Mechel Steel Group OAO
Form F-1/A
October 08, 2004

As filed with the Securities and Exchange Commission on October 8, 2004

Registration No. 333-119497

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

AMENDMENT NO. 2

TO

FORM F-1

REGISTRATION STATEMENT

UNDER THE SECURITIES ACT OF 1933

MECHEL STEEL GROUP OAO

(Exact name of Registrant as specified in its charter)

Russian Federation	**3312**	**None**
(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification No.)**

Krasnopresnenskaya Naberezhnaya 12	**Puglisi & Associates**
Moscow 123610	**850 Library Avenue, Suite 204**
Russian Federation	**Newark, Delaware 19715**
+7-095-258-1828	**+1-302-738-6680**
(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)	**(Name, address, including zip code, and telephone number, including area code, of agent for service)**

with a copy to:

Anna Goldin, Esq.	**Jan A. Castro, Esq.**	**Daniel A. Braverman, Esq.**
Latham & Watkins LLP	**Mechel Steel Group OAO**	**Cleary, Gottlieb, Steen & Hamilton**
Ulitsa Gasheka, 7	**Krasnopresnenskaya Naberezhnaya 12**	**55 Basinghall Street**
Ducat Place II, Suite 900	**Moscow 123610**	**London EC2V 5EH**
Moscow 123056	**Russian Federation**	**United Kingdom**

Russian Federation **+7-095-258-1828** **+44-20-7614-2200**

+7-095-785-1234

Approximate date of commencement of proposed sale to the public: As soon as practicable after this registration statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, check the following box. ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨ ______

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨ ______

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨ ______

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ¨

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered(1)	Proposed maximum offering price per unit(2)	Proposed maximum aggregate offering price(2)	Amount of registration fee(4)
Common shares, nominal value 10 rubles per share(3)	47,871,135	$8.00	$382,969,080	$48,522.18

(1) Includes common shares that (a) are to be offered in the United States by the registrant, (b) are to be offered in the United States by the selling shareholders, (c) may be offered in the United States pursuant to an over-allotment option granted by the selling shareholders to the underwriters and (d) are to be initially sold outside the United States pursuant to Regulation S that may thereafter be resold in the United States in transactions required to be registered under the Securities Act. All common shares being offered will be in the form of American Depositary Shares.
(2) Estimated solely for purposes of calculating the registration fee.
(3) A separate registration statement on Form F-6 has been filed with respect to the registration of ADSs evidenced by American depositary receipts issuable upon the deposit of the common shares registered hereby.
(4) Previously paid.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information contained in this preliminary prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

PRELIMINARY PROSPECTUS Subject to Completion •, 2004

13,875,691 American Depositary Shares

Representing 41,627,073 Common Shares

Each American depositary share, or ADS, represents three common shares of Mechel Steel Group OAO, a public company with limited liability incorporated under the laws of the Russian Federation. We are selling 33,301,659 common shares in the form of ADSs, and the selling shareholders are selling 8,325,414 common shares in the form of ADSs. We will not receive any proceeds from the sale of common shares in the form of ADSs by the selling shareholders. The ADSs will be evidenced by American depositary receipts, or ADRs.

Upon completion of this offering, the principal and selling shareholders will own 85.95% of our shares. If the underwriters over-allotment option is exercised in full, the principal and selling shareholders will own 84.45% of our shares.

Our common shares are listed for trading on the Russian Trading System, or RTS, under the symbol SGML. On September 20, 2004, the last reported sale price per common share on RTS was $3.80, equivalent to a price of $11.40 per ADS. Before this offering, there has been no public market for our ADSs, and the trading price of our common shares on RTS will not necessarily be related to the initial public offering price per ADS. We currently expect that the initial public offering price per ADS in the offering will be between $• and $•. The ADSs have been approved for listing on the New York Stock Exchange under the symbol MTL.

This investment involves a high degree of risk. Please see Risk Factors beginning on page 10 for a discussion of those risks.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Price to Public	Underwriting Discounts	Proceeds to Mechel	Proceeds to Selling Shareholders
Per ADS	$•	$•	$•	$•
Total	$•	$•	$•	$•

The selling shareholders have granted the underwriters a 30-day option to purchase up to an additional 6,244,062 common shares in the form of ADSs at the public offering price per ADS, less the underwriting discount, solely to cover any over-allotments.

The proceeds of this offering will be held in escrow and escrow-type accounts, and trading in the ADSs on the New York Stock Exchange will be subject to cancellation until the placement report for the common shares being offered by us is registered by the Russian Federal Service for the Financial Markets. If the placement report is not registered within 60 days after the closing date (or such later date as we and the selling shareholders agree with the underwriters), we will refund the public offering price, together with interest, if any, to the holders of the ADSs at the time of such cancellation, regardless of the then-prevailing market price of the ADSs.

The underwriters expect to deliver the ADRs evidencing the ADSs to purchasers on or about •, 2004.

Sole Global Coordinator and Sole Bookrunner

UBS Investment Bank

JPMorgan **Morgan Stanley**

Troika Dialog

The date of this prospectus is •, 2004

You should rely only on the information contained in this document or to which we have referred you. We have not authorized anyone to provide you with different information. This document may only be used where it is legal to sell these securities. The information in this document is accurate only as of the date of this prospectus.

TABLE OF CONTENTS

Our business consists of two segments: steel and mining. References in this prospectus to segment revenues are to revenues of the segment excluding intersegment sales, unless otherwise noted.

In May 2004, we acquired a controlling stake in Izhstal OAO, a Russian specialty steel producer. For purposes of describing our market position in periods prior to May 2004 in this prospectus, we include Izhstal s market shares.

In this prospectus, references to U.S. dollars or $ are to the currency of the United States, and references to rubles are to the currency of the Russian Federation. The term tonne as used herein means a metric tonne. A metric tonne is equal to 1,000 kilograms or 2,204.62 pounds.

This document is only being distributed to and is only directed at persons who are outside the United Kingdom or to investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (all such persons together being referred to as relevant persons). The ADSs are only available to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such ADSs will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely on this document or any of its contents.

None of the ADSs has been or will be qualified by prospectus for sale to the public in Canada under applicable Canadian securities laws and, accordingly, any offer or sale of the ADSs in Canada will be made pursuant to an exemption from the applicable prospectus filing requirements, and otherwise in compliance with applicable Canadian laws. Canadian investors should refer to the section of this prospectus entitled Information for Canadian Investors, and Ontario purchasers in particular should refer to Underwriting Information for Canadian Investors Statutory Rights of Action (Ontario Purchasers).

In connection with this offering, UBS Limited or any person acting for UBS Limited may over-allot or effect transactions with a view to supporting the market price of the common shares or ADSs at a level higher than that which might otherwise prevail for a limited period after the issue date. However, there is no obligation on UBS Limited or its agent or agents to do this. Such stabilizing, if commenced, may be discontinued at any time, and must be brought to an end after a limited period.

Prospectus summary

This summary highlights information that we present more fully elsewhere in this prospectus. Because it is a summary, it does not contain all of the information that you should consider before investing. You should read the entire prospectus carefully, including the information discussed in Risk Factors and Cautionary Note Regarding Forward-Looking Statements. Unless the context otherwise requires, references to Mechel, we, us or our refer collectively to Mechel Steel Group OAO and its subsidiaries. Certain steel- and mining-related terms used in this prospectus are defined in Glossary.

OUR COMPANY

We are a low-cost integrated steel and mining group focused on the production of steel long products, as well as mining products such as coal, iron ore and nickel. In 2003 and in the first half of 2004, we had revenues of $2.05 billion and $1.63 billion, respectively. We are the largest and most comprehensive producer of specialty steels and alloys in Russia, producing 52% of total Russian specialty steel output, over three times as much as our nearest competitor. We are also the second largest producer of long products in Russia.

Our steel business comprises the production and sale of semi-finished steel products, carbon and specialty long products, carbon and stainless flat products and value-added downstream metal products including hardware, stampings and forgings. Our steel business also produces significant amounts of coke, both for internal use and for sales to third parties.

We have substantial coal, iron ore and nickel mining interests in Russia and Kazakhstan, with the flexibility to supply our own steel production or sell to third parties depending on price differentials between purchases from local suppliers and sales to foreign and domestic customers. We are capable of internally sourcing all of the coking coal, 92% of the iron ore and 55% of the nickel requirements of our steel segment, assuming in the case of iron ore that third parties process certain quantities of our iron ore concentrate into sinter and pellets. In addition, we are the only specialty steel manufacturer in the world capable of internally sourcing all three of these raw materials. We were the second largest producer of coking coal in Russia in 2003, with a 12% market share. We also control 24% of the coking coal washing capacity in Russia.

Additionally, we own 17.1% of the common shares of Magnitogorsk Iron and Steel Works OAO, or MMK, Russia s largest producer of flat products, with reported revenues of $3.05 billion and $2.17 billion in 2003 and in the first half of 2004, respectively, under International Financial Reporting Standards.

STRATEGY

Our goal is to expand our position in Russia as a leading supplier of carbon long products and as the leading supplier of specialty long products, to further develop our position as a competitive exporter of these products, to expand our mining business and to capitalize on the synergies deriving from our status as an integrated group. We also intend to leverage our core businesses, where appropriate, with acquisitions of value-added downstream businesses.

The key elements of our strategy include the following:

- Ø *Expand our Position as a Leading Producer of Carbon Long Products in Russia.* We have already built a solid presence in this sector, including a market-leading position in engineering steel and strong sales in rebar and wire rod. We intend to improve these positions further, including through the addition of substantial new production capacity achieved by targeted, cost-effective capital expenditures. We plan to increase our raw steel and rolled steel production capacity from

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6.3 million and 5.0 million tonnes in 2004, respectively, to 8.2 million and 7.1 million tonnes in 2007, respectively. Additionally, we seek to benefit from the following factors in Russia:

If the economy continues to expand, the demand for long products, particularly in the construction industry, should increase, providing us with additional sales opportunities.
Substantial infrastructure repairs and industrial upgrade needs should also drive demand for our products.

Ø *Develop and Expand our Position as a High-Quality, Low-Cost Producer of Specialty Long Products.* We are Russia s primary producer of specialty long products. We believe that this higher-margin business provides us with substantial opportunities to increase our revenues and profitability for the following reasons:

Our low-cost production provides us with a competitive base for expanding our market share in Europe, Asia and the CIS countries.
The Russian market for specialty long products has considerable room for growth if demand from domestic engineering and manufacturing sectors recovers from historic post-Soviet lows in the past few years.

Ø *Expand our Mining Business.* We intend to build on our substantial mining experience to achieve the following goals:

Develop our existing coal and iron ore reserves, particularly in order to sell more high-quality coking coal and iron ore concentrate to third parties. We plan to increase our coal production from approximately 15.2 million tonnes in 2004 to 16.6 million tonnes in 2007, and our iron ore concentrate production from approximately 4.0 million tonnes in 2004 to 5.0 million tonnes in 2007.
Make selective acquisitions of coal and other mining enterprises, including new subsoil licenses, particularly in Russia and other CIS countries, as strategic opportunities present themselves.
Maintain our flexibility to internally source raw-material inputs for our steel-making business, depending on price differentials between purchases from local suppliers and sales to foreign and domestic customers.

Ø *Enhance our Position as a Low-Cost Producer.* We intend to further increase our efficiency and reduce our manufacturing costs by:

Selectively investing in technology and capital improvements, including expanding our use of continuous casters in our steel-making.
Preserving our cost advantages in our labor, raw materials and energy inputs.
Achieving additional savings by fully integrating recent acquisitions into our operations.

Ø *Further Capitalize upon Synergies between our Core Businesses.* In addition to synergies deriving from our status as an integrated group, we believe that additional cost savings and opportunities will arise as we benefit from economies of scale and continue to integrate recent acquisitions, in particular by implementing improvements in working practices and operational methods. We regularly evaluate the manner in which our subsidiaries source their raw material needs and transfer products within the group in order to operate in the most efficient way, and we expect to identify and take advantage of further synergies between our core businesses.

Ø *Selectively Expand our Downstream Capacity.* We intend to continue to selectively acquire value-added downstream businesses such as hardware, stampings and forgings producers to help us reach our customer base, including in new markets. This downstream integration:

Is a logical extension of our specialty and low-carbon long product lines, representing a higher-margin, next value-added step for products that we already manufacture.
Is in a market less cyclical than the upstream market, reducing our exposure to market downturns.
Moves us closer to our final customers, enabling us to better understand customer needs, influence buyer behavior and respond quickly to change.

Ø *Selectively Expand our Internal Logistics Capabilities.* We intend to selectively expand our internal logistics capabilities, currently centered on our railway freight and forwarding company, and enhanced by our recent acquisition of Port Posiet, located on the Sea of Japan, to help us to optimize our transportation expenses.

Ø *Maintain Strong Export Sales.* We intend to maintain our strong relationships with our significant export customers. Although we are focused on maintaining our market position within Russia, export sales, which constituted 55% of our total sales in the first half of 2004, allow us to diversify our sales and reduce our reliance on the Russian market in the event that it were to experience a downturn.

Implementation of these strategies is subject to a number of risks. See Risk Factors for a description of these risks.

CORPORATE INFORMATION

Mechel Steel Group OAO is an open joint stock company incorporated under the laws of the Russian Federation. We are a holding company and conduct our business through a number of subsidiaries. See Business and Management s Discussion and Analysis of Financial Condition and Results of Operations. We are registered with the Ministry of Taxes and Duties of the Russian Federation under the state registration number 103770301896. Our principal executive offices are located at Krasnopresnenskaya Naberezhnaya 12, Moscow 123610, Russian Federation. Our telephone number is +7-095-258-1828. Our Internet address is www.mechel.com. Information posted on our website is not a part of this prospectus.

The offering

ADSs representing common shares offered by us	11,100,553 ADSs
ADSs representing common shares offered by the selling shareholders	2,775,138 ADSs
Over-allotment option	The selling shareholders have granted to the underwriters a 30-day option to purchase up to an additional 2,081,354 ADSs representing common shares to cover over-allotments, if any.
ADSs	Each ADS represents the right to receive three common shares (subject to certain restrictions as described under Escrow of proceeds and registration of placement report below). The ADSs are evidenced by American depositary receipts, or ADRs.
Lock-up	We and our selling shareholders will agree, subject to certain conditions, not to issue, transfer or dispose of, directly or indirectly, any shares or ADSs or any securities convertible into or exercisable or exchangeable for shares or ADSs, for a period of 180 days after the date of this prospectus, nor to allow our affiliates to do so, without the prior written consent of UBS.
Use of proceeds	The net proceeds we will receive from the offering will be approximately $• million, assuming an offering price equal to the mid-point of the estimated price range. This amount represents net proceeds after deducting estimated discounts and fees and expenses incurred in connection with the offering. We expect to use the net proceeds from this offering for the following purposes: $• million for capital expenditures, including the purchase of equipment and modernization of facilities; and $• million for acquisitions of additional operations and subsoil licenses. We will not receive any of the proceeds from the sale of ADSs representing common shares offered by the selling shareholders. See Use of Proceeds and Principal and Selling Shareholders for additional information.
Proposed NYSE symbol	MTL

Settlement, delivery and trading	You must pay for the ADSs in same-day funds in U.S. dollars on the closing date of this offering, which is expected to be on or about •, 2004. The shares will be delivered to a custodian for Deutsche Bank Trust Company Americas, as depositary, on the closing date, and the depositary will issue the ADSs, subject to cancellation in the circumstances described in Escrow of proceeds and registration of placement report below. The depositary will initially issue the ADSs in the form of a single global ADR registered in the name of a nominee of The Depository Trust Company, or DTC. You will hold beneficial interests in the ADSs through DTC, and DTC and its direct and indirect participants will record your beneficial interests in their books. We anticipate that trading in the ADSs sold in this offering on the NYSE will commence on a customary basis pursuant to normal settlement procedures on the closing date, but the ADSs will remain subject to cancellation in the circumstances described in Escrow of proceeds and registration of placement report below.
Escrow of proceeds and registration of placement report	The proceeds of this offering will be held in escrow and escrow-type accounts and trading in the ADSs on the NYSE will be subject to cancellation until the placement report for the common shares being offered by us is registered by the Federal Service for the Financial Markets. If the placement report is not registered within 60 days after the closing date (or such later date as we and the selling shareholders agree with the underwriters), we and the selling shareholders will refund the public offering price, together with interest, if any, accrued on the escrowed proceeds to the holders of the ADSs at the time of such cancellation, regardless of the then-prevailing market price of the ADSs. Such return of funds may be delayed due to Russian currency control regulations and may be prevented if there is a change in such regulations. Until the registration of the placement report by the Federal Service for the Financial Markets, you will not be entitled to instruct the depositary to exercise any voting rights on your behalf as our shareholder, and the depositary and its nominee will not be entitled to exercise any voting rights as a shareholder.

	You may not withdraw our shares or other property on deposit with the depositary in respect of the ADSs sold in this offering prior to the registration of the placement report with the Federal Service for the Financial Markets.
	See Escrow of Proceeds and Registration of Placement Report for additional information.
Risk Factors	You should carefully consider all the information in this prospectus. In particular, you should evaluate the information set forth in the section of the prospectus entitled Risk Factors beginning on page 10 before deciding whether to invest in our common shares and ADSs.

Summary consolidated financial data

The financial data set forth below as of December 31, 2003, 2002 and 2001, and for the years then ended have been derived from our audited consolidated financial statements. The financial data set forth below as of June 30, 2004 and 2003, and for the six-month periods then ended have been derived from our unaudited interim consolidated financial statements. Our reporting currency is the U.S. dollar and we prepare our consolidated financial statements in accordance with U.S. GAAP.(1) The unaudited interim consolidated financial statements reflect all normal and recurring adjustments that are necessary for a fair presentation of the financial position and results of operations for the interim periods presented. Results of operations for the six-month period ended June 30, 2004, are not necessarily indicative of results for the full year ended December 31, 2004, for any other interim period or for any future fiscal year. The financial data for 1999 and 2000 are not presented, as financial statements for these years are not available without unreasonable effort and expense.

Our results of operations for the periods presented are significantly affected by acquisitions. Results of operations of these acquired businesses are included in our consolidated financial statements for the periods after their respective dates of acquisition. The financial data below should be read in conjunction with, and are qualified in their entirety by reference to, our consolidated financial statements and related notes included elsewhere in this prospectus and in Management s Discussion and Analysis of Financial Condition and Results of Operations.

	Six months ended June 30,		Year ended December 31,		
	2004	2003	2003	2002	2001
	(in thousands of U.S. dollars, except per share data)				
Consolidated income statement data					
Revenue, net	1,630,063	930,595	2,050,088	1,314,149	1,019,726
Cost of goods sold	(985,370)	(647,809)	(1,440,053)	(947,527)	(721,089)
Gross margin	644,693	282,786	610,035	366,622	298,637
Selling, distribution and operating expenses	(295,587)	(193,430)	(417,259)	(277,478)	(193,853)
Operating income	349,106	89,356	192,776	89,144	104,784
Other income and expense, net	(12,630)	(5,866)	(20,018)	(18,083)	(12,178)
Income before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principle	336,476	83,490	172,758	71,061	92,606
Income tax expense	(74,100)	(23,135)	(47,759)	(2,653)	(30,184)
Minority interest in loss (income) of subsidiaries	(7,920)	6,632	18,979	10,433	(15,521)
Income from continuing operations	254,456	66,987	143,978	78,841	46,901
Loss from discontinued operations, net of tax		(1,317)	(2,422)	(1,835)	(735)
Extraordinary gain, net of tax		5,740	5,740	1,388	1,252
Changes in accounting principle, net of tax		3,670	(3,788)	10,859	
Net income	254,456	67,740	143,508	89,253	47,418
Earnings per share from continuing operations	0.69	0.18	0.39	0.24	0.21
Loss per share effect of discontinued operations			(0.01)	(0.01)	(0.01)
Earnings per share effect of extraordinary gain		0.02	0.02	0.01	0.01
Earnings per share effect of a changes in accounting principle		(0.01)	(0.01)	0.03	0.00

Net income per share	0.69	0.18	0.39	0.27	0.21
Cash dividends per share[(2)]	0.00		0.07	0.04	0.04
Weighted average number of shares outstanding	367,150,968	366,178,815	366,178,815	333,243,450	225,271,391

	Six months ended June 30, 2004	Six months ended June 30, 2003	Year ended December 31, 2003	Year ended December 31, 2002	Year ended December 31, 2001
	(in thousands of U.S. dollars, except per share data)				
Steel segment income statement data					
Revenue, net[3]	1,307,903	778,846	1,678,395	1,050,554	680,314
Cost of goods sold[3]	(964,118)	(572,817)	(1,247,380)	(801,481)	(546,885)
Gross margin	343,785	206,029	431,015	249,073	133,429
Selling, distribution and operating expenses	(180,071)	(145,147)	(301,689)	(194,341)	133,273
Operating income	163,714	60,882	129,326	54,732	155
Mining segment income statement data					
Revenue, net[3]	522,594	251,027	599,756	372,216	339,971
Cost of goods sold[3]	(221,686)	(174,270)	(420,736)	(254,667)	(174,763)
Gross margin	300,908	76,757	179,020	117,549	165,208
Selling, distribution and operating expenses	(115,516)	(48,283)	(115,570)	(83,137)	60,580
Operating income	185,392	28,474	63,450	34,412	104,627
Consolidated balance sheet data (at period end)					
Total assets	2,336,233	n/a	1,834,509	1,387,378	1,116,473
Shareholders equity	705,903	n/a	448,826	278,051	195,122
Long-term debt, net of current portion	152,583	n/a	122,311	36,496	16,525
Consolidated cash flows data					
Net cash provided by operating activities	207,960	43,535	119,466	81,069	34,751
Net cash used in investing activities	(207,805)	(49,963)	(209,901)	(86,633)	(93,068)
Net cash provided by financing activities	43,843	19,162	103,079	3,422	65,701
Non-U.S. GAAP measures[4]					
Consolidated EBITDA	420,818	157,307	341,484	207,452	105,506
Steel segment EBITDA	206,739	116,420	245,832	133,448	2,976
Mining segment EBITDA	214,080	40,887	95,652	74,004	102,529

(1) The value of property, plant and equipment pertaining to non-controlling shareholders in the accounting for minority interests resulting from acquisitions of various subsidiaries has been recorded at appraised values rather than at historical cost as required by U.S. GAAP.

(2) Mechel Steel Group declared a dividend of 149 million rubles (or approximately $5.2 million) on June 24, 2004. Certain companies in our group paid dividends to our controlling shareholders in amounts of $26.3 million, $13.4 million and $8.8 million in the years ended December 31, 2003, 2002 and 2001, respectively.

(3) Segment revenues and cost of goods sold include intersegment sales.

(4) EBITDA represents net income before interest expense, income taxes and depreciation, depletion and amortization. We present 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. We also present EBITDA by segment because our overall performance is best explained with reference to results of each segment.

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 U.S. GAAP. Some of these limitations are as follows:

EBITDA does not reflect the impact of financing costs, which are significant and could further increase if we incur more debt, on our operating performance.

EBITDA does not reflect the impact of income taxes on our operating performance.

EBITDA does not reflect the impact of depreciation, depletion and amortization on our operating performance. The assets of our businesses which are being depreciated, depleted and/or amortized (including, for example, our mineral reserves) will have to be replaced in the future and such depreciation, depletion and amortization expense may approximate the cost to replace these assets in the future. By excluding such expense from EBITDA, EBITDA does not reflect our future cash requirements for such replacements.

Other companies in our industry may calculate EBITDA differently or may use it for different purposes than we do, limiting its usefulness as a comparative measure.

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We compensate for these limitations by relying primarily on our U.S. GAAP operating results and using EBITDA only supplementally. See our consolidated income statements and consolidated statements of cash flows included elsewhere in this prospectus.

EBITDA is a measure of our operating performance that is not required by, or presented in accordance with, U.S. GAAP. EBITDA is not a measurement of our operating performance under U.S. GAAP and should not be considered as an alternative to net income, operating income or any other performance measures derived in accordance with U.S. GAAP or as an alternative to cash flow from operating activities or as a measure of our liquidity. In particular, EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business.

Reconciliation of EBITDA to net income is as follows for the periods indicated:

	Six months ended June 30,		Year ended December 31,		
	2004	2003	2003	2002	2001
	(in thousands of U.S. dollars)				
Consolidated EBITDA reconciliation					
Net income	254,456	67,740	143,508	89,253	47,418
Add:					
Depreciation, depletion and amortization	62,240	46,185	101,689	78,773	13,378
Interest expense	30,022	20,247	48,528	36,773	14,526
Income taxes	74,100	23,135	47,759	2,653	30,184
Consolidated EBITDA	420,818	157,307	341,484	207,452	105,506
Steel segment EBITDA reconciliation					
Net income	91,542	53,551	114,011	57,977	(16,924)
Add:					
Depreciation, depletion and amortization	36,574	32,490	67,272	49,728	154
Interest expense	23,460	17,638	38,363	30,416	11,708
Income taxes	55,163	12,741	26,186	(4,673)	8,038
Steel segment EBITDA	206,739	116,420	245,832	133,448	2,976
Mining segment EBITDA reconciliation					
Net income	162,915	14,189	29,497	31,274	64,341
Add:					
Depreciation, depletion and amortization	25,666	13,695	34,417	29,045	13,224
Interest expense	6,562	2,609	10,165	6,357	2,818
Income taxes	18,937	10,394	21,573	7,328	22,146
Mining segment EBITDA	214,080	40,887	95,652	74,004	102,529

Risk factors

Investment in our ADSs involves a high degree of risk. You should carefully consider the risks described below and the other information contained in this prospectus before making a decision to invest in our common shares and ADSs. Any of the following risks could adversely affect our business, financial condition and results of operations, in which case the trading price of our ADSs could decline and you could lose all or part of your investment.

RISKS RELATING TO OUR BUSINESS AND INDUSTRY

We operate in a cyclical industry, and any local or global downturn in the steel industry may have an adverse effect on our results of operations and financial condition.

The steel industry is cyclical in nature because the industries in which steel customers operate are cyclical and sensitive to changes in general economic conditions. The demand for steel products thus generally correlates to macroeconomic fluctuations in the economies in which steel producers sell products, as well as in the global economy. The prices of steel products are influenced by many factors, including demand, worldwide production capacity, capacity-utilization rates, raw-material costs, exchange rates, trade barriers and improvements in steel-making processes. Steel prices have experienced, and in the future may experience, significant fluctuations as a result of these and other factors, many of which are beyond our control.

Our mining business also sells significant amounts of coal, iron ore and nickel to third parties. Cyclical and other uncontrollable changes in world market prices of these commodities could affect the results of our mining activities. The changes in these prices result from factors, such as demand and transportation costs, which are beyond our control. Prices of these commodities have varied significantly in the past and could vary significantly in the future. Prolonged declines in world market prices for the commodities we sell to third parties would have a material adverse effect on our revenues. A decline in steel prices could also harm our customers for these commodities.

We derived approximately 39% and 49% of our total revenues from sales to customers in Russia in the first half of 2004 and in 2003, respectively. The Russian economy has experienced significantly fluctuating growth rates over the past 10 years. From 1994 to 1998, the Russian economy contracted in real terms at an average rate of 3.7% per year; after the Russian crisis in 1998, the economy recovered and grew in real terms at an average rate of 6.7% per year from 1999 to 2003. Russian production of steel also suffered a substantial decline from over 77 million tonnes in 1991 to 44 million tonnes in 1998, but then recovered to 61 million tonnes in 2003. Further, our products in Russia are mainly used in the engineering, construction and automotive industries, which are particularly vulnerable to general economic downturns. In addition to Russia, Asia and the Middle East are also large destinations for our products, and these areas, like Russia, face greater risks of volatility. Accordingly, any significant decrease in demand for steel products or decline in the price of these products in Russia or other emerging market economies could result in significantly reduced revenues, thereby materially adversely affecting our results of operations and financial condition.

The steel industry is highly competitive, and we may not be able to compete successfully.

We face competition from domestic and foreign steel manufacturers, many of which have greater resources. A number of our Russian competitors are undertaking modernization and expansion plans, which may make them more efficient or allow them to develop new products. For example, it has been reported that MMK intends to spend 75 million to install long products production capacity sufficient to produce 1.5 million tonnes of long products annually commencing in 2005.

We also face price-based competition from steel producers in emerging market countries, including, in particular, Ukraine. Recent consolidation in the steel sector globally has also led to the creation of several very large steel producers, each with greater financial resources and more extensive global operations than Mechel. Moreover, the steel industry suffers from production overcapacity. Increased competition could result in more competitive pricing and reduced profitability.

Successful implementation of our strategy to expand our specialty long product sales depends on our ability to increase our export sales of these products.

While we expect continued growth of demand in the Russian market for specialty long products, our strategy to expand these sales substantially is dependent on our ability to increase our exports of these products to other countries, particularly the European Union, or EU, countries. We face a number of obstacles to this strategy, including trade barriers and sales and distribution challenges.

We will require a significant amount of cash to fund our capital improvements program. Our ability to generate cash or obtain financing depends on many factors beyond our control.

The total cost of our capital improvements over the next five years is expected to be approximately $900 million. Most of our current borrowing is from Russian banks. In the future, we expect to rely to a greater extent than currently on foreign capital markets and other foreign financing sources for our capital needs. It is possible that these foreign sources of financing, as well as domestic sources, may not be available in the future in the amounts we require or at an acceptable cost. See Risks Relating to the Economic Environment in Russia Emerging markets such as Russia are subject to greater risks than more developed markets, and financial turmoil in any emerging market could disrupt our business, as well as cause the price of our ADSs to suffer and Risk Relating to the Economic Environment in Russia The Russian banking system remains underdeveloped, and another banking crisis could place severe liquidity constraints on our business.

Our business strategy foresees additional acquisitions and continued integration, and we may fail to identify suitable targets, acquire them on acceptable terms or successfully integrate them.

Our strategy relies on our status as an integrated steel and mining group, which allows us to benefit from economies of scale, realize synergies, better satisfy the needs of our domestic and international steel customers and compete effectively against other steel producers. We also intend to enhance the profitability of our business by applying our integration strategy to a larger asset base and, towards that end, we need to identify suitable targets that would fit into our operations, acquire them on acceptable terms and successfully integrate them.

The acquisition and integration of new companies pose significant risks to our existing operations, including:

additional demands placed on our senior management, who are also responsible for managing our existing operations;
increased overall operating complexity of our business, requiring greater personnel and other resources;
significant, initial cash expenditures to integrate new acquisitions;

- incurrence of debt to finance acquisitions and higher debt service costs related thereto; and
- strains on our labor force as production may be shifted to new companies or locations to optimize our overall production.

Moreover, the integration of new businesses may also be difficult for a variety of reasons, including differing culture or management styles, poor records or internal controls and inability to establish control over cash flows. For example, regional governments have special perpetual rights, or a golden share, in our subsidiaries Beloretsk Metallurgical Plant and Izhstal, giving them the right to veto certain shareholder decisions and appoint a voting representative on the board of directors of these subsidiaries. The shareholder decisions that may be vetoed by the regional governments are as follows:

- approval of amendments and supplements to the company s charter or approval of a new version of the charter;
- reorganization of the company;
- liquidation of the company;
- changes in the charter capital of the company; and
- approval of major and interested party transactions.

Furthermore, even if we are successful in integrating new businesses, expected synergies and cost savings may not materialize, resulting in lower than expected profit margins.

Our independent registered public accounting firm reported material weaknesses in our internal control and we may not be able to remedy these material weaknesses or prevent future weaknesses. If we fail to maintain effective internal control, we may not be able to accurately report our financial results or prevent fraud. As a result, potential shareholders could lose confidence in our financial reporting, which would harm our business and the trading price of our shares and ADSs.

We have in the past identified, and may in the future identify, areas of our internal control over financial reporting that need improvement. In connection with their audit of our consolidated financial statements for the year ended December 31, 2003, our independent registered public accounting firm reported material weaknesses in our internal control. The Public Company Accounting Oversight Board, or PCAOB, has defined a material weakness as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim statements will not be prevented or detected. Specifically, our financial statement close process and the transformation of our Russian statutory financial statements into U.S. GAAP consolidated financial statements has not reduced to an acceptably low level the risk that errors in amounts that would be material in relation to those financial statements may occur and may not be detected within a timely period by management in the normal course of business. These deficiencies were considered in determining the nature, timing and extent of the procedures performed by our independent registered public accounting firm in their audit of our annual consolidated financial statements, and did not affect the report of our independent registered public accounting firm on our annual consolidated financial statements included herein.

Our business consists of many operating subsidiaries located across several time zones in Russia and Eastern Europe, each of which prepares stand-alone financial statements for statutory purposes under Russian accounting standards or other local country accounting standards. The preparation of our U.S. GAAP consolidated financial statements is a manual process which involves (1) the transformation of these statutory financial statements into U.S. GAAP consolidated financial statements through accounting adjustments and (2) a consolidation of all these stand-alone statutory financial statements. This process is complicated, time-consuming and requires significant attention and time from our senior

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accounting personnel at our subsidiaries and corporate headquarters. Moreover, U.S. GAAP accounting adjustments tend to result in large differences between our statutory and U.S. GAAP financial position and results of operations, and go through substantial senior management review. These difficulties are compounded by the fact that most of our operating subsidiaries were recently acquired and, although we continue to successfully integrate them into our business, significant differences exist in the accounting practices and the level of experience and qualifications of their respective accounting personnel. Most importantly, we undertook the process of preparing U.S. GAAP consolidated financial statements for the first time in the beginning of 2003, resulting in our 2001 and 2002 U.S. GAAP consolidated financial statements being completed in early 2004. In summary, our system of internal control over financial reporting is not designed for the preparation of U.S. GAAP consolidated financial statements and significant adjustments were required to prepare our U.S. GAAP consolidated financial statements for each of the three years ended December 31, 2003, and for the six-month periods ended June 30, 2004 and 2003.

