MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion and analysis of our pro forma consolidated financial information for the years ended 31 December 2006 and 2005 taking into account the MUK Group Acquisition. This discussion and analysis should be read in conjunction with our pro forma consolidated financial information. The pro forma consolidated financial information analysis is based on estimates and assumptions deemed reasonable by us and should be read in conjunction with our historical consolidated financial statements and related notes thereto. The pro forma consolidated financial information is presented for illustrative purposes only and may not, because of its nature, give a true picture of our financial position or results of operations. If the MUK Group Acquisition had occurred on 1 January 2005, our operating results might have been different from those presented below. The pro forma consolidated financial information should not be relied upon as an indication of the operating results that we would have achieved if the MUK Group Acquisition had occurred on 1 January 2005, nor should it be used as an indication of the results that we will achieve following the MUK Group Acquisition. Our future results of operations and financial position may differ materially from the pro forma amounts reflected in our pro forma consolidated financial information included elsewhere in this Offering Circular. We believe that our pro forma consolidated financial information forms the most relevant basis for the analysis of our results of operations. Our pro forma consolidated financial information presents the view of our business taken as a whole while our historical consolidated financial statements provide only a partial view of our business and operating results and shall be analysed only in conjunction with the pro forma consolidated financial information.

In addition, the following also contains a discussion and analysis of our historical consolidated financial condition and results of operations for the years ended 31 December 2006 and 2005. This discussion and analysis should be read in conjunction with our historical consolidated financial statements and their related notes. Moreover, our historical consolidated financial information reflects the acquisition of the Acquired Companies (as defined below) representing business combinations involving entities under common control with us, which have been accounted for in our historical consolidated financial statements using the pooling of interests method to present our consolidated financial statements as if the acquisitions of such Acquired Companies occurred on the date such Acquired Companies were originally established. Moreover, this discussion and analysis contains forward looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward looking statements as a result of numerous factors.

Overview

We are Russia's second largest coking coal producer based on volume. We conduct our business through 11 key subsidiaries located in the Kemerovo region of the Russian Federation in the Kuzbass. Our mining operations include two active underground mines, one underground mine under construction, one open-pit mine and a coal preparation plant, as well as industrial, maintenance and transportation infrastructure. We have leading market positions in Russia with respect to the coal that we produce, which consists of several different types of coking coal, in particular, Zh (fat), GZh (gas fat) and GZhO (gas fat semi-lean) coal. According to IMC, as of 30 June 2006, we had total proved and probable reserves of approximately 781.5 million tonnes of which 5.5 million tonnes were extracted in the second half of the year 2006.

The Reorganisation

In 2006 we undertook a corporate reorganisation (the "**Reorganisation**") in order to consolidate and purchase certain coal mining assets and simplify our corporate structure. The Reorganisation resulted in us (i) acquiring 100 per cent. equity interests in Raspadskaya Preparation Plant, Raspadskaya Coal Company, Raspadskiy Ugol and Raspadskaya Koksovaya (each an "Acquired Company," and collectively, the "**Acquired Companies**") historically owned by Corber Enterprises Limited, and (ii) acquiring a 100 per cent. equity interest in MUK-96 and its 99 per cent. owned subsidiary Razrez Raspadsky (the "**MUK Group Acquisition**"), both historically controlled by Adroliv or Adroliv's affiliates. In addition, in March 2006, ZAO Raspadskaya was reorganised into an open joint stock company, OAO Raspadskaya.

The Reorganisation involved the following steps:

Acquired Companies Transaction

- On 16 June 2006, we entered into an agreement to acquire the Acquired Companies from Corber Enterprises Limited for the aggregate amount of U.S.$306.9 million. We financed such acquisition with our own funds of U.S.$6.9 million and a U.S.$300.0 million loan of 6 July 2006 from Natexis Banques Populaires and ZAO Bank Natexis ("**Natexis**"). Our obligations under the loan are guaranteed by Evraz Group S.A., pursuant to a Guarantee and Indemnity Agreement, dated 7 July 2006. Prior to such acquisition, Corber Enterprises Limited owned a 100 per cent. equity interest in each Acquired Company.

MUK Group Acquisition

- On 14 September 2006, we acquired a 100 per cent. equity interest in MUK-96 from Corber Enterprises Limited in exchange for 300,650,000 of our newly issued ordinary shares. The new shares were issued to Corber Enterprises Limited in a closed subscription approved by our shareholders at a general meeting of shareholders on 8 June 2006. The transaction was completed on 3 October 2006 when the placement report on the share issuance was registered by the Federal Financial Markets Service (the "**FFMS**"). MUK-96 holds a 99 per cent. ownership interest in Razrez Raspadsky. The remaining 1 per cent. interest is held by Raspadskiy Ugol. Our *pro forma* consolidated statements present the operations results that we would have achieved if MUK Group had occurred on 1 January 2005.

Summary of Historical Acquisitions

In the past, we have acquired controlling interests in certain coal-related services, transportation and infrastructure companies.

The table below sets forth our ownership share in those subsidiaries:

	Year of Acquisition of Controlling Interest	% Held as of December 31, 2006
OOO Raspadskaya-Joy	1992	100.00%
OOO Montazhnik Raspadskoy	1999	51.00%
OAO Tomusinskoye Cargo Handling Unit (TPTU)	2000	58.59%
OAO Olzherasskoye Shaft-Sinking Unit (OShPU)	2003	95.12%
OOO Puteets	2004	100.00%

Pro Forma Consolidated Financial Information

General

The discussion and analysis below is based primarily on our *pro forma* consolidated financial information which has been derived by the application of *pro forma* adjustments related to the MUK Group Acquisition to our historical consolidated financial statements. Our *pro forma* consolidated financial information for the years ended 31 December 2006 and 2005 gives effect to the MUK Group Acquisition as if it had occurred as of 1 January 2005. For discussion and analysis of our historical consolidated financial conditions and results of operations please see section "*IFRS Historical Results of Operations*" below.

MUK-96 and Razrez Raspadsky historically had significant production and trading operations with Raspadskaya and its subsidiaries, which affected the trading results of Raspadskaya reflected in the IFRS historical consolidated financial statements. Therefore, we believe that our *pro forma* consolidated financial information forms the most relevant basis for the analysis of the results of operations of our group. The *pro forma* consolidated financial information presents the view of our business taken as a whole while our historical consolidated financial statements of Raspadskaya provide only a partial view of our business and our operating results and shall be analysed only in conjunction with our *pro forma* consolidated financial information. The details of the transactions between Raspadskaya with its subsidiaries, MUK-96 and Razrez Raspadsky are discussed in section "*Certain factors affecting our pro forma consolidated financial information*" below.

In addition, MUK-96 and Razrez Raspadsky have not prepared on a regular basis historical IFRS standalone financial statements. For the purposes of preparing the *pro forma* consolidated financial information included in this Offering Circular, MUK-96 and Razrez Raspadsky compiled their historical financial information in accordance with IFRS except for property, plant and equipment which were accounted for at their fair values determined as at 31 May 2006. The depreciation and depletion charges for the years ended 31 December 2006 and 2005 were determined using a roll-back of property, plant and equipment from 31 May 2006 to 1 January 2005.

Certain factors affecting our *pro forma* consolidated financial information

In 2005 and through the MUK Group Acquisition in 2006, MUK-96 sold raw coal it produced to ZAO "Raspadskaya Financial and Industrial Company" ("**RFPK**"), an entity under control of Adroliv and Adroliv's affiliates. RFPK arranged for the preparation of this raw coal. It acted as a trader for MUK-96 in 2004 and 2005 and earned trading margins on reselling activities. RFPK purchased preparation services from various preparation plants and subsequently all of the coal concentrate to the Group. From 1 June 2006, MUK-96 ceased trading with RFPK. In our IFRS historical financial statements, we recorded the purchases of coal concentrate from RFPK while in our *pro forma* income statement, for comparison purposes, we recognised trading margins earned by RFPK. Related income tax effect was recognised in the *pro forma* income statement for the years ended 31 December 2006 and 2005 at the Russian statutory profit tax rate of 24 per cent. Net profit recognised on these transactions in the *pro forma* consolidated financial information was considered to be a distribution to Adroliv and Adroliv's affiliates.

