

OAO RASPADSKAYA
Management's discussion and analysis
of financial condition and results of operations
for the six-month period ended 30 June 2011

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 2011 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

	1H2011	1H2010	Change	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Revenue	377,438	466,039	(88,601)	(19)%
Cost of sales	(178,123)	(199,789)	(21,666)	(11)%
Gross profit	199,315	266,250	(66,935)	(25)%
Gross profit margin	53%	57%		
Selling and distribution costs	(2,542)	(3,143)	(601)	(19)%
General and administrative expenses	(31,436)	(24,840)	6,596	27%
Social expenses	(3,721)	(3,282)	439	13%
Loss on disposal of PP&E	(153)	(45,106)	(44,953)	(100)%
Foreign exchange gains/(losses)	13,860	(847)	14,707	n/a
Other operating income	1,317	1,616	(299)	(19)%
Other operating expenses	(44,264)	(27,511)	16,753	61%
Operating profit	132,376	163,137	(30,761)	(19)%
Dividend income	24	2	22	x12
Interest income	8,390	7,992	398	5%
Interest expense	(14,083)	(13,709)	374	3%
Gain from a bargain purchase	–	104,735	(104,383)	(100)%
Profit before income tax	126,707	262,157	(135,450)	(52)%
Income tax	(27,661)	(33,004)	(5,343)	(16)%
Profit for the period	99,046	229,153	(130,107)	(57)%
Earnings per share, US¢	12.68	29.37		
EBITDA	179,507	258,923	(79,416)	(31)%
EBITDA margin	48%	56%		
EBIT	117,668	204,390	(86,722)	(42)%
EBIT margin	31%	44%		
Cash used in Capex	78,441	74,882	3,559	5%
	30/Jun/11	31/Dec/10		
Net cash position	(108,232)	(12,409)	95,823	x8.7

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Mineral reserves and resources

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

	Reserves	Resources
	<i>millions of tonnes</i>	<i>millions of tonnes</i>
Raspadskaya	617	1,258
MUK-96	168	304
Razrez Raspadskiy	132	139
Raspadskaya-Koksovaya ⁽¹⁾	129	376
	1,046	2,077

(1) Including ZAO Koksovaya

Under Russian classification, our coking coal is mainly of the GZh (gas fat), Zh (fat), and GZhO (gas fat semi-lean) grades. In addition, under licenses held by Raspadskaya Koksovaya mine, we have deposits of coking coal of the K (coking) and KO (coking semi-lean) grades, which are scarce in Russia and the most valuable coals for coking.

Key factors affecting our results of operations

Certain factors relating to our business and industry, as well as the political, economic and legal environment in Russia, affect our results of operations. Such factors include, among others, exchange rates, production capacity, supply and demand of coking coal (and related prices and sales volumes), and production and other costs.

Exchange rates

In reading this discussion and analysis, an important issue of changes in the Russian ruble/US dollar exchange rate should be taken into consideration. Our performance may be significantly affected by these changes. Our functional currency is the Russian ruble, and our assets, revenues and expenses are mostly denominated in rubles whereas our presentation currency is the US dollar.

Some exchange rates used in preparation of our consolidated financial information are presented in the following table:

	1H2011	1H2010	Change
Average exchange rate, RUB/US\$	28.6242	30.0676	(5)%
	30/Jun/11	31/Dec/10	
Exchange rate, RUB/US\$	28.0758	30.4769	(8)%

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Production capacity

Production capacity of our mines sets a ceiling on our production volumes and, consequently, on sales volumes. Many factors affect our production capacity, among which are equipment capacity and mining conditions. 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 and heavy damage to property, plant and equipment. One of the negative effects of the accident was that Rеспадская 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 will be put into operation before the whole mine will be reconstructed. In 1H2011, reconstruction expenses amounted to US\$43.1m. According to preliminary estimations, the total expenditure on the reconstruction of Rеспадская mine will be about US\$280m. The total 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.