We have taken several steps to correct the material weaknesses reported by our independent registered public accounting firm. In the past year, we hired six accounting personnel who are ACCA-qualified or have passed the Uniform CPA examination administered by American Institute of Certified Public Accountants with experience at other NYSE-listed Russian companies and at Big Four accounting firms in order to improve our U.S. GAAP capabilities. We engaged external consultants to help us correct the material weaknesses and improve our internal control over financial reporting. We have implemented a uniform framework for all our subsidiaries to report their financial information for the close and transformation processes for the preparation of U.S. GAAP consolidated financial statements. Having recently completed the 2003 and six months 2004 U.S. GAAP consolidated financial statements, our accounting personnel at all of our subsidiaries are becoming increasingly familiar with U.S. GAAP and the process of preparing U.S. GAAP consolidated financial statements, which should result in improvements in this process in the future. In addition, our management believes that each of our subsidiaries has effective internal controls (including closing processes) to produce reliable statutory financial statements. Our senior management also devotes significant attention to the preparation of U.S. GAAP consolidated financial statements in order to mitigate the potential effects of the reported material weaknesses.

Notwithstanding the steps we are taking to address these issues, we may not be successful in remedying these material weaknesses or preventing future material weaknesses. We will not be able to obtain the view of our independent registered public accounting firm on whether we have successfully remedied these material weaknesses until our independent registered public accounting firm conducts its audit of our U.S. GAAP consolidated financial statements for the year ending December 31, 2004, which will be completed during the first half of 2005. If we are unable to remedy the material weaknesses, we may not be able to prevent or detect a material misstatement of our annual or interim U.S. GAAP consolidated financial statements.

In addition, any failure to implement new or improved internal controls, or resolve difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our shares and ADSs.

We depend on key accounting staff for the preparation of U.S. GAAP financial information. Given the competition for such personnel and the remote locations of our subsidiaries, our key accounting staff may leave our company, which could disrupt our ability to timely and accurately report U.S. GAAP financial information.

Our subsidiaries maintain their books and records in local currencies and prepare accounting reports in accordance with local accounting principles and practices. In particular, each of our Russian subsidiaries maintains its books in rubles and prepares separate unconsolidated financial statements in accordance with Russian accounting standards. For every reporting period, we translate, adjust and combine these standalone Russian statutory financial statements to prepare consolidated U.S. GAAP financial statements. This is a difficult task requiring U.S. GAAP-experienced accounting personnel at each of our subsidiaries and at our Moscow corporate offices. While we have hired accounting personnel who are CPAs and ACCA-qualified in the past year, Russia has available only a small number of accounting personnel with U.S. GAAP expertise. Moreover, there is an increasing demand for such personnel as more Russian companies are beginning to prepare financial statements on the basis of U.S. GAAP or other international standards. Such competition, combined with the remote locations of our subsidiaries which such personnel may not find suitable in comparison to other opportunities, makes it difficult for us to hire and retain such personnel, and our key accounting staff may leave our company. Under these circumstances, we may have difficulty in remedying the material weaknesses identified by our independent registered public accounting firm and in the timely and accurate reporting of our financial information in accordance with U.S. GAAP.

The potential implementation by the Russian government of a law requiring companies to purchase or lease the land on which they operate may have a material adverse effect on our financial condition.

Much of the land occupied by privatized Russian companies, including most of our subsidiaries, was not included in the privatizations of these companies and is still owned by federal, regional or municipal governments. The companies use the land pursuant to a special title of perpetual use whereby they have the right to use the land but do not have the right to alienate such land.

The Russian Land Code requires privatized Russian companies to purchase or lease the land on which they operate, and gives the current government land owners broad discretion in setting the purchase price and lease terms. This requirement was scheduled to take effect on January 1, 2004, but implementation has been delayed by the Russian legislature to January 1, 2006. At present, we estimate that the cost of purchasing the land on which we operate would be approximately $115 million. Thus, if not eliminated or limited prior to implementation, the requirement that we purchase or lease the land we occupy will require significant expenditures by us and may have a material adverse effect on our financial condition.

Increasing tariffs and restructuring in the energy sector could materially adversely affect our business.

In 2003, our Russian operations purchased approximately 2.2 billion kWh of electricity, representing 55% of their needs, from local subsidiaries of RAO UES, the government-controlled national holding company for the Russian power sector. Domestic electricity prices are regulated by the Russian government. The government is currently in the early stages of implementing a restructuring plan for the power sector aimed at introducing competition, liberalizing the wholesale electricity market and moving from regulated pricing to a market-based system by 2008. This reform process could also cause disruptions to the supply of electricity to us. In addition, while subject to doubt as to whether it will be implemented as currently written, according to the Russian Energy Strategy approved by the Russian government in 2003, electricity tariffs for industrial users are expected to reach 3.2-3.6 cents per kWh by 2006. In 2003, our average cost of electricity was 2.7 cents per kWh. Assuming a price of 3.6 cents per kWh in 2003, our Russian operations would have incurred approximately $27 million in additional costs. Further price increases for electricity may also occur in the future as the industry is restructured and controlled to a greater extent by the private sector. If we are required to pay higher prices for electricity in the future, our costs will rise and our business and prospects could be materially adversely affected.

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Risk factors

Our Russian operations also purchase significant amounts of natural gas, primarily for the production of electricity at our own co-generation facilities, from Gazprom. Gazprom is a government-controlled company and the dominant producer and monopoly transporter of natural gas within Russia. Domestic natural gas prices are regulated by the government. These prices have been rising over the last few years. The average price for industrial consumers was approximately $24 per thousand cubic meters ($0.68 per thousand cubic feet) in 2003, and increased by 17% to approximately $28 per thousand cubic meters ($0.79 per thousand cubic feet) as of January 1, 2004. Further, domestic natural gas prices are significantly below Western European levels, which helps to provide us with a cost advantage over our competitors. Recently, in connection with Russia s potential accession to the World Trade Organization, or WTO, Russia and the EU agreed that Russia would raise domestic gas prices to $37-42 per thousand cubic meters ($1.05-1.19 per thousand cubic feet) by 2006 and to $49-57 per thousand cubic meters ($1.39-$1.61 per thousand cubic feet) by 2010. Assuming a price of $42 per thousand cubic meters in 2003, our Russian operations would have incurred approximately $30 million in additional costs. If we are required to pay a higher price for natural gas, our costs will rise and our business and prospects could be materially adversely affected.

The planned reorganization of the Russian Railways Ministry exposes us to uncertainties regarding transportation costs of raw materials and steel products.

Railway transportation is our principal means of transporting raw materials and steel products to our facilities and to customers, as well as to ports for onward transportation overseas. In 2003, legislation was enacted which sets out the framework for the reorganization of the Russian Railways Ministry into OAO Russian Railroads, a joint stock company, to be followed by the eventual privatization of certain of its functions. It is currently unclear whether this reorganization and privatization will be completed as per the timetable contemplated in the legislation or at all. Currently, the Russian government sets rail tariffs and may further increase these tariffs, as it has done in the past. If the privatization of Russian Railroads or other factors result in increased railway transport costs, our results of operations could be materially adversely affected.

In addition, Russia s rolling stock is currently in a poor state of repair. Failure of Russian Railroads to upgrade its rolling stock within the next few years could result in a shortage of available working rolling stock, a disruption in transportation of our materials and products and cause rail tariffs to increase.

We face numerous protective trade restrictions in the export of our steel products.

We face numerous protective tariffs, duties and quotas which reduce our competitiveness in, and limit our access to, particular markets. Several key steel importing countries currently have import restrictions in place on steel products or intend to introduce them in the future. The EU has a quota system in place with respect to Russian steel imports, and our exports to other European countries that may join the EU in the future will also become subject to the EU s quota system. Our sales into the EU constituted approximately 20% of our steel segment sales in 2003, and we used 96% of our EU steel import quota allocation during 2003. The export of our steel into the EU is an important part of our growth strategy. If EU quotas are not increased in line with our sales growth objectives, our ability to expand our sales in the EU and pursue our growth strategy could be limited.

The United States has a quota system in place with respect to certain Russian steel imports (hot-rolled flat-rolled carbon quality steel products and certain cut-to-length carbon steel plate). It also had a quota system in place with respect to imports of pig-iron, cold-rolled steel, slabs, zinc-plated sheets and some other products from Russia which expired on July 12, 2004. We may attempt to expand our steel product exports to the U.S. market. We expect, however, that depending on market conditions, the United States may impose new anti-dumping duties or other types of trade restrictions which might force us to decrease

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our exports to the United States below current levels. In December 2003, the United States also withdrew safeguard measures in the form of tariffs on most Russian steel exports to the United States after the WTO s Appellate Body had determined them to be inconsistent with the requirements of the WTO.

South Korea and Brazil have announced that they are also considering restrictions on steel imports in order to protect domestic producers. In January 2004, China imposed new anti-dumping duties on cold-rolled steel imports from Russia that are retroactive to September 2003 and will last for five years. In 2003, approximately 80% of our steel segment revenues were derived from sales of steel products that were subject to import restrictions. See Business Steel Business Trade Restrictions.

Russian export tariffs reduce the margins we can obtain for our nickel products.

The export of our nickel products out of Russia, excluding exports to certain other CIS countries, is subject to a 5% tariff prescribed by the Russian government, which results in lower margins in respect of our nickel products sales. The Russian government is considering indexing the tariff to world prices of nickel products as opposed to domestic prices, which would result in higher tariff payments and further reduce our margins from nickel products sales.

We benefit from Russia s tariffs and duties on imported steel, which may be eliminated in the future.

Russia has in place import tariffs with respect to certain steel products imported from outside of Russia, excluding certain other CIS countries. These tariffs generally amount to 5% of value, but also step up to 20% of value for certain higher value-added steel products. In addition, Russia has in place a 21% countervailing duty on Ukrainian rebars, which expires in 2005. Our Russian sales of steel products that are protected by these tariffs and duties accounted for approximately 38% of our steel segment revenues in 2003. We believe we benefit from these tariffs and duties because they prevent subsidized Ukrainian exports to Russia from reducing the prices we can obtain for these products in our domestic markets. These tariffs and duties may be reduced or eliminated in the future, which could materially adversely affect our revenues and results of operations.

Recently, Russia and the EU agreed on terms for Russia s entry into the WTO and, according to press reports, Russia may complete its negotiations with other countries to be able to join the WTO in 2005-2006. Russia s future accession to the WTO could negatively affect our business and prospects. In particular, Russia s entry into the WTO may require lowering or removing of tariffs and duties on steel products, causing increased competition in the domestic steel market from foreign producers. See also Increasing tariffs and restructuring in the energy sector could materially adversely affect our business.

Further appreciation in real terms of the ruble against the U.S. dollar may materially adversely affect our results of operations.

Our reporting currency is the U.S. dollar. Our products are typically priced in rubles for domestic sales and in U.S. dollars (and, to a lesser extent, euros) for export sales, whereas the majority of our direct costs are incurred in rubles and, to a lesser extent, in other local currencies where our operations are based. Appreciation in real terms of the ruble against the U.S. dollar results in an increase in our costs relative to our revenues, adversely affecting our results of operations. In 2003, the ruble appreciated in real terms against the U.S. dollar by 13.6% according to the Russian Central Bank, and further real appreciation of the ruble against the U.S. dollar may materially adversely affect our results of operations.

Estimates of our reserves are subject to uncertainties.

The estimates concerning our reserves contained in this prospectus are subject to considerable uncertainties. These estimates are based on interpretations of geological data obtained from sampling techniques and projected rates of production in the future. Actual production results may differ significantly from reserve estimates. In addition, it may take many years from the initial phase of drilling before production is possible. During that time, the economic feasibility of exploiting a discovery may change as a result of changes in the market price of coal, iron ore or nickel.

We are subject to mining risks.

Our business operations, like those of other mining companies, are subject to all of the hazards and risks normally associated with the exploration, development and production of natural resources, any of which could result in production shortfalls or damage to persons or property. In particular, hazards associated with our open-pit mining operations include:

- flooding of the open pit;
- collapses of the open-pit wall;
- accidents associated with the operation of large open-pit mining and rock transportation equipment;
- accidents associated with the preparation and ignition of large-scale open-pit blasting operations;
- production disruptions due to weather; and
- hazards associated with the disposal of mineralized waste water, such as groundwater and waterway contamination.

Hazards associated with our underground mining operations include:

- underground fires and explosions, including those caused by flammable gas;
- cave-ins or ground falls;
- discharges of gases and toxic chemicals;
- flooding;
- sinkhole formation and ground subsidence; and
- other accidents and conditions resulting from drilling, blasting and removing and processing material from an underground mine.

We are at risk of experiencing any and all of these hazards. The occurrence of any of these hazards could delay production, increase production costs and result in injury to persons and damage to property, as well as liability for us. The liabilities resulting from any of these risks may not be adequately covered by insurance, and we may incur significant costs that could have a material adverse effect upon our business, results of operations and financial condition.

More stringent environmental laws and regulations or more stringent enforcement of existing environmental laws and regulations in the jurisdictions where we operate may have a significant negative effect on our operating results.

Our operations and properties are subject to environmental, health and safety and other laws and regulations in the jurisdictions in which we operate. For instance, our operations generate large amounts of pollutants and waste, some of which are hazardous, such as benzapiren, sulphur oxide, sulphuric acid, nitrogen ammonium, sulphates, nitrites, phenicols and sludges (including sludges containing crome, copper, nickel, mercury and zinc). The discharge, storage and disposal of such hazardous waste is subject to environmental regulations, including some requiring the clean-up of contamination and reclamation, such as requirements for cleaning up highly hazardous waste oil and iron slag. In addition, pollution risks and related clean-up costs are often impossible to assess unless environmental audits have been performed and the extent of liability under environmental laws is clearly determinable.

Generally, there is a greater awareness in Russia of damage caused to the environment by industry than existed during the Soviet era. For example, a recent news article cited us as Russia s tenth worst polluter. Environmental legislation in the jurisdictions where we operate, however, is generally weaker, and less stringently enforced, than in the EU or the United States. More stringent standards may be introduced or enforcement increased in Russia and elsewhere where we conduct our operations. Based on the current regulatory environment in these jurisdictions, as of June 30, 2004, we have not created any reserves for environmental liabilities and compliance costs, other than an accrual in the amount of $23.6 million for asset retirement obligations (ARO), consistent with U.S. GAAP requirements and an accrual in the amount of $3.6 million for our commitment to spend that amount for environmental protection measures at our subsidiary Industria Sarmei in Romania. Any change in this regulatory environment could result in actual costs and liabilities for which we have not provided.

Also, in the course, or as a result, of an environmental investigation, regulatory authorities can issue an order halting part or all of the production at a production facility which has violated environmental standards. In the event that production at one of our facilities was partially or wholly prevented due to this type of sanction, our business could suffer significantly and our operating results would be negatively affected.

In addition, we are generally not indemnified against environmental liabilities or any required land reclamation expenses of our acquired businesses that arise from activities that occurred prior to our acquisition.

Russia s ratification of the Kyoto Protocol may negatively affect us.

The Kyoto Protocol to the United Nations Framework Convention on Climate Change, if ratified by the requisite number of signatory countries, would require the signatory countries to make substantial reductions in greenhouse gas emissions. On September 30, 2004, Russia s government approved the Kyoto Protocol and Russian government officials have indicated that the ratification bill would be submitted to the Duma, or Russia s lower house of Parliament, so it can be ratified by the end of 2004. If ratified by Russia, the Kyoto Protocol will enter into force for all countries that have ratified it. As a step towards implementing the Kyoto Protocol, the EU has adopted a number of acts setting higher environmental standards. Even if Russia does not ratify the Kyoto Protocol, the EU will most likely unilaterally apply provisions of the Kyoto Protocol, raising environmental standards.

Russian industrial technologies may not be able to comply with the raised environmental standards of the EU and such non-compliance may become an additional basis for restricting Russian steel exports to the European market. The amount of EU anti-dumping duty on Russian exports may be increased as a result of adjustments to the relatively low environmental component of production costs of Russian companies used in the calculation of the EU dumping margin.

Our business could be adversely affected if we fail to obtain or renew necessary licenses and permits or fail to comply with the terms of our licenses and permits.

Our business depends on the continuing validity of certain licenses and the issuance of certain new licenses and our compliance with the terms thereof, including subsoil licenses for our mining operations. Regulatory authorities exercise considerable discretion in the timing of license issuance, renewal and monitoring licensees compliance with license terms. Requirements imposed by these authorities may be

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costly and time-consuming and may result in delays in the commencement or continuation of exploration or production operations. Further, private individuals and the public at large possess rights to comment on and otherwise engage in the licensing process, including through intervention in courts and political pressure. Accordingly, the licenses we need may not be issued or renewed, or if issued or renewed, may not be issued or renewed in a timely fashion, or may involve requirements which restrict our ability to conduct our operations or to do so profitably.

Our competitors may also seek to deny our rights to develop certain natural resource deposits by challenging our compliance with tender rules and procedures or compliance with license terms. Political factors can also affect whether non-compliance with licensing regulations and terms of our licenses could lead to suspension or termination of our licenses and permits, and to administrative, civil and criminal liability.

We have a limited history of renewing our subsoil licenses. We recently extended the subsoil license for the Tatianinsk deposit, which was set to expire in June 2002, for a 10-year period. We have not had a need to extend any of our other subsoil licenses. Our five coal subsoil licenses expire on dates falling in 2012 through 2014; our three iron ore subsoil licenses expire on dates falling in 2009 through 2014; and our two nickel subsoil licenses expire on dates falling in 2012 and 2013. See Business Mining Business Mineral Reserves.

Accordingly, these factors may seriously affect our ability to obtain or renew necessary licenses, and if we are unable to obtain or renew necessary licenses or we are only able to obtain them with newly-introduced material restrictions, we may be unable to realize our reserves and our business and results of operations could be materially adversely affected.

In addition, as part of their obligations under licensing regulations and the terms of our licenses and permits, our companies have to comply with numerous industrial standards, recruit qualified personnel, maintain necessary equipment and a system of quality control, monitor our operations, maintain appropriate filings and, upon request, submit appropriate information to the licensing authorities, which are entitled to control and inspect their activities. In the event that the licensing authorities discover a material violation by our company, we may be required to suspend our operations or incur substantial costs in eliminating or remedying such violation, which could have a material adverse effect on our business or results of operations.

Deficiencies in the legal framework relating to subsoil licensing subject our licenses to the risk of governmental challenges and, if our licenses are suspended or terminated, we would be unable to realize our reserves, which could materially adversely affect our business and results of operations.

Most of the existing subsoil licenses in Russia date from the Soviet era. During the period between the dissolution of the Soviet Union in August 1991 and the enactment of the first post-Soviet subsoil licensing law in the summer of 1992, the status of subsoil licenses and Soviet-era mining operations was unclear, as was the status of the regulatory authority governing such operations. The Russian government enacted the Procedure for Subsoil Use Licensing, or Licensing Regulation, on July 15, 1992, which came into effect on August 20, 1992. As was common with legislation of this time, the Licensing Regulation was passed hastily, without adequate consideration of transition provisions, and contained numerous gaps. In an effort to address the problems in the Licensing Regulation, the Ministry of Natural Resources issued ministerial acts and instructions that attempted to clarify and, in some cases, modify the Licensing Regulation. Many of these acts contradicted the law and were beyond the scope of the Ministry s authority, but subsoil licensees had no option but to deal with the Ministry in relation to subsoil issues and comply with its ministerial acts and instructions. Thus, it is possible that licenses applied for and/or issued in reliance on the Ministry s acts and instructions could be challenged by the

prosecutor general s office as being invalid. In particular, deficiencies of this nature subject subsoil licensees to selective and arbitrary governmental claims.

Legislation on subsoil rights still remains internally inconsistent and vague, and the Ministry s acts and instructions are often arguably inconsistent with legislation. Subsoil licensees thus continue to face the situation where both failing to comply with the Ministry s acts and instructions and choosing to comply with them places them at the risk of being subject to arbitrary governmental claims, whether by the Ministry or the prosecutor general s office.

A provision that a license may be suspended or terminated if the licensee does not comply with the significant or material terms of a license is an example of such a deficiency in the legislation. However, the Ministry of Natural Resources has not issued any interpretive guidance on the meaning of these terms. Similarly, under Russia s civil law system, court decisions on the meaning of these terms do not have any precedential value for future cases and, in any event, court decisions in this regard have been inconsistent. These deficiencies result in the regulatory authorities, prosecutors and courts having significant discretion over enforcement and interpretation of the law, which may be used to challenge our subsoil rights selectively and arbitrarily.

Moreover, during the tumultuous period of the transformation of the Russian planned economy into a free market economy in the 1990s, documentation relating to subsoil licenses was not properly maintained and, in many cases, was lost or destroyed. Initially, during the period between the dissolution of the Soviet Union and the privatizations of the mid-1990s, as state subsidies ceased, many mining operations were forced to shut down or scale back production. In addition, during this time, complete governmental planning and oversight ceased, leaving the local management ill-equipped to operate these businesses, which faced severe liquidity problems. The employees, who were often unpaid for months, had little incentive to look after the businesses. In these circumstances, the maintenance of documentation relating to subsoil licenses, as well as compliance with the administrative requirements of the legislation of this period, was not a priority for management. The situation did not significantly improve as these mines were privatized in the mid-1990s, primarily since most Russian businesses during these times continued to face severe liquidity problems and the management focused on the operation of these mines. Thus, in many cases, although it may be clearly evident that a particular enterprise has mined a licensed subsoil area for decades, the historical documentation relating to their subsoil licenses may not be complete.

If, through governmental or other challenges, our licenses are suspended or terminated we would be unable to realize our reserves, which could materially adversely affect our business and results of operations.

Our Romanian operations face certain risks.

Romania is not self-sufficient in energy resources. Domestic energy prices, which are significantly higher than the prices we pay in Russia, have recently increased and may continue to increase in the future, which might hurt the profitability of our operations in Romania. For example, in 2003, the price of natural gas increased by approximately 30% in Romania and has been steadily increasing in 2004 at the rate of 5% per quarter. Shortages in energy supplies (including administrative limitations during peak usage) may limit our production capacity and efficiency and hinder our output. Our Romanian operations also purchase significant amounts of raw materials, such as scrap, for which prices increased significantly in 2003 and, while fluctuating considerably in 2004, scrap prices are expected to exceed 2003 levels at the end of this year. If we are unable to obtain these raw materials on economic terms, the operations of our Romanian subsidiaries could be materially adversely affected.

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In addition, preparations in Romania for its possible admission into the EU will result in increased environmental liabilities and expenditures and labor costs for our Romanian operations, as well as potential trade duties and quotas on the export of steel finished and semi-finished products into Romania.

We also committed to make capital investments of approximately $21.1 million at COST and approximately $19.0 million at Industria Sarmei, as well as to maintain labor force levels over the next five years at these Romanian facilities in connection with their acquisition. Although we have complied with these undertakings to date, our failure to comply in the future could result in the forfeiture of part of our ownership stake in these companies.

We will be controlled by two shareholders who run our business and affairs collectively and whose interests could conflict with those of the holders of the ADSs.

Following the offering and depending on whether the underwriters exercise their over-allotment option in full, between 84.45% and 85.95% of our outstanding common shares will be owned by the Chairman of our Board of Directors, Mr. Igor Zyuzin, and our Chief Executive Officer, Mr. Vladimir Iorich. These two shareholders have acted in concert since signing an Ownership, Control and Voting Agreement dated August 1, 1995, which requires them to vote the same way. See Principal and Selling Shareholders Ownership, Control and Voting Agreement of August 1, 1995 for more information regarding this agreement. Following this offering, these two shareholders will continue to be bound by this agreement. This agreement will give them control over us and the ability to elect a majority of the directors, appoint management, issue additional shares and approve certain actions requiring the approval of a majority of our shareholders. The interests of these shareholders could conflict with those of holders of ADSs and materially adversely affect your investment.

In addition, these two shareholders currently provide leadership to the group as a team and consult extensively with each other before significant decisions are made. This may slow the decision-making process, and a disagreement among these individuals could prevent key strategic decisions from being made in a timely manner. In the event these shareholders are unable to continue to work well together in providing cohesive leadership, our business could be harmed.

Our competitive position and future prospects depend on our senior management s experience and expertise.

Our ability to maintain our competitive position and to implement our business strategy is dependent to a large degree on the services of our senior management team, particularly our Chairman and our Chief Executive Officer. The loss or diminution in the services of members of our senior management team or an inability to attract, retain and maintain additional senior management personnel could have a material adverse effect on our business, financial condition, results of operations or prospects. Moreover, competition in Russia for personnel with relevant expertise is intense due to the small number of qualified individuals, and this situation seriously affects our ability to retain our existing senior management and attract additional qualified senior management personnel.

In the event the title to any privatized company we acquired is successfully challenged, we risk losing our ownership interest in that company or its assets.

Almost all of our business consist of privatized companies, and our business strategy will likely involve the acquisition of additional privatized companies. Privatization legislation in Russia is generally considered to be vague, internally inconsistent and in conflict with other domestic legislation. As the statute of limitations for challenging transactions entered into in the course of privatizations is 10 years, any transfers of title or ownership interests under privatizations are still vulnerable to challenge, including selective action by governmental authorities. In the event that any title to, or our ownership stakes in, the privatized companies acquired by us, including Chelyabinsk Metallurgical Plant, Southern Urals Nickel Plant, Southern Kuzbass Coal Company, Beloretsk Metallurgical Plant, Urals Stampings Plant, Korshunov Mining Plant or Izhstal, are subject to challenge as having been improperly privatized and we are unable to defeat this claim, we risk losing our ownership interest in such company or its assets, which could materially affect our business and results of operations.

If the Federal Antimonopoly Service were to conclude that we acquired or created a new company in contravention of antimonopoly legislation, it could impose administrative sanctions and require the divestiture of this company or other assets.

Our business has grown substantially through the acquisition and founding of companies, many of which required the prior approval or subsequent notification of the Russian Federal Antimonopoly Service or its predecessor agencies. In part, relevant legislation restricts the acquisition or founding of companies by groups of companies or individuals acting in concert without this approval or notification. This legislation is vague in certain parts and subject to varying interpretations. If the Federal Antimonopoly Service were to conclude that an acquisition or the creation of a new company was done in contravention of applicable legislation and competition has been reduced as a result, it could impose administrative sanctions and require the divestiture of this company or other assets, adversely affecting our business strategy and our results of operations.

In the event that the minority shareholders of our subsidiaries were to successfully challenge past interested party transactions or do not approve interested party transactions in the future, we could be limited in our operational flexibility.

We own less than 100% of the equity in many of our subsidiaries, with the remaining equity balance being held by minority shareholders. These subsidiaries have in the past carried out, and continue to carry out, numerous transactions with us and our other subsidiaries which may be considered interested party transactions under Russian law, requiring approval by disinterested directors, disinterested independent directors or disinterested shareholders. See Description of Capital Stock and Certain Requirements of Russian Legislation Interested Party Transactions. These transactions may not always have been properly approved, and therefore may be challenged by minority shareholders. In some cases, minority shareholders may not approve transactions which are interested party transactions requiring approval. In the event these minority shareholders were to successfully challenge past interested party transactions, or do not approve interested party transactions in the future, we could be limited in our operational flexibility and our results of operations could be materially adversely affected.

Our existing arrangements with trade unions may not be renewable on terms favorable to us, and our operations could be adversely affected by strikes and lockouts.

As of June 30, 2004, approximately 88% of our employees were represented by trade unions. Although we have not experienced any business interruption at any of our businesses as a result of labor disputes from the dates of their respective acquisition by us and we consider our employee relations to be good, large union representation subjects our businesses to interruptions through strikes, lockouts or delays in renegotiations of labor contracts. Our existing arrangements with trade unions also may not be renewed on terms favorable to us. In such events, our business and results of operations could be materially adversely affected.

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We do not carry the types of insurance coverage customary in more economically developed countries for a business of our size and nature, and a significant event could result in substantial property loss and inability to rebuild in a timely manner or at all.

The insurance industry is not yet well developed in Russia, and many forms of insurance protection common in more economically developed countries are not yet available in Russia on comparable terms, including coverage for business interruption. At present, our facilities are not insured, and we have no coverage for business interruption or loss of key management personnel or for third-party liability, other than customary insurance coverage with respect to our international trading operations and sales. In the event that a major event were to affect one of our facilities, we could experience substantial property loss and significant disruptions in our production capacity, for which we would not be compensated. For example, if substantial production capacity were lost at our Chelyabinsk Metallurgical Plant, which is our primary steel production facility, we would not be able to replace a substantial portion of this capacity with capacity from our other plants, potentially resulting in the interruption of the production of a number of our products. Additionally, depending on the severity of the property damage, we may not be able to rebuild damaged property in a timely manner or at all. We do not maintain separate funds or otherwise set aside reserves for these types of events. Any such loss or third-party claim for damages may have a material adverse effect on our business, results of operations and financial condition.

Russian currency control regulations hinder our ability to conduct our business.

Over the past several years, the ruble has fluctuated dramatically against the U.S. dollar. The Central Bank of Russia has from time to time imposed various currency control regulations in attempts to support the ruble, and may take further actions in the future. For example, Central Bank regulations currently require us to convert into rubles 25% of our export proceeds. Furthermore, the government and the Central Bank may impose additional requirements on cash inflows and outflows into and out of Russia or on use of foreign currency in Russia, which could prevent us from carrying on necessary business transactions, or from successfully implementing our business strategy.

A new framework law on exchange controls took effect on June 18, 2004. This law empowers the government and the Central Bank of Russia to further regulate and restrict currency control matters, including operations involving foreign securities and foreign currency borrowings by Russian companies. The new law also abolishes the need for companies to obtain transaction-specific licenses from the Central Bank (except for opening bank accounts outside Russia), envisaging instead the implementation of generally applicable restrictions on currency operations. See Description of Capital Stock and Certain Requirements of Russian Legislation Exchange Controls for further description of Russia s currency control regulations. As the evolving regulatory regime is very recent and untested, it is unclear whether it will be more or less restrictive than the prior laws and regulations it has replaced.

Vaguely drafted Russian transfer pricing rules and lack of reliable pricing information may potentially affect our results of operations.

Russian transfer pricing rules entered into force in 1999, giving Russian tax authorities the right to make transfer pricing adjustments and impose additional tax liabilities in respect of all controlled transactions, provided that the transaction price differs from the market price by more than 20%. Controlled transactions include transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions or transactions with significant (by more than 20%) price fluctuations. The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and courts. Due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge our prices and propose adjustments. If such price adjustments are upheld by the Russian courts and implemented, our future financial results could be

adversely affected. In addition, we could face significant losses associated with the assessed amount of prior tax underpaid and related interest and penalties, which could have an adverse effect on our financial condition and results of operations. See also Risks Relating to Russian Legislation and the Russian Legal System Weaknesses and changes in the Russian tax system could materially adversely affect our business and the value of our ADSs.

RISKS RELATED TO OUR ADSs AND THE TRADING MARKET

Because the depositary may be considered the beneficial holder of the shares underlying the ADSs, these shares may be arrested or seized in legal proceedings in Russia against the depositary.

Because Russian law may not recognize ADS holders as beneficial owners of the underlying shares, it is possible that you could lose all your rights to those shares if the depositary s assets in Russia are seized or arrested. In that case, you would lose all the money you invested.

Russian law may treat the depositary as the beneficial owner of the shares underlying the ADSs. This is different from the way other jurisdictions treat ADSs. In the states of the United States, although shares may be held in the depositary s name or to its order, making it a legal owner of the shares, the ADS holders are the beneficial, or real owners. In those jurisdictions, an action against the depositary, the legal owner, would not result in the beneficial owners losing their shares. Russian law may not make the same distinction between legal and beneficial ownership, and it may only recognize the rights of the depositary in whose name the shares are held, not the rights of ADS holders, to the underlying shares. Thus, in proceedings brought against a depositary, whether or not related to shares underlying ADSs, Russian courts may treat those underlying shares as the assets of the depositary, open to seizure or arrest. We do not know yet whether the shares underlying the ADSs may be seized or arrested in Russian legal proceedings against a depositary. In the past, a lawsuit was filed against a depositary bank other than Deutsche Bank Trust Company Americas seeking the seizure of various Russian companies shares represented by ADSs issued by that depositary. In the event that this type of suit were to be successful in the future against Deutsche Bank Trust Company Americas, and the shares underlying our ADSs were to be seized or arrested, the ADS holders involved would lose their rights to such underlying shares.

The holder of an ADS cannot withdraw the shares underlying the ADS prior to the registration of a placement report for these shares, and the failure to register this placement report could result in the offering being held invalid and being withdrawn.

Pursuant to Russian law and under the terms of the deposit agreement, all ADSs shall be deemed pre-released until a report regarding the placement of shares underlying the ADSs is registered by the Russian Federal Service for the Financial Markets. Until the report is registered, the holder of an ADS cannot withdraw the shares underlying the ADSs it holds or instruct the depositary to exercise voting rights with respect to the shares that will underlie the ADSs, as the holder would ordinarily be able to do. The form of the placement report requires us to disclose information about the recipients of the newly issued shares and the total number of shares actually placed. For purposes of such disclosure requirements, we will name the depositary as the recipient of the newly issued shares. The Federal Service for the Financial Markets is statutorily required to make its decision within two weeks after we file the placement report, but the current practice is that registration of a placement report takes between 30 and 44 days after filing. We may not file the placement report until after the closing of this offering. Accordingly, registration of the placement report may occur later than one month after the closing date for the offering or may not occur at all.

The Federal Service for the Financial Markets may refuse to register the placement report or delay its registration in the event that we violated Russian law in the issuance process or if the placement report

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contains false information. In the case of any such refusal or delay, the Federal Service for the Financial Markets must notify us of the alleged violation. If we fail to rectify the violation within the period specified by the Federal Service for the Financial Markets, which is generally 30 days, the placement will be held invalid. Additionally, prior to registration of the placement report, the Federal Service for the Financial Markets may declare the placement invalid to protect investors rights. If the Federal Service for the Financial Markets declares the placement invalid, it will not register the placement report, the underlying shares will be cancelled, and we will be required by Russian law to return the proceeds we receive in this offering. In addition to the Federal Service for the Financial Markets, under Russian law, a court may also hold the placement invalid if the issuer violated Russian law in the issuance process or if the documents submitted to the Federal Service for the Financial Markets or its predecessor agency contained false information.

Pending the registration of the placement report, the proceeds of this offering to us and the selling shareholders will be deposited in rubles in escrow-type accounts and in U.S. dollars in escrow accounts, respectively. See Escrow of Proceeds and Registration of Placement Report.