Certain 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 other, the demand for coking coal, coking coal prices, production costs, exchange rates and social expenses.

Demand and supply of coking coal

Our results of operations are significantly dependent upon the demand/supply balance of coking coal on the domestic and world markets. This balance is primarily influenced by fluctuations in the steel industry and steel production, changes in coal production capacity and other related factors.

The major consumers of our coking coal are large domestic and foreign steel producers. Therefore, our results of operations have historically been influenced by the trends in the Russian and world steel market and cyclical fluctuations in the steel industry in the future will continue to affect our sales of raw coal and coal concentrate. The major portion of our revenues is derived from sales to large domestic steel producers such as MMK, Evraz and NLMK (including Altai Koks). The share of revenues from these plants accounted for up to 60 per cent. and 56 per cent. of our total pro-forma raw coal and coal concentrate sales in 2006 and 2005, respectively. Further sales to these steel and metal producers will have a material influence on our trading results.

For the last several years, coal mining in Russia has been growing with production of coking coal reaching its peak of 75.1 million tonnes in 2004, which reflected an increased demand mainly from Russian metallurgical companies. However, coking coal output in Russia increased by only 0.5 per cent. to 70.3 million tonnes in 2006 compared to approximately 69.9 million tonnes in 2005 according to Rosinformugol. Nevertheless, we managed to increase our sales volume in 2006 by 13 per cent. as compared with 2005 (restated in tonnes of coal concentrate).

Approximately 17 per cent. and 28 per cent. of our total *pro forma* raw coal and coal concentrate sales in 2006 and 2005, respectively, were made to Evraz through its related trading house Evrazresource for further delivery to iron and steel plants controlled by Evraz, such as Nizhny Tagil Iron and Steel Plant ("**NTMK**"), Novokuznetsk Iron and Steel Plant ("**NKMK**") and West Siberian Iron and Steel Plant ("**ZAPSIB**"). The price at which our coal was offered to these related parties was negotiated on an arms-length basis and was on market terms.

Our results of operations are indirectly affected by the increase in the coal production capacities by our competitors. During the last several years, major steel groups have established control over coking coal producing companies through privatisations and further acquisitions. Moreover, following a surge of coking coal prices in 2005, a substantial increase in coking coal production capacities has been announced by a number of producers in the long term. This planned increase in production capacities may result in a greater competition amongst coking coal producers and thus affect the demand for our coal and impact our future trading results. Nonetheless, we believe that the risk of any significant step-up of the Russian metallurgical coal capacity in the short and mid-term remains limited due to the following key factors:

- Requirement to commit to large capital expenditures against the backdrop of traditionally high maintenance capital expenditure carried out by the Russian coal miners;
- Significant lead times to a production launch at green field underground mines;
- Decline of expertise in shaft sinking and mining project management in the post-Soviet period; and
- Prevailing difficult geological and mining conditions that are likely to further aggravate as the mining is forced to go to deeper levels.

Prices for coking coal

Both world and domestic prices for coking coal have a material impact on our results of operation. The average prevailing coking coal price is determined by supply contracts with various industrial customers.

International coking coal price(1)

	2006	2005	2004
	(in U.S. dollars per tonne)		
Premium Hard Coking Coal	116.0	126.9	58.0
Standard Hard Coking Coal	105.0	125.0	55.0
Semi Soft Coking Coal/High-vol PCI	58.0	79.5	43.0

(1) Based upon Japanese Financial Year (April 1 to March 31) and FOB Australia.
Source: Deutsche UFG Research

The table below represents the movement in our coal prices for 2006 and 2005(1):

	2006	2005	% change
	(in U.S. dollars per tonne, except percentages)		
Coal concentrate-average domestic price	60.4	79.9	(24)%
Coal concentrate-average export price	52.2	65.2	(20)%
Average sales price of concentrate	58.6	77.5	(24)%
Raw coal-average domestic price	32.7	48.8	(33)%
Raw coal-average export price	32.5	44.7	(27)%
Average sales price of raw coal	32.7	46.5	(30)%

(1) Presented on the basis of FCA Mezhdurechensk

Domestic prices for our raw coal and coal concentrate were generally significantly higher than export prices. The average prices for our raw coal and coal concentrate reached their peak during 2005 following the trends of the steel market. The prices started to decrease in the second half of 2005 which was a result of the temporary decline in the steel market, and as such, had a material impact on our trading results. Due to this unfavourable market development, our weighted average sales price of coal concentrate and of raw coal in 2006 decreased by 24 per cent. and 30 per cent., respectively, as compared to 2005.

We do not generally hedge our exposure to the risk of fluctuations in the price of coal for the lack of hedging instruments. Consistent with industry practice, our coal sales contracts fix the sale price and the price for coal is set periodically based upon negotiations between the parties.

Sales volumes

The table below sets forth the *pro forma* volumes of our raw coal and coal concentrate sales on the domestic and export markets:

	2006	2005	% change
	(in thousands of tonnes, except percentages)		
Sales of coal concentrate Russia	5,125	4,706	9%
Sales of coal concentrate export	1,423	925	54%
Total sales of coal concentrate	6,548	5,631	16%
Sales of raw coal Russia	1,694	842	101%
Sales of raw coal export	250	1,106	(77)%
Total sales of raw coal	1,944	1,948	0%
Total raw coal and coal concentrate(1)	8,021	7,097	13%

(1) Raw coal restated in tonnes of coal concentrate at output ratio of app. 76 per cent. in 2006 and 75 per cent. in 2005

Our development strategy over the past few years has focused on increasing higher margin coal concentrate production and sales. Moreover, we believe we will be able to take advantage of the higher margins received from the sale of coal concentrate due to the commencement of the coal preparation operations by Raspadskaya Preparation Plant in the fourth quarter of 2005 which had a positive impact on our results of operations during 2006.

Our *pro forma* total sales volumes increased by 16 per cent. in terms of coal concentrate from 2005 to 2006. In 2006 as compared to 2005 our *pro forma* sales volumes of coal concentrate and of raw coal to Russian customers increased by 9 per cent. and 101 per cent., respectively. The increase of the domestic sales allowed us to benefit from more favourable prices on the Russian market in comparison with export sales prices. The *pro forma* volumes of our export concentrate sales were 54 per cent. higher in 2006 than in 2005 in line with our strategy to strengthen our position in the export markets.

Production volumes

Our *pro forma* production costs and costs per unit are significantly affected by the changes in *pro forma* production volumes. A significant proportion of our *pro forma* costs can be classified as fixed costs and, therefore, our *pro forma* production level is one of the key factors in determining our overall cost competitiveness.

The table below sets forth our *pro forma* coal production for 2006 and 2005:

	2006	2005	% change
	(in thousands of tonnes, except percentages)		
Raw coal produced by Raspadskaya mine	7,368	6,395	15%
Raw coal produced by Razrez Raspadsky	2,104	2,211	(5)%
Raw coal produced by MUK-96	1,141	1,111	3%
Total raw coal production	10,613	9,717	9%
Raw coal used in concentrate preparation	8,660	7,471	16%
Coal concentrate produced	6,560	5,621	17%

We have been developing coal production at Razrez Raspadsky since 2003 and MUK-96 since 1996. Coal production has been increasing at a high growth rate for the past few years. However, production at Razrez Raspadsky declined by 5 per cent. in 2006 mainly because of the production complex downtimes due to complicated mining and geological conditions and increased watercut. Raw coal production at MUK-96 grew by only 3 per cent. because of the lengthening of the period of reconstruction at the mining complex. However, we have compensated these production shortages at MUK-96 and Razrez Raspadsky through an increased output from Raspadskaya mine which grew by 15 per cent. in 2006.