On 16 December 2010, Rеспадская mine recommenced operation – extraction started at face 4-9-21 bis (seam #9) with coal reserves about 600 thousand tonnes. We have stated before that a 2nd face at Rеспадская mine would be put in operation in 2Q2011. The shift is caused by a delay in project works made by a specialized design institute; now the project has been coordinated with GlavGosExpertiza, and face 4-7-25 will be launched in the very nearest future. In addition, we plan to launch a 3rd face in 4Q2011 and a 4th face at the very beginning of 2012.

On 28 April 2010, we acquired from Evraz a 100% ownership interest in ZAO Koksovaya, a mining company located in Mezhdurechensk, Russia, for a cash consideration of US\$40.0m. Koksovaya mine extracts coking coal of the K and KO grades. On 1 February 2011, ZAO Koksovaya was merged with ZAO Rеспадская-Koksovaya.

Our activities depend on our ability to maintain steady production levels. Therefore, the availability and development of mineral reserves, maintenance of our mining equipment and overall facilities, as well as ensuring safe working conditions for our personnel are crucial for the results of our operations..

Supply and demand of coking coal

Our operating results are profoundly influenced by the balance of supply and demand of different types of coking coal on domestic and international markets. The balance determines prices of coking coal and drives sales volumes. The balance is primarily influenced by fluctuations in the volume of production of steel and coke, by changes in coal production capacity and other related factors which in their turn are driven by the condition of the Russian and global economies.

Our customers are large domestic and foreign steel and coke producers. Therefore, our results are influenced by situation in the Russian and international steel markets.

After a big drop in demand caused by the global economy recession of 2008-9, the demand in Russia and the world for metallurgical products and, consequently, for coking coal has been gradually restoring which affected positively our sales.

Our results can be indirectly affected by the situation with the coal production capacities and the sales volumes of our competitors. We believe that there will be no significant increase of the Russian coking coal capacity in the short- to medium-term mainly due to the following factors: prevailing difficult geological and mining conditions that are likely to further aggravate as the mining is forced to go to deeper levels; and significant lead times and investments 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 2010 and 2011, we operated in the frames of long-term contracts with our major Russian customers and negotiated the volumes and prices on the quarterly basis. In contracts, our domestic sales prices are set in rubles, and export prices are set in US dollars.

We made all our domestic sales and sales to Ukraine (in 1H2010) under FCA Mezhdurechensk terms. In 1H2010, all sales to Asia were made under FOB Shipping point delivery terms, in which case transportation and other related costs were included in the contract price.

Ever since the end of the global recession, the recovering demand has been driving prices of our coal up.

Quarterly dynamics of weighted average prices of our coal concentrate for 2010 and 1H2011 are set out in the following table:

	1Q2010	2Q2010	3Q2010	4Q2010	1Q2011	2Q2011
	<i>US\$ per tonne</i>					
Russia (FCA)	103.0	125.0	122.8	131.2	147.1	174.1
QoQ change	12%	21%	(2)%	7%	12%	18%
Ukraine (FCA)	104.2	126.6	–	–	–	–
QoQ change	18%	22%	(100%)	–	–	–
Asia (FOB)	136.4	164.6	–	–	–	–
QoQ change	36%	21%	(100%)	–	–	–

Our export price depends on the market. After the accident at Raspadskaya mine in May 2010, temporarily, there have been no export sales.

In 3Q2011, the domestic price of our coal concentrate on FCA Mezhdurechensk terms remained 4,930 rubles per tonne.

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

	1H2011	1H2010	Change
	<i>US\$ per tonne</i>		
Russia (FCA)	160.2	111.2	44%
Ukraine (FCA)	–	109.6	(100%)
Asia (FOB)	–	152.1	(100%)

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Sales volumes

At present, although we see a significant demand for coking coal on both domestic and export markets, our impaired production capacity keeps our sales volumes in check since May 2010.