In the event that the registration of the placement report does not occur within 60 days after the closing date, or such other date to which we, the selling shareholders and the underwriters agree, called the termination date, we will be required to issue a press release and to notify the depositary, the escrow agent, the bank holding the escrow-type account, the underwriters and the New York Stock Exchange by the close of business on the termination date of the termination of this offering. In this instance, pursuant to the terms of the escrow and escrow-type account agreements and the underwriting agreement, all funds received in respect of the ADSs in the escrow-type and escrow accounts, together with interest, if any, accrued thereon for the period from the closing date to the termination date, and any additional amounts necessary so that the funds being released would be equal (after conversion of all ruble funds into U.S. dollars) to the original U.S. dollar proceeds of the offering will be released to the depositary. The depositary will promptly distribute in U.S. dollars through DTC to the holders of the ADSs as of the termination date the funds it has received from the escrow and escrow-type accounts in accordance with the provisions of the deposit agreement applicable to cash dividends and distributions. See Description of American Depositary Shares Share Dividends and Other Distributions How will I receive dividends and other distributions on the shares underlying my ADSs? Cash for more information.

The amount returned to the then-holders of the ADSs in the event that the registration of the placement report does not occur will be the public offering price together with interest accrued, if any, and will be paid to the holders of the ADSs as of the time of such cancellation regardless of prior trading and the then-prevailing market price for the ADSs. Any attempt to claim damages from us for the difference between the public offering price together with interest accrued, if any, and the then-prevailing market prices for the ADSs would be subject to significant difficulties. See Limitation on Enforcement of Civil Liabilities for more information. Moreover, the return of the funds may be delayed due to Russian currency control regulations, and may be prevented if there is a change in such regulations. See Risks Relating to Our Business and Industry Russian currency control regulations hinder our ability to conduct our business.

Your voting rights with respect to the shares represented by our ADSs are limited by the terms of the deposit agreement for our ADSs and relevant requirements of Russian law.

You will be able to exercise voting rights with respect to the common shares represented by ADSs only in accordance with the provisions of the deposit agreement relating to the ADSs and relevant requirements of Russian law. However, there are practical limitations upon your ability to exercise your voting rights due to the additional procedural steps involved in communicating with you. For example, the Federal

Law on Joint Stock Companies of December 26, 1995, or the Joint Stock Company Law, and our charter require us to notify shareholders at least 20 days in advance of any meeting, at least 30 days in advance of a meeting relating to a reorganization and at least 50 days in advance of an extraordinary meeting relating to election of directors. Our common shareholders will receive notice directly from us and will be able to exercise their voting rights by either attending the meeting in person or voting by power of attorney.

As an ADS holder, you, by comparison, will not receive notice directly from us. Rather, in accordance with the deposit agreement, we will provide the notice to the depositary. The depositary has undertaken in turn, as soon as practicable thereafter, to mail to you notice of such meeting, copies of voting materials (if and as received by the depositary from us) and a statement as to the manner in which instructions may be given by holders. To exercise your voting rights, you must then instruct the depositary how to vote its shares. Because of this extra procedural step involving the depositary, the process for exercising voting rights may take longer for you than for holders of common shares. ADSs for which the depositary does not receive timely voting instructions will not be voted.

In addition, although securities regulations expressly permit the depositary to split the votes with respect to the shares underlying the ADSs in accordance with instructions from ADS holders, this regulation remains untested, and the depositary may choose to refrain from voting at all unless it receives instructions from all ADS holders to vote the shares in the same manner. You may thus have significant difficulty in exercising voting rights with respect to the shares underlying the ADSs. See Description Of American Depositary Shares Voting Rights for a description of the voting rights of holders of ADSs.

Because there has been no prior active public trading market for our common shares and ADSs, this offering may not result in an active or liquid market for our ADSs, and their price may be highly volatile.

Before this offering, there has been no public trading market for our ADSs and no active public market for our common shares. Although our ADSs have been admitted for listing on the New York Stock Exchange, an active public market may not develop or be sustained after this offering. Active, liquid trading markets generally result in lower price volatility and more efficient execution of buy and sell orders for investors. If a liquid trading market for our ADSs does not develop, the price of our ADSs may be more volatile and it may be more difficult to complete a buy or sell order for our ADSs.

The liquidity of a securities market is often a function of the volume of the underlying shares that are publicly held by unrelated parties. Although ADS holders are entitled to withdraw the shares underlying the ADSs from the depositary (following the registration of the placement report with the Federal Service for the Financial Markets), there is very limited public free float of our shares (constituting less than 0.02%) on RTS, the Russian stock exchange where they are currently listed. In addition, the shares being sold by the company in this offering cannot be sold on the RTS until three months from the date of the registration of the placement report. During the period from the registration of the placement report until such time as the shares being sold by the company can be traded on the RTS (expected to be up to three months from the registration of the placement report), when you cancel your ADSs and deliver them to the depositary, you will receive shares being sold by the selling shareholders, and only if all such shares shall have been withdrawn will you receive shares being sold by the company, irrespective of how you acquired your ADSs. Nevertheless, depending upon the demand for withdrawals, you may only be able to withdraw shares that cannot be sold on RTS during this period.

The trading prices of the ADSs may be subject to wide fluctuations in response to many factors, including:

- variations in our operating results and those of other steel and mining companies;
- variations in national and industry growth rates;
- actual or anticipated announcements of technical innovations or new products or services by us or our competitors;
- changes in governmental legislation or regulation;
- general economic conditions within our business sector or in Russia; or
- extreme price and volume fluctuations on the Russian or other emerging market stock exchanges.

In addition, the Russian stock market has experienced extreme price and volume fluctuations. These market fluctuations could adversely affect the value of our ADSs. Moreover, the market price of our ADSs may decline below the offering price, which will be determined by negotiation between us and representatives of the underwriters.

You may be unable to repatriate your earnings from our ADSs.

Russian legislation currently requires dividends on common shares to be paid in rubles and permits such ruble funds to be converted into U.S. dollars by the depositary for distribution to owners of ADSs without restriction. Also, ADSs may be sold by non-residents of Russia for U.S. dollars outside Russia without regard to Russian currency control laws as long as the buyer is not a Russian resident for currency control purposes.

The ability to convert rubles into U.S. dollars is subject to the availability of U.S. dollars in Russia s currency markets. Although there is an existing market within Russia for the conversion of rubles into U.S. dollars, including the interbank currency exchange and over-the-counter and currency futures markets, the further development of this market is uncertain. At present, there is no market for the conversion of rubles into foreign currencies outside of Russia and no viable market in which to hedge ruble- and ruble-denominated investments.

You will experience immediate and substantial dilution.

The initial public offering price of the ADSs is substantially higher than the pro forma consolidated net tangible book value per ADS. You will pay a price per ADS that substantially exceeds the value of our assets after subtracting our liabilities. Additionally, holders of ADSs will contribute •% of our total capitalization, but will own only 10.0% of our total equity outstanding, assuming no exercise of the underwriters over-allotment option. Therefore, you will incur immediate and substantial dilution in net tangible book value per ADS of $•, assuming no exercise of the underwriters over-allotment option.

Future sales of shares or ADSs may affect the market price of our shares and ADSs.

Sales, or the possibility of sales, of substantial numbers of our shares or ADSs in the public markets, including the Russian stock market, following the offering could have an adverse effect on the market trading prices of our ADSs. Our subsequent equity offerings may reduce the percentage ownership of our shareholders. Moreover, newly issued preferred shares may have rights, preferences or privileges senior to those of our common shares.

You may not be able to benefit from the United States-Russia double tax treaty.

In accordance with Russian legislation, dividends paid to a nonresident holder generally will be subject to Russian withholding at a 15% rate for legal entities, and at the rate of 30% for individuals. This tax may be reduced to 5% to 10% under the United States-Russia income tax treaty for U.S. holders. However, the Russian tax rules applicable to U.S. holders are characterized by significant uncertainties and by the absence of interpretive guidance. Russian tax authorities have not provided any guidance regarding the treatment of ADS arrangements, and it is unclear how the Russian tax authorities will ultimately treat those arrangements. In particular, it is unclear whether Russian tax authorities will treat U.S. holders as the beneficial owners of the underlying shares for the purposes of the United States-Russia income tax treaty. If the Russian tax authorities were not to treat U.S. holders as the beneficial owners of the underlying shares, then the U.S. holders would not be able to benefit from the provisions of the United States-Russia double tax treaty. See Taxation Russian Income and Withholding Tax Considerations United States-Russia Income Tax Treaty Procedures and Taxation of Dividends and United States Federal Income Tax Considerations Taxation of dividends on common shares or ADSs for a more detailed discussion of this issue and administration procedures.

Capital gain from sale of ADSs may be subject to Russian income tax.

Under Russian tax legislation, gains arising from the disposition of Russian shares and securities, such as our common shares, as well as financial instruments derived from such shares, such as our ADSs, may be subject to Russian income or withholding taxes. However, no procedural mechanism currently exists to withhold any capital gains or for subsequent remittance of such amounts to the Russian tax authorities with respect to sales made between non-residents or sales of ADSs on the New York Stock Exchange. See Taxation Russian Income and Withholding Tax Considerations United States-Russia Income Tax Treaty Procedures.

You may have limited recourse against us and our directors and executive officers because we generally conduct our operations outside the United States and all of our directors and executive officers reside outside the United States.

Our presence outside the United States may limit your legal recourse against us. Mechel Steel Group is incorporated under the laws of the Russian Federation. All of our directors and executive officers reside outside the United States, principally in Russia. All or a substantial portion of our assets and the assets of our directors and executive officers are located outside the United States. As a result, you may not be able to effect service of process within the United States upon us or our directors and executive officers or to enforce in U.S. court judgments obtained against us or our directors and executive officers in jurisdictions outside the United States, including actions under the civil liability provisions of U.S. securities laws. In addition, it may be difficult for you to enforce, in original actions brought in courts in jurisdictions outside the United States, liabilities predicated upon U.S. securities laws.

There is no treaty between the United States and the Russian Federation providing for reciprocal recognition and enforcement of foreign court judgments in civil and commercial matters. These limitations may deprive you of effective legal recourse for claims related to your investment in the ADSs. The deposit agreement provides for actions brought by any party thereto against us to be settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association, provided that any action under the U.S. federal securities laws or the rules or regulations promulgated thereunder may, but need not, be submitted to arbitration. The Russian Federation is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards, but it may be difficult to enforce arbitral awards in the Russian Federation due to a number of factors, including the inexperience of Russian courts in international commercial transactions, official and unofficial political resistance to enforcement of awards against Russian companies in favor of foreign investors, Russian courts inability to enforce such orders and corruption.

RISKS RELATING TO THE POLITICAL ENVIRONMENT IN RUSSIA

Political and governmental instability could adversely affect the value of our ADSs.

Since 1991, Russia has sought to transform itself from a one-party state with a centrally-planned economy to a democracy with a market-oriented economy. As a result of the sweeping nature of the reforms, and the failure of some of them, the Russian political system remains vulnerable to popular dissatisfaction, including dissatisfaction with the results of privatizations in the 1990s, as well as to demands for autonomy from particular regional and ethnic groups. Moreover, the composition of the Russian government the prime minister and the other heads of federal ministries has at times been highly unstable. For example, six different prime ministers headed governments between March 1998 and May 2000. On December 31, 1999, President Yeltsin unexpectedly resigned. Vladimir Putin was subsequently elected president on March 26, 2000, and reelected for a second term on March 14, 2004. While President Putin maintained governmental stability and even accelerated the reform process during his first term, he may adopt a different approach over time. In February 2004, for example, President Putin dismissed his entire cabinet, including the prime minister. This was followed on March 12, 2004, by President Putin s announcement of a far-reaching restructuring of the Russian government, with the stated aim of making the government more transparent and efficient. The changes included, for example, reducing the number of ministries from 30 to 14 and dividing the government into three levels: ministries, services and agencies. In addition to the restructuring of the Russian federal government, President Putin has recently proposed that the executives of sub-federal political units be no longer directly elected by population but instead be nominated by the President of the Russian Federation and confirmed by the legislature of the sub-federal political unit. Further, President Putin has proposed to eliminate individual races in State Duma elections, so that voters would only cast ballots for political parties. These new structures are largely not yet finalized and implemented.

Future changes in government, major policy shifts or lack of consensus between President Putin, the prime minister, Russia s parliament and powerful economic groups could disrupt or reverse economic and regulatory reforms. Any disruption or reversal of the reform policies, recurrence of political or governmental instability or occurrence of conflicts with powerful economic groups could have a material adverse effect on our company and the value of investments in Russia, like our ADSs.

Political and other conflicts create an uncertain operating environment that hinders our long-term planning ability and could adversely affect the value of investments in Russia.

The Russian Federation is a federation of 89 sub-federal political units, consisting of republics, territories, regions, cities of federal importance and autonomous regions and districts. The delineation of authority and jurisdiction among the members of the Russian Federation and the federal government is, in many instances, unclear and remains contested. Lack of consensus between the federal government and local or regional authorities often results in the enactment of conflicting legislation at various levels and may lead to further political instability. In particular, conflicting laws have been enacted in the areas of privatization, securities, corporate legislation and licensing. Some of these laws and governmental and administrative decisions implementing them, as well as certain transactions consummated pursuant to them, have in the past been challenged in the courts, and such challenges may occur in the future. This lack of consensus hinders our long-term planning efforts and creates uncertainties in our operating environment, both of which may prevent us from effectively and efficiently carrying out our business strategy. See also Risks Relating to Our Business and Industry In the event the title to any privatized company we acquired is successfully challenged, we risk losing our ownership interest in that company or its assets and Risks Relating to the Russian Legislation and the Russian Legal System Weaknesses relating to the Russian legal system and Russian legislation create an uncertain environment

for investment and business activity and thus could have a material adverse effect on our business and the value of our ADSs.

Additionally, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions and, in certain cases, military conflict, such as the continuing conflict in Chechnya, which has brought normal economic activity within Chechnya to a halt and disrupted the economies of neighboring regions. Various armed groups in Chechnya have regularly engaged in guerrilla attacks in that area. Violence and attacks relating to this conflict have also spread to other parts of Russia, and a number of fatal terrorist attacks have been carried out by Chechen terrorists throughout Russia, including in Moscow. The further intensification of violence, including terrorist attacks and suicide bombings, or its continued spread to other parts of Russia, could have significant political consequences, including the imposition of a state of emergency in some or all of Russia. Moreover, any terrorist attacks and the resulting heightened security measures may cause disruptions to domestic commerce and exports from Russia, and could materially adversely affect our business and the value of investments in Russia, like our ADSs.

RISKS RELATING TO THE ECONOMIC ENVIRONMENT IN RUSSIA

Emerging markets such as Russia are subject to greater risks than more developed markets, and financial turmoil in any emerging market could disrupt our business, as well as cause the price of our ADSs to suffer.

Generally, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved in, and are familiar with, investing in emerging markets. Investors should also note that emerging markets such as Russia are subject to rapid change and that the information set out herein may become outdated relatively quickly. Moreover, financial turmoil in any emerging market country tends to adversely affect prices in stock markets of all emerging market countries as investors move their money to more stable, developed markets. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in Russia and adversely affect the Russian economy. In addition, during such times, emerging market companies can face severe liquidity constraints as foreign funding sources are withdrawn. Thus, even if the Russian economy remains relatively stable, financial turmoil in any emerging market country could seriously disrupt our business, as well as result in a decrease in the price of our ADSs.

Economic instability in Russia could adversely affect our business.

Since the dissolution of the Soviet Union, the Russian economy has experienced at various times:

- significant declines in gross domestic product;
- hyperinflation;
- an unstable currency;
- high government debt relative to gross domestic product;
- a weak banking system providing limited liquidity to Russian enterprises;
- a large number of loss-making enterprises that continued to operate due to the lack of effective bankruptcy proceedings;
- significant use of barter transactions and illiquid promissory notes to settle commercial transactions;
- widespread tax evasion;
- the growth of black and gray market economies;

- pervasive capital flight;
- high levels of corruption and the penetration of organized crime into the economy;
- significant increases in unemployment and underemployment; and
- the impoverishment of a large portion of the Russian population.

The Russian economy has been subject to abrupt downturns. In particular, on August 17, 1998, in the face of a rapidly deteriorating economic situation, the Russian government defaulted on its ruble-denominated securities, the Central Bank of Russia stopped its support of the ruble and a temporary moratorium was imposed on certain hard currency payments. These actions resulted in an immediate and severe devaluation of the ruble, a sharp increase in the rate of inflation, a dramatic decline in the prices of Russian debt and equity securities and the inability of Russian issuers to raise funds in the international capital markets. These problems were aggravated by the near collapse of the Russian banking sector after the events of August 17, 1998. This further impaired the ability of the banking sector to act as a reliable and consistent source of liquidity to Russian companies, and resulted in the loss of bank deposits in some cases.

Russia s inexperience with a market economy also poses numerous risks. The failure to satisfy liabilities is widespread among Russian businesses and the government. Furthermore, it is difficult for us to gauge the creditworthiness of some of our customers, as there are no reliable mechanisms, such as credit reports or credit databases, for evaluating their financial condition. Consequently, we face the risk that some of our customers or other debtors will fail to pay us or fail to comply with the terms of their agreements with us, which could adversely affect our results of operations.

Recent trends in the Russian economy such as the increase in the gross domestic product, a relatively stable ruble and a reduced rate of inflation may not continue or may be abruptly reversed. Additionally, because Russia produces and exports large quantities of oil and natural gas, the Russian economy is especially vulnerable to fluctuations in the price of oil and natural gas on the world market and a decline in the price of oil or natural gas could significantly slow or disrupt the Russian economy. Recent military conflicts and international terrorist activity have created significant uncertainty about the supply of oil and natural gas and delayed the expected recovery of the global economy, and such future events may continue to adversely affect the global economic environment, which could result in a decline in the demand for oil and natural gas. A strengthening of the ruble in real terms relative to the U.S. dollar, changes in monetary policy, inflation or other factors could adversely affect Russia s economy and our business in the future. Any such market downturn or economic slowdown could also severely limit our and our customers access to capital, also adversely affecting our and our customers businesses in the future.

The Russian banking system remains underdeveloped, and another banking crisis could place severe liquidity constraints on our business.

Russia s banking and other financial systems are not well developed or regulated, and Russian legislation relating to banks and bank accounts is subject to varying interpretations and inconsistent applications. The August 1998 financial crisis resulted in the bankruptcy and liquidation of many Russian banks and almost entirely eliminated the developing market for commercial bank loans at that time. Although the Central Bank of Russia has the mandate and authority to suspend banking licenses of insolvent banks, many insolvent banks still operate. Most Russian banks also do not meet international banking standards, and the transparency of the Russian banking sector still lags far behind internationally accepted norms. Aided by inadequate supervision by the regulators, many banks do not follow existing Central Bank regulations with respect to lending criteria, credit quality, loan loss reserves or diversification of exposure. Further, in Russia, bank deposits generally are not insured.

Risk factors

Recently, there has been a rapid increase in lending by Russian banks, which many believe has been accompanied by a deterioration in the credit quality of the borrowers. In addition, a robust domestic corporate debt market is leading to Russian banks increasingly holding large amounts of Russian corporate ruble bonds in their portfolios, which is further deteriorating the risk profile of Russian bank assets. The serious deficiencies in the Russian banking sector, combined with the deterioration in the credit portfolios of Russian banks, may result in the banking sector being more susceptible to market downturns or economic slowdowns, including due to Russian corporate defaults that may occur during any such market downturn or economic slowdown. In addition, the Russian Central Bank has recently revoked the licenses of certain Russian banks, which resulted in market rumors about additional bank closures and many depositors withdrawing their savings. If a banking crisis were to occur, Russian companies would be subject to severe liquidity constraints due to the limited supply of domestic savings and the withdrawal of foreign funding sources that would occur during such a crisis.

There is currently a limited number of creditworthy Russian banks, most of which are located in Moscow. We have tried to reduce our risk by receiving and holding funds in a number of Russian banks, including subsidiaries of foreign banks. Nonetheless, we hold the bulk of our excess ruble and foreign currency cash in Russian banks, including subsidiaries of foreign banks, in part because we are required to do so by Central Bank regulations and because the ruble is not transferable or convertible outside of Russia. There are few, if any, safe ruble-denominated instruments in which we may invest our excess ruble cash. Another banking crisis or the bankruptcy or insolvency of the banks from which we receive or with which we hold our funds could result in the loss of our deposits or affect our ability to complete banking transactions in Russia, which could have a material adverse effect on our business, financial conditions and results of operations.

Russia s physical infrastructure is in very poor condition, which could disrupt normal business activity.

Russia s physical infrastructure largely dates back to Soviet times and has not been adequately funded and maintained over the past decade. Particularly affected are the rail and road networks, power generation and transmission, communication systems and building stock. For example, during the winter of 2000-2001, electricity and heating shortages in Russia s far-eastern Primorye Region seriously disrupted the local economy. In August 2000, a fire at the main communications tower in Moscow interrupted television and radio broadcasting and the operation of mobile phones for weeks. Road conditions throughout Russia are poor, with many roads not meeting minimum requirements for use and safety. The federal government is actively considering plans to reorganize the nation s rail, electricity and telephone systems. Any such reorganization may result in increased charges and tariffs while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems. Russia s poor physical infrastructure disrupts the transportation of goods and supplies and adds costs to doing business in Russia, and further deterioration in the physical infrastructure could have a material adverse effect on our business. In addition, there are a number of nuclear and other dangerous installations in Russia where safety systems to contain ecological risks may not be sufficiently effective. The occurrence of accidents in these installations, as well as the generally unfavorable ecological situation in Russia, may also have a material adverse effect on our business.

RISKS RELATING TO THE SOCIAL ENVIRONMENT IN RUSSIA

Crime and corruption could disrupt our ability to conduct our business.

The political and economic changes in Russia in recent years have resulted in significant dislocations of authority, reduced policing and increased lawlessness. The local and international press have reported that significant organized criminal activity has arisen, particularly in large metropolitan centers. Property

crimes in large cities have increased substantially. In addition, the local and international press have reported high levels of official corruption, including the bribing of officials for the purpose of initiating investigations by government agencies. Press reports have also described instances in which government officials engaged in selective investigations and prosecutions to further the commercial interests of government officials or certain individuals. Additionally, published reports have indicated that a significant number of Russian media outlets regularly publish disparaging articles in return for payment. The depredations of organized or other crime, demands of corrupt officials or claims that we have been involved in official corruption or illegal activities may in the future bring negative publicity, which could disrupt our ability to conduct our business effectively and could thus materially adversely affect the value of our ADSs.

Social instability could increase support for renewed centralized authority, nationalism or violence, materially adversely affecting our ability to conduct our business.

The failure of the government and many private enterprises to pay full salaries on a regular basis and the failure of salaries and benefits generally to keep pace with the rapidly increasing cost of living in Russia have led in the past, and could lead in the future, to labor and social unrest. For example, in 1998, miners in several regions of Russia, demanding payment of overdue wages, resorted to strikes which included blocking major railroads. This type of labor and social unrest may have political, social and economic consequences, such as increased support for a renewal of centralized authority, nationalism, restrictions on foreign involvement in the Russian economy and violence. Any of these or similar consequences of social unrest could restrict our operations and lead to the loss of revenue, materially adversely affecting us.

RISKS RELATING TO RUSSIAN LEGISLATION AND THE RUSSIAN LEGAL SYSTEM

Weaknesses relating to the Russian legal system and Russian legislation create an uncertain environment for investment and business activity and thus could have a material adverse effect on our business and the value of our ADSs.

Russia is still developing the legal framework required to support a market economy. The following risks relating to the Russian legal system create uncertainties with respect to the legal and business decisions that we make, many of which do not exist in countries with more developed market economies:

- inconsistencies among (1) federal laws; (2) decrees, orders and regulations issued by the president, the government and federal ministries; and (3) regional and local laws, rules and regulations;
- the lack of judicial and administrative guidance on interpreting Russian legislation;
- substantial gaps in the regulatory structure due to delay or absence of implementing regulations;
- the relative inexperience of judges and courts in interpreting Russian legislation;
- corruption within the judiciary;
- a high degree of unchecked discretion on the part of governmental authorities; and
- bankruptcy procedures that are not well developed and are subject to abuse.

For example, over the last year one of our competitors tried to keep our iron ore operations, Korshunov Mining Plant, from emerging from bankruptcy proceedings in order to prevent us from exercising our

rights as the controlling shareholder, even though creditors representing almost all of its debt had agreed to a settlement plan. In September 2003, a Russian commercial court approved a settlement agreement.

Under Russian corporate law, negative net assets calculated on the basis of Russian accounting standards, or RAS, can serve as a basis for a court to order the liquidation of the company, upon a claim by governmental authorities. Numerous Russian companies have negative net assets due to very low historical asset values reflected on their RAS balance sheets; however, their solvency, i.e., their ability to pay debts as they come due, is not otherwise adversely affected by such negative net assets. In a highly-publicized case a few years ago, a court ordered the liquidation of a company with negative net assets, although it was otherwise solvent. We currently have and may have in the future subsidiaries with negative net assets under RAS, and thus are subject to the potential for arbitrary government action in this regard.

Moreover, the regulation and supervision of the securities market, financial intermediaries and issuers are considerably less developed in Russia than in the United States and Western Europe. Securities laws, including those relating to corporate governance, disclosure and reporting requirements, have only recently been adopted, whereas laws relating to anti-fraud safeguards, insider trading restrictions and fiduciary duties are rudimentary. In addition, the Russian securities market is regulated by several different authorities which are often in competition with each other. These include

- the Federal Service for the Financial Markets;
- the Ministry of Finance;
- the Federal Antimonopoly Service;
- the Central Bank of Russia; and
- various professional self-regulatory organizations.

The regulations of these various authorities are not always coordinated and may be contradictory.

In addition, Russian corporate and securities rules and regulations can change rapidly, which may adversely affect our ability to conduct securities-related transactions. While some important areas are subject to virtually no oversight, the regulatory requirements imposed on Russian issuers in other areas result in delays in conducting securities offerings and in accessing the capital markets. It is often unclear whether or how regulations, decisions and letters issued by the various regulatory authorities apply to our company. As a result, we may be subject to fines or other enforcement measures despite our best efforts at compliance.

Additionally, several fundamental laws have only recently become effective. The enactment of new legislation in the context of a rapid evolution to a market economy and the lack of consensus about the scope, content and pace of economic and political reforms has resulted in ambiguities, inconsistencies and anomalies in the overall Russian legal system. The enforceability and underlying constitutionality of many recently enacted laws are in doubt, and many new laws remain untested. For example, the regulations governing approvals by the Russian Federal Service for the Financial Markets of placement reports in offerings like this, as well as the regulations regarding issuance of permissions for depositary receipt programs and voting by depositaries at the instruction of ADS holders, are relatively new and untested. This makes it difficult to assess the risk that the placement report will not be registered and that the shares underlying the ADSs in this offering will be cancelled. In addition, Russian legislation often contemplates implementing regulations that have not yet been promulgated, leaving substantial gaps in the regulatory infrastructure. All of these weaknesses could affect our ability to enforce our legal rights, including rights under our contracts, or to defend ourselves against claims by others.

The judiciary s lack of independence and inexperience, the difficulty of enforcing court decisions and governmental discretion in instigating, joining and enforcing claims could prevent us or you from obtaining effective redress in a court proceeding, which could have a material adverse effect on our business or the value of our ADSs.

The independence of the judicial system and the prosecutor general s office and their immunity from economic, political and nationalistic influences in Russia is less than complete. The court system is

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understaffed and underfunded. Judges and courts are generally inexperienced in the area of business and corporate law. Judicial precedents generally have no binding effect on subsequent decisions. Not all Russian legislation and court decisions are readily available to the public or organized in a manner that facilitates understanding. The Russian judicial system can be slow, and court orders are not always enforced or followed by law enforcement agencies. All of these factors make judicial decisions in Russia difficult to predict and effective redress uncertain. Additionally, court claims and governmental prosecutions are often used in furtherance of political aims, which the courts themselves support. We may be subject to such claims and may not be able to receive a fair hearing.

These uncertainties also extend to property rights. During Russia s transformation from a centrally planned economy to a market economy, legislation was enacted to protect private property against expropriation and nationalization. However, it is possible that, due to the lack of experience in enforcing these provisions and political factors, these protections would not be enforced in the event of an attempted expropriation or nationalization. Some government entities have tried to renationalize privatized businesses. Expropriation or nationalization of any of our entities, their assets or portions thereof, potentially without adequate compensation, could have a material adverse effect on our business.

Unlawful, selective or arbitrary government action may have an adverse effect on our business and the value of our ADSs.

Governmental authorities have a high degree of discretion in Russia and at times act selectively or arbitrarily, without hearing or prior notice, and sometimes in a manner that is contrary to law or influenced by political or commercial considerations. Moreover, the government also has the power in certain circumstances, by regulation or government act, to interfere with the performance of, nullify or terminate contracts. Unlawful, selective or arbitrary governmental actions have reportedly included denial or withdrawal of licenses, sudden and unexpected tax audits, criminal prosecutions and civil actions. Federal and local government entities have also used common defects in matters surrounding share issuances and registration as pretexts for court claims and other demands to invalidate such issuances and registrations or to void transactions, often for political purposes. S&P has expressed concerns that Russian companies and their investors can be subjected to government pressure through selective implementation of regulations and legislation that is either politically motivated or triggered by competing business groups. In this environment, our competitors may receive preferential treatment from the government, potentially giving them a competitive advantage over us.

In addition, in 2003 and thus far in 2004, the Ministry for Taxes and Levies has begun to aggressively crack down on certain Russian companies use of tax-optimization schemes, and press reports have speculated that these enforcement actions have been selective.

Unlawful, selective or arbitrary government action, if directed at us, could have a material adverse effect on our business and on the value of our ADSs.

Shareholder liability under Russian legislation could cause us to become liable for the obligations of our subsidiaries.

The Civil Code and the Joint Stock Company Law generally provide that shareholders in a Russian joint stock company are not liable for the obligations of the joint stock company and bear only the risk of loss of their investment. This may not be the case, however, when one person is capable of determining decisions made by another person. The person capable of determining such decisions is called an effective parent. The person whose decisions are capable of being so determined is called an effective subsidiary. The effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between such persons, and

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the effective parent gives obligatory directions to the effective subsidiary.

Moreover, an effective parent is secondarily liable for an effective subsidiary s debts if an effective subsidiary becomes insolvent or bankrupt as a result of the action or inaction of an effective parent. This is the case no matter how the effective parent s capability to determine decisions of the effective subsidiary arises. For example, this liability could arise through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary s losses from the effective parent which caused the effective subsidiary to take action or fail to take action knowing that such action or failure to take action would result in losses. Accordingly, given our status as a holding company, we could be liable in some cases for debts of our consolidated Russian subsidiaries. The total liabilities of our consolidated Russian subsidiaries, as of June 30, 2004, was $966.8 million, excluding intercompany indebtedness.

Because there is little minority shareholder protection in Russia, your ability to bring, or recover in, an action against us will be limited.

In general, minority shareholder protection under Russian law derives from supermajority shareholder approval requirements for certain corporate action, as well as from the ability of a shareholder to demand that the company purchase the shares held by that shareholder if that shareholder voted against or did not participate in voting on certain types of action. Companies are also required by Russian law to obtain the approval of disinterested shareholders for certain transactions with interested parties. See Description of Capital Stock and Certain Requirements of Russian Legislation Description of Capital Stock Rights Attaching to Common Shares for a more detailed description of some of these protections. While these protections are similar to the types of protections available to minority shareholders in U.S. corporations, in practice, corporate governance standards for many Russian companies have proven to be poor, and minority shareholders in Russian companies have suffered losses due to abusive share dilutions, asset transfers and transfer pricing practices. Shareholder meetings have been irregularly conducted, and shareholder resolutions have not always been respected by management. Shareholders of some companies also suffered as a result of fraudulent bankruptcies initiated by hostile creditors.

In addition, the supermajority shareholder approval requirement is met by a vote of 75% of all voting shares that are present at a shareholders meeting. Thus, controlling shareholders owning slightly less than 75% of outstanding shares of a company may have a 75% or more voting power if certain minority shareholders are not present at the meeting. In situations where controlling shareholders effectively have 75% or more of voting power at a shareholders meeting, they are in a position to approve amendments to the charter of the company, which could be prejudicial to the interests of minority shareholders. It is possible that our majority shareholders and our management in the future may not run us and our subsidiaries for the benefit of minority shareholders, and this could materially and adversely affect the value of your investment in our ADSs. See Risks Relating to Our Business and Industry We will be controlled by two shareholders who run our business and affairs collectively and whose interests could conflict with those of the holders of the ADSs for more discussion of the potential control our current shareholders may have following this offering.

Disclosure and reporting requirements, as well as anti-fraud legislation, have only recently been enacted in Russia. Most Russian companies and managers are not accustomed to restrictions on their activities arising from these requirements. The concept of fiduciary duties of management or directors to their companies and shareholders is also relatively new and is not well developed. Violations of disclosure and reporting requirements or breaches of fiduciary duties to us and our subsidiaries or to our shareholders could materially adversely affect the value of your investment in our ADSs.

While the Joint Stock Companies Law provides that shareholders owning not less than 1% of the company s stock may bring an action for damages on behalf of the company, Russian courts to date do not have experience with respect to such lawsuits. Russian law does not contemplate class action litigation. Accordingly, your ability to pursue legal redress against us may be limited, reducing the protections available to you as a holder of ADSs.

Shareholder rights provisions under Russian law may impose additional costs on us, which could cause our financial results to suffer.

Russian law provides that shareholders, including holders of our ADSs, that voted against or did not participate in voting on certain matters have the right to sell their shares to the company at market value, as determined in accordance with Russian law. The decisions that trigger this right to sell shares include

- decisions with respect to reorganization;
- approval by shareholders of a major transaction, which, in general terms, is a transaction involving property worth more than 25% of the book value of our assets calculated according to Russian accounting standards; and
- amendment of our charter that restricts the shareholder s rights.

Our obligation to purchase the shares in these instances is limited to 10% of our net assets calculated according to Russian accounting standards, at the time the matter at issue is voted upon. Our or our subsidiaries obligation to purchase shares in these circumstances could have an adverse effect on our cash flows and our business.

The lack of a central and rigorously regulated share registration system in Russia may result in improper record ownership of our shares, including the shares underlying your ADSs.