Production costs and efficiency

Our competitiveness and long-term profitability are, to a significant degree, dependent upon our ability to maintain low-cost and efficient operations.

The table below sets forth the total *pro forma* cash cost of production[(1)] for 2006 and 2005:

	2006	2005	% change
	(in thousands of U.S. dollars)		
Cost of revenues	240,189	252,390	(5)%
Less:			
Cost of resold concentrate	—	(2,117)	n/a
Cost of other resold goods	(713)	(1,131)	(37)%
Change in finished goods	(1,953)	6,738	(129)%
Depreciation, depletion and amortisation	(90,938)	(87,287)	4%
Total cash cost of production less depreciation, depletion and amortisation	146,585	168,593	(13)%
Including:			
Total cash cost of raw coal production	127,379	124,294	2%
Total cash cost of preparation	19,206	44,299	(57)%

(1) Cash cost of production represents cost of sales before cost of resold goods, changes in finished goods and depreciation, depletion and amortisation. We present cash cost of production and other measures calculated using cash cost of production because we consider them important supplemental measures of our operating performance and believe they are frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. Cash cost of production and other measures calculated using cash cost of production have limitations as analytical tools, and you should not consider them in isolation, or as a substitute for analysis of our operating results as reported under IFRS. We compensate for these limitations by relying primarily on our IFRS operating results and using cash cost measures only supplementally. Cash cost of production and other measures calculated using cash cost of production are measures of our operating performance that is not required by, or presented in accordance with, IFRS. Cash cost of production and other measures calculated using cash cost of production are not measurement of our operating performance under IFRS and should not be considered as an alternative to net income, operating income or any other performance measures derived in accordance with IFRS.

The table below sets forth our *pro forma* cash cost of raw coal produced for 2006 and 2005:

	2006	2005	% change
	(in thousands of U.S. dollars, except percentages)		
Cash cost of raw coal production			
Cash cost of raw coal produced by Raspadskaya mine	86,900	84,170	3%
Cash cost of raw coal produced by Razrez Raspadsky	25,434	27,167	(6)%
Cash cost of raw coal produced by MUK-96	15,045	12,957	16%
Total cash cost of raw coal production	127,379	124,294	2%
	(in U.S. dollars per tonne, except percentages)		
Cash cost per tonne of raw coal produced by Raspadskaya mine	11.8	13.2	(11)%
Cash cost per tonne of raw coal produced by Razrez Raspadsky	12.1	12.3	(2)%
Cash cost per tonne of raw coal produced by MUK-96	13.2	11.7	13%
Total cash cost per tonne of raw coal produced	12.0	12.8	(6)%

Pro forma cash costs associated with raw coal production comprise the major portion of our costs and can be broadly categorised into costs attributable to payroll of production personnel and related taxes, materials and utilities. In 2006 the *pro forma* cash cost of raw coal production increased by 2 per cent. whereas our volume of production increased by 9 per cent.

The average salary and related taxes increase and the increase of the costs of materials in 2006 had a negative impact on our cost of coal production. However, the decrease of overburden removal outsourced to third parties at Razrez Raspadsky, the decrease in the cost of equipment maintenance and the decrease in mineral resources tax expenses as a consequence of the fall in coal prices positively affected our cost of coal produced.

Decrease of equipment maintenance expense and the mineral resources tax expense were the main factors for the decrease of the cash cost of raw coal production at Raspadskaya mine in 2006. The increase of the cash cost of raw coal production at MUK-96 mine was due to the lengthening of the period of equipment reassembling at the mining complex up to the end of the year 2006 and substantial fixed costs during the period caused by the lack of coal production during such equipment reassembling. In 2006, we ceased outsourcing of the overburden removal to the third parties. This allowed us to reduce the cash cost per tonne of raw coal at Razrez Raspadsky in 2006 in comparison with 2005.

The table below sets forth our *pro forma* coal concentrate production and costs of preparation[(1)] for 2006 and 2005:

	2006	2005	% change
	(in thousands of tonnes, except percentages)		
Raw coal used in concentrate preparation	8,660	7,471	16%
Coal concentrate produced	6,560	5,621	17%
Output ratio	76%	75%	1%
	(in thousands of U.S. dollars, except percentages)		
Estimated cash cost of raw coal used in concentrate preparation[(2)]	103,919	95,629	9%
Cash cost of preparation	19,206	44,299	(57)%
Total cash cost of coal concentrate produced	123,125	139,928	(12)%
	(in U.S. dollars per tonne, except percentages)		
Preparation cash cost per tonne of raw coal used	2.2	5.9	(63)%
Preparation cash cost per tonne of coal concentrate produced	2.9	7.9	(63)%
Total cash cost per tonne of coal concentrate produced	18.8	24.9	(24)%

(1) Cash costs exclude depreciation, depletion and amortization

(2) Estimated cash cost per tonne of raw coal used in concentrate preparation is a computed value calculated based on the volumes of raw coal used in concentrate preparation and the weighted average cash cost per tonne of raw coal produced.

Pro forma coal concentrate cash production costs include preparation services rendered by the third parties and transportation of raw coal to such third parties' preparation facilities. Changes in prices for these services have an impact on our results of operations. In the fourth quarter of 2005, our wholly owned subsidiary Raspadskaya Preparation Plant commenced operations.

The cash costs of internal coal preparation by Raspadskaya Preparation Plant are significantly lower than the costs of preparation services by third parties' plants, including the associated transportation costs. In 2006 we decreased the use of the third parties' preparation services by 82 per cent. and increased the use of our own preparation of concentrate by 4.8 million tonnes. Additionally, our own preparation plant is located close to the raw coal production facilities, which allowed us to also benefit from a significant reduction of coal transportation expenses.

The table below sets forth our *pro forma* preparation costs of concentrate produced and of raw coal processed (less depreciation, depletion and amortisation) for 2006 and 2005:

	2006	2005	% change
	(in thousands of tonnes, except percentages)		
Raw coal prepared by Raspadskaya Preparation Plant	7,557	1,199	530%
Raw coal prepared by third parties	1,103	6,272	(82)%
Total raw coal used in concentrate preparation	8,660	7,471	16%
Coal concentrate produced by Raspadskaya Preparation Plant.	5,735	929	517%
Coal concentrate produced by third parties	825	4,692	(82)%
Total coal concentrate produced	6,560	5,621	17%
Cash cost of preparation by Raspadskaya Preparation Plant	11,996	1,831	555%
Cash cost of preparation by third parties	5,444	27,914	(80)%
Transportation	1,766	14,554	(88)%
Total cost of preparation	19,206	44,299	(57)%
	(in U.S. dollars per tonne, except percentages)		
Preparation cost per tonne of raw coal used by Raspadskaya Preparation Plant	1.6	1.5	7%
Preparation cost per tonne of raw coal used by third parties	4.9	4.5	9%
Transportation cost per tonne of raw coal used by third parties	1.6	2.3	(30)%
Preparation cost per tonne of coal concentrate produced by Raspadskaya Preparation Plant	2.1	2.0	5%
Preparation cost per tonne of coal concentrate produced by third parties	6.6	5.9	12%
Transportation cost per tonne of coal concentrate produced by third parties	2.1	3.1	(32)%

The preparation *pro forma* cash cost per tonne of raw coal used for concentrate production varies depending on the preparation plant, mainly due to higher cost of raw coal transportation to the third party plants in the remote locations.