Quarterly dynamics of sales volumes of our coal concentrate for 2010 and 1H2011 are set out in the following table:

	1Q2010	2Q2010	3Q2010	4Q2010	1Q2011	2Q2011
	<i>thousands of tonnes</i>					
Russia	1,580	974	676	902	935	904
<i>QoQ change</i>	<i>(18)%</i>	<i>(38)%</i>	<i>(31)%</i>	<i>33%</i>	<i>4%</i>	<i>(3)%</i>
Ukraine	258	88	–	–	–	–
<i>QoQ change</i>	<i>(22)%</i>	<i>(66)%</i>	<i>(100)%</i>	–	–	–
Asia	395	482	–	–	–	–
<i>QoQ change</i>	<i>92%</i>	<i>22%</i>	<i>(100)%</i>	–	–	–
Export – Total	653	570	–	–	–	–
Total	2,233	1,544	676	902	935	904
<i>QoQ change</i>	<i>(10)%</i>	<i>(31)%</i>	<i>(56)%</i>	<i>33%</i>	<i>4%</i>	<i>(3)%</i>

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

	1H2011		1H2010		Change	
	Volume	Portion	Volume	Portion		
	<i>thousands of tonnes</i>		<i>thousands of tonnes</i>		<i>thousands of tonnes</i>	
Coal concentrate – Russia						
MMK	560	23%	392	10%	168	43%
Kemerovo-Koks	520	21%	619	16%	(99)	(16)%
Evraz	286	12%	706	19%	(420)	(59)%
NLMK (including Altai-Koks)	202	8%	398	10%	(196)	(49)%
Mechel	169	7%	231	6%	(62)	(27)%
Ural Steel	19	1%	101	3%	(82)	(81)%
Other	83	3%	108	3%	(25)	(23)%
	1,839	75%	2,555	67%	(716)	(28)%
Coal concentrate – export						
China	–	–	756	20%	(756)	(100)%
Ukraine ⁽¹⁾	–	–	346	9%	(346)	(100)%
Republic of Korea	–	–	120	3%	(120)	(100)%
	–	–	1,222	32%	(1,222)	(100)%
Coal concentrate – total	1,839	75%	3,777	99%	(1,938)	(51)%
Raw coal – Russia (Evraz)	608	25%	21	1%	587	x29
Coal concentrate and raw coal	2,447	100%	3,798	100%	(1,351)	(36)%

(1) Including sales to coke plants of Evraz in the volume of 318 thousand tonnes in 1H2010

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A considerable part of our coal products was sold to largest domestic steel and coke producers, with most of which in 2Q2011 we signed long-term contracts till 2013-5.

Our related party Evraz remained our largest customer – its share in total coal concentrate and raw coal sales volume was 37% in 1H2011 and 28% in 1H2010.

Before May 2010, we diversified and expanded our export sales. The most important feature of the diversification was the move toward the Asian export market which made Asia our largest export market in 1H2010 for the first time in our history. In future, in line with our market strategy to increase export sales in our total sales, we intend to get back to the Asian market because of its large potential for growth and our settled relations with the clients there. In the medium term, we plan to export no less than 35% of our total coal concentrate and raw coal sales volume.

Starting May 2010, we sell raw coal of the K and KO grades extracted by Koksovaya mine which accounts for a sharp increase in the sales volumes of raw coal. As part of ZAO Koksovaya acquisition deal, in May 2010 we signed a 10-year contract for delivery of a part of coal produced by Koksovaya mine to Evraz at market price and in accordance with existing commercial practice. All the raw coal we sold was of the K and KO grades and was sold to Evraz only.

After May 2010, in order to minimize the negative effects of the sudden drop in coking coal production for the Russian metallurgical industry, we supply a limited number of Russian customers only. As our production volumes increase, we will supply other customers, both domestic and foreign.

After launching a 2nd face we plan to gradually increase export sales. For this reason, we started negotiations with both existing and new clients on several export directions.