Ownership of Russian joint stock company shares (or, if the shares are held through a nominee or custodian, then the holding of such nominee or custodian) is determined by entries in a share register and is evidenced by extracts from that register. Currently, there is no central registration system in Russia. Share registers are maintained by the companies themselves or, if a company has more than 50 shareholders or so elects, by licensed registrars located throughout Russia. Regulations have been issued regarding the licensing conditions for such registrars, as well as the procedures to be followed by both companies maintaining their own registers and licensed registrars when performing the functions of registrar. In practice, however, these regulations have not been strictly enforced, and registrars generally have relatively low levels of capitalization and inadequate insurance coverage. Moreover, registrars are not necessarily subject to effective governmental supervision. Due to the lack of a central and rigorously regulated share registration system in Russia, transactions in respect of a company s shares could be improperly or inaccurately recorded, and share registration could be lost through fraud, negligence, official and unofficial governmental actions or oversight by registrars incapable of compensating shareholders for their misconduct. This creates risks of loss not normally associated with investments in other securities markets. Further, the depositary, under the terms of the agreement governing the deposit of ADSs, will not be liable for the unavailability of shares or for the failure to make any distribution of cash or property with respect thereto due to the unavailability of the shares. See Description of Capital Stock and Certain Requirements of Russian Legislation Description of Capital Stock Registration and Transfer of Shares and Description of American Depositary Shares Registrar for more discussion of the share registration system and registrars in the Russian Federation.

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Weaknesses and changes in the Russian tax system could materially adversely affect our business and the value of our ADSs.

Generally, taxes payable by Russian companies are substantial and numerous. These taxes include, among others:

- income taxes;
- value-added tax, or VAT;
- excise taxes;
- unified social tax; and
- property tax.

The tax environment in Russia has historically been complicated by the fact that various authorities have often issued contradictory pieces of tax legislation. Because of the political changes which have occurred in Russia over the past several years, there have recently been significant changes to the Russian taxation system.

Global tax reform commenced in 1999 with the introduction of Part One of the Tax Code, which sets general taxation guidelines. Since then, Russia has been in the process of replacing legislation regulating the application of major taxes such as corporate income tax, VAT and property tax with new chapters of the Tax Code. For instance, new chapters of the Tax Code on VAT, unified social tax and personal income tax came into force on January 1, 2001; the profits tax and mineral extraction tax chapters came into force on January 1, 2002; and the newly introduced corporate property tax chapter of the Tax Code came into force on January 1, 2004.

In practice, the Russian tax authorities often have their own interpretation of the tax laws that rarely favors taxpayers, who often have to resort to court proceedings to defend their position against the tax authorities. Differing interpretations of tax regulations exist both among and within government ministries and organizations at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Tax declarations, together with related documentation such as customs declarations, are subject to review and investigation by a number of authorities, each of which may impose fines, penalties and interest charges. Generally, taxpayers are subject to inspection for a period of three calendar years of their activities which immediately preceded the year in which the audit is carried out. As previous audits do not exclude subsequent claims relating to the audited period, the statute of limitations is not entirely effective. In addition, in some instances, new tax regulations have been given retroactive effect. Recently, the Constitutional Court of the Russian Federation ruled that VAT paid on a commercial enterprise s purchases, or input VAT, cannot be offset against VAT collected from sales to the extent that the input VAT was incurred on items purchased with borrowed funds.

Moreover, financial statements of Russian companies are not consolidated for tax purposes. Therefore, each of our Russian entities pays its own Russian taxes and may not offset its profit or loss against the loss or profit of another entity in our group. In addition, pursuant to legislation that entered into force on January 1, 2002, payments of intercompany dividends between two Russian entities are subject to a withholding tax of 6% at the time they are paid out of profits, though this tax does not apply to dividends once they have already been taxed.

The foregoing conditions create tax risks in Russia that are more significant than typically found in countries with more developed tax systems, imposing additional burdens and costs on our operations, including management resources. In addition to our substantial tax burden, these risks and uncertainties complicate our tax planning and related business decisions, potentially exposing us to significant fines and penalties and enforcement measures despite our best efforts at compliance, and could adversely affect our business and the value of our ADSs.

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RISKS RELATING TO OTHER JURISDICTIONS

We also face risks associated with conducting business in the countries of the former Soviet Union and former Soviet-bloc countries in Eastern and Central Europe.

We currently have two steel mills in Romania, a hardware plant in Lithuania and coal operations in Kazakhstan. We may acquire additional operations in the countries of the former Soviet Union and former Soviet-bloc countries in Eastern and Central Europe. As with Russia, these countries are emerging markets subject to greater political, economic, social and legal risks than more developed markets. In many respects, the risks inherent in transacting business in these countries are similar to those in Russia, especially those risks set out above in Risks Relating to the Economic Environment in Russia, Risks Relating to the Social Environment in Russia and Risks Relating to Russian Legislation and the Russian Legal System.

Moreover, these countries are new operating environments for us, which are located, in many instances, a great distance from our Russian operations and across multiple international borders. We thus expect to have less control over their activities and these businesses may face more uncertainties with respect to their operational needs. These factors may hurt the profitability of our current and future operations in these countries.

Cautionary note regarding forward-looking statements

Matters discussed in this prospectus may constitute forward-looking statements. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts. The words believe, expect, anticipate, intend, estimate, forecast, project, will, may, should and s identify forward-looking statements. Forward-looking statements appear in a number of places including, without limitation, Risk Factors, Business and Management s Discussion and Analysis of Financial Condition and Results of Operations, and include statements regarding:

- strategies, outlook and growth prospects;
- future plans and potential for future growth;
- liquidity, capital resources and capital expenditures;
- growth in demand for our products;
- economic outlook and industry trends;
- developments of our markets;
- the impact of regulatory initiatives; and
- the strength of our competitors.

The forward-looking statements in this prospectus are based upon various assumptions, many of which are based, in turn, upon further assumptions, including without limitation, management s examination of historical operating trends, data contained in our records and other data available from third parties. Although we believe that these assumptions were reasonable when made, these assumptions are inherently subject to significant uncertainties and contingencies which are difficult or impossible to predict and are beyond our control and we may not achieve or accomplish these expectations, beliefs or projections. In addition to these important factors and matters discussed elsewhere herein, important factors that, in our view, could cause actual results to differ materially from those discussed in the forward-looking statements include the achievement of the anticipated levels of profitability, growth, cost and synergy of our recent acquisitions, the timely development and acceptance of new products, the impact of competitive pricing, the ability to obtain necessary regulatory approvals, the condition of the Russian economy, political stability in Russia, the impact of general business and global economic conditions and other important factors described herein and from time to time in the reports to be filed by us with the Securities and Exchange Commission, or the SEC.

Except to the extent required by law, neither we, nor any of our agents, employees or advisors intend or have any duty or obligation to supplement, amend, update or revise any of the forward-looking statements contained in this prospectus.

Escrow of proceeds and registration of placement report

Under Russian law, placement of the shares underlying the ADSs we offer pursuant to this prospectus is subject to our registration of a placement report with the Federal Service for the Financial Markets. The placement report may not be filed with the Federal Service for the Financial Markets until after the closing of this offering. We intend to file the placement report as soon as practicable following the closing of the offering. The Federal Service for the Financial Markets is statutorily required to make its decision within two weeks after we file the placement report but the current practice is that registration of a placement report takes between 30 and 44 days after filing.

Accordingly, prior to the registration of the placement report by the Federal Service for the Financial Markets, all sums paid for the ADSs will be held in escrow and escrow-type accounts. The underwriting agreement and agreements governing these accounts will provide that, pending the registration of the placement report by the Federal Service for the Financial Markets, the proceeds of this offering will be deposited as follows:

- the net proceeds to us will be converted into rubles and deposited in ruble-denominated escrow-type accounts at Raiffeisenbank Austria ZAO, a Russian subsidiary of Raiffeisenbank Zentralbank Österreich AG; and
- the underwriters commission and the net proceeds to the selling shareholders will be deposited in a U.S. dollar-denominated escrow account at UBS AG.

As Russian law does not allow for escrow accounts of the nature commonly seen in the United States, we have entered into a series of agreements with Raiffeisenbank Austria ZAO to replicate in substance the functions of an escrow account. We refer to the accounts established under these agreements as escrow-type accounts.

In the event that the placement report is not registered by the Federal Service for the Financial Markets within 60 days after the closing date (or such later date to which we and the selling shareholders agree with the underwriters), we will be required to issue a press release and to notify the depositary, the banks holding the escrow and escrow-type accounts, the underwriters and the NYSE of the termination of this offering by the close of business on the termination date. In this instance, all funds received in respect of the ADSs in the escrow-type and escrow accounts will be released to the depositary, together with interest, if any, accrued upon those funds from the closing date to the termination date and any additional amounts required so that the funds being released to the depositary would be equal (after conversion of all ruble funds into U.S. dollars) to the original U.S. dollar proceeds of the offering. The depositary will promptly distribute in U.S. dollars through DTC the funds it receives to the holders of the ADSs on the termination date.

In these unlikely circumstances, the amount returned to the holders of the ADSs as of the termination date will be the offer price for the ADSs, including interest, if any, regardless of the then-prevailing market prices for the ADSs. The return of funds may be delayed due to Russian currency control regulations and may be prevented if there is a change in such regulations.

Until the registration of the placement report by the Federal Service for the Financial Markets, you will not be entitled to instruct the depositary to exercise any voting rights on your behalf as our shareholder, and the depositary and its nominee will not be entitled to exercise any voting rights as a shareholder.

You may not withdraw our shares or other property with the depositary in respect of the ADSs sold in this offering prior to the registration of the placement report with the Federal Service for the Financial Markets.

See Risk Factors Risks Related to our ADSs and the Trading Market The holder of an ADS cannot withdraw the shares underlying the ADS prior to the registration of a placement report for these shares, and the failure to register this placement report could result in the offering being held invalid and being withdrawn.

Use of proceeds

The net proceeds to us from the offering will be approximately $• million, assuming an offering price equal to the mid-point of the estimated price range, which we will receive in rubles. This amount represents net proceeds after deducting estimated fees and expenses incurred in connection with the offering. We expect to use the net proceeds from this offering for the following purposes:

- $• million for capital expenditures, including the purchase of equipment and modernization of facilities; and
- $• million for acquisitions of additional operations and subsoil licenses.

We are not currently engaged in any discussions or negotiations with any acquisition target in which the completion of an acquisition has reached the probable stage.

We will not receive any of the proceeds from the sale of ADSs representing common shares offered by the selling shareholders.

Until the registration of a placement report regarding the placement of shares underlying the ADSs by the Federal Service for the Financial Markets, the proceeds from this offering will be held in escrow and escrow-type accounts at UBS AG and Raiffeisenbank Austria ZAO, a Russian subsidiary of Raiffeisenbank Zentralbank Österreich AG. The terms of the deposit of funds into these accounts will provide that the net proceeds will be released to us, and that the sums due to the selling shareholders and the underwriters will be released to them, only upon the registration of the placement report. Although under Russian law the placement report should be registered within two weeks after the report is filed with the Russian Federal Service for the Financial Markets, the registration may take longer or may not occur at all. See Escrow of Proceeds and Registration of Placement Report and Risk Factors Risks Related to our ADSs and the Trading Market The holder of an ADS cannot withdraw the shares underlying the ADS prior to the registration of a placement report for these shares, and the failure to register this placement report could result in the offering being held invalid and being withdrawn for more detail.

Dividend policy

Mechel Steel Group declared a dividend of 149 million rubles (or approximately $5.2 million) on June 24, 2004. Other than this dividend, Mechel Steel Group has not declared or paid any dividends on its common shares since its incorporation on March 19, 2003. Certain companies in our group paid dividends to our controlling shareholders in amounts of $26.3 million, $13.4 million and $8.8 million in the years ended December 31, 2003, 2002 and 2001, respectively. Commencing in 2005, with respect to the year ended December 31, 2004, we expect to declare and pay an annual dividend equal to at least 15% of our annual net income, as determined under U.S. GAAP, subject to any applicable Russian legal restrictions. See Description of Capital Stock and Certain Requirements of Russian Legislation Description of Capital Stock Dividends.

Dividend payments, if any, must be recommended by our board of directors and approved by our shareholders. In particular, dividends may be declared only out of net profits calculated under Russian accounting standards and as long as the following conditions have been met:

- our charter capital has been paid in full;
- the value of our net assets, calculated under Russian accounting standards, is not less (and would not become less as a result of the proposed dividend payment) than the sum of our charter capital, our reserve fund and the difference between the liquidation value and the par value of our issued and outstanding preferred shares;
- we have repurchased all shares from shareholders having the right to demand repurchase; and
- we are not, and would not become as the result of the proposed dividend payment, insolvent.

For a further description, please refer to Description of Capital Stock and Certain Requirements of Russian Legislation Description of Capital Stock Dividends.

We anticipate that any dividends we may pay in the future on the common shares represented by the ADSs will be declared and paid to the depositary in rubles and will be converted into U.S. dollars by the depositary and distributed to holders of ADSs, net of the depositary s fees and expenses. Accordingly, the value of dividends received by holders of ADSs will be subject to fluctuations in the exchange rate between the ruble and the U.S. dollar.

Capitalization

The following table sets forth our short-term debt and capitalization at June 30, 2004, on a historical basis and as adjusted to give effect to the issue and sale of 33,301,659 common shares in the offering at an assumed offering price of $• per ADS (the mid-point of the estimated price range) and the application of the net proceeds of the offering as described under Use of Proceeds. You should read this table together with the information under Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements included elsewhere in this prospectus.

	At June 30, 2004	
	Historical	As Adjusted
	(in thousands of U.S. dollars)	
Short-term debt (including current portion of long-term debt)(1)	385,371	•
Long-term debt, net of current portion(1)	152,583	•
Shareholders equity:		
Common shares	121,935	•
Treasury shares	(4,614)	•
Additional paid-in capital	93,327	•
Retained earnings	441,968	•
Accumulated other comprehensive income	53,287	•
Total shareholders equity	705,903	•
Total capitalization	858,486	•

(1) Of our total indebtedness at June 30, 2004, $436.2 million, was secured and $101.8 million was unsecured.

There has been no material change in our capitalization since June 30, 2004.

Dilution

Our net tangible book value as of June 30, 2004, was $512.9 million, or $4.17 per ADS. Net tangible book value per ADS represents the amount of our total tangible assets less total liabilities and minority interest, divided by the product of the number of shares outstanding and the ratio of one ADS per three shares.

Dilution in net tangible book value per ADS represents the difference between the amount per ADS paid by purchasers of ADSs in this offering and the net tangible book value per ADS immediately after the completion of this offering. After giving effect to the sale by us of 33,301,659 shares represented by ADSs in the offering at an assumed initial offering price of $• per ADS (the mid-point of the estimated price range), and after deducting the underwriting discount and estimated offering expenses payable by us, our net tangible book value as of June 30, 2004, as adjusted, would have been $• million, or $• per ADS. This represents an immediate increase in net tangible book value of $• per ADS to existing shareholders and an immediate dilution of $• per ADS to new investors purchasing ADSs in the offering.

The following table illustrates the per-ADS dilution.

Assumed initial public offering price per ADS		•
Net tangible book value before the offering	$ 4.17	
Increase in net tangible book value per ADS attributable to new investors	•	
Pro forma net tangible book value per ADS after the offering		•
Dilution to new investors		•

The following table sets forth, as of June 30, 2004, on an as adjusted basis and, in each case, as converted into ADSs for comparison purposes:

- the number of shares purchased from us and the total consideration and the average price per share paid to us by existing shareholders; and
- the number of shares to be sold by us in this offering and the total consideration and the average price per share to be paid by new investors purchasing ADSs representing these shares (before deducting the underwriting discount and estimated offering expenses).

	ADSs Purchased		Total Consideration		Average Price per ADS
	Number	Percent	Amount	Percent	
Existing shareholders					
New investors					
Total					

The preceding tables assume that the underwriters will not exercise their over-allotment option. If the underwriters over-allotment option is exercised in full, the net tangible book value of as of December 31, 2003, as adjusted, would have been $•, or $• per ADS, which would result in dilution to new investors of $• per ADS, and the number of shares held by the new investors would increase to • shares (represented by • ADSs), or •% of the total number of shares to be outstanding after this offering, and the number of shares held by existing shareholders would be • shares (equivalent to • ADSs), or •% of the total number of shares to be outstanding after this offering.

Selected consolidated financial data

The financial data set forth below as of December 31, 2003, 2002 and 2001, and for the years then ended have been derived from our audited consolidated financial statements. The financial data set forth below as of June 30, 2004 and 2003, and for the six-month periods then ended have been derived from our unaudited interim consolidated financial statements. Our reporting currency is the U.S. dollar and we prepare our consolidated financial statements in accordance with U.S. GAAP.[(1)] The unaudited interim consolidated financial statements reflect all normal and recurring adjustments that are necessary for a fair presentation of the financial position and results of operations for the interim periods presented. Results of operations for the six-month period ended June 30, 2004, are not necessarily indicative of results for the full year ended December 31, 2004, for any other interim period or for any future fiscal year. The financial data for 1999 and 2000 are not presented, as financial statements for these years are not available without unreasonable effort and expense.

Our results of operations for the periods presented are significantly affected by acquisitions. Results of operations of these acquired businesses are included in our consolidated financial statements for the periods after their respective dates of acquisition. The financial data below should be read in conjunction with, and are qualified in their entirety by reference to, our consolidated financial statements and related notes included elsewhere in this prospectus and in Management s Discussion and Analysis of Financial Condition and Results of Operations.

	Six months ended June 30,		Year ended December 31,		
	2004	2003	2003	2002	2001
	(in thousands of U.S. dollars, except per share data)				
Consolidated income statement data					
Revenue, net	1,630,063	930,595	2,050,088	1,314,149	1,019,726
Cost of goods sold	(985,370)	(647,809)	(1,440,053)	(947,527)	(721,089)
Gross margin	644,693	282,786	610,035	366,622	298,637
Selling, distribution and operating expenses	(295,587)	(193,430)	(417,259)	(277,478)	(193,853)
Operating income	349,106	89,356	192,776	89,144	104,784
Other income and expense, net	(12,630)	(5,866)	(20,018)	(18,083)	(12,178)
Income before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principle	336,476	83,490	172,758	71,061	92,606
Income tax expense	(74,100)	(23,135)	(47,759)	(2,653)	(30,184)
Minority interest in loss (income) of subsidiaries	(7,920)	6,632	18,979	10,433	(15,521)
Income from continuing operations	254,456	66,987	143,978	78,841	46,901
Loss from discontinued operations, net of tax		(1,317)	(2,422)	(1,835)	(735)
Extraordinary gain, net of tax		5,740	5,740	1,388	1,252
Changes in accounting principle, net of tax		(3,670)	(3,788)	10,859	
Net income	254,456	67,740	143,508	89,253	47,418
Earnings per share from continuing operations	0.69	0.18	0.39	0.24	0.21
Loss per share effect of discontinued operations			(0.01)	(0.01)	(0.01)
Earnings per share effect of extraordinary gain		0.02	0.02	0.01	0.01
Earnings per share effect of a changes in accounting principle		(0.01)	(0.01)	0.03	0.00

Net income per share	0.69	0.18	0.39	0.27	0.21
Cash dividends paid per share[(2)]	0.00		0.07	0.04	0.04
Weighted average number of shares outstanding	367,150,968	366,178,815	366,178,815	333,243,450	225,271,391

Selected consolidated financial data

	Six months ended June 30,		Year ended December 31,		
	2004	2003	2003	2002	2001
	(in thousands of U.S. dollars, except per share data)				
Steel segment income statement data					
Revenue, net(3)	1,307,903	778,846	1,678,395	1,050,554	680,314
Cost of goods sold(3)	(964,118)	(572,817)	(1,247,380)	(801,481)	(546,885)
Gross margin	343,785	206,029	431,015	249,073	133,429
Selling, distribution and operating expenses	(180,071)	(145,147)	(301,689)	(194,341)	(133,273)
Operating income	163,714	60,882	129,326	54,732	155
Mining segment income statement data					
Revenue, net(3)	522,594	251,027	599,756	372,216	339,971
Cost of goods sold(3)	(221,686)	(174,270)	(420,736)	(254,667)	(174,763)
Gross margin	300,908	76,757	179,020	117,549	165,208
Selling, distribution and operating expenses	(115,516)	(48,283)	(115,570)	(83,137)	(60,580)
Operating income	185,392	28,474	63,450	34,412	104,627
Consolidated balance sheet data (at period end)					
Total assets	2,336,233	n/a	1,834,509	1,387,378	1,116,473
Shareholders equity	705,903	n/a	448,826	278,051	195,122
Long-term debt, net of current portion	152,583	n/a	122,311	36,496	16,525
Consolidated cash flows data					
Net cash provided by operating activities	207,960	43,535	119,466	81,069	34,751
Net cash used in investing activities	(207,805)	(49,963)	(209,901)	(86,633)	(93,068)
Net cash provided by financing activities	43,843	19,162	103,079	3,422	65,701
Non-U.S. GAAP measures(4)					
Consolidated EBITDA	420,818	157,307	341,484	207,452	105,506
Steel segment EBITDA	206,739	116,420	245,832	133,448	2,976
Mining segment EBITDA	214,080	40,887	95,652	74,004	102,529

(1) The value of property, plant and equipment pertaining to non-controlling shareholders in the accounting for minority interests resulting from acquisitions of various subsidiaries has been recorded at appraised values rather than at historical cost as required by U.S. GAAP.

(2) Mechel Steel Group declared a dividend of 149 million rubles (or approximately $5.2 million) on June 24, 2004. Certain companies in our group paid dividends to our controlling shareholders in amounts of $26.3 million, $13.4 million and $8.8 million in the years ended December 31, 2003, 2002 and 2001, respectively.

(3) Segment revenues and cost of goods sold include intersegment sales.

(4) EBITDA represents net income before interest expense, income taxes and depreciation, depletion and amortization. We present 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. We also present EBITDA by segment because our overall performance is best explained with reference to results of each segment.

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 U.S. GAAP. Some of these limitations are as follows:

EBITDA does not reflect the impact of financing costs, which are significant and could further increase if we incur more debt, on our operating performance.

EBITDA does not reflect the impact of income taxes on our operating performance.

EBITDA does not reflect the impact of depreciation, depletion and amortization on our operating performance. The assets of our businesses which are being depreciated, depleted and/or amortized (including, for example, our mineral reserves) will have to be replaced in the future and such depreciation, depletion and amortization expense may approximate the cost to replace these assets in the future. By excluding such expense from EBITDA, EBITDA does not reflect our future cash requirements for such replacements.

Other companies in our industry may calculate EBITDA differently or may use it for different purposes than we do, limiting its usefulness as a comparative measure.

We compensate for these limitations by relying primarily on our U.S. GAAP operating results and using EBITDA only supplementally. See our consolidated income statements and consolidated statements of cash flows included elsewhere in this prospectus.

EBITDA is a measure of our operating performance that is not required by, or presented in accordance with, U.S. GAAP. EBITDA is not a measurement of our operating performance under U.S. GAAP and should not be considered as an alternative to net income, operating income or any other performance measures derived in accordance with U.S. GAAP or as an alternative to cash flow from operating activities or as a measure of our liquidity. In particular, EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business.

Selected consolidated financial data

Reconciliation of EBITDA to net income is as follows for the periods indicated:

	Six months ended June 30,		Year ended December 31,		
	2004	2003	2003	2002	2001
	(in thousands of U.S. dollars)				
Consolidated EBITDA reconciliation					
Net income	254,456	67,740	143,508	89,253	47,418
Add:					
Depreciation, depletion and amortization	62,240	46,185	101,689	78,773	13,378
Interest expense	30,022	20,247	48,528	36,773	14,526
Income taxes	74,100	23,135	47,759	2,653	30,184
Consolidated EBITDA	420,818	157,307	341,484	207,452	105,506
Steel segment EBITDA reconciliation					
Net income	91,542	53,551	114,011	57,977	(16,924)
Add:					
Depreciation, depletion and amortization	36,574	32,490	67,272	49,728	154
Interest expense	23,460	17,638	38,363	30,416	11,708
Income taxes	55,163	12,741	26,186	(4,673)	8,038
Steel segment EBITDA	206,739	116,420	245,832	133,448	2,976
Mining segment EBITDA reconciliation					
Net income	162,915	14,189	29,497	31,274	64,341
Add:					
Depreciation, depletion and amortization	25,666	13,695	34,417	29,045	13,224
Interest expense	6,562	2,609	10,165	6,357	2,818
Income taxes	18,937	10,394	21,573	7,328	22,146
Mining segment EBITDA	214,080	40,887	95,652	74,004	102,529

Exchange Rates

The following tables show, for the periods indicated, certain information regarding the exchange rate between the ruble and the U.S. dollar, based on data published by the Central Bank of Russia.

These rates may differ from the actual rates used in preparation of our financial statements and other financial information provided herein.

Rubles per U.S. dollar

	High	Low	Average(1)	Period End
Year ended December 31,				
2003	31.88	29.25	30.61	29.45
2002	31.86	30.14	31.39	31.78
2001	30.30	28.16	29.22	30.14
2000	28.87	26.90	28.13	28.16
1999	27.00	20.65	24.67	27.00

(1) The average of the exchange rates on the last business day of each full month during the relevant period.

Selected consolidated financial data

	High	Low
September 2004	29.26	29.21
August 2004	29.28	29.14
July 2004	29.13	29.04
June 2004	29.09	29.00
May 2004	29.08	28.87
April 2004	29.00	28.50

The exchange rate between the ruble and the U.S. dollar on October 1, 2004, was 29.22 rubles per one U.S. dollar.

No representation is made that the ruble or U.S. dollar amounts in this prospectus could have been or can be converted into U.S. dollars or rubles, as the case may be, at any particular rate or at all. The ruble is generally not convertible outside Russia. A market exists within Russia for the conversion of rubles into other currencies, but the limited availability of other currencies may inflate their values relative to the ruble.

Unaudited condensed pro forma consolidated income statements

The following unaudited condensed pro forma consolidated income statements for the year ended December 31, 2003, and the six months ended June 30, 2004, are presented to give effect to (1) the acquisition of Korshunov Mining Plant OAO, or KMP, effected on October 16, 2003, as if it had been consummated on January 1, 2003; and (2) the acquisition of Izhstal OAO, or Izhstal, effected on May 14, 2004, as if it had been consummated on January 1, 2003.

We have prepared the unaudited condensed pro forma consolidated income statement for the year ended December 31, 2003, based on our audited consolidated financial statements for the year ended December 31, 2003, which include the results of operations of KMP from the date of acquisition, October 16, 2003, to December 31, 2003, and the audited consolidated financial statements of Izhstal for the year ended December 31, 2003.

We have prepared the unaudited condensed pro forma consolidated income statement for the six months ended June 30, 2004, based on our unaudited consolidated financial statements for the six months ended June 30, 2004, which include the results of operations of Izhstal from the date of acquisition, May 14, 2004, to June 30, 2004, and Izhstal unaudited historical financial data.

The following unaudited condensed pro forma consolidated income statements have been prepared to illustrate the effects of the acquisition of KMP and Izhstal by us accounted for using the purchase method of accounting. We believe the assumptions used to prepare the unaudited condensed pro forma consolidated income statements provide a reasonable basis for presenting the significant effects directly attributable to the acquisitions of KMP and Izhstal. The unaudited condensed pro forma consolidated income statements do not purport to represent what our results of operations would actually have been if the acquisitions of KMP and Izhstal had in fact occurred on January 1, 2003, or to project our results of operations for any future period or date.

The unaudited condensed pro forma consolidated income statements, including the notes thereto, should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, our audited consolidated financial statements, our unaudited interim consolidated financial statements for the six months ended June 30, 2004, and the audited consolidated financial statements of KMP and Izhstal, with the related notes thereto included elsewhere in this prospectus.

Unaudited condensed pro forma consolidated income statements

UNAUDITED CONDENSED PRO FORMA CONSOLIDATED INCOME STATEMENT

For the year ended December 31, 2003

	Mechel (A)	KMP (B)	Izhstal (C)	Pro forma adjustments (D)	Notes	Pro forma
	(in thousands of U.S. dollars, except share and per share amounts)					
Revenue, net (including related party amounts of $211,943, $45,323 and $138, in Mechel, KMP and Izhstal, respectively)	$ 2,050,088	$ 45,728	$ 140,650	$ (51,381)	F	$ 2,185,085
Cost of goods sold (including related party amounts of $212,492, $39,418 and $121, in Mechel, KMP and Izhstal, respectively)	(1,440,053)	(39,445)	(132,679)	54,240	E, F	(1,557,937)
Gross margin	610,035	6,283	7,971			627,148
Selling, distribution and operating expenses:						
Selling and distribution expenses	(214,519)	(633)	(3,316)			(218,468)
General, administrative and other operating expenses	(202,740)	(7,165)	(18,748)	1,543	E	(227,110)
Total selling, distribution and operating expenses	(417,259)	(7,798)	(22,064)			(445,578)
Operating income (loss)	192,776	(1,515)	(14,093)			181,570
Other income and (expense):						
Interest income	2,292		8			2,300
Interest expense	(48,528)	(621)	(1,125)	(110)	G	(50,384)
Other income (expense), net	27,940	(153)	117			27,904
Foreign exchange gain	(1,722)	49	273			(1,400)
Total other income and (expense), net	(20,018)	(725)	(727)			(21,580)
Income (loss) before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principles	172,758	(2,240)	(14,820)			159,990
Income tax (expense) benefit	(47,759)	1,111	2,267	527	E	(43,854)
Minority interest in loss (income) of subsidiaries	18,979			4,874	H	23,853
Income (loss) from continuing operations	$ 143,978	$ (1,129)	$ (12,553)			$ 139,989
Basic and diluted income from continuing operations per common share (U.S. dollars per share)						$ 0.38
Shares used in computing basic and diluted income from continuing operations per common share						366,178,815

Unaudited condensed pro forma consolidated income statements

UNAUDITED CONDENSED PRO FORMA CONSOLIDATED INCOME STATEMENT

For the six months ended June 30, 2004

	Mechel (A)	Izhstal (C)	Pro forma adjustments (D)	Notes	Pro forma
	(in thousands of U.S. dollars, except share and per share amounts)				
Revenue, net (including related party amounts of $33,950 and $25 in Mechel and Izhstal, respectively)	$ 1,630,063	$ 64,005	$ (2,953)	J	$ 1,691,115
Cost of goods sold (including related party amounts of $6,279 and $25 in Mechel and Izhstal, respectively)	(985,370)	(57,117)	4,743	I, J	(1,037,744)
Gross margin	644,693	6,888			653,371
Selling, distribution and operating expenses:					
Selling and distribution expenses	(173,571)	(656)			(174,227)
General, administrative and other operating expenses	(122,016)	(5,783)	876	I	(126,923)
Total selling, distribution and operating expenses	(295,587)	(6,439)			(301,150)
Operating income (loss)	349,106	449			352,221
Other income and (expense):					
Interest income	1,125	11			1,136
Interest expense	(30,022)	(604)		G	(30,626)
Other income (expense), net	13,230	(2,249)			10,981
Foreign exchange gain	3,037	34			3,071
Total other income and (expense), net	(12,630)	(2,808)			(15,438)
Income (loss) before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principles	336,476	(2,359)			336,783
Income tax (expense) benefit	(74,100)	(361)	293	I	(74,168)
Minority interest in loss (income) of subsidiaries	(7,920)		1,044	H	(6,876)
Income (loss) from continuing operations	$ 254,456	$ (2,720)			$ 255,739
Basic and diluted income from continuing operations per common share (U.S. dollars per share)					$ 0.70
Shares used in computing basic and diluted income from continuing operations per common share					367,150,968

Unaudited condensed pro forma consolidated income statements

Notes

(A) Mechel Steel Group OAO Historical Financial Data

Mechel Steel Group OAO historical financial data is derived from our audited consolidated financial statements for the year ended December 31, 2003, and the unaudited consolidated financial statements for the six months ended June 30, 2004, presented elsewhere in this prospectus. We acquired our control in KMP in October 2003 and, accordingly, KMP is included in our historical results of operations from the date of acquisition, October 16, 2003, to December 31, 2003. We acquired our control in Izhstal in May 2004 and, accordingly, Izhstal is included in our historical results of operations from the date of acquisition, May 14, 2004, to June 30, 2004, and in our historical consolidated balance sheet as of June 30, 2004.

(B) Korshunov Mining Plant OAO Historical Financial Data

On December 25, 2002, we acquired 62.5% of the common shares of KMP for total consideration of $34.5 million in cash. The voting rights for these shares, however, were restricted due to the bankruptcy proceedings, and the investment was carried at cost. Until the ratification on September 29, 2003, by a court of the Settlement Agreement with KMP s creditors (we were the second largest creditor after the government, which was owed in arrears for taxes and social charges, including various penalties and interest), the equity interest did not provide for the ability to exercise either control or significant influence. The control restrictions were completely removed and we obtained full control over KMP s operations in October 2003, upon which the acquisition of KMP was accounted for using the purchase method of accounting.

Despite the lack of control over KMP, we continued to increase our stake in KMP s equity and, in February 2003, acquired an additional 7.7% of the common shares for approximately $1,000 in cash. Together with the cash paid for the shares of KMP, we provided loans and other continuing support to KMP which were aimed to pay the current liabilities and the tax and commercial debt arrears of KMP pursuant to the Settlement Agreement. At the date of acquisition, the cost of our investment in KMP s equity, in total comprising 70.3% of its voting shares, and the amount of loans and advances provided to KMP amounted to $132.3 million.

(C) Izhstal OAO Historical Financial Data

On May 14, 2004, we acquired a 26.9% interest in Izhstal at an auction held by the government, increasing our total interest in Izhstal to 59.4% of its total voting shares, comprising common and preferred shares. Subsequent to May 14, 2004, we continued to increase our interest in Izhstal, buying shares in the open market, and by the end of May 2004, we had accumulated 61.6% of the voting stock. Izhstal was accounted for using the purchase method of accounting. For our total holding of shares of Izhstal, we paid $25.1 million in cash.

(D) Acquisition of KMP and Izhstal

These reflect the acquisition adjustments relating to the KMP and Izhstal acquisitions. The acquisitions were accounted for in accordance with the purchase method of accounting. The acquisition adjustments reflect the allocation of purchase price for each acquisition to the respective acquired tangible and intangible assets and liabilities. The allocation reflects the estimated fair values of the tangible and intangible assets and liabilities on the respective acquisition dates of KMP and Izhstal. Negative goodwill, i.e., the excess of the fair value of the net assets acquired over the purchase price paid, if any, has been allocated as a pro rata reduction of the amounts that otherwise would have been assigned to all of the acquired assets except (1) financial assets other than investments accounted for by the equity method; (2) assets to be disposed of by sale; (3) deferred tax assets; and (4) any other current assets.