Currently, Raspadskaya Preparation Plant is capable of preparing 7.5 million tonnes of raw coal annually (nameplate capacity). Raspadskaya Preparation Plant's services have allowed us to decrease the use of the third parties' preparation services and produce most of the coal concentrate from our raw coal at our own preparation plant. This led to significant benefits from the cost reduction at the coal preparation stage. The effect of the decrease of cash cost coal production was approximately U.S.$25.1 million or U.S.$5.0 per tonne. We are targeting an additional preparation nameplate capacity of 3.0 million tonnes of raw coal per annum to be put into operation at Raspadskaya Preparation Plant in the first quarter of 2008.

Railway costs

All of the raw coal and coal concentrate which we sell is transported by railway. We are among few Russian coal producers that own and operate an integrated coal transportation network that is directly connected to the federal railway system operated by Russian Railways. Our proprietary coal transportation network is operated by our subsidiary TPTU and includes 15 kilometres of railway which connects our production facilities with the federal railway station at Mezhdurechensk, Kemerovo region of the Russian Federation.

From the Mezhdurechensk railway station, our raw coal and coal concentrate is transported for final delivery to customers by Russian Railways via the federal railway system. Currently, the Russian government regulates rail tariffs and may increase these tariffs in the future, as it has done in the past. As transportation costs are usually paid by our customers, fluctuations of the railway tariffs affect the total cost paid by our customers, and as such, may impact the demand for our coal from any customers located far from our production site.

Exchange rates and inflation rates

Our functional currency is the Russian rouble. Our presentation currency is the U.S. dollar. Our revenues from the domestic sales accounted for 82 per cent. and 79 per cent. of total raw coal and coal concentrate *pro forma* revenues for 2006 and 2005, respectively. Prices for domestic sales are set in roubles. Most of our costs except for certain equipment purchased are also denominated in roubles.

In recent years, the U.S. dollar has depreciated against the rouble. This depreciation has increased our revenues and costs presented in U.S. dollar terms in our consolidated financial statements.

Production facilities maintenance

Our activities are dependent upon our ability to maintain steady production levels. Therefore, the maintenance of our mining equipment and overall facilities, as well as ensuring safe working conditions for our personnel is crucial for the results of our operations. As one of our top priorities, we place an emphasis on keeping our mining equipment in high quality condition and on creating a healthy and safe working environment at each of our facilities through the implementation of stringent safety measures.

Overview of the Pro Forma Results of Operations for the Years ended 31 December 2006 and 2005

The table below sets forth our *pro forma* consolidated income statement for the years ended 31 December 2006 and 2005:

	2006	**2005**	**% change**
	(in thousands of U.S. dollars, except percentages)		
Revenue			
Sale of goods	465,394	531,765	(12)%
Rendering of services	3,395	9,409	(64)%
Cost of revenues	(240,189)	(252,390)	(5)%
Gross profit	**228,600**	**288,784**	**(21)%**
Gross profit margin	**49%**	**53%**	
Selling and distribution costs	(19,235)	(5,255)	266%
General and administrative expenses	(41,198)	(30,190)	36%
Social and social infrastructure maintenance expenses	(6,809)	(7,118)	(4)%
Loss on disposal of property, plant and equipment	(1,591)	(1,188)	34%
Foreign exchange gains/(losses), net	8,975	(468)	n/a%
Other operating income, (expenses), net	(2,145)	(10,307)	(79)%
Dividend income	15	93	(84)%
Interest income	1,187	3,540	(66)%
Interest expense	(18,588)	(9,092)	104%
Profit before income tax	**149,211**	**228,799**	**(35)%**
Profit before income tax margin	**32%**	**42%**	
Income tax expense	(37,678)	(63,360)	(41)%
Profit for the year	**111,533**	**165,439**	**(33)%**
Profit for the year margin	**24%**	**31%**	

Pro forma revenue

The table below summarises our *pro forma* domestic and export revenues by product types for the years ended 31 December 2006 and 2005:

	2006		2005		
	Amount	**% of total revenue**	**Amount**	**% of total revenue**	**% change**
	(In thousands of U.S. dollars, except percentages)				
Sales of coal concentrate Russia	309,298	66%	376,036	69%	(18)%
Sales of coal concentrate export	74,335	16%	60,266	11%	23%
Total sales of coal concentrate	383,633	82%	436,302	80%	(12)%
Sales of raw coal Russia	55,366	12%	41,122	8%	35%
Sales of raw coal export	8,127	2%	49,443	9%	(84)%
Total sales of raw coal	63,493	14%	90,565	17%	(30)%
Sale of other goods and rendering of services	21,663	4%	14,307	3%	51%
Total sales	468,789	100%	541,174	100%	(13)%

Approximately 96 per cent. of our *pro forma* revenues in 2006 were derived from sales of raw coal and coal concentrate. Our *pro forma* coal concentrate sales increased from 80 per cent. of total revenues in 2005 to 82 per cent. in 2006 in line with our strategy of substituting raw coal with higher value-added concentrate.

Pro forma revenues in 2006 decreased by 13 per cent. primarily due to the decline of average prices for coal and coal concentrate despite the fact that our total raw coal production by volume increased by 9 per cent.

The major portion of our *pro forma* raw coal and coal concentrate sales is related to our Russian customers who primarily include large metal and steel plants. Our major customers in 2006 and 2005 were MMK, Evraz and NLMK (including Altay Koks, a subsidiary of NLMK from 2006). Our related party Evraz, through its wholly owned subsidiary Evrazresource, purchases raw coal and coal concentrate for Evraz's metal and steel plants on market terms. Evraz's share in consumption of our products decreased from 28 per cent. to 17 per cent. in 2005 and 2006, respectively. Total consumption of raw coal and coal concentrate by our other two large customers, MMK, NLMK (including Altay Koks, a subsidiary of NLMK from 2006), accounted for 43 per cent. and 29 per cent. of our *pro forma* coal products revenues in 2006 and 2005, respectively.

Pro forma export revenues amounted to U.S.$82.5 million and U.S.$109.7 million in 2006 and 2005, respectively. Ukraine accounts for the major portion of our *pro forma* export sales. Pro forma export sales represent 18 per cent. and 20 per cent. of total coal products revenues in 2006 and 2005, respectively.

The decrease of the *pro forma* coal concentrate revenues was mainly a result of the 24 per cent. decline of prices while the *pro forma* volumes of prepared coal concentrate showed a 16 per cent. increase.

The decrease of the *pro forma* raw coal's share of total *pro forma* revenue continued in 2006 as the higher volumes of raw coal produced by us have been used for the concentrate production. Our *pro forma* revenues from raw coal sales in 2006 were 30 per cent. lower than in 2005.

Pro forma sales of other goods and rendering of services includes railway tariffs recharged to customers, transportation services of TPTU provided to local producers and preparation plants, sales of various goods and service revenues of our Group. Railway tariff represented transportation services of external providers paid by us and subsequently billed to and paid by our customers.

***Pro forma* cost of revenues**

The table below sets forth the breakdown of *pro forma* cost of revenues by major categories for 2006 and 2005:

	2006		2005		
	Amount	**% of production costs**	**Amount**	**% of production costs**	**% change**
	(in thousands of U.S. dollars, except percentages)				
Cost of production					
Depreciation, depletion and amortisation	90,938	38%	87,287	34%	4%
Payroll	47,869	20%	40,877	16%	17%
Materials	41,538	17%	35,280	14%	18%
Mineral resources tax and other taxes in production costs	14,232	6%	15,238	6%	(7)%
Payroll taxes	12,366	5%	11,053	4%	12%
Electricity	10,187	4%	6,297	2%	62%
Preparation services from third parties	5,444	2%	27,914	11%	(80)%
Pension costs	4,759	2%	4,251	2%	12%
Transportation	1,766	1%	14,554	6%	(88)%
Other services and costs	8,424	5%	13,129	5%	(36)%
Cost of production	*237,523*	*100%*	*255,880*	*100%*	*(7)%*
Cost of resold coal and coal concentrate	—		2,117		n/a%
Cost of other resold goods	713		1,131		(37)%
Change in finished goods	1,953		(6,738)		n/a%
Cost of revenues	240,189		252,390		(5)%

Despite significant increase of our *pro forma* raw coal production in 2006, our *pro forma* cost of production, including cost of coal mining and subsequent coal concentrate preparation, decreased over the reviewed period. This decrease is primarily due to reduction of third parties' preparation services and related transportation expenses.

