net deferred income tax (liability)/asset	**(3)**	**13**

Deferred income tax balances were classified in the consolidated balance sheet as follows:

	December 31,	
	2005	**2004**
Current deferred income tax asset	26	24
Current deferred income tax liability	(26)	(11)
Non-current deferred income tax asset	2	3
Non-current deferred income tax liability	(5)	(3)
Net deferred income tax (liability)/asset	**(3)**	**13**

Retained earnings of foreign subsidiaries included USD 22 million (2004: USD 22 million) on which deferred income tax has not been provided for because remittance of the earnings has been indefinitely postponed through reinvestment and, as a result, such amounts are considered to be permanently invested.

In accordance with SFAS No. 52 and SFAS No. 109 *Accounting for Income Taxes*, deferred tax assets and liabilities are not recognized for temporary differences arising from the re-measurement of the local currency into the functional currency using historical exchange rates. Also, in accordance with SFAS No. 109, no deferred tax assets or liabilities are recognized for the effects of tax indexation of property, plant and equipment. These deferred tax assets and liabilities would be recognized in the event that the functional currency of MMK was subsequently determined to be the local currency.

Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred income tax assets are deductible, management believes it is more likely than not that Group companies will realize the benefits of the deductible differences. Accordingly, no valuation allowances have been provided against deferred tax assets at December 31, 2005 and 2004.

(In millions of US dollars, unless otherwise stated)

17. Accounts and notes payable

	December, 31	
	2005	**2004**
Trade accounts payable	161	166
Advances from customers	151	106
Income tax payable	18	11
Other taxes payable	54	44
Other current liabilities	76	76
	460	**403**

18. Long-term bank deposits

As at the balance sheet date the Group had long term subordinated cash deposit totalling USD 99 million (2004: USD 103 million) placed in a Russian bank, which is not available to be withdrawn from the bank until 15 December 2009.

19. Stockholders' equity

Common and preferred stock

As at the balance sheet date the authorised and issued share capital comprised common stock of 10,630,221,600 shares (2004: 7,972,665,600 shares).

During the year ended 31 December 2005 the Parent Company converted all non-redeemable non-cumulative preferred stock of 2,657,556,000 which existed at 31 December 2004 to a new class of preferred stock which was convertible to common stock at a ratio of 1:1. All preferred stock was subsequently converted to common stock during the year.

All stock has a par value of RUR 1. There was no unpaid stock as at the balance sheet date.

Dividends

Dividends payable are restricted to the maximum retained earnings of the Group, which are determined in accordance with the legislation of the Russian Federation. At the balance sheet date reserves available for distribution, in accordance with Russian legislation, amounted to USD 1,935 million (2004: USD 1,949 million).

The following ordinary and preferred dividends were approved at the annual shareholders meeting on 22 April 2005 and the extraordinary shareholders meetings on 30 August 2005 and 29 November 2005:

	2005
RUR 2.662 per qualifying common stock	816
RUR 1.995 per preferred stock	189
	1,005

Voting rights of stockholders

The holders of fully paid common stock are entitled to one vote per share at the annual and general stockholder meetings of the Group.

Treasury stock

At the balance sheet date the Group held 472,831,549 shares of its own common stock (2004: 335,171,436 shares of its own common stock and 66,173,891 of its own preferred stock). The Group also controls the voting rights of a further 6,280,687,620 shares of its own common stock (2004: 4,298,295,194 shares of its own common stock and 2,000,731,570 of its own preferred stock), which subsidiaries of the Group hold in a trustee capacity under trust management agreements. Dividends accrue to the beneficial owners of the stock. Transactions with the stock held under the trust management agreements can only be performed after receiving express written instructions from the Founder of the trust.

20. Earnings per share

The calculation of basic and diluted earnings per share as at December 31, 2005 was based on the distributed and undistributed earnings attributable to common and preferred stockholders and the weighted average number of common shares and preferred shares outstanding during the year then ended, calculated as follows:

Net income attributable to common and preferred stockholders

	Year ended December 31,	
	2005	**2004**
Net income for the year	947	1,232
Dividends on common stock	(781)	-
Dividends on non-redeemable non-cumulative preferred stock	(183)	-
Undistributed earnings	**(17)**	**1,232**
Undistributed earnings attributable to common stockholders	**(17)**	**903**
Undistributed earnings attributable to preferred stockholders	**-**	**329**

Weighted average number of common stock

	Year ended December 31,	
In thousands of shares	**2005**	**2004**
Common stock	8,637,055	7,972,666
Effect of own stock held	(386,125)	(773,928)
Weighted average number of common shares at December 31	**8,250,930**	**7,198,738**