Revenue

Domestic and export sales by type of our products are set out in the following table:

	1H2011		1H2010		Change	
	Amount	Portion	Amount	Portion		
	US\$000		US\$000		US\$000	
Coal concentrate – Russia	294,673	80%	284,184	62%	10,489	4%
Coal concentrate – export	–	–	171,196	37%	(171,196)	(100)%
	294,673	80%	455,380	99%	(160,707)	(35)%
Raw coal – Russia	74,047	20%	1,900	1%	72,147	x39
	368,720	100%	457,280	100%	(88,560)	(19)%
Sales of other goods	4,787		6,118		(1,331)	(22)%
Rendering of services	3,931		2,641		1,290	49%
Revenue	377,438		466,039		(88,601)	(19)%

In 1H2011, 98% of our total revenue was derived from sales of coal concentrate and raw coal.

Sales of other goods mainly consisted of resale of steel products.

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

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Production volumes

Our production volumes are driven by demand but also restricted by production capacity. A significant proportion of our costs can be classified as fixed costs which is typical for the extraction industry and therefore our production level is one of the key factors in determining our overall cost competitiveness.

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

	1H2011	1H2010	Change	
	<i>thousands of tonnes</i>	<i>thousands of tonnes</i>	<i>thousands of tonnes</i>	
Raw coal extraction	3,458	4,778	(1,320)	(28)%
Raw coal preparation	2,584	4,822	(2,238)	(46)%
Coal concentrate production	1,866	3,659	(1,793)	(49)%
Output ratio	72.2%	75.9%		

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

Despite a strong demand for coking coal, in 1H2011 production volumes were lower than in 1H2010 because of the accident in May 2010.

On the whole, we fulfilled 1H2011 budget plan, and production at Raspadskaya mine in 2Q2011 increased by 10% QoQ amounting to 464 thousand tonnes.

The decrease in production and sales volumes of raw coal in 2Q compared to 1Q was affected by a suspension of production at Raspadskaya-Koksovaya mine, while 1H2011 budget plan was fulfilled by 108%.

Production costs and efficiency

Our competitiveness and long-term profitability depend to a significant degree on our ability to maintain relatively low costs and high efficiency of our operations.

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

	1H2011		1H2010		Change	
	Amount	Portion	Amount	Portion		
	<i>US\$000</i>		<i>US\$000</i>		<i>US\$000</i>	
Payroll	38,337	21%	33,084	23%	5,253	16%
Payroll taxes	16,117	9%	10,174	7%	5,943	58%
Other taxes	10,194	6%	11,448	8%	(1,254)	(11)%
Materials	35,312	20%	21,467	15%	13,845	64%
Electricity	7,701	4%	7,380	5%	321	4%
Other costs and expenses	15,206	8%	7,959	6%	7,247	91%
Cash cost of production	122,867	68%	91,512	64%	31,355	34%
Depreciation, depletion (excluding mineral reserve) and amortization	38,525	22%	34,090	24%	4,435	13%
Depletion of mineral reserve	17,784	10%	17,182	12%	602	4%
Cost of production	179,176	100%	142,784	100%	36,392	25%
Transportation costs	-		48,813		(48,813)	(100)%
Cost of resold goods	4,753		5,883		(1,130)	(19)%
Cost of rendering of services	3,174		2,282		892	39%
Change in finished goods	(8,980)		27		9,007	n/a
Cost of sales	178,123		199,789		(21,666)	(11)%

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

	1H2011	1H2010	Change	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Cash cost of extraction of coal	113,699	81,572	32,127	39%
	<i>US\$</i>	<i>US\$</i>	<i>US\$</i>	
Cash cost of extraction of 1t of coal	32.9	17.1	15.8	92%

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

	1H2011	1H2010	Change	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Estimated cash cost of coal used in concentrate preparation ⁽¹⁾	81,662	80,891	771	1%
Cash cost of preparation	9,168	9,940	(772)	(8)%
Cash cost of production transportation of coal	1,535	2,461	(926)	(38)%
Estimated cash cost of coal concentrate	92,365	93,292	(927)	(1)%
	<i>US\$</i>	<i>US\$</i>	<i>US\$</i>	
Estimated cash cost of 1t of coal used in concentrate preparation	31.6	16.8	14.8	88%
Cash cost of preparation of 1t of coal used	3.5	2.1	1.4	67%
Cash cost of production transportation of 1t of coal	0.6	0.5	0.1	20%
Estimated cash cost of 1t of concentrate ⁽²⁾	49.5	25.5	24.0	94%

(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 72.2% for 1H2011 and 75.9% for 1H2010.