Unaudited condensed pro forma consolidated income statements

We believe the assumptions underlying the unaudited condensed pro forma consolidated income statements are reasonable. The unaudited condensed pro forma consolidated income statements are being furnished solely for informational purposes and are not necessarily indicative of the combined results of operations that might have been achieved for the period indicated, nor is it necessarily indicative of our future results. For example, the pro forma information does not reflect cost savings that we expect to realize from operational synergies, as these expected cost savings and operational synergies may not be realized, and does not reflect integration costs, in each case, for the periods presented.

(E) Purchase Accounting Adjustments

a. Adjustments to depreciation and amortization as a result of the impact of the purchase accounting adjustments for KMP and Izhstal property, plant and equipment; these adjustments also affected the valuation of cost of goods sold and general, administrative, selling and other operating expenses, as well as the amount of loss recognized on the disposal of property, plant and equipment in the normal course of business during 2003.

b. Adjustment to record the impact on depletion of the acquired mineral licenses with the total estimated fair value of $76.7 million for KMP during the period before October 16, 2003; Izhstal had no mineral licenses.

The above pro forma adjustments are summarized below as an increase or (decrease) to a respective item in our pro forma income statement:

	KMP	Izhstal	Total
Cost of goods sold:			
Depreciation and amortization(a)	$	$ (5,927)	$ (5,927)
Depletion and amortization of acquired mineral licenses(b)	(2,652)		(2,652)
Total pro forma adjustments to cost of goods sold	(2,652)	(5,927)	(8,579)
General, administrative and other operating expenses(a):			
Disposal of property, plant and equipment		(938)	(938)
Depreciation and amortization		(605)	(605)
Total pro forma adjustments to general, administrative and other operating expenses		(1,543)	(1,543)

c. The adjustment to the income tax expense reflects the amount necessary to present the pro forma income tax expense at our year-end effective tax rate of 27.6%.

(F) Intercompany Transactions

Reflects the elimination of intercompany revenue ($51.4 million) and intercompany purchases in cost of goods sold ($45.7 million) relating to the trade operations between KMP and us during the period from January 1, 2003, to October 15, 2003. We did not have transactions with Izhstal during 2003.

(G) Interest Expense

Reflects the pro forma adjustments to interest expense arising from the debt incurred to finance the acquisition of Izhstal shares. We obtained a $13.6 million ruble-denominated, short-term loan bearing 10% interest per annum and the interest charged on the debt outstanding until repayment was included as a pro forma adjustment as interest expense, for a total of $110,000 for the year ended December 31, 2003. No pro forma adjustment was made for the six months ended June 30, 2004, as the above $110,000 is already included in the Mechel interest expense for this period.

(H) Minority Interests

Reflects the pro forma adjustment to record the minority s 38.4% interest in the losses of Izhstal during 2003 and for the six months ended June 30, 2004.

Unaudited condensed pro forma consolidated income statements

(I) Purchase Accounting Adjustments

Adjustments to depreciation and amortization as a result of the impact of the purchase accounting adjustments for Izhstal property, plant and equipment; these adjustments also affected the valuation of cost of goods sold ($1.8 million) and general, administrative and other operating expenses ($0.9 million). The adjustment to the income tax expense reflects the amount necessary to present the pro forma income tax expense at our effective tax rate of 22.0% for the six months ended June 30, 2004.

(J) Intercompany Transactions

Reflects the elimination of intercompany revenue and intercompany purchases in cost of goods sold ($3.0 million) relating to trade operations between Izhstal and us during the period from January 1, 2004, to May 14, 2004.

Management s discussion and analysis of financial condition and results of operations

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements, related notes and other information included elsewhere in this prospectus. This section contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in forward-looking statements as a result of various factors, including those described under Risk Factors and Cautionary Note Regarding Forward-Looking Statements.

THE REORGANIZATION

Mechel Steel Group OAO was incorporated on March 19, 2003, under the laws of the Russian Federation in connection with a reorganization to serve as a holding company for various steel and mining companies owned by Messrs. Igor Zyuzin and Vladimir Iorich. These individuals acquired these companies at various times from 1995 to the present and have acted in concert since that time pursuant to an Ownership, Control and Voting Agreement which requires them to vote the same way. The reorganization involved the contribution of these companies by these individuals to Mechel in exchange for all the outstanding capital stock of Mechel. Many of the contributed companies had shareholders other than Messrs. Zyuzin and Iorich, and these shareholders were not involved in the reorganization and continue to retain minority interests in certain of our subsidiaries.

The acquisition of these companies by Mechel Steel Group represents a reorganization under common control, and has been accounted for in a manner akin to a pooling. Mechel Steel Group s consolidated financial statements, therefore, have been prepared on the basis that Mechel Steel Group existed for all periods presented since its inception and owned these companies to the same extent as owned by Messrs. Zyuzin and Iorich in those periods.

In connection with the reorganization, in late 2003 and the first half of 2004, we disposed of our controlling stakes in (1) Belov Insurance Company ZAO, a small insurance company in which we had acquired a controlling stake in 2001, and (2) Uglemetbank ZAO, a small bank in which we had acquired a controlling stake in 1999, to their management and other unrelated investors. These companies provided our coal companies and their employees with routine banking, finance and insurance services. The results for these businesses have been classified as discontinued operations for all periods presented.

In August 2004, we terminated production at Mechel Zeljezara, a Croatian steel mill that produced pipes. Mechel Zeljezara s assets were acquired out of bankruptcy proceedings in March 2003. See note 2(g) to our audited consolidated financial statements. We decided to terminate production at Mechel Zeljezara due to significant increases in input costs and a persistent weakness in pipe prices. In September 2004, we concluded a termination agreement providing for the return to the seller of the Mechel Zeljezara assets, the redemption of the bank guarantee that we granted to the government of Croatia in the amount of $4.3 million and the donation of spare parts at Mechel Zeljezara in the amount of $1.8 million, in return for a waiver of any and all claims against us. See note 10 to our interim consolidated financial statements.

BUSINESS STRUCTURE

Segments

We have organized our businesses into two segments:

the steel segment, comprising production and sale of semi-finished steel products; carbon and

Management s discussion and analysis of financial condition and results of operations

specialty long products; carbon and stainless flat products; value-added downstream metal products including hardware, forgings and stampings; and coke and coking products; and

the mining segment, comprising production and sale of coal (coking and steam), iron ore and nickel, which supplies raw materials to our steel business and also sells substantial amounts of raw materials to third parties.

The table below sets forth by segment our primary steel and mining subsidiaries, presented in chronological order by date of acquisition:

Name	Location	Business	Date Control Acquired	Voting Interest[(1)] %
Steel Segment				
Chelyabinsk Metallurgical Plant	Russia	Semi-finished steel products, carbon and specialty long and flat steel products, forgings, coke and coking products	December 2001	82.7
Vyartsilya Metal Products Plant	Russia	Hardware	May 2002	93.3
Beloretsk Metallurgical Plant	Russia	Long steel products, hardware, limestone[(2)]	June 2002	90.2
COST	Romania	Carbon and specialty long steel products, forgings, hardware	August 2002	81.0
Urals Stampings Plant	Russia	Stampings	April 2003	93.8
Industria Sarmei	Romania	Semi-finished steel products, long steel products, hardware	June 2003	81.0
Mechel Nemunas	Lithuania	Hardware	October 2003	100.0
Izhstal	Russia	Specialty and carbon steel long products, hardware, stampings and forgings	May 2004	62.2
Mining Segment				
Southern Kuzbass Coal Company	Russia	Coking coal concentrate, steam coal, steam coal concentrate	January 1999	96.7
Sibirginsk Open Pit Mine	Russia	Coking coal, steam coal, steam coal concentrate	January 1999	86.3
Krasnogorsk Open Pit Mine	Russia	Steam coal, steam coal concentrate	January 1999	77.7
Tomusinsk Open Pit Mine	Russia	Coking coal, steam coal	January 1999	74.4
Olzherassk Open Pit Mine	Russia	Coking coal, steam coal	December 1999	78.9
Tomusinsk Group Processing Plant	Russia	Coking coal concentrate	December 2000	94.8
Kuzbass Central Processing Plant	Russia	Coking coal concentrate	December 2000	88.4
Siberian Central Processing Plant	Russia	Coking coal concentrate	December 2000	90.8
Southern Urals Nickel Plant	Russia	Ferro nickel	December 2001	79.3
Lenin Mine	Russia	Coking coal	December 2001	53.5
Korshunov Mining Plant	Russia	Iron ore concentrate	October 2003	75.0
Mechel Coal Resources	Kazakhstan	Coking coal, coking coal concentrate	December 2003	100.0
Port Posiet	Russia	Shipping	February 2004	80.0

(1) As of October 1, 2004. Some of our Russian subsidiaries have preferred shares outstanding which have voting rights commensurate with common shares if dividends on these shares have not been paid. We have calculated voting interest by including these preferred shares for subsidiaries where dividends have not been paid.

(2) Our Pugachev limestone quarry is owned by Beloretsk Metallurgical Plant and is within the steel segment.

Intersegment sales

We are an integrated steel and mining group. Our mining segment supplies 100% of our steel segment s coking coal requirements and a substantial portion of the steel segment s nickel requirements. Our steel segment also supplies wires, ropes and other hardware to our mining segment for use in its day-to-day operations, as well as coke for use in the production of nickel. The prices at which we record these transfers are based on market prices, and these transactions are eliminated as intercompany transactions for purposes of our consolidated financial statements. For the six months ended June 30, 2004, and for the years ended December 31, 2003 and 2002, mining segment sales to the steel segment amounted to $160.3 million, $185.8 million and $69.6 million, respectively. For the six months ended June 30, 2004, and for the years ended December 31, 2003 and 2002, steel segment sales to the mining segment amounted to $40.1 million, $42.3 million and $39.0 million, respectively.

Following our acquisition of a majority stake in Korshunov Mining Plant in December 2002, our steel segment purchased a significant portion of its iron ore requirements from Korshunov Mining Plant. These purchases were priced on an arm s-length basis. We subsequently consolidated Korshunov Mining Plant in October 2003. These purchases, to the extent they date from prior to our consolidation of Korshunov Mining Plant, are not eliminated as intercompany transactions for purposes of our consolidated financial statements. Additionally, we sell Korshunov Mining Plant s products to third parties. In 2003, we sourced approximately 39% of our iron ore requirements from Korshunov Mining Plant. In 2004, in response to market conditions, we began to export iron ore concentrate to China, and increased sales to neighboring Russian steel plants, while purchasing iron ore concentrate from Russian suppliers to meet our own requirements. We retain the flexibility to continue to sell iron ore concentrate to China and to neighboring Russian steel plants, and elsewhere, and to source our iron ore requirements from local Russian iron ore producers, depending upon conditions in the Russian and global iron ore markets.

SUMMARY OF ACQUISITIONS

We have sought to develop an integrated steel and mining business through the purchase of under-performing assets which we believe offer significant upside potential, particularly as we implement improvements in working practices and operational methods. Pending the implementation of these practices and our other integration strategies, our margins are initially adversely affected after each acquisition.

Following is a summary of the terms of acquisition of our primary steel and mining subsidiaries since 2001. Each of the acquisitions was accounted for using the purchase method of accounting, so the results of operations of each acquired business are included in our consolidated income statements since their respective dates of acquisition of control. In certain cases where we acquired our interest in these businesses over a period of time and thus control was not acquired until subsequent acquisitions of shares, until such controlling stake was acquired, these businesses were accounted for using the equity method of accounting or at cost, as appropriate. Our results of operations for the periods presented herein are thus not comparable from period to period due to these acquisitions and their accounting treatment.

Chelyabinsk Metallurgical Plant. Chelyabinsk Metallurgical Plant is an integrated blast furnace and BOF/EAF steel mill that produces coke, semi-finished and rolled carbon and specialty steel products and forgings. Glencore International, an international trading company, which is currently one of our biggest customers, acquired a 65.1% stake in Chelyabinsk Metallurgical Plant during its privatization by the Russian government in 1992. In December 2001, we acquired Glencore s stake in Chelyabinsk Metallurgical Plant. We have paid a total of $133.0 million for our current stake in Chelyabinsk Metallurgical Plant.

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Southern Urals Nickel Plant. Southern Urals Nickel Plant operates two open-pit nickel mines and a nickel processing facility. Southern Urals Nickel Plant was privatized by the Russian government in 1993. We acquired a 46.0% stake in Southern Urals Nickel Plant in September 2001 and increased that stake to a controlling stake in December 2001. We have paid a total of $9.9 million for our current stake in Southern Urals Nickel Plant.

Lenin Mine. Lenin Mine produces coking coal. Lenin Mine was privatized by the Russian government in 1993. We acquired a 26.9% stake in Lenin Mine through market purchases beginning from 1997. We acquired another 25% stake as a result of our acquisition of Mezhdurechensk Coal Company in December 2001 from the Russian government. We subsequently merged Mezhdurechensk Coal Company into Southern Kuzbass Coal Company. We have paid a total of $0.3 million for our current stake in Lenin Mine.

Vyartsilya Metal Products Plant. Vyartsilya Metal Products Plant is a hardware plant that produces wire, nails and steel nets. Vyartsilya Metal Products Plant was formed in June 1996 as a spin-off from Vyartsilya Metal Products Plant OAO, which was privatized by the Karelian government in 1994. We acquired a 88.1% stake in Vyartsilya Metal Products Plant from employee-shareholders in May 2002. We have paid a total of $0.1 million for our current stake in Vyartsilya Metal Products Plant.

Beloretsk Metallurgical Plant. Beloretsk Metallurgical Plant is a hardware plant that produces wire rod and a broad range of hardware. Beloretsk Metallurgical Plant was privatized by the Bashkir government in 1994. We acquired a 33.3% stake in Beloretsk Metallurgical Plant from third parties in 2001, and increased our stake to a controlling interest in June 2002. In November 2003, we acquired another 29.4% stake in Beloretsk Metallurgical Plant from the regional government, and in March 2004, we acquired another 9.7% stake in Beloretsk Metallurgical Plant, bringing our total stake to 90.2%. Beloretsk Metallurgical Plant also owns the Pugachev limestone quarry. We paid a total of $15.2 million for our current stake in Beloretsk Metallurgical Plant. The regional government has a golden share in Beloretsk Metallurgical Plant, giving it the right to veto certain shareholder decisions and appoint a voting representative on the board of directors.

Combinatul de Oteluri Speciale Targoviste. COST is a Romanian steel mill that produces long products and forgings. We acquired an 79.7% stake in COST from the Romanian government in August 2002. At the time we acquired COST, it was in bankruptcy proceedings. The consideration consisted of $3.5 million in cash and a commitment on our part to invest $21.1 million in the modernization of the plant and upgrade of its capacity over five years, as well as a commitment to maintain its workforce level for five years. Under the transaction documents, our stake in COST is pledged to the Romanian government until we fulfill our commitments.

Urals Stampings Plant. Urals Stampings Plant is Russia s largest producer of stampings from specialty steel and heat-resistant titanium alloys for the aerospace, power and other industries. Urals Stampings Plant was privatized by the Russian government in 1993. We acquired a 93.8% stake in Urals Stampings Plant from third parties in April 2003 for $11.3 million in cash.

Industria Sarmei. Industria Sarmei is a Romanian steel mill that produces rolled products and hardware, including wires, ropes and nails. We acquired a 73.4% stake in Industria Sarmei from the Romanian government in June 2003. The consideration consisted of $2.8 million in cash and a commitment on our part to invest $19.0 million in the modernization of the plant and upgrade of its capacity over five years, a commitment to spend $3.6 million in environmental protection, as well as a commitment to maintain its workforce level for five years. In connection with the acquisition, certain debt of Industria Sarmei was converted into shares, and we subsequently acquired these shares for $1.3 million, increasing our stake to 79.8%. Under the transaction documents, our stake in Industria Sarmei is pledged to the Romanian government until we fulfill our commitments.

Mechel Nemunas. Mechel Nemunas is a Lithuanian hardware plant that produces wire, calibrated steel products, nails, rods and nets. We acquired a 75.1% stake in Mechel Nemunas for $4.0 million in cash in October 2003. From November to December 2003, we acquired the remaining 24.9% stake in Mechel Nemunas for $1.0 million in cash.

Korshunov Mining Plant. Korshunov Mining Plant operates three surface iron ore mines and an iron ore concentrating plant. Korshunov Mining Plant was privatized by the local government in 1993. We acquired a 62.5% interest in Korshunov Mining Plant in December 2002 when it was in bankruptcy proceedings. In September 2003, a court approved a debt settlement plan. We recorded our investment in Korshunov Mining Plant at cost until we acquired control in October 2003, and have consolidated its results since that time. We have paid a total of $132.3 million (including loans and advances) for our current stake in Korshunov Mining Plant.

Mechel Coal Resources. Mechel Coal Resources is a newly-formed Kazakh company holding our Kazakh coal assets. It consists of (1) the assets of Coal Washing Factory-38, a coal washing plant, which we acquired in December 2003 for $1.0 million in cash and $1.0 million in assumed debt; and (2) the assets of K.O. Gorbachev Mine, an underground coal mine primarily producing coking coal, which we acquired in May 2004 for $1.6 million in cash.

Port Posiet. Port Posiet is located in Russia s Far East on the Sea of Japan. We acquired an 80.0% stake in Port Posiet for $30.0 million in cash in February 2004. We intend to ship primarily our coking coal concentrate, as well as steel products, to Asia through this port.

Izhstal. Izhstal is a Russian specialty steel plant which produces rolled products, hardware, stampings and forgings. We acquired a 61.6% stake in Izhstal for $25.1 million in cash in February through May 2004. The regional government has a golden share in Izhstal, giving it the right to veto certain shareholder decisions and appoint a voting representative on the board of directors.

The acquisition of Chelyabinsk Metallurgical Plant in December 2001, an integrated steel mill with its own coking batteries, was the most significant steel acquisition and it is the center of our steel segment operations. Prior to its acquisition, we were primarily a coal mining and trading company. In the year of its acquisition, we had been running Chelyabinsk Metallurgical Plant on a contract basis, our trading operations had been selling Chelyabinsk Metallurgical Plant s products and we had supplied it with most of its coking coal requirements, so we were already familiar with its operations and customers. The addition of Beloretsk Metallurgical Plant in June 2002, a market leader in hardware in Russia and whose products our trading operations had been selling prior to its acquisition, significantly expanded our presence in this product category, and this presence was also bolstered by our acquisition of Vyartsilya Metal Products Plant in May 2002. Beloretsk Metallurgical Plant and Vyartsilya Metal Products Plant are supplied with semi-finished steel by Chelyabinsk Metallurgical Plant. Our downstream product mix was also further widened by the purchase of Urals Stampings Plant in April 2003, which uses Chelyabinsk Metallurgical Plant s specialty steel to make value-added stampings. We further solidified our presence in the Russian specialty steel market by the acquisition of Izhstal in May 2004. Additionally, our Eastern European acquisitions, COST in August 2002, Industria Sarmei in June 2003 and Mechel Nemunas in October 2003, marked our expansion outside Russia. COST produces specialty long products and Industria Sarmei and Mechel Nemunas produce hardware. Mechel Nemunas is supplied with semi-finished steel from our Russian operations.

Within the mining segment, our acquisitions of Southern Urals Nickel Plant in December 2001 and Korshunov Mining Plant in October 2003 added ferro nickel and iron ore concentrate production to our mining segment, and provided us with the ability to internally source a substantial portion of our raw

Management s discussion and analysis of financial condition and results of operations

material needs. Mechel Coal Resources represents the expansion of our mining operations beyond Russia, focusing on the coal-rich regions of Kazakhstan. It consists of a coal washing plant and an underground coal mine producing primarily coking coal.

RESULTS OF OPERATIONS

The following table sets forth our income statement data for the six months ended June 30, 2004 and 2003.

	Six months ended June 30, 2004		Six months ended June 30, 2003	
	amount	% of revenues	amount	% of revenues
	(in thousands of U.S. dollars, except for percentages)			
Revenue, net	1,630,063	100.0	930,595	100.0
Cost of goods sold	(985,370)	(60.4)	(647,809)	(69.6)
Gross margin	644,693	39.6	282,786	30.4
Selling, distribution and operating expenses	(295,587)	(18.1)	(193,430)	(20.8)
Operating income	349,106	21.4	89,356	9.6
Other income and expense, net	(12,630)	(0.8)	(5,866)	(0.6)
Income before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principle	336,476	20.6	83,490	9.0
Income tax expense	(74,100)	(4.5)	(23,135)	(2.5)
Minority interest in loss (income) of subsidiaries	(7,920)	(0.5)	6,632	0.7
Income from continuing operations	254,456	15.6	66,987	7.2
Loss from discontinued operations, net of tax			(1,317)	(0.1)
Extraordinary gain, net of tax			5,740	0.6
Changes in accounting principle, net of tax			(3,670)	(0.4)
Net income	254,456	15.6	67,740	7.3

The following table sets forth our income statement data for the years ended December 31, 2003, 2002 and 2001.

	Year ended December 31, 2003		Year ended December 31, 2002		Year ended December 31, 2001	
	amount	% of revenues	amount	% of revenues	amount	% of revenues
	(in thousands of U.S. dollars, except for percentages)					
Revenue, net	2,050,088	100.0	1,314,149	100.0	1,019,726	100.0
Cost of goods sold	(1,440,053)	(70.2)	(947,527)	(72.1)	(721,089)	(70.7)

Gross margin	610,035	29.8	366,622	27.9	298,637	29.3
Selling, distribution and operating expenses	(417,259)	(20.4)	(277,478)	(21.1)	(193,853)	(19.0)
Operating income	192,776	9.4	89,144	6.8	104,784	10.3
Other income and expense, net	(20,018)	(1.0)	(18,083)	(1.4)	(12,178)	(1.2)
Income before income tax, minority interest, discontinued operations, extraordinary gain and changes in accounting principle	172,758	8.4	71,061	5.4	92,606	9.1
Income tax expense	(47,759)	(2.3)	(2,653)	(0.2)	(30,184)	(3.0)
Minority interest in loss (income) of subsidiaries	18,979	0.9	10,433	0.8	(15,521)	(1.5)
Income from continuing operations	143,978	7.0	78,841	6.0	46,901	4.6
Loss from discontinued operations, net of tax	(2,422)	(0.1)	(1,835)	(0.1)	(735)	(0.1)
Extraordinary gain, net of tax	5,740	0.3	1,388	0.1	1,252	0.1
Changes in accounting principle, net of tax	(3,788)	(0.2)	10,859	0.8		
Net income	143,508	7.0	89,253	6.8	47,418	4.7

Management s discussion and analysis of financial condition and results of operations

Six months ended June 30, 2004, compared to six months ended June 30, 2003

Revenues

Consolidated revenues increased by $699.5 million, or 75.2%, to $1,630.1 million in the six months ended June 30, 2004, from $930.6 million in the six months ended June 30, 2003. The following table sets out revenues by segment.

	Six months ended June 30,	
Revenues by segment	**2004**	**2003**
	(in thousands of U.S. dollars)	
Steel segment		
To third parties	1,267,754	759,693
To mining segment	40,149	19,153
Total	1,307,903	778,846
Mining segment		
To third parties	362,309	170,902
To steel segment	160,285	80,125
Total	522,594	251,027
Eliminations	200,434	99,278
Consolidated revenues	1,630,063	930,595
% from steel segment	77.8	81.6
% from mining segment	22.2	18.4

Steel segment

Our steel segment revenues in the six months ended June 30, 2004, increased by $529.1 million, or 67.9%, to $1,307.9 million from $778.8 million in the six months ended June 30, 2003. The increase in steel segment revenues is primarily explained by the following increases:

Rebar sales increased by $120.6 million, or 79.5%, due to price increases, and wire rod sales increased by $69.2 million, or 83.5%, due to price increases and particularly as a result of sharp increases in prices for the higher-quality wire rod we produce at Beloretsk Metallurgical Plant.

Sales of semi-finished products increased by $123.5 million, or 226.3%, due equally to price and volume increases.
Hardware sales were higher by $48.8 million, or 85.8%, including an increase in wire sales of $33.8 million, or 83.6%, and an increase in rope sales of $8.7 million, or 85.3%, both due to price increases.
Sales of carbon and low-alloy flat products increased by $37.9 million, or 94.3%, primarily due to price increases.
Sales of stainless and alloyed long products increased by $7.7 million, or 23.7%, primarily due to price increases.
Carbon and low-alloyed long product sales grew by $41.0 million, or 59.7%, mostly as a result of price increases.
High quality forgings and forged alloy sales increased by $15.7 million, or 41.9%, due equally to price and volume increases.
Sales of coke and coking products to third parties increased by $7.9 million, or 34.6%, and sales to the mining segment, which uses coke in the production of nickel, grew by $20.1 million, or 114.0%, in both cases primarily as a result of substantial increases in the price of coke.

Tube sales increased by $8.6 million, or 157.6%, primarily as a result of volume increases.
Pig iron sales increased by $31.0 million, or 465.6%, primarily as a result of price increases.
Sales of steel products to our mining segment increased by $0.9 million.

In addition to the above, the following increases were related to acquisitions:

Revenues at Mechel Zeljezara for the first two months of 2004, Urals Stampings Plant for the first three months of 2004 and Industria Sarmei for the first five months of 2004, which are not included in the comparative analysis by product above, amounted to $74.2 million.
Revenues at Mechel Nemunas and Izhstal for the six months ended June 30, 2004, amounted to $53.5 million.

These increases in steel products sales were offset by sales decreases as follows:

Sales of MMK products in the six months ended June 30, 2003, amounted to $105.1 million. Starting in January 2004, we stopped reselling MMK products. See Certain Transactions Related Party Transactions Magnitogorsk Iron & Steel Works.
Stainless flat product sales decreased by $6.8 million, or 13.4%, mostly due to a volume decrease.
Trading sales of iron ore from Korshunov Mining Plant in the six months ended June 30, 2003, amounted to $19.8 million and were included in steel segment sales; after Korshunov Mining Plant s consolidation in October 2003, its revenues are being reflected in the mining segment.

Excluding intersegment sales, export sales were 50.2% of steel segment sales in the six months ended June 30, 2004, compared to 47.3% in the six months ended June 30, 2003.

Mining segment

Our total mining segment sales in the six months ended June 30, 2004, increased by $271.6 million, or 108.2%, to $522.6 million from $251.0 million in the six months ended June 30, 2003.

Coking coal concentrate sales to third parties increased by $74.7 million, or 91.9%, primarily due to price increases, as well as to a 15.5% increase in sales volume. Coking coal concentrate supplied to the steel segment increased by $56.2 million, or 92.9%, to satisfy increased steel production at Chelyabinsk Metallurgical Plant. Steam coal and steam coal concentrate sales to third parties increased by $37.2 million, or 70.0%, due equally to price and volume increases.

Nickel sales to third parties increased by $34.0 million, or 148.7%, primarily due to price increases. Nickel supplied to the steel segment increased by $2.0 million, or 10.2%.

We recorded iron ore sales in the mining segment beginning in October 2003 with our consolidation of Korshunov Mining Plant. For the six months ended June 30, 2004, sales to third parties amounted to $48.4 million and supplies to the steel segment amounted to $22.0 million, for a total of $70.4 million.

These increases in mining products sales were partly offset by a decrease of $4.3 million in other products and services sales, consisting primarily of transportation, blasting, and municipal services, as well as sales of energy.

Excluding intersegment sales, export sales were 72.6% of mining segment sales in the six months ended June 30, 2004, compared to 43.7% in the six months ended June 30, 2003. The increase in the proportion of our export sales was due to higher export prices in relation to domestic prices (the weighted average export price of our mining products increased by $18 per tonne, whereas the weighted average domestic price of our mining products increased by $6 per tonne), as well as increased export volume levels in response to the higher export prices.

Cost of goods sold and gross margin

Consolidated cost of goods sold was 60.4% of consolidated revenues in the six months ended June 30, 2004, as compared to 69.6% of consolidated revenues in the six months ended June 30, 2003, resulting in an increase in the consolidated gross margin percentage in the six months ended June 30, 2004, to 39.6% from 30.4% in the six months ended June 30, 2003. Cost of goods sold primarily consists of costs relating to raw materials (including products purchased for resale), direct payroll, depreciation and energy. The table below sets forth cost of goods sold and gross margin by segment for the six months ended June 30, 2004 and 2003, including as a percentage of segment revenues.

	Six months ended June 30, 2004		Six months ended June 30, 2003	
Cost of goods sold and gross margin by segment	**amount**	**% of segment revenues**	**amount**	**% of segment revenues**
	(in thousands of U.S. dollars, except for percentages)			
Steel segment				
Cost of goods sold	964,118	73.7	572,817	73.5
Gross margin	343,785	26.3	206,029	26.5
Mining segment				
Cost of goods sold	221,686	42.4	174,270	69.4
Gross margin	300,908	57.6	76,757	30.6

Steel segment

Steel segment cost of goods sold increased by $391.3 million, or 68.3%, to $964.1 million in the six months ended June 30, 2004, from $572.8 million in the six months ended June 30, 2003. Steel segment cost of goods sold was 73.7% of segment revenues, as compared to 73.5% in the six months ended June 30, 2003.

Mining segment

Mining segment cost of goods sold increased by $47.4 million, or 27.2%, to $221.7 million in the six months ended June 30, 2004, from $174.3 million in the six months ended June 30, 2003. Mining segment gross margin percentage increased from 30.6% in the six months ended June 30, 2003, to 57.6% in the six months ended June 30, 2004. The improvement in the mining segment s gross margin was attributable to a substantial increase in the average sales price of coal and nickel, which increased by 57% and 69%, respectively.

Selling, distribution and operating expenses

Selling, distribution and operating expenses increased by $102.2 million, or 52.8%, to $295.6 million in the six months ended June 30, 2004, from $193.4 million in the six months ended June 30, 2003. As a percentage of consolidated revenues, selling, distribution and operating expenses decreased to 18.1% in the six months ended June 30, 2004, as compared to 20.8% in the six months ended June 30, 2003. Our selling, distribution and operating expenses consist primarily of selling and distribution expenses, taxes other than income tax, provision for doubtful accounts and general, administrative and other operating expenses. The table below sets forth these costs by segment for the six months ended June 30, 2004 and 2003, including as a percentage of segment revenues.

	Six months ended June 30, 2004		Six months ended June 30, 2003	
Selling, distribution and operating expenses by segment	**amount**	**% of segment revenues**	**amount**	**% of segment revenues**
	(in thousands of U.S. dollars, except for percentages)			
Steel segment				
Selling and distribution expenses	96,550	7.4	79,163	10.1
Taxes other than income tax	18,086	1.4	16,328	2.1
Provision for doubtful accounts	1,058	0.1	6,622	0.9
General, administrative and other operating expenses	64,377	4.9	43,035	5.5
Total	180,071	13.8	145,148	18.6
Mining segment				
Selling and distribution expenses	77,021	14.7	28,818	11.5
Taxes other than income tax	7,286	1.4	6,644	2.6
Provision for doubtful accounts	(754)	(0.1)	(304)	(0.1)
General, administrative and other operating expenses	31,963	6.1	13,124	5.2
Total	115,516	22.1	48,283	19.2

Steel segment

Selling and distribution expenses consisted almost entirely of transportation expenses related to our selling activities, and decreased as a percentage of steel segment revenues from 10.1% in the six months ended June 30, 2003, to 7.4% in the six months ended June 30, 2004, primarily as a result of the increasing use of our own railway freight and forwarding company for our transportation needs, which we established at the end of 2002.

Taxes other than income tax includes property and land taxes, road users tax and other taxes. These amounted to $18.1 million in the six months ended June 30, 2004, an increase of $1.8 million, or 10.8%, from $16.3 million in the six months ended June 30, 2003. As a percentage of segment revenues, these taxes declined from 2.1% to 1.4%. Property and land taxes amounted to $10.4 million in the six months ended June 30, 2004, an increase of $1.3 million, or 14.1%, from $9.1 million in the six months ended June 30, 2003, due to an increase in the property tax base (as a result of putting into operation new fixed assets).

Provision for doubtful accounts decreased by $5.6 million, or 84.0%, from $6.6 million in the six months ended June 30, 2003, to $1.1 million in the six months ended June 30, 2004, due to an improvement in the aging of the accounts receivable as of the respective period ends.

General, administrative and other expenses, which consisted of payroll and related social taxes, depreciation, rent and maintenance, legal and consulting expenses, office expenses and other expenses, increased by $21.3 million, or 49.6%, to $64.4 million in the six months ended June 30, 2004, from $43.0 million in the six months ended June 30, 2003, and decreased as a percentage of segment revenues from 5.5% in the six months ended June 30, 2003 compared to 4.9% in the six months ended June 30, 2004. Payroll and related social taxes increased by $13.6 million, primarily due to acquisitions and salary increases. Social expenses increased by $3.0 million. Rent and maintenance, business travel expenses and office expenses increased by $2.6 million. Professional expenses, which include audit, accounting, legal and engineering fees, increased by $0.8 million.

Mining segment

Selling and distribution expenses consisted almost entirely of transportation expenses related to our selling activities, and increased as a percentage of mining segment revenues from 11.5% in the six months ended June 30, 2003, to 14.7% in the six months ended June 30, 2004, primarily as a result of an increase in our export sales with higher cost of transportation than domestic sales, partly offset by the increased use of our own railway freight and forwarding company for our transportation needs, which we established in the end of 2002.

Taxes other than income tax increased by $0.6 million, or 9.7%, from $6.6 million in the six months ended June 30, 2003, to $7.3 million in the six months ended June 30, 2004. Property and land taxes increased by $0.4 million due to an increase in the property tax base (as a result of putting into operation new fixed assets).

Provision for doubtful accounts was negative in both periods due to an improvement in the aging of the accounts receivable as of the respective period ends. Some of the accounts receivable outstanding that were fully provided for in previous periods were collected during each of the six-month periods ended June 30, 2004 and 2003.

General, administrative and other expenses increased by $18.8 million, or 143.5%, to $32.0 million in the six months ended June 30, 2004, from $13.1 million in the six months ended June 30, 2003, representing an increase as a percentage of segment revenues from 5.2% to 6.1%. Salaries and related social taxes increased by $7.4 million, social expenses increased by $2.8 million, legal and consulting fees increased by $1.5 million and rent and maintenance and office expenses increased by $0.9 million. The increase in salaries and social expenses was primarily due to the acquisition of Korshunov Mining Plant in October 2003 and salary increases at our coal companies.