Pro forma depreciation, depletion and amortisation

Depreciation, depletion and amortisation were the major component of our *pro forma* cost of production, comprising 38 per cent. and 34 per cent. in 2006 and 2005, respectively. The depletion charge for the period before 31 May 2006 is calculated using the units of production method.

The table below sets forth our *pro forma* depreciation, depletion and amortisation recognised in production costs, general and administrative expenses and other operating expenses for 2006 and 2005:

	2006	**2005**	**% change**
	(in thousands of U.S. dollars, except percentages)		
Depreciation, depletion (excluding mineral reserve) and amortisation	51,528	46,371	11%
Depletion of mineral reserve	41,018	41,284	(1)%
Total	92,546	87,655	6%

The increase of depreciation, depletion and amortisation in 2006 was caused by the commencement of operations at our preparation plant in the fourth quarter of 2005.

Pro forma payroll and payroll taxes

Payroll and related payroll taxes accounted for 25 per cent. and 20 per cent. of production costs in 2006 and 2005, respectively.

The table below sets forth our *pro forma* payroll costs and related payroll taxes, as included in cost of sale and in general and administrative expenses, for 2006 and 2005:

	2006	**2005**	**% change**
Average total number of employees	7,245	6,840	6%
Total net payroll (in thousands of U.S. dollars)	66,696	56,471	18%
Total payroll taxes (in thousands of U.S. dollars)	15,997	14,264	12%
Average annual payroll per employee, net (in U.S. dollars)	9,206	8,256	12%
Effective payroll tax rate, %	24%	25%	(4)%

The increase of the *pro forma* payroll costs in 2006 resulted from a 6 per cent. increase in the number of our employees, 12 per cent. growth of the average monthly salary of employees reflecting the labour cost inflation in the period and rouble appreciation. The increase in personnel is primarily attributable to the preparation plant recently put into operation and increased number of workers at MUK-96 and OShPU as a consequence of the increased works at our mines.

The payroll taxes contain Unified Social Tax ("**UST**") and mandatory industrial accident and occupational disease insurance charges. UST includes our regular contributions to the State Pension Fund in accordance with the Russian legislation. We have no legal or constructive obligation to pay further contributions in respect of these benefits.

Pro forma preparation services and transportation costs

Pro forma costs associated with coal preparation by third parties included the coal preparation services and transportation expenses related to the delivery of raw coal to the preparation plants. The costs of coal preparation services by third parties accounted for 2 per cent. of the total production costs in 2006 in comparison with 11 per cent. in 2005. Transportation services accounted for 1 per cent. of the total *pro forma* production costs in 2006 as opposed to 6 per cent. in 2005.

Prior to the fourth quarter 2005, all our coal preparation was outsourced to third parties. After Raspadskaya Preparation Plant commenced operations in the fourth quarter 2005, we started coal preparation internally. As a result of this, the volumes of coal preparation outsourced to third parties' plants decreased in 2006, which has positively impacted our results – see – "*Production Costs and Efficiency*" for details.

Pro forma mineral resources tax and other taxes in production costs

Taxes included in *pro forma* production costs primarily include mineral resources tax. Mineral resources tax and other taxes accounted for 6 per cent. of *pro forma* production costs in 2006 and in 2005.

Pro forma materials, electricity and transportation costs

The increase in *pro forma* materials, electricity and transportation costs in 2006 was primarily caused by the higher prices, tariffs and volume of transportation services as compared with 2005. Also, the increased consumption of fuel, lubricants and electricity was caused primarily by the commencement of operations at Raspadskaya Preparation Plant in the fourth quarter of 2005.

Pro forma pension costs

Besides mandatory payments to the State Pension Fund recorded as part of the payroll tax expense, we provide additional pensions and other post-employment benefits to substantially all of our employees in the form of non-obligatory contributions to a non-profit organisation called Pensioner Raspadskoy, which provides regular payments to our retired employees in addition to the obligatory state pension payments.

Prior to 2005, we did not accrue any liabilities in relation to our contributions to Pensioner Raspadskoy. In 2006 and 2005, the liability was recognised in the balance sheet in respect of post-employment benefits which amounted to the present value of the defined benefit obligation at the balance sheet calculated using the projected unit credit method, together with adjustments for unrecognised actuarial gains or losses and past service costs. Also, prior to 2006, we did not accrue any pension liabilities for OShPU, TPTU and Raspadskaya Preparation Plant. The recognition of all these liabilities in 2006 resulted in a significant *pro forma* expense of U.S.$6.2 million recognised in financial statements for this year (including U.S.$4.8 million recorded as part of *pro forma* production costs and U.S.$1.1 million recognised in *pro forma* general and administrative expenses) whereas in 2005 *pro forma* pension costs were U.S.$6.0 million.

Other pro forma services and costs

The decrease in other *pro forma* services and costs was mainly driven by the reduction of third party services rendered to Razrez Raspadsky in relation to the strip mining operations extensively performed in 2005.

Pro forma expenses

Pro forma selling and distribution costs

Pro forma selling and distribution costs increased to approximately U.S.$19.2 million in 2006 from U.S.$5.3 million in 2005 and included customs fees pertaining to export sales as well as various expenses related to transportation of our products, mainly the transportation of coal concentrate sold to NLMK on terms FCA Lipetsk and DAF and FOB for our export sales, the volumes of which have increased.

Pro forma general and administrative expenses

The table below sets forth our *pro forma* general and administrative expenses for 2006 and 2005:

	2006	**% of total**	**2005**	**% of total**	**% change**
	(In thousands of U.S. dollars, except percentages)				
Payroll	18,827	46%	15,594	52%	21%
Property and other taxes	6,500	16%	3,932	13%	65%
Payroll tax	3,631	9%	3,211	11%	13%
Pension costs	1,099	3%	1,187	4%	(7)%
Raw materials	953	2%	809	3%	18%
Insurance	764	2%	605	2%	26%
Depreciation and amortisation	731	2%	368	1%	99%
Electricity	80	0%	80	0%	0%
Other services and costs	8,613	20%	4,404	14%	96%
Total	41,198	100%	30,190	100%	36%

The increase of our *pro forma* general and administrative expenses in 2006 resulted primarily from the increased activity of our managing company, Raspadskaya Coal Company, in particular attributable to costs related to the activities in respect of our initial public offering in November 2006. Higher payroll and payroll tax changes resulted from increased employees' bonuses as well as higher headcount of management, administrative and accounting personnel due to the commencement of Raspadskaya Preparation Plant operations.

The increase in *pro forma* payroll and related taxes in 2006 was primarily due to the increase in the number of Raspadskaya Coal Company employees in comparison to 2005.

Pro forma property and other taxes accounted for 16 per cent. and 13 per cent. of the general and administrative expenses in 2006 and 2005, respectively. Pro forma taxes included *pro forma* property tax, environmental tax, land tax, transportation tax and land lease costs. The increase of *pro forma* taxes in 2006 was due to the increase in the property tax as a result of the commencement of operation by our own preparation plant and a higher pollution tax compared to 2005.

Pro forma general and administrative expenses in 2006 also included pension costs related to the pension contributions that we make to a non-for-profit organisation Pensioner Raspadskoy in addition to obligatory state pension payments. Please see section "*Overview of the Pro Forma Results of Operations for the Years ended 31 December 2006 and 2005 – Pro forma cost of revenues-Pro forma pension costs*" above for further details.

Other *pro forma* services and costs including bank services, information, communication, consulting, audit and other fees increased by 96 per cent. in 2006, which was associated with increased audit and consulting fees during that period and with various one time administrative costs including our initial public offering in November 2006.