Weighted average number of preferred stock

	Year ended December 31,	
In thousands of shares	**2005**	**2004**
Preferred stock	1,993,167	2,657,556
Effect of own stock held	(62,446)	(32,434)
Weighted average number of preferred shares at December 31	**1,930,721**	**2,625,122**

Basic and diluted earnings per share – common stock

	Year ended December 31,	
In USD per share	**2005**	**2004**
Distributed earnings	0.095	-
Undistributed earnings	-	0.125
	0.095	**0.125**

(In millions of US dollars, unless otherwise stated)

Basic and diluted earnings per share – preferred stock

	Year ended December 31,	
In USD per share	**2005**	**2004**
Distributed earnings	0.095	-
Undistributed earnings	-	0.125
	0.095	**0.125**

21. Financial instruments

Exposure to credit, interest rate and currency risk arises in the normal course of the Group's business. The Group does not use derivative financial instruments to reduce exposure to fluctuations in foreign exchange rates and interest rates.

Credit risk

Financial instruments that potentially subject the Group to significant credit risk consist primarily of cash and cash equivalents, accounts receivable and bank deposits. The Group has bank accounts held in Credit Ural Bank, a related party of the Group. The Group also holds deposits in leading Russian banks, and uses promissory notes acquired from Credit Ural Bank as cash equivalents. Credit risk evaluations are performed for all banks in which the Group holds deposits, and all customers requiring credit over a certain amount. The Group does not require collateral in respect of financial assets. The maximum exposure to credit risk is represented by the carrying amount of each financial asset and the contractual amounts of the financial guarantees (refer note 27(i)). Refer also to note 22 "Concentration of risk".

Interest rate risk

The Group incurs interest rate risk primarily on loans and borrowings. The interest rate and terms of repayment of loans are disclosed in note 13. The Group borrows on both a fixed and variable interest rate basis. All variable interest rate loans and borrowings are re-priced on a monthly basis.

Foreign currency risk

The Group incurs foreign currency risk on sales, purchases and borrowings that are denominated in a currency other than the US dollar. The currencies giving rise to this risk are primarily the Russian rouble and the euro.

Fair value

The Group estimates the fair values of its financial assets and liabilities as not being materially different from their carrying values. The estimate of fair value is intended to approximate the amount at which the financial instrument could be exchanged in a current transaction between willing parties, and is subject to management judgment and economic uncertainties.

22. Concentration of risk

(i) Significant customer/ supplier

During 2005 the Group made sales of USD 678 million (2004: USD 1,475 million) to MMK Metal Limited, a customer which trades MMK steel on the export market. These sales represented 13% (2004: 31%) of the Group's total revenue. In addition, the Group purchased iron ore concentrate and pellets of USD 51 million (2004: USD 572 million) from MMK Metal Limited. As at the balance sheet date MMK Metal Limited owed the Group USD 80 million (2004: USD 335 million). In 2005 credit terms provided to MMK Metal Limited were extended to 180 days (2004: 90 days) from the date of delivery of steel products.

No other individual customer or supplier represented more than 10% of the Group's revenue during 2005 or 2004.

(ii) Significant deposits on account

As at the balance sheet date the Group held cash, cash equivalents and bank deposits amounting to USD 960 million (2004: USD 1,977 million) in a major Russian bank.

(In millions of US dollars, unless otherwise stated)

(iii) Significant guarantee

As at the balance sheet date the Group had provided a guarantee of USD 134 million (2004: USD 49 million) for a related party of the Group.

23. Acquisition of subsidiaries

In July, October and December 2005 the Group acquired 78%, 15% and 3% effective ownership respectively of the voting rights in OAO Shelkovsky Zavod Spetzmontazhizdelie for USD 8 million.

In addition, a 100% voting interest in OOO MetAl was acquired by the Group for USD 44 million. In 2004 OOO MetAl had been considered by management to be a variable interest entity of the Group and was consolidated in the consolidated financial statements for the year ended 31 December 2004. The Company has not finalised allocation of the purchase price to the estimated fair values of assets and liabilities acquired.

24. Acquisition of affiliates

During 2005 the Group acquired 37% of the voting shares of OAO Vladivostok Trade Sea Port ("VTSP") for USD 41 million. These shares were subsequently contributed to OOO M-Port, a jointly controlled entity established during 2005. M-Port acquired a further 20% of the voting stock of VTSP. As at the balance sheet date the Group held an effective ownership in VTSP of 47%.