The significant increase in estimated cash cost of production of 1t of concentrate was due to the increase in estimated cash cost of coal in concentrate preparation by 1% and the decrease in concentrate production volume by 49%.

The increase in cash cost of extraction of 1t of coal was due to the decrease in extraction volume (mainly because the reconstruction of Raspadskaya mine was not completed) as well as to the proportion of fixed costs remaining high.

We expect the ruble-denominated estimated cash cost of production of 1t of concentrate will decrease as Raspadskaya mine increases its production volume.

Payroll and payroll taxes

Payroll and payroll taxes (labor costs) constitute the largest item of our production cash costs – 44% in 1H2011 and 55% in 1H2010.

Payroll taxes consist of regular mandatory contributions to the state Pension Fund of Russia, contributions to medical insurance funds, and mandatory industrial accident and occupational disease insurance charges. We have no legal or constructive obligation to pay further contributions in respect of the state benefits.

Information on our overall labor force and costs is summarized in the following table:

	1H2011	1H2010	Change	
Average total number of employees	8,116	7,787	329	4%
Total payroll, <i>US\$000</i>	66,948	52,100	14,848	28%
Total payroll taxes, <i>US\$000</i>	26,885	14,614	12,271	84%
Effective payroll tax rate	40%	28%		

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The increase in average total number of employees by 4% YoY was due to the acquisition of ZAO Koksovaya.

The increase in total payroll by 28% YoY reflected labor costs inflation of 9.4%, the strengthening of the ruble by 5%, the real pay growth by 9.6% and an increase in the average number of employees by 4%.

The significant increase in payroll taxes was due to changes in the legislation. Starting 1 January 2011 payroll taxes rate increased from 26% to 34%. Besides, starting 1 January 2011, for certain categories of miners, additional accident insurance payments are introduced. From 1 January 2012 payroll payments will be reduced from 34% to 30%.

Other taxes

Other taxes included in production costs consist primarily of the mineral extraction tax (MET) and the land lease rental. The decrease in other taxes by 11% YoY was mainly due to a lower land lease rental during the reconstruction period at Raspadskaya mine.

Starting 1 April 2011, a new scheme of MET calculation for coal industry is in place – MET is calculated based on actual extraction volumes and a fixed rate is set by the Russian Government. Moreover, MET can be decreased by qualified expenses incurred on enhancement of work safety. In 1H2011 as compared to 1H2010, MET increased because of higher coking coal prices.

Materials and electricity

The increase in materials cost by 64% YoY was mainly due to an increase in the volume of overburden by 39%, an increase in overburden transportation distances by 29%, an increase in diesel price by 56%, and increased volumes of repairs of mining equipment. Electricity cost increased by 4% because of an increase of the tariff by 20% with an offset from decreased electricity consumption resulting from the accident at Raspadskaya mine.

Other costs and expenses

Other costs and expenses increased by 91% YoY due to an increase in drilling and blasting services costs (a consequence of an increase of the depth and volume of overburden at Razrez Raspadskiy) as well as to higher costs of mining equipment and property repairs services.

Depreciation, depletion and amortization

Depreciation, depletion and amortization comprise a significant portion in our cost of production – 32% in 1H2011 and 37% in 1H2010.

Depreciation, depletion (excluding mineral reserve) and amortization increased by 13% YoY mainly because of additions of property, plant and equipment and the acquisition of ZAO Koksovaya.

Depletion of mineral reserves is directly proportional to extraction volumes. Mineral reserves represent tangible assets acquired in business combinations which concerns companies MUK-96, Razrez Raspadskiy and Koksovaya. The increase in depletion charge by 4% YoY was due to an increase in extraction by the three companies.