Pro forma social and social infrastructure maintenance expenses

Similarly to many of the large Russian production companies, we bear certain social costs and social infrastructure maintenance expenses primarily in the form of donations and assistance to social sphere objects. *Pro forma* social and social infrastructure maintenance expenses slightly decreased from U.S.$7.1 million in 2005 to U.S.$6.8 million in 2006.

Pro forma gain (loss) on disposal of property, plant and equipment

Pro forma loss on disposal of property, plant and equipment was U.S.$1.6 million and U.S.$1.2 million in 2006 and 2005, respectively.

Pro forma foreign exchange gains (losses), net

Pro forma foreign exchange gains and losses relate to translation difference arising from revaluation of assets and liabilities denominated in foreign currencies (primarily U.S. dollar denominated loans) and exchange rate differences on sales and purchase of foreign currencies. Foreign exchange gains in 2006 were due to a translation of the U.S.$300 million loan from Natexis into rouble equivalent.

Pro forma other operating income (expenses), net

Other *pro forma* net operating income (expenses) mainly consist of revenues and costs associated with non-core aspects of our business such as rent and other non-recurring items. Other net operating expenses decreased from U.S.$10.3 million in 2005 to U.S.$2.1 million in 2006. This decrease related to the non-recurring costs incurred on the liquidation of damages caused by a fire in the Raspadskaya mine in June 2005. The cost of liquidation amounted to approximately U.S.$7.6 million in 2005.

Pro forma interest income

Pro forma interest income amounted to U.S.$1.2 million and U.S.$3.5 million in 2006 and 2005, respectively, and related to short-term deposits held in various banks. Deposits were held with Bank of Moscow, CB Garant Invest, Vneshtorgbank and Sberbank and deposits were held for the short-term cash management purposes. The decrease of interest income was due to decrease of cash available for deposits.

Pro forma interest expense

Pro forma interest expense amounted to U.S.$18.6 million and U.S.$9.1 million in 2006 and 2005, respectively. Our *pro forma* interest expense primarily related to interest on loans, which amounts to U.S.$16.4 million and U.S.$8.2 million in 2006 and 2005, respectively. Interest expense related mainly to loans obtained by Raspadskaya from Natexis and by Raspadskaya Preparation Plant at its development stage.

Pro forma income tax expense

Our *pro forma* income tax expense was U.S.$37.7 million and U.S.$63.4 million in 2006 and 2005, respectively. The substantial decrease in income tax was a result of lower *pro forma* profits in 2006.

Pro forma profit for the year

Our *pro forma* profit for the year decreased in 2006 as compared to 2005 and amounted to U.S.$111.5 million vs. U.S.$165.4 million, respectively, reflecting the same trends as *pro forma* gross profit and *pro forma* profit before tax.

Pro forma EBITDA

The following table sets forth our *pro forma* EBITDA[1] calculation for 2006 and 2005:

	2006	2005
	(In thousands of U.S. dollars)	
Net profit	**111,533**	**165,439**
Adjusted for:		
Depreciation, depletion (excluding mineral reserve) and amortisation[2]	51,528	46,371
Depletion of mineral reserve	41,018	41,284
Dividend income	(15)	(93)
Interest income	(1,187)	(3,540)
Interest expense	18,588	9,092
Income tax expense	37,678	63,360
EBITDA	**259,143**	**321,913**
EBITDA, % of revenue	55%	59%

(1) Pro forma EBITDA represents net *pro forma* profit before interest income (expense), dividend income, income taxes and depreciation, depletion and amortisation. We present *pro forma* EBITDA because we consider it an important supplemental measure of our operating performance and believe it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. Pro forma EBITDA has limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for analysis of our operating results as reported under *pro forma* financial statements and historical consolidated IFRS financial statements. We compensate for these limitations by relying primarily on our *pro forma* and historical IFRS operating results and are using *pro forma* EBITDA only as a supplement. Pro forma EBITDA is a measure of our operating performance that is not required by, or presented in accordance with, IFRS. Pro forma EBITDA is not a measurement of our operating performance under IFRS and should not be considered as an alternative to net income, operating income or any other performance measures derived in accordance with IFRS or as an alternative to cash flow from operating activities or as a measure of our liquidity. In particular, *pro forma* EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business.

(2) Depreciation, depletion (excluding mineral reserve) and amortisation for the year ended 31 December 2006 includes charges relating to cost of sales, general and administrative expenses and other operating expenses amounting to U.S.$49.9 million, U.S.$0.7 million and U.S.$0.9 million, respectively. Depreciation, depletion (excluding mineral reserve) and amortisation for the year ended 31 December 2005 includes charges relating to cost of sales and general and administrative expenses amounting to U.S.$46.0 million and U.S.$0.4 million, respectively.

IFRS Historical Results of Operations

Our IFRS historical audited income statements present the financial results and results of operations of Raspadskaya and its subsidiaries. Financial results and results of operations of MUK-96 and Razrez Raspadsky are not included in our historical audited income statements before 31 May 2006 and included from 1 June 2006. Historically, Raspadskaya had significant trading and production operations with MUK-96 and Razrez Raspadsky. On 14 September 2006, we acquired the 100 per cent. equity interest in MUK-96 and its 99 per cent. owned subsidiary Razrez Raspadsky. See section "*The Reorganisation*" above for further details.

We believe that our *pro forma* consolidated financial information form the most relevant basis for the analysis of our results of operations. Our *pro forma* consolidated financial information presents the view of our business taken as a whole while our historical consolidated financial statements provide only a partial view on our business and operating results and shall be analysed only in conjunction with the *pro forma* consolidated financial information.

Overview of the IFRS Historical Audited Results of Operations for the Years ended 31 December 2006 and 2005

The table below sets forth our IFRS historical income statement for the years ended 31 December 2006 and 2005:

	2006	2005	% change
	(In thousands of tonnes, except percentages)		
Revenue	472,090	548,891	(14)%
Cost of revenues	(260,208)	(315,422)	(18)%
Gross profit	**211,882**	**233,469**	**(9)%**
Gross profit margin	**45%**	**43%**	
Selling and distribution costs	(19,235)	(5,255)	266%
General and administrative expenses	(39,391)	(25,587)	54%
Social and social infrastructure maintenance expenses	(6,809)	(7,118)	(4)%
Loss on disposal of property, plant and equipment	(1,591)	(1,188)	34%
Foreign exchange gains	8,006	113	n/a
Other operating income (expenses), net	(2,467)	(9,639)	(74)%
Dividend income	15	93	(84)%
Interest income	1,077	3,294	(67)%
Interest expense	(17,518)	(5,665)	209%
Profit before income tax	**133,969**	**182,517**	**(27)%**
Profit before income tax margin	**28%**	**33%**	
Income tax expense	(33,793)	(49,909)	(32)%
Profit for the year	**100,176**	**132,608**	**(24)%**
Profit for the year margin	**21%**	**24%**	

Revenue

Revenue in 2006 decreased by U.S.$76.8 million, or 14 per cent., to U.S.$472.1 million from U.S.$548.9 million in 2005 primarily due to the fact that average prices for coal and coal concentrate were approximately 22 per cent. lower in 2006 than in 2005 when the prices were at their peak. Approximately 98 per cent. of our revenue in 2006 was derived from the sale of raw coal and coal concentrate. The share of export revenue in raw coal and coal concentrate sales decreased and comprised 20 per cent. and 21 per cent. in 2006 and 2005, respectively.

Revenue shown in the IFRS historical income statement for 2006 is U.S.$3.3 million higher than that shown in the *pro forma* income statement for the same period due to the eliminating in our *pro forma* income statement certain revenues received by Raspadskaya and its subsidiaries from MUK-96 in the period from 1 January 2006 to 31 May 2006.