25. Affiliate and other related party transactions

As at the balance sheet date the Group had the following investments in affiliates:

	Country of incorporation	Ownership		Voting interest	
		2005	2004	2005	2004
OOO MMK Trans	Russia	50%	50%	50%	50%
M-Port	Russia	50%	-	50%	-
Kazankovskaya Mine	Russia	50%	-	50%	-

Affiliate and other related party transactions

The Group had the following related party transactions during the year with:

Enterprises in which the Directors had a financial interest	December 31,	
	2005	2004
Domestic sales of steel	78	65
Purchases of scrap metal	337	245
Loans and overdrafts obtained	24	21
Loans and overdrafts repaid	20	27
Bank charges	11	11
Lease payments	8	15
Insurance payments	30	31
Loan repaid	26	-
Loan provided	26	-

Affiliates	December 31,	
	2005	2004
Sales of steel	1	13
Purchases of freight services	17	19
Loans provided	15	2
Domestic purchases	10	12

(In millions of US dollars, unless otherwise stated)

As at the balance sheet date the Group had the following related party balances outstanding with:

Enterprises in which the Directors had a financial interest	December 31,	
	2005	**2004**
Cash and cash equivalents	44	85
Loans and overdraft facilities	9	5
Promissory notes receivable	-	30
Loans and borrowings	-	24
Trade payables	4	1
Advances received	2	-
Advances paid	-	21
Lease payable	18	19
Insurance payable	1	-

Affiliates	December 31,	
	2005	**2004**
Advances paid	3	2
Trade payables	2	-

26. Commitments

(i) Capital commitments

The Group is committed to capital expenditure of approximately USD 394 million (2004: USD 495 million).

(ii) Social commitments

The Group makes contributions to mandatory and voluntary social programs. The Group's social assets, as well as local social programs, benefit the community at large and are not normally restricted to the Group's employees. The Group has transferred certain social operations and assets to local authorities, however, management expects that the Group will continue to fund these social programs for the foreseeable future. These costs are recorded in the year they are incurred.

(In millions of US dollars, unless otherwise stated)

27. Contingencies

(i) *Financial guarantees*

The Group has provided financial guarantees for loans obtained by certain related and third party suppliers of the Group. Amounts related to the Group's financial guarantees are as follows:

	2005	2004
Due to expire in more than 12 months		
Related party suppliers	156	31
Third party suppliers	20	-
Due to expire within 12 months		
Related party suppliers	5	49
Third party suppliers	2	-
	183	**80**

The Group's estimated maximum exposure to credit losses in the event of non-performance by the other parties to these financial guarantees is represented by the contractual amounts disclosed above. Assets of the Group were also pledged against loans advanced to related parties (refer note 14). Management believes that the likelihood of material payments being required under these agreements is remote. As at December 31, 2005 the Group did not have any contractual commitments to extend financial guarantees, credit or other assistance.

(ii) *Litigation*

As at the balance sheet date the Group did not have any material unresolved claims against it.

(iii) *Taxation contingencies*

The taxation system in the Russian Federation is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are often unclear, contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities, which have the authority to impose severe fines, penalties and interest charges. A tax year remains open for review by the tax authorities during the three subsequent calendar years; however, under certain circumstances a tax year may remain open longer. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation.

These circumstances may create tax risks in the Russian Federation that are substantially more significant than in other countries. Management believes that it has provided adequately for all tax liabilities based on its interpretations of applicable Russian tax legislation, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

(iv) *Environmental liabilities*

The Group is obligated to undertake certain environmental remediation activities to ensure site restoration of a large iron ore quarry in the Magnitogorsk region. In accordance with permission granted by the Magnitogorsk Regional Ecological Committee, the Group utilises production waste to fill the iron ore quarry where this waste does not exceed a prescribed toxicity level. Amounts of waste which exceed this toxicity level are not significant and are treated by licensed specialists. The future cost associated with the restoration of the iron ore quarry are not expected to be significant. These costs and other environmental compliance costs associated with air and water pollution are included in the normal operating expenses of the Group as they are incurred.

Environmental regulations are currently under consideration in the Russian Federation and the Group is continuously evaluating its obligations relating to new and changing legislation. The likelihood and amount of liabilities relating to environmental obligations under proposed or any future legislation cannot be reasonably estimated at present and could become material.

Under existing legislation, management believes that there are no significant unrecorded liabilities or contingencies, which could have a significant adverse effect on the operating results or financial position of the Group.