Operating income

Operating income increased by $259.8 million, or 290.7%, to $349.1 million in the six months ended June 30, 2004, from $89.4 million in the six months ended June 30, 2003. Operating income as a percentage of consolidated revenues increased from 9.6% in the six months ended June 30, 2003, to 21.4% in the six months ended June 30, 2004, due to the substantial improvement in the gross margin percentage and the relatively stable selling, distribution and operating expenses compared to growth in consolidated revenues.

The table below sets out operating income by segment, including as a percentage of segment revenues.

Operating income by segment	Six months ended June 30, 2004 amount	Six months ended June 30, 2004 % of segment revenues	Six months ended June 30, 2003 amount	Six months ended June 30, 2003 % of segment revenues
	(in thousands of U.S. dollars, except for percentages)			
Steel segment	163,714	12.5	60,882	7.8
Mining segment	185,392	35.5	28,474	11.3

Steel segment

Steel segment operating income in the six months ended June 30, 2004, increased by $102.8 million, or 168.9%, to $163.7 million from $60.9 million in the six months ended June 30, 2003. Operating margin percentage increased from 7.8% to 12.5% due to the stability in the gross margin percentage and the slower growth in selling, distribution and operating expenses compared to the growth in segment revenues.

Mining segment

Mining segment operating income in the six months ended June 30, 2004, increased by $156.9 million, or 551.1%, to $185.4 million from $28.5 million in the six months ended June 30, 2003. Operating margin percentage increased from 11.3% to 35.5% due to significant growth in segment gross margin, partly offset by growth in selling, distribution and operating expenses.

Other income and expense, net

Other income and expense, net consists of income (loss) of equity investees, interest income, interest expense, other income and foreign exchange gain. The table below sets forth these costs for the six months ended June 30, 2004 and 2003, including as a percentage of sales:

	Six months ended June 30, 2004		Six months ended June 30, 2003	
Other income and expense, net	**amount**	**% of revenues**	**amount**	**% of revenues**
	(in thousands of U.S. dollars, except for percentages)			
Income (loss) from equity investees	2,595	0.2	826	0.1
Interest income	1,125	0.1	100	0.0
Interest expense	(30,022)	(1.9)	(20,247)	(2.1)
Other income, net	10,635	0.6	10,576	1.1
Foreign exchange gain (loss)	3,037	0.2	2,879	0.3
Total	(12,630)	(0.8)	(5,866)	(0.6)

The income from equity investees in the six months ended June 30, 2003, was related to investees of Southern Kuzbass Coal Company. Most of the income from equity investees in the six months ended June 30, 2004, related to Mechel Energy AG, and also included income from investees of Southern Kuzbass Coal Company.

Interest income increased by $1.0 million to $1.1 million in the six months ended June 30, 2004, from $0.1 million in the six months ended June 30, 2003. Our businesses earned interest income on the cash balances held with financial institutions. Interest expense increased by $9.8 million, or 48.3%, to $30.0 million in the six months ended June 30, 2004, from $20.2 million in the six months ended June 30, 2003. This increase related to an increase in short-term debt and long-term debt, as well as to debt of acquired businesses of $0.8 million.

In the six months ended June 30, 2004, we recorded other income of $10.6 million, primarily consisting of the following: gains of $18.0 million from fines and penalties forgiven due to the timely payment of restructured prior period taxes and social charges owed by our Russian subsidiaries to the government (see note 13 to our audited consolidated financial statements), a loss of $2.1 million on the sale of promissory note, a loss of $0.8 million on the sale of investment securities, loss of $0.3 million on other sales and other expenses of $3.9 million.

In the six months ended June 30, 2004, foreign exchange gain was $3.0 million, as compared to a gain of $2.9 million in the six months ended June 30, 2003.

Income tax expense

Income tax expense increased by $51.0 million to $74.1 million in the six months ended June 30, 2004, from $23.1 million in the six months ended June 30, 2003, and our effective tax rate decreased to 22.0% from 27.7%. The decrease in the effective tax rates is due primarily to the recognition of an $18.0 million gain on forgiveness of fines and penalties (see above), which is non-taxable, as well as more of our income being generated in jurisdictions having lower tax rates.

Minority interest

Minority interest in income of subsidiaries amounted to $7.9 million in the six months ended June 30, 2004, compared to a minority interest in loss of subsidiaries of $6.6 million in the six months ended June 30, 2003. Minority interest in income of subsidiaries in the current period consisted primarily of the share of minority shareholders in the net income of Chelyabinsk Metallurgical Plant and our coal subsidiaries in the amount of $10.1 million, partly offset by the share of minority shareholders in the net losses of Beloretsk Metallurgical Plant and COST. Minority interest in loss of subsidiaries in the prior period was primarily attributable to the share of minority shareholders in the net losses of Beloretsk Metallurgical Plant and COST ($6.9 million).

Income from continuing operations

Income from continuing operations in the six months ended June 30, 2004, was $254.5 million, compared to $67.7 million in the six months ended June 30, 2003, as a result of the factors explained above.

Income from discontinued operations

As of December 31, 2002, we had committed to a plan to discontinue and sell our interests in Uglemetbank, a Russian bank providing banking services to our coal subsidiaries, and Belov Insurance Company, an insurance company providing life and property insurance to our coal subsidiaries. We recognized a loss of $1.3 million in the six months ended June 30, 2003, associated with these companies.

Extraordinary gain

In accordance with SFAS No. 141 and SFAS No. 142, the excess of the fair value of net assets acquired over the purchase price (after reducing the value of non-current assets to zero) in the amount of $5.7 million which was related to the acquisitions of minority interests in Industria Sarmei in June 2003 was recorded as extraordinary gain, net of tax, in the six months ended June 30, 2003.

Changes in accounting principle

Upon adoption of SFAS No. 143 on January 1, 2003, we recorded approximately $3.7 million, including tax benefit, as a charge to cumulative effective changes in accounting principles. See note 3(x) to our audited consolidated financial statements.

Net income

For the reasons set forth above, our net income increased in the six months ended June 30, 2004, by $186.7 million, or 275.6%, from $67.7 million in the six months ended June 30, 2003, to $254.5 million in the six months ended June 30, 2004.

Year ended December 31, 2003, compared to year ended December 31, 2002

Revenues

Consolidated revenues increased by $735.9 million, or 56.0%, to $2,050.1 million in 2003, from $1,314.1 million in 2002. The following table sets out revenues by segment.

Revenues by segment	Year ended December 31, 2003	2002
	(in thousands of U.S. dollars)	
Steel segment		
To third parties	1,636,145	1,011,537
To mining segment	42,250	39,017
Total	1,678,395	1,050,554
Mining segment		
To third parties	413,943	302,612
To steel segment	185,813	69,604
Total	559,756	372,216
Eliminations	228,063	108,621
Consolidated revenues	2,050,088	1,314,149
% from steel segment	79.8	77.0
% from mining segment	20.2	23.0

Steel segment

Our steel segment revenues in 2003 increased by $627.8 million, or 59.8%, to $1,678.4 million from $1,050.6 million in 2002. The increase in steel segment revenues is primarily explained by the following increases:

Rebar sales increased by $102.8 million, or 49.1%, due to price increases, and wire rod sales increased by $60.2 million, or 53.7%, due to price increases and particularly as a result of sharp increases in prices for the higher-quality wire rod we produce at Beloretsk Metallurgical Plant.

Hardware sales were higher by $50.7 million, or 71.2%, including an increase in wire sales of $32.1 million, or 60.5%, due to volume increases, and an increase in rope sales of $10.3 million, or 80.9%, due to price increases.

Sales of carbon and low-alloy flat products increased by $41.2 million, or 85.6%, primarily due to price increases, particularly as a result of an increase in the proportion of our export sales of these products.

Trading sales of iron concentrate ore from Korshunov Mining Plant prior to its consolidation in October 2003 increased by $34.8 million, which after consolidation are being reflected in the mining segment.

Sales of stainless and alloyed long products increased by $23.5 million, or 61.1%, primarily due to volume increases.

Carbon and low-alloyed long product sales grew by $20.4 million, or 22.6%, mostly as a result of price increases, as well as an increase in export volumes. A decrease in domestic sales volumes was offset by price increases.

Stainless flat product sales were higher by $14.2 million, or 20.5%, due to price increases.

Forgings and forged alloy sales increased by $11.9 million, or 54.9%, primarily as a result of volume increases.

Sales of coke and coking products to third parties increased by $10.1 million, or 29.3%, and sales to the mining segment, which uses coke in the production of nickel, grew by $13.5 million, or 58.2%, in both cases primarily as a result of substantial increases in the price of coke.
Sales of carbon and low-alloyed forgings increased by $7.6 million, or 47.9%, as a result of increases in both volumes and prices.
Pig iron sales increased by $5.7 million, or 59.4%, primarily as a result of price increases.
Sales of MMK products increased by $68.2 million, or 44.0%, primarily as a result of price increases. We purchased hot-rolled and cold-rolled plates and coils and galvanized sheets from MMK for resale internationally through our trading subsidiary, Mechel Trading. Starting in January 2004, we stopped reselling MMK products. See Certain Transactions Related Party Transactions Magnitogorsk Iron & Steel Works.

In addition to the above, the following increases were related to acquisitions:

Revenues at Mechel Zeljezara, Urals Stampings Plant and Industria Sarmei, which were acquired in March, April and June 2003, respectively, amounted to $98.3 million.
Revenues at Vyartsilya Metal Products Plant for the first four months of 2003 and COST for the first seven months of 2003, which are not included in the comparative analysis by product above, amounted to $96.4 million.

These increases in steel products sales were offset by sales decreases as follows:

Sales of steel products to our mining segment decreased by $10.3 million as compared to the previous year.
Sales of semi-finished products to Beloretsk Metallurgical Plant, Vyartsilya Metal Products Plant and Urals Stampings Plant in 2002 in the amount of $36.7 were no longer reflected as sales in 2003 due to their acquisition.

Excluding intersegment sales, export sales were 44.6% of steel segment sales in 2003, compared to 50.8% in 2002. The decrease in the proportion of our steel segment sales represented by export sales was due to increases in domestic prices in relation to export prices.

Mining segment

Our total mining segment sales in 2003 increased by $227.5 million, or 61.1%, to $599.8 million from $372.2 million in 2002.

Coking coal concentrate sales to third parties increased by $56.3 million, or 45.5%, primarily due to price increases, as well as to an 11.1% increase in sales volume. Coking coal concentrate supplied to the steel segment increased by $97.9 million, or 247.1%, as coke production at Chelyabinsk Metallurgical Plant more than doubled. Steam coal and steam coal concentrate sales increased by $18.5 million, or 18.3%, primarily due to price increases.

Nickel sales to third parties increased by $28.7 million, or 55.8%, as volumes and prices increased. Nickel supplied to the steel segment increased by $10.0 million, or 33.4%, primarily due to price increases.

We recorded iron ore concentrate sales in the mining segment beginning in October 2003 with our consolidation of Korshunov Mining Plant, with sales to third parties of $20.1 million, and supplies to the steel segment of $8.3 million, for a total increase of $28.4 million.

These increases in mining products sales were partly offset by a decrease of $12.6 million in other products and services sales, consisting primarily of transportation, blasting and municipal services, as well as sales of energy.

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Excluding intersegment sales, export sales were 45.1% of mining segment sales in 2003, compared to 49.6% in 2002.

Cost of goods sold and gross margin

Consolidated cost of goods sold was 70.2% of consolidated revenues in 2003, as compared to 72.1% of consolidated revenues in 2002, resulting in an increase in the consolidated gross margin percentage in 2003 to 29.8% from 27.9% in 2002. The table below sets forth cost of goods sold and gross margin by segment for 2003 and 2002, including as a percentage of segment revenues.

	Year ended December 31, 2003		Year ended December 31, 2002	
Cost of goods sold and gross margin by segment	**amount**	**% of segment revenues**	**amount**	**% of segment revenues**
	(in thousands of U.S. dollars, except for percentages)			
Steel segment				
Cost of goods sold	1,247,380	74.3	801,481	76.3
Gross margin	431,015	25.7	249,073	23.7
Mining segment				
Cost of goods sold	420,736	70.2	254,667	68.4
Gross margin	179,020	29.8	117,549	31.6

Steel segment

Steel segment cost of goods sold increased by $445.9 million, or 55.6%, to $1,247.4 million in 2003, from $801.5 million in 2002. Steel segment cost of goods sold was 74.3% of segment revenues, as compared to 76.3% in 2002. The improvement in the steel segment s gross margin was primarily attributable to an increase in the average sales price and partly related to improvements in our working practices and operational methods. These improvements were partially offset by our acquisitions of under-performing steel plants in Eastern Europe, the average gross margin of which was a negative 3%. As we integrate these acquisitions and continue to introduce improvements in working practices and operational methods, we expect this average gross margin to improve.

Mining segment

Mining segment cost of goods sold increased by $166.0 million, or 65.2%, to $420.7 million in 2003 from $254.7 million in 2002. Mining segment gross margin percentage decreased from 31.6% in 2002 to 29.8% in 2003. The deterioration in the mining segment gross margin percentage was attributable to a 51.2% increase in the price of coke which, although supplied by our steel segment, is transferred to the mining segment (for the production of nickel) at market-based prices.

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Management s discussion and analysis of financial condition and results of operations

Selling, distribution and operating expenses

Selling, distribution and operating expenses increased by $139.8 million, or 50.4%, to $417.3 million in 2003 from $277.5 million in 2002. As a percentage of consolidated revenues, selling, distribution and operating expenses decreased to 20.4% in 2003, as compared to 21.1% in 2002. The table below sets forth these costs by segment for 2003 and 2002, including as a percentage of segment revenues.

Selling, distribution and operating expenses by segment	Year ended December 31, 2003 amount	Year ended December 31, 2003 % of segment revenues	Year ended December 31, 2002 amount	Year ended December 31, 2002 % of segment revenues
	(in thousands of U.S. dollars, except for percentages)			
Steel segment				
Selling and distribution expenses	152,972	9.1	129,033	12.3
Taxes other than income tax	32,612	1.9	21,457	2.0
Goodwill impairment		0.0		0.0
Provision for doubtful accounts	9,935	0.6	2,776	0.3
General, administrative and other operating expenses	106,170	6.3	41,075	3.9
Total	301,689	18.0	194,341	18.5
Mining segment				
Selling and distribution expenses	61,546	10.3	39,073	10.5
Taxes other than income tax	12,105	2.0	8,915	2.4
Goodwill impairment		0.0	7,219	1.9
Provision for doubtful accounts	76	0.0	846	0.2
General, administrative and other operating expenses	41,843	7.0	27,084	7.3
Total	115,570	19.3	83,137	22.3

Steel segment

Selling and distribution expenses consisted almost entirely of transportation expenses related to our selling activities, and decreased as a percentage of steel segment revenues from 12.3% in 2002 to 9.1% in 2003, primarily as a result of our increasing use of our own railway freight and forwarding company for our transportation needs, which we established at the end of 2002.

Taxes other than income tax include property and land taxes, road users tax, and other minor taxes. These amounted to $32.6 million in 2003, an increase of $11.2 million, or 52.0%, from $21.5 million in 2002. As a percentage of segment revenues, these taxes declined from 2.0% to 1.9%. Property and land taxes amounted to $18.4 million in 2003, an increase of $7.6 million, or 71.0%, from $10.8 million in 2002 due to an increase in the property tax rate. We also incurred fines and penalties in the amount of $9.0 million in 2003 as a result of the conclusion of tax reviews of

Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant and two trading subsidiaries which are now dormant. Beginning from January 1, 2003, the road users tax was abolished, which tax amounted to $8.2 million in 2002.

Provision for doubtful accounts increased by $7.2 million, or 257.9%, from $2.8 million in 2002 to $9.9 million in 2003, and increased as a percentage of segment revenues from 0.3% to 0.6%. This increase is attributable to our recent acquisitions: Mechel Zeljezara in the amount of $1.0 million, Industria Sarmei in the amount of $0.6 million and COST in the amount of $0.6 million. In addition, we created a new provision for bad debts in the amount of $2.5 million in 2003 at Chelyabinsk Metallurgical Plant in relation to advances and other receivables.

General, administrative and other expenses, which consisted of payroll and related social taxes, depreciation, rent and maintenance, legal and consulting expenses, office expenses and other expenses, increased by $65.1 million, or 158.5%, to $106.2 million in 2003 from $41.1 million in 2002,

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representing an increase as a percentage of segment revenues from 3.9% to 6.3%. Payroll and related social taxes increased by $35.9 million, primarily due to acquisitions and salary increases at Chelyabinsk Metallurgical Plant and Beloretsk Metallurgical Plant. Rent, maintenance and office expenses increased by $10.4 million. Professional expenses, which include audit, accounting, legal and engineering fees, increased by $7.4 million, primarily as a result of our reorganization, establishment of reporting infrastructure, our first-time application of U.S. GAAP in the preparation of our consolidated financial statements and work on this offering, as well as several ongoing management information system projects at Chelyabinsk Metallurgical Plant, such as the transition to new accounting software. Asset write-offs and retirements in 2003 amounted to $3.3 million, primarily due to the closure of a steel-making shop at Beloretsk Metallurgical Plant. Social expenses increased by $2.9 million.

Mining segment

Selling and distribution expenses consisted almost entirely of transportation expenses related to our selling activities, and decreased as a percentage of mining segment revenues from 10.5% in 2002 to 10.3% in 2003, primarily as a result of increased use of our own railway freight and forwarding company for our transportation needs, which we established at the end of 2002.

Taxes other than income tax increased by $3.2 million, or 35.8%, from $8.9 million in 2002 to $12.1 million in 2003. Property and land taxes increased by $3.1 million due to an increase in the property tax rate. Beginning from January 1, 2003, the road user tax was abolished, which amounted to $3.8 million in 2002.

In 2002, goodwill in the amount of $7.2 million was impaired, relating to Usinsk Mine (which was shut down in that period) and Uglemetbank (which continued to experience losses through that period). All of our stake in Uglemetbank was disposed of in late 2003 and the first half of 2004.

Provision for doubtful accounts decreased to $0.1 million in 2003 from $0.8 million in 2002 due to an improvement in the aging of the accounts receivable as of the respective period ends.

General, administrative and other expenses increased by $14.8 million, or 54.5%, to $41.8 million in 2003 from $27.1 million in 2002, representing a decrease as a percentage of segment revenues from 7.3% to 7.0%. Salaries and related social taxes increased by $7.1 million, legal and consulting fees increased by $2.1 million, rent and maintenance and office expenses increased by $2.1 million and social expenses increased by $1.2 million.

Operating income

Operating income increased by $103.6 million, or 116.3%, to $192.8 million in 2003 from $89.1 million in 2002. Operating income as a percentage of consolidated revenues increased from 6.8% in 2002 to 9.4% in 2003 due to the improvement in the gross margin percentage and the slower growth in selling, distribution and operating expenses compared to growth in consolidated revenues.

The table below sets out operating income by segment, including as a percentage of segment revenues.

	Year ended December 31, 2003		Year ended December 31, 2002	
Operating income by segment	**amount**	**% of segment revenues**	**amount**	**% of segment revenues**
	(in thousands of U.S. dollars, except for percentages)			
Steel segment	129,326	7.7	54,732	5.2
Mining segment	63,450	10.6	34,412	9.2

Management s discussion and analysis of financial condition and results of operations

Steel segment

Steel segment operating income in 2003 increased by $74.6 million, or 136.3%, to $129.3 million from $54.7 million in 2002. Operating margin percentage increased from 5.2% to 7.7% due to improvement in the gross margin and the slower growth in selling, distribution and operating expenses compared to the growth in the segment revenues.

Mining segment

Mining segment operating income in 2003 increased by $29.0 million, or 84.4%, to $63.5 million from $34.4 million in 2002. Operating margin percentage increased from 9.2% to 10.6% due to slower growth in selling, distribution and operating expenses compared to growth in segment revenues, offset by the deterioration in the gross margin.

Other income and expense, net

Other income and expense, net consists of income (loss) of equity investees, interest income, interest expense, other income and foreign exchange gain. The table below sets forth these costs for 2003 and 2002, including as a percentage of sales:

	Year ended December 31, 2003		Year ended December 31, 2002	
Other income and expense, net	**amount**	**% of revenues**	**amount**	**% of revenues**
	(in thousands of U.S. dollars, except for percentages)			
Income (loss) from equity investees	1,221	0.1	(2,675)	(0.2)
Interest income	2,292	0.1	4,447	0.3
Interest expense	(48,528)	(2.4)	(36,773)	(2.8)
Other income, net	26,719	1.3	7,794	0.6
Foreign exchange gain	(1,722)	(0.1)	9,094	0.7
Total	(20,018)	(1.0)	(18,083)	(1.4)

The majority of loss from equity investees in 2002 arose in relation to Beloretsk Metallurgical Plant prior to our acquisition of control. Income from equity investees in 2003 was related primarily to investees of Southern Kuzbass Coal Company.

Interest income decreased by $2.2 million to $2.3 million in 2003 from $4.4 million in 2002. We earned interest income on promissory notes received from their customers and on cash balances held with financial institutions. We have significantly reduced the use of promissory notes, and intend to halt their use entirely.

Interest expense increased by $11.8 million, or 32.0%, to $48.5 million in 2003 from $36.8 million in 2002. This increase related to an increase in short-term borrowings and long-term debt, as well as to debt of acquired businesses of $0.4 million.

In 2003, we recorded other income of $26.7 million, primarily consisting of the following: gains of $9.6 million from fines and penalties forgiven due to the timely payment of restructured prior period taxes and social charges owed by our Russian subsidiaries to the government (see note 13 to our audited consolidated financial statements), a gain of $2.7 million on the sale of promissory note, a gain of $2.4 million on the sale of investment securities and a gain of $1.4 million from our being released from certain accounts payable obligations for which the statute of limitations had lapsed.

In 2003, foreign exchange loss was $1.7 million, as compared to a gain of $9.1 million in 2002. Effective from January 1, 2003, Russia no longer meets the criteria for a highly inflationary economy. Therefore, commencing January 1, 2003, our Russian subsidiaries changed their functional currency from the U.S.

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dollar to the ruble. See note 3 to our audited consolidated financial statements. As the ruble depreciated in nominal terms against the U.S. dollar in 2002 and appreciated against the U.S. dollar in 2003, foreign exchange gains in 2002 were driven by devaluation of payables denominated in rubles in 2002, while foreign exchange losses in 2003 were driven by devaluation of receivables denominated in the U.S. dollar.

Income tax expense

Income tax expense increased by $45.1 million to $47.8 million in 2003 from $2.7 million in 2002 and our effective tax rate increased to 27.6% from 3.7% as a result of a significant increase in non-deductible expenses and a change in the property, plant and equipment book to tax bases difference treatment. In 2002, the book to tax bases difference resulting from the remeasurement of property, plant and equipment from the local currency (rubles) into the functional currency (U.S. dollars) using historical exchange rates for financial reporting purposes, as required for companies operating in a hyperinflationary economy, was treated as a permanent difference that reduced the effective tax rate for 2002 by 22.7%. Effective from January 1, 2003, Russia no longer met the criteria for a highly inflationary economy and, therefore, the permanent difference related to the remeasurement of property, plant and equipment in 2002 became temporary in 2003. This change from permanent to temporary treatment was primarily responsible for the increase in the effective tax rate between the periods. See note 15 to our audited consolidated financial statements.

Minority interest

Minority interest in loss of subsidiaries amounted to $19.0 million in 2003 compared to $10.4 million in 2002. Minority interest in loss of subsidiaries in 2003 consisted primarily of the share of minority shareholders in the net losses of Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant and COST in the amount of $18.3 million. Minority interest in loss of subsidiaries for these companies in 2002 was $15.8 million.

Income from continuing operations

Income from continuing operations in 2003 was $144.0 million, compared to $78.8 million in 2002, as a result of the factors explained above.

Income from discontinued operations

As of December 31, 2002, we had committed to a plan to discontinue and sell our interests in Uglemetbank, a Russian bank providing banking services to our coal subsidiaries, and Belov Insurance Company, an insurance company providing life and property insurance to our coal subsidiaries. We recognized a loss of $2.4 million in 2003 as a result of operations and loss on disposal of Uglemetbank and Belov Insurance Company, compared to a loss of $1.8 million in 2002 associated with these companies.

Extraordinary gain

In accordance with SFAS No. 141 and SFAS No. 142, the excess of the fair value of net assets acquired over the purchase price (after reducing the value of non-current assets to zero) in the amounts of $5.7 million and $1.4 million which was related to the acquisitions of minority interests in Industria Sarmei in June 2003 and subsidiaries of Southern Kuzbass Coal Company in December 2002 was recorded as extraordinary gain, net of tax, in 2003 and 2002, respectively.

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Changes in accounting principle

Upon adoption of SFAS No. 143 on January 1, 2003, we recorded approximately $3.8 million, including tax benefit, as a charge to cumulative effective changes in accounting principles. See note 3(x) to our audited consolidated financial statements.

Net income

For the reasons set forth above, our net income increased in 2003 by $54.3 million, or 60.8%, from $89.3 million in 2002 to $143.5 million in 2003.

Year ended December 31, 2002, compared to year ended December 31, 2001

Revenues

Consolidated revenues increased by $294.4 million, or 28.9%, to $1,314.1 million in 2002 from $1,019.7 million in 2001. The following table sets out revenues by segment.

	Year ended December 31,	
Revenues by segment	**2002**	**2001**
	(in thousands of U.S. dollars)	
Steel segment		
To third parties	1,011,537	679,755
To mining segment	39,017	559
Total	1,050,554	680,314
Mining segment		
To third parties	302,612	339,971
To steel segment	69,604	
Total	372,216	339,971
Eliminations	108,621	559
Consolidated revenues	1,314,149	1,019,726

% from steel segment	77.0	66.7
% from mining segment	23.0	33.3

Steel segment

Our steel segment revenues increased by $370.2 million, or 54.4%, to $1,050.6 million from $680.3 million in 2001. In 2001, the operations of our steel segment consisted exclusively of reselling the steel products we were purchasing from Chelyabinsk Metallurgical Plant and Beloretsk Metallurgical Plant, which we acquired at the end of 2001 and in 2002, respectively. Revenues attributable to sales of products produced at these plants increased by $428.1 million, or 109.5%, from $391.1 million in 2001 to $819.1 million in 2002. This increase was primarily due to the fact that after we acquired these plants, we were able to sell many types of steel products manufactured at these plants which we were not able to source from these plants in 2001, including higher-margin products such as stainless plates, alloyed steels and forgings.

Other factors which explain the increase in revenues associated with these plants are general increases in the domestic and export prices of steel products, as well as slightly higher across-the-board sales volumes due to increases in production at these plants in 2002 as compared to 2001. In 2002, our steel segment revenues also included four months of operations of COST and seven months of operations of Vyartsilya Metal Products Plant, which we did not have during 2001, which amounted to $29.0 million and $6.9 million, respectively, in 2002. In addition, our steel segment supplied coke, wires, ropes and other hardware to our mining segment in 2002, which were recorded at $39.0 million, while such intercompany sales in 2001 were negligible because we did not own steel producing assets in 2001.

These increases in steel products sales were offset by several factors. In 2002, our sales of products of other manufacturers, primarily MMK, declined by $80.5 million. Additionally, sales of raw materials by our steel segment to Chelyabinsk Metallurgical Plant in 2001, such as ferroalloys and scrap, were no longer considered sales after our consolidation of Chelyabinsk Metallurgical Plant. These sales decreased by $51.4 million.

Excluding intersegment sales, export sales were 50.8% of steel segment sales in 2002, compared to 64.9% in 2001, as domestic steel prices rose.

Mining segment

Our mining segment revenues increased by $32.2 million, or 9.5%, to $372.2 million in 2002 from $340.0 million in 2001. At the end of 2001, we acquired Southern Urals Nickel Plant, from which we purchased nickel for resale prior to its acquisition. Revenues related to Southern Urals Nickel Plant increased by $60.6 million, or 291.2%, from $20.8 million in 2001 to $81.5 million in 2002 due to our ability to sell all of the plant s production after its acquisition. In 2002, we also started supplying ferro nickel from Southern Urals Nickel Plant to our steel segment s Chelyabinsk Metallurgical Plant.

Revenues related to coal increased by $24.2 million, or 10.1%, from $239.2 million in 2001 to $263.3 million in 2002. Steam coal sales decreased by $1.9 million, or 2%, in 2002 as compared to 2001. Steam coal shipment volumes decreased by 664,000 tonnes, or 12%, as a result of a 550,000 tonnes decrease in sales to Mosenergo, our principal customer of steam coal, and a 114,000 tonnes decrease due to the installation of a dressing mill at Krasnogorsk Open Pit Mine, which produces a higher-margin concentrate of steam coal by separating coal waste. The volume decrease was offset in part by an increase of $2 per tonne in the average price of steam coal, which was a result of higher exports and higher-margin steam coal sales. Coking coal concentrate sales increased by $24.1 million, or 18%, in 2002 as compared to 2001. Sales volume increased by 577,000 tonnes, while prices increased by an average of $1 per tonne.

These increases were offset as re-sales of iron ore concentrate to Chelyabinsk Metallurgical Plant, which were $46.6 million in the year ended December 31, 2001, and which were considered as third party mining segment sales in 2001, were no longer considered as such following Chelyabinsk Metallurgical Plant s consolidation on December 27, 2001.

Excluding intersegment sales, export sales were 49.6% of mining segment sales in 2002, compared to 24.1% in 2001. Export sales increased as export prices for coal increased while domestic prices decreased.

Cost of goods sold and gross margin

Consolidated cost of goods was 72.1% of consolidated revenues in 2002, as compared to 70.7% of consolidated revenues in 2001, resulting in a decrease in the consolidated gross margin percentage in 2002 (27.9%) as compared to 2001 (29.3%). The table below sets forth cost of goods sold and gross margin by segment for 2002 and 2001, including as a percentage of segment revenues.

Cost of goods sold and gross margin by segment	Year ended December 31, 2002 amount	Year ended December 31, 2002 % of segment revenues	Year ended December 31, 2001 amount	Year ended December 31, 2001 % of segment revenues
	(in thousands of U.S. dollars, except for percentages)			
Steel segment				
Cost of goods sold	801,481	76.3	546,885	80.4
Gross margin	249,073	23.7	133,429	19.6
Mining segment				
Cost of goods sold	254,667	68.4	174,763	51.4
Gross margin	117,549	31.6	165,208	48.6

Steel segment

Steel segment cost of goods sold was 76.3% of segment revenues, as compared to 80.4% in 2001, resulting in an increase in the steel gross margin percentage in 2002 (23.7%) as compared to 2001 (19.6%). The improvement in gross margin percentage in 2002 was primarily attributable to our acquisition and operation of steel plants. The nature of the steel segment s cost of goods sold also changed in 2002, as we acquired the steel plants from which we had been purchasing products for resale, effectively re-allocating these plants sales margin to us, as well as allowing us to re-allocate certain costs previously included in cost of goods sold to other expense categories. All costs of production, which were previously reflected in the price we paid for products purchased for resale, were recorded in our financial statements as cost of goods sold, including raw materials, direct payroll, depreciation and energy costs. Operational improvements at our steel plants also contributed to improved margins.

Mining segment

Mining segment cost of goods sold increased by $79.9 million, or 45.7%, in 2002 as compared to 2001. Cost of goods sold relating to nickel, which constituted 22.3% of total mining segment cost of goods sold in 2002, increased by $42.5 million, or 304% in 2002 as compared to 2001, as nickel sales volumes increased. In 2001, nickel cost of goods sold consisted of purchases of nickel from Southern Urals Nickel Plant, which we acquired at the end of 2001, whereas nickel cost of goods sold in 2002 consisted of the actual direct costs of production incurred.

Cost of goods sold relating to coal and coal concentrate, which together constituted 62.8% of the total mining segment cost of goods sold in 2002, increased by $24.2 million, or 18%, in 2002 as compared to 2001. Depreciation, depletion and amortization included in coal cost of goods sold increased by $15.9 million, or 133.4%, primarily due to the additional depreciation, depletion and amortization costs related to Lenin Mine, which we acquired at the end of 2001, and Sibirginsk Open Pit Mine, arising from further development of its mining facilities. The remaining increase in coal cost of goods sold primarily resulted from price increases in ruble-denominated costs such as wages and fuel.

Mining gross margin percentage decreased in 2002 (31.6%) as compared to 2001 (48.6%), primarily due to increases in coal production costs explained above and a change in the product mix towards nickel sales, which are characterized by lower margins relative to coal sales.

An additional factor in the decline in gross margin was the exclusion of re-sales of iron ore concentrate to Chelyabinsk Metallurgical Plant, which were considered as third party mining segment sales in 2001, but

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were no longer considered as such following Chelyabinsk Metallurgical Plant s consolidation on December 27, 2001. The gross margin of iron ore concentrate sales was significantly higher than that of coal.

Selling, distribution and operating expenses

Selling, distribution and operating expenses increased by $83.6 million, or 43.1%, to $277.5 million in 2002 from $193.9 million in 2001. As a percentage of consolidated revenues, selling, distribution and operating expenses increased to 21.1% in 2002 as compared to 19.0% in 2001. The table below sets forth our selling, distribution and operating expenses by segment for 2002 and 2001, including as a percentage of segment revenues.

Selling, distribution and operating expenses by segment	Year ended December 31, 2002 amount	Year ended December 31, 2002 % of segment revenues	Year ended December 31, 2001 amount	Year ended December 31, 2001 % of segment revenues
	(in thousands of U.S. dollars, except for percentages)			
Steel segment				
Selling and distribution expenses	129,033	12.3	123,397	18.1
Taxes other than income tax	21,457	2.0	1,179	0.2
Goodwill impairment		0.0		0.0
Provision for doubtful accounts	2,776	0.3	1,327	0.2
General, administrative and other operating expenses	41,075	3.9	7,371	1.1
Total	194,341	18.5	133,274	19.6
Mining segment				
Selling and distribution expenses	39,073	10.5	37,231	11.0
Taxes other than income tax	8,915	2.4	5,555	1.6
Goodwill impairment	7,219	1.9		0.0
Provision for doubtful accounts	846	0.2	2,457	0.7
General, administrative and other operating expenses	27,084	7.3	15,337	4.5
Total	83,137	22.3	60,580	17.8

Steel segment

Selling and distribution expenses consisted primarily of transportation expenses related to our selling activities (94%), and decreased as a percentage of steel segment revenues in 2002 as compared to 2001, primarily due to a decrease in steel segment export sales from 64.9% in 2001 to 50.8% in 2002.