Cost of revenues

Cost of revenues is primarily comprised of payroll of production personnel and related taxes, materials, depreciation, depletion and amortisation and other services related to our coal mining. The cost of revenue in 2006 decreased by U.S.$55.2 million, or 18 per cent., to U.S.$260.2 million from U.S.$315.4 million in 2005. The decrease was primarily attributable to the eliminating of expenses incurred by Razrez Raspadsky while performing mining and preparation services for Raspadskaya.

Cost of revenues as shown in our IFRS historical income statement is U.S.$20.0 million and U.S.$63.5 million higher 2006 and 2005, respectively, than in the *pro forma* income statements for those periods. This is due to the eliminating of sales of coal concentrate by RFPK to Raspadskiy Ugol and preparation and mining services by Razrez Raspadsky in the *pro forma* income statement for those periods. Since June 2005 RFPK ceased operating as a trade agent of MUK-96 and purchases of coal concentrate were eliminated, and therefore the purchases of those companies were lower in 2006 than in 2005.

Selling and distribution costs

Selling and distributions costs increased to U.S.$19.2 million in 2006 from U.S.$5.3 million in 2005 and included customs fees pertaining to the export sales as well as various expenses related to transportation of our products, mainly the transportation of coal concentrate sold to NLMK on terms FCA Lipetsk and DAF and FOB for our export sales, the volumes of which have increased.

General and administrative expenses

General and administrative expenses primarily include payroll, related taxes of management and administrative and finance personnel, pension costs, property tax, land tax, transportation tax, land lease payments and pollution taxes. General and administrative costs for 2006 increased by U.S.$13.8 million, or 54 per cent., to U.S.$39.4 million from U.S.$25.6 million for 2005. The increase was primarily the result of expanded operations by Raspadskaya Coal Company, the commencement of the Raspadskaya Preparation Plant operations and increased compensation to employees.

General and administrative expenses are higher as shown in our *pro forma* income statement due to additional expenses incurred by administrative and accounting personnel of MUK-96 and Razrez Raspadsky in the period from 1 January 2006 to 31 May 2006.

Social and social infrastructure maintenance expenses

Social and social infrastructure maintenance expenses normally comprise voluntary and discretionary charity and donations to social sphere objects and non-profit organizations, social development funds and assistance to the administration. Social and infrastructure costs for 2006 decreased by U.S.$0.3 million, or 4 per cent., to U.S.$6.8 million from U.S.$7.1 million in 2005.

Other operating income (expenses), net

Other net operating income (expenses) consist primarily of revenues and costs associated with non-core aspects of our business such as rent and various non recurring expenses. Other net operating expenses for 2006 decreased from U.S.$9.6 million in 2005 to U.S.$2.5 million in 2006. This decrease related to the non-recurring costs incurred on the liquidation of damages caused by a fire in the Raspadskaya mine in June 2005. The cost of liquidation amounted to approximately U.S.$7.6 million in 2005.

Interest income

Interest income for 2006 decreased by U.S.$2.2 million, or 67 per cent., to U.S.$1.1 million from U.S.$3.3 million for 2005. The decrease was due to the lower amount of cash available for investing in short-term bank deposits.

Interest expense

Interest expense for 2006 increased by U.S.$11.9 million, or 209 per cent., to U.S.$17.5 million from U.S.$5.7 million for 2005. The primary portion of our interest expense related to the loans obtained by Raspadskaya from Natexis.

Income tax expense

Income tax expense for 2006 decreased by U.S.$16.1 million, or 32 per cent., to U.S.$33.8 million from U.S.$49.9 million for 2005. The decrease was primarily the result of similar decrease in the profits before taxes.

Profit for the year

Profit for 2006 decreased by U.S.$32.4 million, or 24 per cent., to U.S.$100.2 million from U.S.$132.6 million for 2005. The decrease was due to fall in coal prices.

Liquidity and Capital Resources

Our primary sources of liquidity are cash generated from operating activities, debt financing and access to equity capital markets. Our plan going forward is to finance our capital expenditures; interest and dividends primarily out of our operating cash flows, as well as to finance our capital expenditures through additional borrowings.

Our *pro forma* consolidated financial information does not contain a cash flow statement and, therefore, the below analysis is based on the historical consolidated cash flow statement of Raspadskaya. If *pro forma* cash flow statements were prepared, they would significantly differ from the historical consolidated cash flow statement of Raspadskaya.

Analysis of Cash Flows Based On Our Historical Consolidated Financial Statements as of and for the Years Ended 31 December 2006 and 2005

The table below sets forth our IFRS historical cash flow statement for the years ended 31 December 2006 and 2005:

	2006	2005
	(in U.S. dollars thousands)	
Cash and cash equivalents at the beginning of the period	26,946	48,100
Net cash generated from operating activities	178,613	154,583
Net cash used in investing activities	(375,630)	(92,192)
Net cash from (used in) financing activities	214,971	(82,134)
Effect of foreign exchange rate changes on cash and cash equivalents	4,319	(1,411)
Cash and cash equivalents at the end of the period	49,219	26,946

Net cash generated from operating activities

The table below presents the cash flow from operating activities over the analysed periods:

	2006	2005
	(in U.S. dollars thousands)	
Net profit	**100,176**	**132,608**
Adjustments to reconcile net profit to net cash provided by operating activities:		
Depreciation, depletion and amortisation	68,336	30,785
Deferred income tax benefit	(11,141)	(1,575)
(Gain)/loss on disposal of property, plant and equipment	1,591	1,188
Interest income	(1,077)	(3,294)
Interest expense	17,518	5,665
Post-employement benefit expense	5,628	5,729
Other gains and losses	(7,838)	559
Operating cash flow before changes in working capital and provisions	**173,193**	**171,665**
Changes in working capital:		
Inventories	(2,271)	(6,335)
Trade and other receivables	(3,980)	(2,722)
Receivables from/payables to related parties	6,442	15,334
Trade and other payables	(19,387)	(7,774)
Taxes payable	24,616	(15,585)
Net cash flow from operating activities	**178,613**	**154,583**

The continuing decrease of coking coal prices on the domestic market resulted in the U.S.$32.4 million decrease in net profit in 2006 as compared to 2005.

MUK-96 assets acquisition increased the depreciation, depletion and amortisation in 2006 as compared with 2005.

Offset of input VAT related to completed construction projects and favourable changes in the VAT legislation allowed us to improve our operating cash flow.

Net cash flows used in investing activities

The major components of the *pro forma* net cash flow from investing activities are presented in the following table:

	2006	2005
	(in U.S. dollars thousands)	
Purchases of property, plant and equipment	(100,768)	(104,732)
Purchases of subsidiaries from the Company's parent, net of cash acquired	(274,986)	—
Other investing activities, net	124	12,540
Net cash flow from investing activities	**(375,630)**	**(92,192)**

Net cash used in investing activities included purchases of subsidiaries and property, plant and equipment for Raspadskaya Preparation Plant. Net cash in amount of U.S.$275.0 million used in investing activities during 2006 is related to the acquisition of Raspadskaya Preparation Plant, Raspadskaya Coal Company, Raspadskaya Koksovaya and Raspadskiy Ugol from Corber Enterprises Limited for U.S.$306.9 million less cash acquired through acquisition of subsidiaries in amount of U.S.$31.9 million.

Net cash used in financing activities

The major components of the net cash flow from financing activities are presented in the following table:

	2006	2005
	(in U.S. dollars thousands)	
Proceeds from issuance of share capital	1,316	—
Purchases of treasury shares	(1,182)	(1,048)
Proceeds from sale of purchased treasury shares	19,967	—
Proceeds from loans and promissory notes	315,296	52,529
Repayment loans and promissory notes, including interest	(73,930)	(36,459)
Dividends paid	(46,275)	(97,156)
Other financing activities, net	(221)	—
Net cash flow from financing activities	**214,971**	**(82,134)**

Net cash used in financing activities was U.S.$82.1 million during 2005 whereas in 2006 there was a cash inflow amounting to U.S.$215.0 million which was mainly due to credit proceeds from loans. In 2006, credit out payments was considerably higher than in 2005.