Other income and expenses

Transportation costs

Transportation costs mainly consist of railroad costs and loading services in ports under FOB terms. Transportation costs dropped to zero in 1H2011 because there were no export sales.

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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.

Selling and distribution costs

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

	1H2011		1H2010		Change	
	Amount	Portion	Amount	Portion		
	US\$000		US\$000		US\$000	
Payroll	12,830	41%	10,697	43%	2,133	20%
Payroll taxes	3,574	11%	2,052	8%	1,522	74%
Other taxes	5,531	18%	5,483	17%	48	1%
Materials	892	3%	768	2%	124	16%
Other costs and expenses	6,174	19%	4,267	15%	1,907	45%
Depreciation and amortization	2,435	8%	1,573	5%	862	55%
	31,436	100%	24,840	100%	6,596	27%

The most significant part of our general and administrative expenses is labor costs – 52% in 1H2011 and 62% in 1H2010.

Property tax is the main part of other taxes.

Other costs and expenses include insurance, bank, information, communication, consulting, audit and other services. The increase in other costs and expenses by 45% YoY was mainly due to an increase in certain expenses such as building renovation, outsourcing of washing and cleaning services, and security services.

Social expenses

As is the case for many of large Russian production companies, we have certain social expenses that are primarily in the form of donations and social sphere infrastructure maintenance. The increase in social expenses by 13% YoY was mainly due to social services inflation and the decrease of the US\$/ruble rate.

Loss on disposal of property, plant and equipment

The profit (loss) arising from the disposal (derecognition) of items of property, plant and equipment is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the items.

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 1H2011, the depreciation of the US dollar resulted in a gain of US\$25.6 on US dollar loans and borrowings and a loss of US\$11.9 from cash and deposits.

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Other operating income and expenses

Other operating income and expenses consist of non-recurring income and expenses. Other operating expenses significantly increased (61% YoY) because we incurred certain expenses associated with the liquidation of the consequences of the accident at Raspadskaya mine.

Expenses associated with the liquidation of the consequences of the accident included payroll and payroll taxes, cost of materials, electricity, services, drilling, reconstruction of coal faces, compensatory social payments and other expenses. In addition, after Raspadskaya mine stopped operation in May 2010, depreciation and amortization of its production property, plant and equipment has been included in other operating expenses.

Interest income and interest expense

Interest income mainly related to deposits held in Russian banks. The increase in interest income was mainly due to a larger amount of bank deposits held in 1H2011 as compared to 1H2010.

The core of interest expense is the 7.5% coupon on our Eurobonds – we pay US\$12.25m semi-annually. In addition, in 1H2011, there was interest cost on benefit obligation in the amount of US\$1.8m.

Income tax

In 1H2011, the amount of income tax expense (US\$27.7m) represents the difference between the tax accrued (US\$36.5m) and the change in the amount of the deferred income tax liability and asset (US\$8.8m).

EBITDA

Consolidated EBITDA, as stipulated in the Loan Agreement on the Eurobonds, is calculated in the following table:

	1H2011	1H2010	Change	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Profit for the period	99,046	229,153	(130,107)	(57)%
<i>Adjusted for:</i>				
Foreign exchange (gains)/losses, net	(13,860)	847	14,707	<i>n/a</i>
Change in bad debt allowance	(626)	(658)	(32)	(5)%
Consolidated Profit	84,560	229,342	(144,782)	(63)%
<i>Adjusted for:</i>				
Dividend income	(24)	(2)	22	<i>x12</i>
Interest income	(8,390)	(7,992)	398	5%
Interest expense	14,083	13,709	374	3%
Amortization of debt issuance cost	(222)	(212)	10	5%
Gain from a bargain purchase of subsidiary	–	(104,735)	(104,735)	<i>n/a</i>
Extraordinary loss on disposal of PP&E	–	41,276	41,276	(100)%
Income tax	27,661	33,004	(5,343)	(16)%
EBIT	117,668	204,390	(86,722)	(42)%
<i>Adjusted for:</i>				
Depreciation, depletion and amortization	64,821	56,608	8,213	15%
Capitalized depreciation	(2,982)	(2,075)	907	44%
Consolidated EBITDA	179,507	258,923	(79,416)	(31)%
EBITDA margin	48%	56%		