Taxes other than income tax included property and land taxes, road users tax, and other minor taxes. These amounted to $21.5 million in 2002 compared to $1.2 million in 2001. The steel facilities we acquired in 2002 faced certain taxes, which were not incurred by our trading operations in 2001, including property taxes ($4.3 million in 2002) and land taxes ($6.5 million in 2002). In addition, road users tax increased by $7.2 million in 2002 from $1.0 million in 2001, resulting from our acquisition of steel facilities; for trading companies, the tax is imposed on the markup, while for production companies the tax is imposed on the entire amount of revenues. Beginning from January 1, 2003, the road users tax was abolished.

Provision for doubtful accounts increased to $2.8 million in 2002 from $1.3 million in 2001, but was relatively stable as a percentage of sales. The increase in provision for doubtful accounts was due to acquired plants: Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant and COST.

General, administrative and other expenses, which consisted of payroll and related social taxes, depreciation, rent and maintenance, legal and consulting expenses, office expenses and other expenses, increased by $33.7 million, or 457.2%, to $41.1 million in 2002 from $7.4 million in 2001, and more

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than trebled as a percentage of segment revenues. The large increase in these expenses was related to the addition of steel-making facilities to our steel segment and the changing nature of our steel segment from trading operations to both manufacturing and trading. The changes in these expenses were primarily increases of $11.8 million for payroll and related social taxes, $5.5 million for social expenses, $5.4 million for depreciation, $4.3 million for rent and maintenance, and $4.1 million for office expenses. The increase in payroll and related social taxes arose primarily as a result of the addition of the administrative staff of the newly acquired companies.

Mining segment

Selling and distribution expenses remained relatively stable as a percentage of mining segment revenues in 2002 as compared to 2001.

Taxes other than income tax increased by $3.4 million, or 60.5%, in 2002 to $8.9 million from $5.6 million in 2001. This increase related primarily to property and land taxes, which increased by $1.8 million due to new acquisitions (Southern Urals Nickel Plant and Usinsk Mine). Road users tax increased by $0.7 million due to the increased taxable base relating to the mining segment (for trading companies, the tax is imposed on the mark up, while for production companies the tax is imposed on the entire amount of revenues). Beginning from January 1, 2003, the road users tax was abolished.

In 2002, goodwill in the amount of $7.2 million was impaired, relating to Usinsk Mine (which was shut down in that year) and Uglemetbank (which continued to experience losses through 2002). All but a 17.0% stake in Uglemetbank was disposed of in late 2003 and early 2004. We intend to sell our remaining stake in Uglemetbank during the first half of 2004.

Provision for doubtful accounts decreased by $1.6 million, or 65.6%, to $0.8 million in 2002 from $2.5 million in 2001. This decrease was related to the reorientation of sales of coking coal and nickel from third parties to our steel segment.

General, administrative and other expenses increased by $11.7 million, or 76.6%, to $27.1 million in 2002 from $15.3 million in 2001. A significant factor was the addition of nickel facilities to our mining segment. Payroll and related social taxes increased by $5.4 million in 2002 to $11.7 million, from $6.2 million in 2001, as a result of the addition of the administrative staff of the newly acquired nickel facilities. Office expenses increased by $2.2 million and social expenses increased by $1.4 million.

Operating income

Operating income decreased by $15.6 million, or 14.9%, to $89.1 million in 2002 from $104.8 million in 2001. Operating income as a percentage of consolidated revenues decreased from 10.3% in 2001 to 6.8% in 2002 as a result of the decrease in gross margins combined with increases in selling, distribution and operating expenses, as explained above. The table below sets out operating income by segment, including as a percentage of segment revenues.

Operating income by segment	Year ended December 31, 2002		Year ended December 31, 2001	
	amount	% of segment revenues	amount	% of segment revenues
	(in thousands of U.S. dollars, except for percentages)			
Steel segment	54,732	5.2	155	0.0
Mining segment	34,412	9.2	104,627	30.8

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Steel segment

Steel segment operating income in 2002 increased by $54.6 million to $54.7 million from $0.2 million in 2001. Operating margin percentage increased to 5.2% in 2002 from 0.0% in 2001. The improvement in the steel segment operating margin percentage is due to our acquisition and operation of steel plants, as well as to operational improvements at these plants.

Mining segment

Mining segment operating income in 2002 decreased by $70.2 million to $34.4 million from $104.6 million in 2001. Operating margin percentage decreased from 30.8% in 2001 to 9.2% in 2002, primarily due to the decrease in gross margins combined with the increases in general, administrative and other operating expenses, as explained above.

Other income and expense, net

Other income and expense, net consists of interest income (loss) of equity investees, interest income, interest expense, other income and foreign exchange gain. The table below sets forth these costs for both 2002 and 2001, including as a percentage of sales:

	Year ended December 31, 2002		Year ended December 31, 2001	
Other income and expense, net	**amount**	**% of revenues**	**amount**	**% of revenues**
	(in thousands of U.S. dollars, except for percentages)			
Income (loss) from equity investees	(2,675)	(0.2)	146	0.0
Interest income	4,447	0.3	453	0.0
Interest expense	(36,773)	(2.8)	(14,526)	(1.4)
Other income, net	7,794	0.6		0.0
Foreign exchange gain	9,094	0.7	1,749	0.2
Total	(18,083)	(1.4)	(12,178)	(1.2)

The majority of the loss (81%) from equity investees arose in relation to Beloretsk Metallurgical Plant prior to our acquisition of control.

Interest income increased by $4.0 million to $4.5 million in 2002 from $0.5 million in 2001. The increase related primarily to new acquisitions. Our recently-acquired businesses earned interest income on promissory notes received from their customers and on the cash balances held with financial institutions.

Interest expense increased by $22.2 million, or 153.2%, to $36.7 million in 2002 from $14.5 million in 2001. Out of this increase, $21.0 million related to existing debt of businesses acquired in late 2001 and in 2002. In 2001 and 2002, the weighted average rate of interest on our indebtedness was stable at 17.5%.

In 2002, we recorded other income of $7.8 million, consisting of gains of $4.0 million from our being released from certain accounts payable obligations for which the statute of limitations had lapsed and gains of $3.8 million from fines and penalties forgiven due to the timely payment of restructured prior period taxes and social charges owed by our Russian subsidiaries to the government (see note 13 to our audited consolidated financial statements).

In 2002, we recorded an increase in foreign exchange gains of $7.3 million attributable to ruble-denominated debt and income tax liabilities of new businesses that we acquired at the end of 2001 and 2002.

Income tax expense

Income tax expense decreased by $27.5 million, or 91.2%, to $2.7 million in 2002 from $30.2 million in 2001. Our effective tax rate decreased to 3.7% in 2002 from 32.6% in 2001, primarily because of significant basis differences attributable to property, plant and equipment in the steel segment resulting from the acquisition of Chelyabinsk Metallurgical Plant in the end of 2001.

Minority interest

Minority interest in loss of subsidiaries amounted to $10.4 million in 2002 as compared to a minority interest in income of subsidiaries of $15.5 million in 2001. In 2002, minority interest in loss of subsidiaries was comprised of the share of minority shareholders in the net losses of Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant and COST in the amount of $15.8 million. Excluding this minority interest in loss of subsidiaries, minority interest in net income of subsidiaries decreased by $10.6 million in 2002. This decrease is primarily attributable to the decrease in net income of coal subsidiaries in the mining segment, as explained above.

Income from continuing operations

Income from continuing operations in 2002 was $78.8 million, compared to $46.9 million in 2001, as a result of the factors explained above.

Loss from discontinued operations

As of December 31, 2002, we had committed to a plan to discontinue and sell our interests in Uglemetbank, a Russian bank providing banking services to our coal subsidiaries, and Belov Insurance Company, an insurance company providing life and property insurance to our coal subsidiaries. For 2002 and 2001, Uglemetbank and Belov Insurance Company had combined losses of $1.8 million and $0.7 million, respectively.

Extraordinary gain

In accordance with SFAS No. 141, the excess of the fair value of net assets acquired over the purchase price (after reducing the value of non-current assets to zero) in the amounts of $1.4 million and $1.3 million, which related to the acquisitions of minority interests in subsidiaries of Southern Kuzbass Coal Company in November 2001 and December 2002, respectively, was recorded as extraordinary gain, net of tax, in the consolidated income statements for the years ended December 31, 2002 and 2001, respectively.

Changes in accounting principle

As required by SFAS No. 142, we wrote off and recognized as income unamortized deferred credit related to negative goodwill in the amount of $10.9 million in 2002, related to the acquisition of subsidiaries of Southern Kuzbass Coal Company in 2000. See note 3(c) to our audited consolidated financial statements.

Net income

For the reasons set forth above, our net income increased by $41.8 million, or 88.2%, from $47.4 million in 2001 to $89.3 million in 2002.

LIQUIDITY AND CAPITAL RESOURCES

Capital requirements

Our principal on-going financing requirements are to finance production of steel and steel products and our mining operations, and to fund the following major activities:

- Future growth through acquisitions;
- Capital expenditures, including the purchase of equipment, modernization of facilities;
- Retirement of our short-term and portions of our long term debt;
- Changes in working capital; and
- General corporate purposes.

We anticipate that acquisitions, capital expenditures and repayments of outstanding debt will represent the most significant uses of funds for the next several years.

We continue to consider acquisitions as one of our major growth strategies. Historically, funding of this strategy came from cash flows from existing operations, external financing sources and our shareholders in the form of contributions to our charter capital. We intend to finance acquisitions in the future through cash flow generated by our business, as well as external debt.

Our business is heavily dependent on plant and machinery for the production of steel and steel products, as well as investments in our mining operations. Investments to maintain and expand production facilities are, accordingly, an important priority and have a significant effect on our cash flows and future results of operations. We expect our capital expenditures to increase significantly in the next few years. See Business Capital Improvements Program for the objectives of our capital expenditure program and its details. Over the next five years, *i.e.,* through 2009, we expect our overall capital expenditures to total approximately $900 million, relatively evenly distributed throughout this period. We plan to finance our capital expenditures out of our cash flows from operations and financing activities, including the proceeds of this offering. Our failure to undertake planned expenditures on production facilities could adversely affect our ability to maintain and/or enhance our competitive position and develop higher margin products.

In the near future we plan to extinguish about $70 million of short-term debt through the issuance of longer-term, ruble-denominated bonds. We have not identified the specific short-term debt that we intend to retire, but intend to focus, wherever practical, on ruble-denominated short-term debt. Our total outstanding debt as of June 30, 2004, and December 31, 2003, was $538.0 million and $464.4 million, respectively. See Quantitative and Qualitative Disclosures About Market Risk for information regarding the type of financial instruments, the maturity profile of debt, currency and interest rate structure. See also note 5 to our interim consolidated financial statements.

Mechel Steel Group declared a dividend of 149 million rubles (or approximately $5.2 million) on June 24, 2004. Other than this dividend, we have not declared or paid any dividends on our common shares since our incorporation on March 19, 2003. Certain companies in our group paid dividends to our controlling shareholders in amounts of $26.3 million, $13.4 million and $8.8 million in the years ended December 31, 2003, 2002 and 2001, respectively. Commencing in 2005, with respect to the year ended December 31, 2004, we expect to declare and pay an annual dividend equal to 15% of our annual net income, as determined under U.S. GAAP, subject any applicable Russian legal restrictions. See Dividend Policy and Description of Capital Stock and Certain Requirements of Russian Legislation Description of Capital Stock Dividends.

Capital resources

We plan to finance our capital requirements through a mix of cash flows from operating and financing activities. Historically, our major sources of cash have been cash provided by operations and short-term debt, and we expect that these sources will continue to be our principal sources of cash in the future, although we intend to increasingly substitute longer-term debt for short-term debt as we did in 2003. Accordingly, apart from the proceeds from the current offering, we intend to continue to rely primarily on cash provided by operations and borrowings to meet our future working capital and other capital requirements. We do not depend on off-balance sheet financing arrangements.

Net cash provided by operating activities was $208.0 million and $43.5 million in the six months ended June 30, 2004 and 2003, respectively, and $119.5 million, $81.1 million and $34.8 million in the years ended December 31, 2003, 2002 and 2001, respectively.

The principal reason for the constant growth of net cash provided by operating activity is the increasing profitability of our business. The operating cash inflows are derived from payments received from sales of our steel and mining products, reduced by cash disbursements for direct labor, raw materials and parts, selling, distribution and operating expenses, interest expense and income taxes.

Changes in working capital items period to period, including as a result of external factors, have had and will continue to have a significant effect on cash provided by operating activities. For example, increasing prices of purchased raw materials may warrant maintaining higher inventory levels in order to hedge against further price increases, deteriorating economic conditions may result in delayed collections of accounts receivable and vendors may require more prompt payments as a condition of doing business with us. The increasing size of our business has required and will continue to require higher levels of working capital. In the six months ended June 30, 2004, operating cash flows were lower by $78.6 million than they would otherwise have been due to our maintenance of higher inventory levels during the period. In 2003, operating cash flows were lower by $110.6 million than they would otherwise have been due to our maintenance of higher inventory levels during the year. See Trends Inventory. In 2001, operating cash flows were lower by $65.2 million than they would otherwise have been due to an increase in accounts receivable during the year.

Net cash utilized by investing activities was $207.8 million, $209.9 million, $86.6 million and $93.1 million in the six months ended June 30, 2004, and in the years ended December 31, 2003, 2002 and 2001, respectively. Substantially all of the cash for investing activities related to the acquisition of businesses and of various machinery and equipment. Expenditures for acquisition of businesses amounted to $54.2 million, $106.9 million, $21.1 million and $47.8 million in the six months ended June 30, 2004, and in the years ended December 31, 2003, 2002 and 2001, respectively. Capital expenditures amounted to $141.6 million, $116.4 million, $61.0 million and $38.0 million in the six months ended June 30, 2004, and in the years ended December 31, 2003, 2002 and 2001, respectively.

Net cash provided by financing activities was $43.8 million, $103.1 million, $3.4 million and $65.7 million in the six months ended June 30, 2004, and in the years ended December 31, 2003, 2002 and 2001, respectively. In 2003, two of our Russian subsidiaries issued long-term ruble-denominated bonds, the proceeds of which were used to finance our capital expenditures and repay our short-term borrowings, as follows:

On February 4, 2003, Chelyabinsk Metallurgical Plant issued ruble-denominated bonds in an aggregate principal amount of 1 billion rubles (approximately $31 million). The bonds were issued at 100% of par value. Interest is payable every six months in arrears. The interest rate for the first coupon period was determined upon the issuance based on the bids of buyers and comprised 16.85% p.a. The interest rate for the second, third and fifth coupon periods is set by us is made public 10 days before the respective coupon period starts.

Bondholders are entitled to early

redemption of the bonds at face value before the second, third and fifth coupon periods. The interest rate for the fourth and sixth coupon periods are set as equal to the rate for the immediately preceding coupon period. The bonds are guaranteed by our subsidiary Southern Kuzbass Coal Company. The obligatory redemption date of the bonds is February 4, 2006. In August 2003, we repurchased a portion of these bonds from bondholders exercising their right of early redemption. The balance outstanding at December 31, 2003, was $22.2 million. At June 30, 2004, the balance outstanding increased to $34.5 million primarily due to our resale of the previously repurchased bonds.

On June 19, 2003, Mechel Trading House issued ruble-denominated bonds in an aggregate principal amount of 3 billion Rubles (approximately $98 million). The bonds were issued at 100% of face value. Interest is payable every six months in arrears. The interest rate for the first coupon period was determined upon the issuance based on the bids of buyers and comprised 11.75% p.a. The interest rate for the second, third and fifth coupon periods is set by us and is made public 10 days before the respective coupon period starts. Bondholders are entitled to early redemption of the bonds at face value before the second, third and fifth coupon periods. The interest rate for the fourth and sixth coupon periods are set as equal to the rate for the immediately preceding coupon period. The bondholders have an option to demand repayment of the bonds starting June 19, 2006, with an obligatory redemption date on June 19, 2009. The balance outstanding at June 30, 2004, and December 31, 2003, was $103.4 million and $101.9 million, respectively (such difference being a result of changes in the U.S. dollar/ruble exchange rates).

Proceeds from the offering will be used for a combination of purposes, including capital expenditures and acquisitions. See Use of Proceeds.

Liquidity

We had cash and cash equivalents of $63.5 million at June 30, 2004, and $19.3 million at December 31, 2003. Of these amounts, $41.3 million and $13.7 million was held in U.S. dollars, euros and other hard currencies and $22.2 million and $5.6 million was held in rubles and other currencies of the CIS and Eastern Europe, respectively. A majority of our cash and cash equivalents are held by Chelyabinsk Metallurgical Plant, Southern Urals Nickel Plant and our principal trading companies, Mechel Trading, Mechel Metal Supply and Mechel Trading House.

As of June 30, 2004, and December 31, 2003, we had unused credit lines of approximately $139.3 million and $4.3 million, respectively, out of total available credit lines of $677.3 million and $468.7 million, respectively. These credit lines permit drawings at a weighted average interest rate of approximately 5.4% and 6.8% at June 30, 2004, and December 31, 2003, respectively. We have not had, and do not believe that we will have, difficulty gaining access to short-term financing sufficient to meet our current requirements.

The following table summarizes our liquidity as of June 30, 2004, and December 31, 2003.

Estimated Liquidity	**June 30, 2004**	**December 31, 2003**
	(in millions of U.S. dollars)	
Cash and cash equivalents	63.5	19.3
Amounts available under credit facilities	139.3	4.3
Total estimated liquidity	202.8	23.6

We had a working capital deficit of $39.3 million, $148.0 million and $149.4 million as of June 30, 2004, and December 31, 2003 and 2002, respectively. We expect to improve our working capital position significantly through completion of this offering and through the replacement of short-term with longer-term debt.

We believe that our liquidity will be adequate to satisfy our obligations for the foreseeable future, including spending for the major items of our capital expenditures currently in progress or expected to be commenced in 2004 through 2006. See Business Capital Improvements Program. Future requirements for our business needs, including the funding of acquisitions and capital expenditures, debt service for outstanding financings, and any amounts that may ultimately be paid in connection with contingencies, are expected to be financed by a combination of internally generated funds (including non-core asset sales), proceeds from the sale of stock, borrowings and other external financing sources. However, our business may not generate sufficient operating cash flow and external financing sources may not be available in an amount sufficient to enable us to service or refinance our indebtedness or to fund other liquidity needs. However, our ability to rely on some of these alternatives could be affected by factors such as the liquidity of the Russian and other financial markets, prevailing interest rates, our credit rating and the Russian government s policies regarding ruble and foreign currency borrowings.

Our opinion concerning liquidity and our ability to avail ourselves in the future of the financing options mentioned in the above forward-looking statements are based on currently available information. To the extent that this information proves to be inaccurate, future availability of financing may be adversely affected. Factors that could affect the availability of financing include our performance (as measured by various factors including cash provided from operating activities), levels of inventories and accounts receivable, the state of international debt and equity markets, investor perceptions and expectations of past and future performance, the global financial climate, and, in particular, with respect to borrowings, the level of our outstanding debt and credit ratings by rating agencies.

Other than as described above and elsewhere in this prospectus, no significant change has occurred since June 30, 2004.

Contractual Obligations and commercial commitments

The following table sets forth the amount of our contractual obligations and commercial commitments as of December 31, 2003.

		Payments due by period			
Contractual Obligations and commercial commitments	**Total**	**Less than 1 year**	**2-3 years**	**4-5 years**	**More than 5 years**
		(in thousands of U.S. dollars)			
Short-Term Borrowings(1)	308,969	308,969			
Long-Term Debt Obligations(1)	155,436	33,124	12,485	106,863	2,963
Purchase Obligations(2)	18,644	18,644			
Restructured Taxes Payable(3)	122,597	25,717	24,124	47,517	25,239
Asset Retirement Obligations(4)	13,937	1,995	6,773	1,403	3,765
Other Long-Term Liabilities	1,418		1,247	171	
Commitments under Subsoil Licenses(5)	13,000	*	*	*	*

(1) Does not include interest. In 2003, our interest expense was $48.5 million and we paid out $31.3 million for interest, net of amounts capitalized.

(2) Accounts payable for capital expenditures.

(3) Consists of Russian and Romanian restructured prior period taxes and social charges and related fines and penalties. This does not include $124.2 million in current period taxes and social contributions due as of December 31, 2003. See note 13 to our audited consolidated financial statements. This also does not include income taxes. In 2003, our income tax expense amounted to $47.8 million and we paid out $53.9 million in income taxes.

(4) See note 3(x) to our audited consolidated financial statements.

(5) We have certain environmental and safety commitments under the licensing agreements relating to our subsoil licenses. We estimate that we will spend approximately $13 million in total to satisfy these commitments. See Regulatory Matters Subsoil Licensing Maintenance and Termination of Licenses. Due to the small amounts involved and our flexibility to make these expenditures over a period of time, we do not track these commitments by year.

In the course of acquisition of our Romanian subsidiaries, we undertook certain commitments in respect of future capital expenditures connected with the development of production facilities. For COST, we committed to invest $21.1 million in the modernization of the plant and upgrade of its capacity over a period of five years from the date of acquisition (August 2002). For Industria Sarmei, we committed to invest $19.0 million in the modernization of the plant and upgrade of its capacity over a period of five years from the date of acquisition (June 2003). An additional commitment to invest in environmental protection at Industria Sarmei was accrued for and amounted to $3.6 million. As of June 30, 2004, the total of unfulfilled commitments and accruals was approximately $33.2 million. These investments are required to be made in annual installments from the dates of their respective acquisitions, and our investment commitments are secured by our shares in these subsidiaries.

INFLATION

Inflation in the Russian Federation was 20.2% in 2000, 18.6% in 2001, 15.1% in 2002, and 12.0% in 2003. With the exception of our coal operations in 2002, inflation has generally not had a material impact on our results of operations in recent years, primarily because producers in the market segments in which we compete are able to increase selling prices in line with increases in ruble-denominated costs.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of business, our financial position is routinely subject to a variety of risks. We are exposed to market risks associated with foreign currency exchange rates, interest rates, commodity and equity prices. We are also subject to the risks associated with the business environment in which we operate, including the collectibility of accounts receivable.

Except for a single instance of hedging foreign currency exchange rates risk more fully discussed below, we do not enter into hedge transactions to manage the risks specified above.

We do not hold or issue derivative financial instruments for trading purposes.

Currency risk

The functional currencies for our Russian and Romanian subsidiaries are the ruble and lei, respectively. The U.S. dollar is the functional currency of our other international operations. Our reporting currency is the U.S. dollar.

As the economies of Russia and Romania were considered highly inflationary through December 31, 2002 and December 31, 2003, respectively, transactions and balances of our Russian and Romanian subsidiaries not already measured in U.S. dollars were remeasured as if the functional currency were the U.S. dollar, in accordance with the relevant provisions of SFAS No. 52, Foreign Currency Translation. The objective of this remeasurement process is to produce the same results that would have been reported if the accounting records had been kept in U.S. dollars. Under this method, monetary assets and liabilities are translated using the exchange rate as of the balance sheet dates. Non-monetary assets and liabilities, including non-current non-monetary assets, liabilities and shareholders equity, are stated at their actual U.S. dollar cost or are restated from their historic cost, by applying the historical exchange rate as at the date of the original transaction. Income and expenses are restated by applying the monthly average exchange rates. Items in the statement of cash flows are translated at the monthly average exchange rates and where applicable at the exchange rates on the dates of the transactions. Foreign currency differences arising from remeasurement of the local currencies to U.S. dollars are included in the consolidated income statement as Foreign exchange gain (loss).

Effective from January 1, 2003, Russia no longer meets the criteria for a highly inflationary economy for purposes of applying SFAS No. 52. Accordingly, for the periods starting January 1, 2003, Mechel and its Russian subsidiaries no longer remeasure transactions and balances from rubles into U.S. dollars but translate rubles into U.S. dollars using the current rate method as prescribed by SFAS No. 52. The translation adjustments resulting from the process of translating financial statements from the functional currency into the reporting currency are included in determining other comprehensive income.

The initial implementation of this change had the effect of decreasing the U.S. dollar value of the combined net assets of our Russian subsidiaries by $30.9 million and increasing the accumulated other comprehensive income by the same amount. The impact of the change was to record $30.9 million of income for the year ended December 31, 2003, as a component of accumulated net other comprehensive income in the shareholders equity section of the consolidated balance sheet.

The Russian ruble and the Romanian lei are generally not convertible outside Russia and Romania, respectively, so our ability to hedge against further devaluation by converting to other currencies is significantly limited. Further, our ability to convert Russian rubles and Romanian leis into other currencies in Russia and Romania, respectively, is subject to rules that restrict the purposes for which conversion and the payment in foreign currencies are allowed.

In December 2002, we engaged in series of forward transactions to buy U.S. dollars amounting to $11 million in total for euros to hedge our exposure to movements in foreign currency exchange rates arising on euro-denominated accounts receivable of Mechel Trading, our Swiss trading company. This derivative was not designated as a hedge for accounting purposes. Such forward transactions amounted to $53.4 million during the year ended December 31, 2003. We intend to continue to engage in such transactions.

During the year ended December 31, 2003, we acquired other subsidiaries having their primary operations in Romania, Croatia and Lithuania, one in each country. The functional currencies of our Croatian and Lithuanian operations are their respective local currencies, the Croatian kuna and the Lithuanian lit, which were added to the list of our exposure foreign currencies.

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We are exposed to movements in the ruble and euro exchange rates relative to the U.S. dollar, our reporting currency. The following table sets forth our monetary assets and liabilities by currency at December 31, 2003.

Balance as of December 31, 2003	U.S. dollar	ruble	euro	lei	Other	Total
			(in thousands of U.S. dollars)			
Current Assets:						
Cash and cash equivalents	9,894	5,916	332	2,612	549	19,303
Trade receivables, net	46,458	21,475	16,359	3,342	3,296	90,930
Due from related parties	399	28,131				28,530
Deferred income taxes		6,496		4,062		10,558
Prepayments and other current assets	10,317	157,151	236	3,110	629	171,443
Total current assets	67,068	219,169	16,927	13,126	4,474	320,764
Current Liabilities:						
Short-term borrowings and current maturities of long-term debt	(140,538)	(163,760)	(6,635)	(31,160)		(342,093)
Accounts payable and accrued expenses:						
Advances received	(36,510)	(36,616)		(1,270)	(24)	(74,420)
Accrued expenses and other current liabilities	(14,201)	(44,390)		(1,934)	(2,919)	(63,444)
Taxes and social charges payable	(5,878)	(137,905)		(5,488)	(618)	(149,889)
Trade payables to vendors of goods and services	(36,879)	(66,503)	(6,486)	(28,713)	(5,998)	(144,579)
Due to related parties	(8,075)	(5,812)				(13,887)
Asset retirement obligation		(1,556)		(439)		(1,995)
Deferred income taxes	(3,424)	(13,459)				(16,883)
Deferred revenue	(52,662)	(251)		(2)		(52,915)
Total current liabilities	(298,167)	(470,252)	(13,121)	(69,006)	(9,559)	(860,105)
Long-term Liabilities:						
Restructured taxes and social charges payable, net of current portion		(89,363)		(7,516)		(96,879)
Long-term debt, net of current portion	(9,956)	(102,548)		(9,807)		(122,311)
Asset retirement obligation, net of current portion		(10,959)		(983)		(11,942)
Due to related parties						
Deferred income tax		(95,007)		(13,677)		(108,684)
Other long-term liabilities	(1,081)	(321)		(16)		(1,418)
Total long-term liabilities	(11,037)	(298,198)		(31,999)		(341,234)
Minority interest		(184,344)				(184,344)
Net monetary assets (liabilities)	(242,136)	(733,625)	3,806	(87,879)	(5,085)	(1,064,919)

The table below summarizes our debt position by currency and rate method.

	U.S. dollar	ruble	euro	lei	Total
		(in thousands of U.S. dollars)			
Total debt including	150,494	266,307	6,635	40,968	464,404
Fixed-rate debt	136,327	266,307	6,635	40,968	450,237

Variable-rate debt	14,167	14,167

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Interest rate risk

Our interest rate exposure results mainly from debt obligations. At December 31, 2003, we had debt amounting to $464.4 million, which comprised variable-rate borrowings of $14.2 million (3.1%) and fixed-rate borrowings of $450.2 million (96.9%).

We have not entered into transactions designed to hedge against interest rate risks, which may exist under our current, or future indebtedness. Once the market in Russia for hedging instruments matures, we will assess our options for hedging interest rate risks and may enter into such arrangements.

The table below presents the principle cash flows and related range of interest rates, by expected maturity dates, of our variable and fixed-rate debt obligations as of December 31, 2003.

		Expected maturity date as of December 31,						Annual Interest rate (Actual at
	Currency	2004	2005	2006	2007	There-after	Total	December 31, 2003)
		(in thousands of U.S. dollars)						
Variable-rate U.S. dollar debt:								
Raiffeisenbank	U.S. dollar	7,000					7,000	LIBOR+4.75%(5.87)%
Raiffaisenbank	U.S. dollar	5,667					5,667	LIBOR+5%(6.12)%
Mosnarbank	U.S. dollar	1,500					1,500	LIBOR+5%(6.12)%
Total		14,167					14,167	
Fixed-rate U.S. dollar debt:								
BNP	U.S. dollar	52,768					52,768	3.06-3.19%
Alfa-bank	U.S. dollar	32,048					32,048	9.5-11.0%
BCP	U.S. dollar	4,242					4,242	3.81-3.82%
Sberbank	U.S. dollar	1,650		2,209			3,859	9.0-11.0%
Die Erste Vienna	U.S. dollar	3,280					3,280	3.5%
Raiffeisenbank	U.S. dollar	1,521					1,521	4.47%
ING Bank	U.S. dollar	1,401					1,401	2.56%
Credit Suisse	U.S. dollar	1,287					1,287	3.45-4.05%
VBP	U.S. dollar	1,234					1,234	3.4%
Uralsib	U.S. dollar	1,155					1,155	10.5%
Uglemetbank	U.S. dollar	679					679	20.0%
Latekobank	U.S. dollar	540					540	10.0%
Other banks	U.S. dollar	688					688	Various
Corporate Lenders	U.S. dollar	31,149		380			31,529	0-10%
Total		133,642		2,589			136,231	
Fixed-rate euro debt:								
BNP, Geneva	euro	6,635					6,635	4.31%

Total		6,635			6,635	
Fixed-rate ruble debt:						
Sberbank	ruble	62,591			62,591	9.5-14.0%
Gazprombank	ruble	29,809			29,809	13.5-14.3%
Uralsib	ruble	10,115			10,115	11.0-13.5%
Bank of Moscow	ruble		3,400		3,400	12.0%
Uglemetbank	ruble	2,193			2,193	21.0%
Bank Zenit	ruble	2,000			2,000	10.5%
Vserossiyskiy Bank	ruble	1,976			1,976	14.0-16.5%
Vneshtorgbank	ruble	1,901			1,901	13.0%
Kuzbassugolbank	ruble		1,700		1,700	11.0%
Alfa-bank	ruble	861			861	13.0%
Other banks	ruble	10			10	Various
Bonds	ruble			101,852	101,852	11.75%

	Currency	2004	2005	2006	2007	There-after	Total	Annual Interest rate (Actual at December 31, 2003)
		Expected maturity date as of December 31, (in thousands of U.S. dollars)						
Bonds	ruble	22,150					22,150	16.9%
Corporate Lenders	ruble	14,924					14,924	0.0-10.0%
Promissory notes	ruble	7,958		15		2,948	10,921	0.0%
Total		156,488		5,115		104,800	266,403	
Fixed-rate lei debt:								
APAPS	lei	27,091	2,389	2,392	1,687	3,339	36,898	24%
Raiffaisenbank	lei	2,103					2,103	19.5-21.25%
BCR	lei	1,226					1,226	20.0%
BRD	lei	509					509	23.9%
Unicredit Buhuresti	lei	232					232	20.5%
Total		31,161	2,389	2,392	1,687	3,339	40,968	
Total debt:		342,093	2,389	10,096	1,687	108,139	464,404	

The carrying amounts of short-term loans approximate their fair values due to their short maturity. We believe that the carrying value of our long-term debt approximates its fair value.

Commodity price risk

In the normal course of our business, we are primarily exposed to market risk of price fluctuations related to the purchase, production and sale of steel products, and to a lesser extent, to the purchase, production and sale of coal, coke and other products.

We do not use commodity derivatives or long-term sales or supply agreements to manage our commodity price risks.

Under certain of our steel products sales agreements we grant a third party reseller a sales price concession under which the selling price, which is typically prepaid by the reseller, is subject to adjustment based upon the level of market prices when the reseller delivers the products to the end customers. Historically, these selling price adjustments occur within an eight- to sixteen-week period from the date the products are delivered to the reseller. As of December 31, 2003 and 2002, we had 156,410 and 152,342 metric tonnes of our steel products in the distribution channel for which we received prepayments in the amount of $45.5 million and $32.1 million, respectively. See Critical Accounting Estimates Revenue recognition.

Equity price risk

As disclosed in Note 8 to our audited consolidated financial statements included herein, as of December 31, 2003 and 2002, we had a significant cost method equity investment in MMK. These investments are exposed to market risk of fluctuations in equity prices.

These investments are shares of Russian companies that are not publicly traded and, accordingly, their market values are not available. Currently, it is not practicable for us to estimate the fair values of these investments because we have not yet obtained or developed the valuation models necessary to make the estimates, and the cost of obtaining an independent valuation is believed by the management to be excessive considering the significance of the investments. Therefore, these investments are omitted from quantitative risk information disclosure presented herein.

We do not use derivative instruments or any other arrangements to manage our equity price risks.

CRITICAL ACCOUNTING ESTIMATES

The preparation of our consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at year-end, and the reported amount of revenues and expenses during the year. Management regularly evaluates these estimates. Management estimates are based on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Accordingly, actual results may differ materially from current expectations under different assumptions or conditions.

The value of property, plant and equipment pertaining to non-controlling shareholders in the accounting for minority interests resulting from acquisitions of various subsidiaries has been recorded at appraised values rather than at historical cost as required by U.S. GAAP.