Capital Expenditures

The following table sets forth capital expenditures for the years ended 31 December 2006 and 2005:

	2006	2005
	(in U.S. dollars thousands)	
Raspadskaya	53,022	69,317
Raspadskaya Preparation Plant	15,928	21,597
MUK-96	16,265	13,626
Raspadskaya Koksovaya	13,973	10,440
Razrez Raspadsky	11,574	19,866
Other	5,333	3,549
Total capital expenditures	**116,095**	**138,395**

Indebtedness and contractual obligations

The following table sets forth our indebtedness as of 31 December 2006:

	Payments Due By Period		
	Less than 1 year	1-2 years	Total
	(in U.S. dollars thousands)		
Long term debt, including current portion	22,172	34,821	56,993
Short term debt, including interest	302,061	—	302,061
Capital lease obligations	880	—	880
Operating lease obligations	26	—	26
Total	325,139	34,821	359,960

In July 2006, we entered into a U.S.$300.0 million loan agreement with Natexis. This short-term loan is payable by 30 June 2007. We used this loan agreement to pay our U.S.$306.9 million debt to Corber Enterprises Limited for the transfer of the ownership interests in the Acquired Companies. The loan agreement is guaranteed by Evraz. We intend to refinance this loan agreement from the proceeds of the offering of the Notes.

Off-Balance Sheet Arrangements

We do not have off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, revenues and expenses, results of operations, liquidity, capital expenditures, or capital resources.

Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risks with respect to foreign currency exchange rates, interest rates and commodity prices volatility.

Commodity price risk

As we operate in only one business segment we are primarily exposed to the effects of fluctuations in the price of raw coking coal and coal concentrate. As the price for these products is not quoted on international markets, the average prevailing price currently relevant to our business is determined based on the existing contracts for sale and purchase of coking coal in the domestic, Ukrainian, Romanian and Hungarian markets as well as markets of some other countries of Eastern Europe which are the major destinations where our coal is sold.

Our customers primarily operate in the steel industry. The steel market has historically faced cyclical fluctuations which have influenced the results of our operations and are expected to continue to do so in the future. We do not hedge our exposure to price risk and historically have not been involved in transactions with related derivatives.

Foreign currency exchange rate risk

Our principal customers operate in the domestic market and, therefore, most of the sales are priced in roubles. Most of our costs are also incurred in roubles. In the event we continue export sales or expand our export operations, we may be exposed to foreign currencies fluctuations which could affect our results of operations.

Interest rate risk

We are exposed to interest rate risk principally in relation to our outstanding bank debt. The major portion of our debt is short-term. The risk exists that in case of changes in the prevailing market interest rates we will not be able to renegotiate the borrowing terms. We currently do not hedge this risk.

Critical Accounting Policies and Estimates

The preparation of our financial information requires management to make judgments concerning the election of accounting methods, estimates and assumptions that are sensitive to changes in market conditions or other uncertainties that could affect our reported results. The following are what we consider to be our critical accounting policies and the judgments used to develop our reported results. For a summary of all our significant accounting policies, including the critical accounting policies discussed below, see Note 2 to our audited historical consolidated financial information.

Impairment of property, plant and equipment

We assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, we estimate the recoverable amount of the asset. This requires an estimation of the value in use of the cash-generating units (each individual subsidiary) to which the item is allocated. Estimating the value in use requires us to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. No impairment losses were recognised or reversed in the years ended 31 December 2006 and 2005.

Mineral Reserves

Mineral reserves are a material factor in the Group's computation of depreciation, depletion and amortisation charge. The Group estimates its mineral reserves in accordance with the Australasian Code for Reporting of Exploration Results, Mineral Resources and Ore Reserves (the "**JORC Code**"). Estimating reserves in accordance with JORC Code involves some degree of uncertainty. The uncertainty depends mainly on the amount of reliable geological and engineering data available at the time of the estimate and the interpretation of this data, which also requires a degree of subjectivity based on certain assumptions.

The relative degree of uncertainty can be conveyed by placing reserves into one of the principal classifications, either proved and probable reserves or measured and indicated resources. Proved and probable reserves are more certain to be recovered than measured and indicated resources. Estimates of proved and probable reserves are reviewed and revised annually. Revisions occur due to the evaluation or re-evaluation of already available geological, engineering and production data; availability of new data; or changes in underlying assumptions. Proved and probable reserves are used to calculate the unit of production rates for depreciation, depletion and amortisation. The Group has included in proved and probable reserves those quantities that are expected to be extracted during the next 20 years assuming that certain licences will be renewed in 2014. An increase in the Group's license periods and increase in reported proved and probable reserves would generally lead to lower depreciation, depletion and amortisation charge and could materially affect earnings. A reduction in proved and probable reserves will increase depreciation, depletion and amortisation charge, reduce income and could also result in an immediate impairment of mining assets. Given the relatively small number of producing mines and open pit operations, it is possible that any changes in reserve estimates, year on year, could significantly affect prospective charges for depreciation, depletion and amortisation.

Site restoration provisions

The Group review site restoration provisions at each balance sheet date, and adjusts them to reflect the current best estimate in accordance with IFRIC 1 "Changes in Existing Decommissioning, Restoration and Similar Liabilities". The amount recognised as a provision in the best estimate of the expenditure required to settle the present obligation at the balance sheet date. The risk and uncertainties that inevitably surround many events and circumstances are taken into account in reaching the best estimate of a provision. Considerable judgment is required in forecasting future site restoration costs. Future events that may affect the amount required to settle an obligation are reflected in the amount of a provision where there is sufficient objective evidence that they will occur. As of 31 December 2006 and 2005, site restoration provisions that are included in other non-current liabilities were $1,447 and nil, respectively.

Fair values of assets and liabilities acquired in business combinations

We are required to recognise separately, at the acquisition date, the identifiable assets, liabilities and contingent liabilities acquired or assumed in the business combination at their fair values, which involves estimates. Such estimates are based on valuation techniques which require considerable judgment in forecasting future cash flows and developing other assumptions.

Post-employment benefits

We use actuarial valuation method for measurement of the present value of post-employment benefit obligations and related current service cost. This involves the use of demographic assumptions about the future characteristics of current and former employees who are eligible for benefits (mortality, both during and after employment, rates of employee turnover, disability and early retirement, etc.) as well as financial assumptions (discount rate, future salary and benefit levels, expected rate of return on plan assets, etc.).

Operating Environment of the Group and Taxation

Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product and a reduced rate of inflation, Russia continues to institute economic reforms and develop its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As of the date of this document, management believes that its interpretation of the relevant legislation is appropriate and that the Group's tax, currency and customs positions will be sustained.

Allowances

We make allowances for doubtful accounts receivable. Significant judgment is used to estimate doubtful accounts. In estimating doubtful accounts such factors are considered as current overall economic conditions, industry specific economic conditions, historical and anticipated customer performance. Changes in the economy, industry, or specific customer conditions may require adjustments to the allowance for doubtful accounts recorded in the consolidated financial statements.

Deferred income tax assets

Deferred tax assets are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. The estimation of that probability includes judgments based on the expected performance.

New Accounting Standards

The Group has not applied the following IFRSs and IFRIC Interpretations that have been issued but are not yet effective:

- IFRS 7 "Financial Instruments: Disclosures";
- IFRS 8 "Operating Segments";
- IAS 1 (amended 2005) "Presentation of Financial Statements – Capital Disclosures";
- IFRIC 8 "Scope of IFRS 2";
- IFRIC 9 "Reassessment of Embedded Derivatives";
- IFRIC 10 "Interim Financial Reporting and Impairment";
- IFRIC 11 "IFRS 2 – Group and Treasury Share Transactions"
- IFRIC 12 "Service Concessions Arrangements"