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Working capital, indebtedness, liquidity and capital expenditures

Our working capital is calculated in the following table:

	<u>30/Jun/11</u>	<u>31/Dec/10</u>	<u>Change</u>	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Inventories	100,573	77,199	23,374	30%
Receivables	87,647	79,950	7,697	10%
Prepayments	10,937	12,749	(1,812)	(14)%
Taxes recoverable	10,181	23,672	(13,492)	(57)%
<i>Less:</i>				
Payables	(60,394)	(43,592)	16,802	39%
Taxes payable	(35,592)	(30,259)	5,333	18%
Advances	(18)	(19)	(1)	(5)%
Working capital	<u>113,334</u>	<u>119,700</u>	(6,366)	(5)%

The increase in inventories by 30% (US\$23.4m) was to a large degree due to the recommencement of production process at Raspadskaya mine that led to an increase in the operating consumption of materials and spare parts.

The increase in receivables by 10% (US\$7.7m) was mainly due to increased prices of coking coal.

Taxes recoverable (mainly income tax and VAT) decreased by 57% (US\$13.5m) due to a partial recovery of taxes previously overpaid.

The increase in payables by 39% (US\$16.8m) was mainly due to the recommencement of production process at Raspadskaya mine.

The increase in taxes payable by 18% (US\$5.3m, mainly income tax and VAT) was largely due to increased prices of coking coal.

Consolidated Net Indebtedness, as stipulated in the Loan Agreement on the Eurobonds, is calculated in the following table:

	<u>30/Jun/11</u>	<u>31/Dec/10</u>	<u>Change</u>	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Long-term loans	4,170	304,104	(299,934)	(99)%
Short-term loans and current portion of long-term loans	302,856	6,499	296,357	x46.6
<i>Less:</i>				
Short-term bank deposits	(158,396)	(158,384)	12	0%
Cash and cash equivalents	(256,862)	(164,628)	92,234	56%
Consolidated Net Indebtedness/(Net cash position)	<u>(108,232)</u>	<u>(12,409)</u>	95,823	x8.7

Our short-term debt was represented primarily by 7.5% Eurobonds in the amount of US\$300m due 22 May 2012. Other short-term loans were mainly letters of credit we open to buy imported equipment.

As at 30 June 2011, cash and cash equivalents, short- and long-term bank deposits increased by US\$92.2m YoY and totaled US\$415.3m.

On 25 August 2011, the Extraordinary General Meeting decided to distribute interim dividends for 1H2011 in the amount of US\$135m which represents 5.00 rubles (US\$0.17) per share.

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.

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Our cash flow statement is summarized in the following table:

	2011	2010	Change	
	<i>US\$000</i>	<i>US\$000</i>	<i>US\$000</i>	
Cash and cash equivalents at 1 January	164,628	28,277	136,351	x5.8
Net cash from operating activities	159,636	232,054	(72,418)	(31)%
Net cash used in investing activities	(66,553)	(140,027)	(73,474)	(52)%
Net cash used in financing activities	(15,961)	(28,221)	(12,260)	(43)%
Effect of foreign exchange rate changes on cash and cash equivalents	15,112	(1,680)	16,792	n/a
Cash and cash equivalents at 30 June	256,862	90,403	166,459	184%

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

The cash used in our investing activities was used in capital expenditures and to increase short-term bank deposits.

Cash used in our capital expenditures is set out in the following table:

	1H2011		1H2010		Change	
	Amount	Portion	Amount	Portion	Change	
	<i>US\$000</i>		<i>US\$000</i>		<i>US\$000</i>	
Mines	73,563	94%	71,547	96%	2,016	3%
Other	4,878	6%	3,335	4%	1,543	46%
	78,441	100%	74,882	100%	3,559	5%

The increase in cash capex by 5% was mainly a result of the strengthening of the ruble.

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.