Management believes that the following are the more significant judgments and estimates used in the preparation of the financial statements.

Accounting for business combinations

During the past years, we have completed several significant business combination transactions. In the future, we may continue to grow our business through business combinations. We accounted for all combinations using the purchase method of accounting.

The accounting for business combinations under the purchase method is complicated and involves the use of significant judgment. Under the purchase method of accounting, a business combination is accounted for at a purchase price based upon the fair value of the consideration given, whether it is in the form of cash, assets, stock or the assumption of liabilities. The assets and liabilities acquired are measured at their fair values, and the purchase price is allocated to the assets and liabilities based upon these fair values. Determining the fair values of the assets and liabilities acquired involves the use of judgment, since the majority of the assets and liabilities acquired do not have fair values that are readily determinable. Different techniques may be used to determine fair values, including market prices, where available, appraisals, comparisons to transactions for similar assets and liabilities and present value of estimated future cash flows, among others. Since these estimates involve the use of significant judgment, they can change as new information becomes available.

The most difficult estimations of individual fair values are those involving property, plant and equipment and identifiable intangible assets. We use all available information to make these fair value determinations and, for major business acquisitions, typically engage an outside appraisal firm to assist in the fair value determination of the acquired long-lived assets. We have, if necessary, up to one year after the acquisition closing date to finish these fair value determinations and finalize the purchase price allocation.

Goodwill represents the excess of the purchase price over the fair value of the acquired underlying identifiable net assets resulting from business acquisitions and is originally stated at cost. At the acquisition date goodwill is allocated to the reporting units it relates to. Annually, or if conditions indicate an earlier review is necessary, the carrying value of the reporting unit is compared to an estimate of its fair value. If the estimated fair value is less than the carrying value, goodwill is impaired, and will be written down in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. As of December 31, 2003 and 2002, we reported goodwill of $5.4 million and $3.3 million, respectively. During the years ended December 31, 2003, 2002 and 2001, we recognized goodwill impairment of $nil, $7.2 million and $nil, respectively.

Negative goodwill represents the excess of the fair value of the acquired identifiable net assets over the purchase price of the acquisition. Negative goodwill was allocated to the acquired non-current assets, except for deferred taxes and long-term investments in marketable securities, if any, until they were reduced to zero. The remaining negative goodwill was amortized to income over its estimated life of 20 years prior to the adoption of SFAS No. 142 on January 1, 2002. The remaining unamortized negative goodwill at January 1, 2002, was recognized in the income statement as a change in accounting principle. In accordance with SFAS No. 141, Business Combinations, any negative goodwill remaining after reducing to zero the value of assets acquired in a business combination shall be recognized as an extraordinary item in the income statement. For the investees accounted for under the equity method, the excess of cost of the stock of those companies over our share of fair value of their net assets as of the acquisition date is treated as embedded goodwill. Similar to consolidated subsidiaries, SFAS No. 142 requires that goodwill from equity method investments be no longer amortized over its estimated useful life. Subsequent changes to the value of this balance resulting from our share of income or losses including impairment of the embedded goodwill are included in the consolidated income statements.

Mineral licenses and mining long-lived assets

We use estimates for proven and probable reserves, recoverable resources therefrom, and/or assumptions of future coal, nickel and iron ore prices. Such estimates and assumptions affect the fair value of the mineral reserves rights at the date of its acquisition, impairment of mineral reserves rights and other long-lived assets and the ability to realize income tax benefits associated with deferred tax assets.

Estimates of mineral reserves are based primarily on engineering evaluations. Mineral licenses are amortized using the units-of-production method over the shorter of the license term or the estimated proven and probable reserve depletion period. In March 2004, the FASB ratified the consensus reached by the Emerging Issues Task Force on Issue No. 04-2, Whether Mineral Rights Are Tangible or Intangible Assets, which resolves the inconsistency between the Task Force s consensus that mineral rights are tangible assets and the guidance in SFAS No. 141 that characterizes mineral rights as intangible assets. In that consensus, the EITF determined mineral rights or licenses are tangible assets. The adoption of this did not have a material impact on our financial position or results of operations.

Our estimate of mineral reserves together with estimates of sales volumes and prices for the products are significant factors used in performing annual impairment assessments of our long-lived mining assets, including mineral reserves rights. Changes in estimates of reserves and other assumptions regarding pricing and volumes could materially influence these assessments. Should our estimates of the quantity of sales and prices not materialize, significant impairments of our long-lived mining assets may result. These estimates and assumptions also affect the rate at which depreciation and depletions are charged to earnings.

Because currently there is no history of subsoil licenses renewals, our existing mineral reserves rights and long-lived mining assets are being depleted/depreciated over the periods covered by existing licenses on the deposit-by-deposit basis.

On an ongoing basis, management evaluates its estimates and assumptions; however, actual amounts could differ from those based on such estimates and assumptions. As of December 31, 2003 and 2002, the carrying amount of our mineral licenses amounted to $160.1 million and $81.0 million, respectively.

Stock-based compensation

We follow the provisions of SFAS No. 123, Accounting for Stock-Based Compensation , for the stock-based compensation arrangement with one of our executives. SFAS No. 123 generally allows companies to either account for stock-based compensation under the provisions of SFAS No. 123 or under the

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provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees , and to make disclosures in accordance with the provisions of SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure an amendment of SFAS No. 123 . Because the fair value accounting requires use of valuation models that were not developed for use in valuing employee stock awards, we have elected to account for our stock-based compensation in accordance with the provisions of APB Opinion No. 25 and related interpretations.

Accordingly, the compensation cost was recognized based on the excess, if any, of the fair market value of the shares on the measurement date (July 1, 2003) over the amount the executive must pay to acquire the shares. We are recognizing compensation expense on a straight-line basis over the remaining vesting period of the award through April 15, 2004.

We do not present pro forma disclosures as if the fair value method had been applied, as the result would be substantially the same given that the exercise price of the award was zero.

Revenue recognition

Revenue is recognized on an accrual basis when earned and realizable, which generally occurs when products are delivered to customers. In some instances, while title of ownership has been transferred, the revenue recognition criteria has not been met as the selling price is subject to adjustment based upon the market price when the customer receives the product. Accordingly, in those instances, revenue and the related cost of goods sold are recorded as deferred revenues and deferred cost of inventory in transit in the consolidated balance sheets and are not recognized in the consolidated income statement until the price becomes fixed and determinable, which typically occurs when the price is settled with the end-customer, generally within eight- to sixteen-week period from the date of the goods delivery. Sales are recognized net of applicable provisions for discounts and allowances and associated sales taxes (VAT) and export duties.

We categorize revenues as follows:

- Domestic
  - Russia: sales of Russian production within Russia
  - Other domestic: sales of non-Russian production within the country of production
- Export: sales of production outside of country of production

Property, plant and equipment

For other than mineral licenses and other long-lived mining assets and processing plant and equipment, we record depreciation primarily using the straight-line method on a pro rata basis.

The following useful lives are used as a basis for recording depreciation:

Category of asset	**Useful economic lives estimates, years**
Buildings	20-45
Land improvements	20-50
Operating machinery and equipment	7-30
Transportation equipment and vehicles	4-15
Tools, furniture, fixtures and other	4-8

Remaining useful economic lives of our property, plant and equipment are being revisited on an annual basis.

We evaluate carrying value of our property, plant, and equipment for impairment whenever indicators of impairment exist.

Accounts receivable

Accounts receivable are stated at net realizable value. We review the valuation of accounts receivable on a regular basis. The allowance for doubtful accounts is estimated based on historical experience of cash collections and future expectations of conditions that might impact the collectibility of accounts.

Deferred income taxes

We record a valuation allowance to reduce our deferred tax assets to an amount that is more likely than not to be realized. In estimating levels of future taxable income, we have considered historical results of operations in recent years and would, if necessary, consider the implementation of prudent and feasible tax planning strategies to generate future taxable income. If future taxable income is less than the amount that has been assumed in determining the deferred tax asset, then an increase in the valuation reserve will be required, with a corresponding charge against income. On the other hand, if future taxable income exceeds the level that has been assumed in calculating the deferred tax asset, the valuation reserve could be reduced, with a corresponding credit to income.

Litigation, claims and assessment

We are subject to various lawsuits, claims and proceedings related to matters incidental to its business. Accruals of probable cash outflows have been made based on an assessment of a combination of litigation and settlement strategies. It is possible that results of operations in any future period could be materially affected by changes in assumptions or by the effectiveness of these strategies.

We record liabilities for potential tax deficiencies. These liabilities are based on management s judgment of the risk of loss. In the event that we were to determine that tax-related items would not be considered deficiencies or that items previously not considered to be potential deficiencies could be considered as potential tax deficiencies (as a result of an audit, tax ruling or other positions or authority) an adjustment to the liability would be recorded through income in the period such determination was made.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Asset Retirement Obligations

Effective January 1, 2003, we adopted SFAS No. 143, Accounting for Asset Retirement Obligations, which applies to legal obligations associated with the retirement and removal of long-lived assets. SFAS No. 143 requires entities to record the fair value of an asset retirement obligation (ARO) as a liability in the period when it is incurred (typically when the asset is installed at the production location). When the liability is recorded, the entity capitalizes the cost by increasing the carrying amount of the related properties, plant and equipment. Over time, the liability is increased for the change in its present value each period, and the capitalized cost is depreciated over the useful life of the related asset.

Upon adoption of SFAS No. 143 on January 1, 2003, we recorded approximately $3.8 million, including tax benefit, as a charge to cumulative effective changes in accounting principles. Application of this new accounting principle resulted in an increase in property, plant and equipment of $5.5 million and an asset retirement obligation liability of $9.3 million. The application of SFAS No. 143 reduced income from continuing operations by $2.6 million, net income by $6.4 million (after income taxes of $nil), or $0.02 per basic and diluted share, for the year ending December 31, 2003. The following table summarizes the balance sheet impact of our initial adoption of SFAS No. 143 as of January 1, 2002, computed on a pro forma basis as if the provisions of SFAS No. 143 had been applied during all periods affected:

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	Balance at January 1, 2003	Pro forma Balance at January 1, 2002
Asset retirement cost included in the related mining assets	7,966	4,093
Accumulated depreciation of capitalized asset retirement costs	(2,492)	(2,052)
Asset retirement cost, included in mining assets, net	5,474	2,041
Asset retirement obligation	9,262	4,290

We have numerous asset removal obligations that we are required to perform under law or contract once an asset is permanently taken out of service. Most of these obligations are not expected to be paid until many years into the future and will be funded from general company resources at the time of removal. Our asset retirement obligations primarily relate to our steel and mining production facilities with related landfills and dump areas and our mines. The following table presents the movements in ARO for the year ending December 31, 2003.

Asset retirement obligation	**Year ended December 31, 2003**
Balance at beginning of year	9,262
Liabilities incurred in the current period	2,144
Liabilities settled in the current period	
Accretion expense	2,433
Revision in estimated cash flow	
Translation and other	98
Balance at end of year	13,937

Guarantees

In November 2002, the Financial Accounting Standards Board issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. It elaborates on the disclosures to be made by a guarantor about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of the guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. This interpretation is applicable on a prospective basis to guarantees issued or modified as from 2003. The disclosure requirements are effective for financial statements ending after December 15, 2002. Our adoption of Interpretation No. 45 on January 1, 2003 did not have a material impact on our financial position and results of operations.

Consolidation of Variable Interest Entities

In December 2003, the FASB issued Interpretation No. 46R, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51, which revised Interpretation No. 46, issued in January 2003. FIN 46R addresses the consolidation of business enterprises (variable interest entities) to which the usual condition (ownership of a majority voting interest) of consolidation does not apply. It focuses on financial interests that indicate control. It concludes that in the absence of clear control through voting interests, a company s exposure (variable interest) to the economic risks and potential rewards from the variable interest entity s assets and activities are the best evidence of control. Variable interests are rights and obligations that convey economic gains or losses from changes in the value of the variable interest entity s assets and liabilities. Variable interests may arise from financial instruments, service contracts, and other arrangements. If an enterprise holds a majority of the variable interests of an entity, it would be considered the primary beneficiary. The primary beneficiary would be required to include assets, liabilities, and the results of operations of the variable interests entity in its financial statements.

We will adopt FIN 46R in 2004. We have not determined what impact, if any, FIN 46R will have on our financial position or results from operations.

TREND INFORMATION

Steel industry

We expect the Russian steel industry to continue to benefit from domestic and global demand for steel. In 2003, domestic consumption of steel products rose 10% year-on-year and we expect domestic consumption to continue to grow, with engineering, construction and tube production being the main drivers of domestic demand. The construction industry, in particular, is the most dynamically developing sector with an annual growth rate of approximately 14% in 2003.

The global demand for steel has been increasing by 3% per annum, and is expected to remain relatively strong in the near term, despite a decrease in Chinese demand. More control over production capacity following consolidation in Western Europe and bankruptcy-related closures in North America have allowed for increasing supply-side discipline among producers, which has supported the steel price recovery over the last 18 months. During that period, steel inventory levels have been reduced, which may further support steel prices in the near term, although likely not at the levels recently seen. The extent to which these developments occur will depend on a number of factors, including primarily the sustainability of Asian demand in the face of a slowdown in China and the extent and pace of economic recovery in Europe and the United States.

Steel prices remained strong in the first half of 2004, and we expect global steel prices to peak in the first half of 2005, and begin to decrease during the second half of 2005, due in part to increases in production levels as producers respond to the generally favorable demand and pricing environment, as well to a continuing slowdown in China. We expect steel prices in Russia to generally track international prices.

Coal industry

The Asian countries are among the major net importers of sea-borne steam and coking coal. On the back of strong demand, inventory levels in the coal industry have been significantly reduced, resulting in higher price levels despite capacity expansions, primarily in Australia. Coking coal prices are dependent on the situation in the steel industry, and are likely to continue rising in 2005 due to increases in the production of steel, as well as due to the shortage and high prices for steel scrap which results in the greater utilization of blast furnaces requiring coke. Coke supply remains constrained globally due to fully utilized production capacities, with Chinese coke exports expected to further decrease, which will put further pressure on availability and price levels during 2004 and 2005. Announced plans for supply increases in Australia are not expected to outweigh expected longer-term increases in demand from Brazil and India. The steam coal market is driven by non-steel related factors, and we expect prices to remain high in 2004 and 2005 before correcting towards 2006, driven by demand growth from power and industrial users and restocking.

Iron ore industry

The iron ore industry is currently characterized by high demand from Asia and supply and transportation constraints. Capacity expansions are primarily targeted to meeting the demand increase, generated primarily in China, although demand from China has decreased in recent months. The outlook for 2005 and beyond will depend on supply and demand balance in the industry, but we do not anticipate that the increase in iron ore production will be such as to shift this balance significantly and we expect prices for iron ore to remain at high levels.

Nickel industry

Nickel prices have increased significantly since 2001. Stock-building ahead of a ramp-up in stainless steel production in 2004, strong demand from China and speculative demand, combined with a strike at one of the facilities of Inco, the world s second largest producer, have underpinned the price rise. We believe that demand and prices will remain relatively stable through the remainder of 2004, with a slight decrease in 2005. However, by 2006, lower demand growth particularly in stainless steel, coupled with an anticipated slowdown in China should force a reduction in the nickel price.

Sales

Within the context of a positive demand and pricing environment, we expect to increase our steel products production levels and shipments as we continue to increase our production capacities, particularly at Chelyabinsk Metallurgical Plant. See Business Steel Business Facilities. We expect that a continuing improvement in the Russian steel market will increase our domestic steel sales as a proportion of our overall steel sales.

We also expect our mining segment sales to increase as we continue production increases. We expect that our coking coal sales will trend towards an even split between internal consumption and third party sales, with third party sales consisting primarily of sales to Europe and Ukraine, with increasing sales to Asia as well. We also expect to increase our export sales of steam coal, given the significant price differential which currently exists. We believe that our mining segment may help to counterbalance any near term downturn in steel prices, as we increase our iron ore sales to China, assuming sustained Chinese demand.

Inventory

The recent downturn in the Chinese steel sector has resulted in an increase in our inventory of iron ore concentrate. We expect that this inventory will gradually decrease as domestic iron ore sales increase, and that it will cease to be a significant factor when our new sinter plant at Chelyabinsk Metallurgical Plant begins to operate in the first half of 2005.

Overall, our raw materials inventory was at twice the amount at December 31, 2003, as compared to December 31, 2002, and outpaced growth in the cost of goods sold (12.5% and 9.6% as a percentage of cost of goods sold in 2003 and 2002, respectively), due to the growth in our business through acquisitions, significantly higher prices for scrap and ferroalloys in Eastern Europe and Russia and the maintenance of higher stock levels in order to hedge against further price increases. Similar trends in our raw materials inventory continued in 2004 (12.7% and 10.9% as a percentage of cost of goods sold for the six months ended June 30, 2004 and 2003, respectively, on an annualized basis).

Costs

Our steel costs per tonne should remain relatively stable, as higher production volumes, cost savings from the continuing integration of our recent steel acquisitions and efficiency and output gains arising as a result of the targeted capital expenditure program, particularly at Chelyabinsk Metallurgical Plant, help to offset increasing payroll costs and raw material prices and potential increases in electricity and natural gas tariffs. Specifically, as we continue to introduce operational and technical changes at our plants allowing us to better integrate their products, we expect to be better able to control our cost increases. The new sinter plant at Chelyabinsk will allow us to substantially increase our ability to internally source our iron ore feed requirements, without the need to utilize third-party processing, while the increasing use of continuous casters should provide both efficiency and production increases. We also expect these technology improvements to reduce our energy requirements per tonne, partially reducing the impact of potential increases in electricity and natural gas tariffs.

Within our mining segment, we expect our coal costs per tonne to increase gradually as a result of increasing payroll costs, while nickel costs per tonne should decrease significantly in 2005 as a result of technological and operational improvements, before beginning to gradually increase thereafter. We expect our iron ore costs per tonne to remain relatively stable.

SEASONALITY

Seasonal effects have a relatively limited impact on our results. Nonetheless, slowing of demand and, thus, a reduction in sales volumes (and a concomitant increase in inventories) is typically evident in the first and fourth quarters of the financial year as a result of the general reduction in economic activity associated with the New Year holiday period in Russia and elsewhere. We also maintain larger stockpiles of scrap during the winter months in order to avoid potential supply disruptions due to inclement weather. We are also dependent on the Russian construction market, which also experiences slowdowns in the winter months. However, our sales of steam coal typically increase during the second and third quarters as a result of increased steam coal purchases by utilities for the winter.

Consumption of combustive, lubricative and energy supplies during the winter months is generally higher than during the rest of the year. In addition, railroad carriers demand that iron-ore concentrate be fully dried and coal concentrate be partially dried for transportation during the winter months, resulting in higher costs during that time.

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GLOBAL STEEL INDUSTRY OVERVIEW

Steel is one of the most important, multi-functional and adaptable materials in use today, and is considered to be the backbone of industrial development. Steel s versatility is attributable to the fact that it is hot and cold formable, weldable, hard, resistant to corrosion, water and heat, 100% recyclable and has good machinability. Among the myriad industries in which steel is used are the construction, transportation and engineering industries. Steel is also used in the production of power lines, pipelines, white goods and containers.

The steel industry is affected by a combination of factors, including periods of economic growth or recession, worldwide production capacity and the existence of, and fluctuations in, steel imports and protective trade measures. Steel prices respond to supply and demand and have fluctuated in response to general and industry-specific economic conditions.

The steel industry operates predominantly on a regional basis given the high cost of transporting steel. For example, the top five producers in each of Japan and the EU control more than 60% of their respective regional markets. However, despite the limitations associated with transportation costs, as well as the restrictive effects of protective tariffs, duties and quotas, global imports and exports have increased in the last decade.

While steel production has been historically concentrated in the EU, North America, Japan and the former Soviet Union, steel production in China and the rest of Asia has grown in importance over the past decade. In 2003, China was the largest single producer of steel at 220 million tonnes, as well as the largest consumer of steel at 237 million tonnes. China imports steel to meet its requirements, and is expected to remain a net importer of steel over the next decade, even after taking into account the planned increases in its production capacity. The EU, the United States and Japan were the next largest producers and consumers of steel. Russian steel production substantially declined between 1990 and 1998, but has steadily recovered since then. The following table sets forth raw steel production data by country or region for the years 1997-2003.

	2003	2002	2001	2000	1999	1998	1997
	(in millions of tonnes)						
China	220	182	141	126	123	114	109
EU	160	159	159	163	155	160	160
Japan	111	108	103	106	94	94	105
United States	91	92	90	101	96	97	98
Russia	61	59	58	58	50	42	49
Other Asia	97	92	88	87	81	80	95
Other Europe	48	45	45	45	42	47	51
Other	157	149	140	144	130	126	132
Total	945	886	824	830	771	760	799

Source: International Iron and Steel Institute

The strategy and product mix of steel producers generally varies between producers in industrial countries and producers in emerging markets. Historically, commodity steel producers in industrialized countries had limited export markets due to the high cost of transporting steel relative to the low value of commodity steel grades. In the second half of the last century, producers in emerging markets began to

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compete with industrialized country steel producers as they took advantage of the lower manufacturing costs in their countries to offset high transportation costs. In response, producers in Western Europe and Japan invested heavily in new technology and capacity to produce high value-added steel grades in order to differentiate their product portfolio and protect their margins by reducing their exposure to commodity steel prices. However, these similar and simultaneous investments resulted in a build-up of production overcapacities and have put pricing pressures on the value-added segments.

Recently, the growth and consolidation of both steel consumers and raw-material suppliers has weakened the bargaining power of steel producers and put further pressure on their margins. Steel producers have responded with a phase of industry consolidation. Usinor, Arbed and Aceralia in Europe merged to form Arcelor, the world s largest steel company, as did Kawasaki Steel and NKK in Japan, creating JFE. Nucor acquired Birmingham Steel and ISG acquired Acme, LTV and Bethlehem Steel in the United States. Consolidation has enabled the steel companies to lower their production cost and allowed for a more stringent supply-side discipline, including through selective capacity closures. Despite this consolidation, in 2003 it is estimated that the top five companies Arcelor Group (Luxembourg), Nippon Steel Corporation (Japan), POSCO (Korea), LNM Group (the Netherlands) and JFE Steel (Japan) accounted for only 18% of global output, of which Arcelor accounted for only 5%.

RUSSIAN STEEL INDUSTRY OVERVIEW

Following the collapse of the Soviet Union, the Russian steel industry suffered a substantial decline in production from over 77 million tonnes in 1991 to 44 million tonnes in 1998. Since then, output has increased by nearly 39%, and in 2003, Russia produced 61 million tonnes of raw steel, or 7% of world production, making it the world s fourth largest producer of crude steel. Russia also produced nearly 52 million tonnes of rolled products in 2003, operating at about 90% of installed capacity. Of this amount, 27 million tonnes (or 51% of the total output of rolled steel) were exported, comprising 8% of all global exports for semi-finished and finished steel products, making Russia the number three exporter of such products after Japan and Germany. Semi-finished products comprised 43% of exports. Overall, the Russian steel industry sells over 51% of its output abroad and benefits from healthy global markets, particularly in Asia, which is the most important market for Russian producers.

Domestic consumption is also on the rise, driven by both upstream and downstream industries. Steel consumption in the Russian economy in 2003 remained relatively low at 229 kilograms per capita, down from nearly 398 kilograms in 1992 and substantially less than in such countries as Japan, which consumed 571 kilograms per capita, the United States, which consumed 318 kilograms per capita, and countries in Western Europe, which consumed on average 462 kilograms per capita.

Russian steel producers tend to focus on vertical integration, which allows them a stable supply of certain raw materials (*e.g.*, coking coal for pig iron and non-ferrous metals for stainless steel products) and stable demand from customers up the product chain. In addition, Russian companies are modernizing former state-owned steel production facilities, achieving significant reductions in manufacturing costs, placing their costs well below those of Western European producers, and improving product quality and technology. During the last decade, the share of open-hearth furnaces decreased from 53% in 1990 to 22% in 2003, and the share of continuous casting increased from 23% to 59% during the same period.

Domestic market

Steel production in Russia decreased from 1991 through 1998 as a result of the general economic decline in Russia during this period and the consequent reduced demand from the primary steel product consumers: the construction, infrastructure and engineering industries and the military sector.

Domestic consumption of rolled steel products in Russia has followed a U-shaped curve since 1990.

Industry

Consumption was at 65 million tonnes in 1990 and it declined steadily due to lower consumption by heavy industry, reaching bottom in 1998 when consumption was a mere 13 million tonnes. However, the devaluation of the ruble in 1998 resulted in economic growth and a sharp pick-up in domestic demand for steel products. Consumption grew by 24% in 1999, which was followed by 43% additional growth in 2000, outpacing both GDP and industrial production growth. In 2003, consumption was 27 million tonnes.

Russia does not import significant quantities of steel. Imported steel comprised only 8% of total steel consumed in Russia during 2003.

Export market

Asia, the Middle East and the EU are the dominant export destinations for Russian steel producers. China, which is the largest steel importer in the world, accounted for 13% and 38% of Russia s total hot rolled steel and cold rolled steel exports in 2003, respectively. In 2003, Russian producers exported 27 million tonnes of rolled products, of which semi-finished products (slabs and billets) accounted for 44%, flat products for 40%, and long products for 16%. The abolition of steel export duties in 2002 by the Russian government has also improved the export market.

Exports of rolled products gradually gained importance during the 1990s, increasing from 12 million tonnes in 1991 to 27 million tonnes in 2003. Exports currently represent over 51% of total production.

The following table sets forth by percentage the export destinations for Russian steel products in 2003.

Region	%
Europe	30
Asia	43
Middle East	16
CIS (other than Russia)	5
Africa	3
North and South America	3
Total	100

Source: Metall-Expert

Producers

The Russian steel industry is characterized by a relatively high concentration of production, with the five largest steel companies accounting for 82% of Russia s total steel products. These five companies can be divided into two groups by product type. MMK, Severstal, and Novolipetsk Iron & Steel Works, or NLMK, focus mainly on flat products, while EvrazHolding and Mechel Steel Group produce primarily long products. We are the second largest producer of long products in Russia after EvrazHolding.

We are also the largest comprehensive producer of specialty steels and alloys in Russia. Besides us, there are a number of relatively small companies for example, Oskol Electric Metallurgical Works, or OEMK, Zlatoust Metallurgical Plant, or ZMK, and Electrostal that make various specialty steels and alloys. However, each of these competitors produces only a limited range of products and lags significantly behind us in terms of overall production of specialty steels.

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The following table provides information on Russian rolled steel production volumes by producer in 2003 and each producer s main products.

Company	Output (in thousands of tonnes)	Market Share	Main products
EvrazHolding[1]	11,009	22%	Long
MMK	10,162	20%	Flat/long
Severstal	8,807	17%	Flat/long
NLMK	8,234	16%	Flat
Mechel Steel Group	3,506	7%	Long/flat
NOSTA	2,469	5%	Flat/long
OEMK	2,119	4%	Long
Other	4,647	9%	
Total	50,953	100%	

Source: Chermet

(1) EvrazHolding consists of Nizhny Tagil Metallurgical Plant, Zapadno-Sibirsky Metallurgical Plant (ZapSib) and Kuznetsky Metallurgical Plant.

GLOBAL COAL INDUSTRY OVERVIEW

There are two principal types of coal: steam (thermal) coal and coking (metallurgical) coal. Steam coal is used in electricity generation, while coking coal is used to manufacture coke for use in steel manufacture and other metallurgical applications. Coking coal is harder than steam coal and it swells when heated in blast furnaces, which characteristic is essential in steel making operations. Approximately 500 600 kilograms of coking coal is used per tonne of steel produced. Hard coking coal is supplemented by the direct injection of pulverized coal, or PCI, at rates of 100 200 kilograms per tonne of steel. PCI uses cheaper steam and semi-soft coking coal to cut down costs.

In recent years, the global coal industry has consolidated partly as a result of oil companies and other non-mining companies leaving the sector. The top five export coal producers (Rio Tinto, BHP Billiton, Anglo-American, Xstrata and Drummond) now supply 40% of the total traded coal market, with the top ten producers controlling 60%. As a result, coal suppliers have gained more pricing power.

RUSSIAN COAL INDUSTRY OVERVIEW

Russia possesses the world s second largest coal reserves after the United States. Its proven coal reserves total 157 billion tonnes, accounting for 16% of the world s proven coal reserves. In 2003, Russia produced 276 million tonnes of coal, of which about 75% was steam coal and the balance was coking coal. Approximately 70% of Russia s coking coal output was controlled by Russian steel producers.

Coal production is heavily concentrated in the Kuznetsky Basin and the Kansko-Achinskii Basin, which are east of the Ural mountains. The two basins together accounted for 66% of Russia s total output in 2003, with Kuznetsky producing primarily coking coal and Kansko-Achinskii producing primarily steam coal. In 2003, approximately 20% of the coal produced in Russia was consumed in the European part of Russia.

The export of coal has been growing over the past several years. In 2003, Russian coal companies exported approximately 60 million tonnes of coal, 20% higher than in 2002.

Industry

GLOBAL NICKEL INDUSTRY OVERVIEW

The stainless steel industry dominates nickel use, accounting for over 70% of world nickel demand in 2003. Nickel scrap makes up approximately half of the stainless steel raw materials feed of nickel and, as nickel scrap supplies are becoming tighter, there has been an increase in demand for primary nickel.

The supply of primary nickel is dominated by the world s largest producer, Norilsk Nickel, which operates in arctic Siberia and northwestern Russia. It accounted for 20% of the world s total primary nickel production in 2003. The Canadian producer, Inco, is the next-largest producer, accounting for 15% of the world s total primary nickel production in 2003. The top five producers of nickel accounted for 55% of the world s total primary nickel production in 2003.

RUSSIAN NICKEL INDUSTRY OVERVIEW

Russia ranks second in the world by nickel reserves, on par with Canada and following Australia. The country s reserves are estimated at 6.6 million tonnes of contained nickel, or 11% of the global total. Norilsk Nickel accounts for 89% of Russia s nickel reserves. Its reserves are made up of sulphide ores of the Taimyr and Kola Peninsulas, and are also rich in copper, cobalt and precious metals. The balance of Russia s resources is comprised of deposits of poorer silicate ores of the Central and Southern Urals, developed by Southern Ural Nickel Plant and Ufaleinickel.

Russia accounts for over 330,000 tonnes of the total 1.4 million tonnes of nickel produced globally in 2003. Norilsk Nickel produced 260,000 tonnes of nickel, complemented by smaller-size plants such as Southern Ural Nickel Plant and Ufaleinickel. Over 90% of Russian nickel production was exported, with the domestic market for primary nickel presently limited to approximately 25,000 tonnes. Consequently, the industry is highly dependent on international metal prices as quoted at the London Metal Exchange, or LME.

GLOBAL IRON ORE INDUSTRY OVERVIEW

The iron ore industry is characterized by a high degree of consolidation, with 70% of the seaborne iron ore trade controlled by Rio Tinto, CVRD and BHP Billiton. The major producing countries are Brazil, China and Australia. Several projects in Australia, Brazil and South Africa are expected to increase global production.

Traditionally, Europe, Japan and China have been the major iron ore consumption centers, but areas such as the CIS, South Korea and Thailand have higher growth rates as the European and Japanese markets mature. Following an economic slowdown in 2001 and concurrent reduced iron ore demand, markets rebounded in 2002, with China and certain CIS countries showing significant increases in demand in connection with increases in steel production in these countries.

Iron ore production has experienced falling production costs due to productivity enhancements. Freight rates remain a major cost constraint, comprising about half of total costs in 2003. Freight costs thus maintain the regional segregation of the industry.

RUSSIAN IRON ORE INDUSTRY OVERVIEW

Russia produced 85.8 million tonnes of iron ore in 2003, accounting for 8% of global production. Russia, however, has higher production costs than other large producing countries such as Australia and Brazil due to more complex extraction processes. Iron ore exports totaled 17.7 million tonnes, or 21% of Russian production, in 2003. Imports totaled 12.9 million tonnes.

The 13 largest Russian mining companies accounted for 95% of total iron ore production in 2003, with the top three producers accounting for 53%. Approximately 55% of Russia s iron ore output was

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controlled by Russian steel producers in 2003. Production is concentrated in the Kursk region (56%), the Northwest district (18%) and the Urals district (14%), which together accounted for 88% of total production.

Total iron ore feed consumption of Russian steel mills is composed of concentrate (63%), pellets (29%), and sinter (8%).

STEEL-MAKING PROCESS AND TYPES OF STEEL

The principal raw material used to produce steel is iron ore. Mined iron ore is crushed, homogenized and mixed with limestone and coke. The mixture is sintered and then fed, in alternating layers with coke, into a blast furnace. This is injected with hot air and the coke burns to produce carbon monoxide, which reacts with the iron oxide to reduce the latter (by removing the oxygen) to produce pig iron (94-96% iron, 3-4% carbon and 1-2% non-ferrous elements). Pig iron is processed further in a basic oxygen furnace (also called BOF) to produce liquid or raw steel, so called because it still must undergo additional refining. In the basic oxygen furnace, pig iron from the blast furnace is purified in an oxygen converter and combined with additional products, such as limestone and scrap, which burn off most of the unwanted metals and other contaminants, leaving raw steel as the end product. Other metals, such as manganese and nickel, are then added for their specific alloying characteristics. Globally, approximately 65-70% of raw steel is made in basic oxygen furnaces, which are integrated, large-scale operations that generally must produce 3-4 million tonnes per annum to be economic.

Another method of raw steel production is the electric arc furnace (also called EAF, or mini-mill), which is normally a much smaller operations producing 200,000-300,000 tonnes per annum. Globally, approximately 30-35% of raw steel is made in EAFs. In the electric arc furnace, steel is recycled from scrap. Heat is supplied from electricity that arcs between graphite electrodes and a metal bath. This process is suitable for producing almost all stainless steel and other alloyed steel products, and for most long carbon steel products. However, it is not an economically competitive production method for high-purity flat carbon steel products.

Steel products are broadly subdivided into two categories flat and long products. Flat products are those products such as slabs, which may be converted into hot rolled or cold rolled coils and/or coated sheets. They are used primarily in manufacturing industries, such as the white goods and automotive industries. Long products are used for construction-type applications (beams, rebars). To create flat and long products, molten raw steel is cast in continuous casting machines or casting forms, where it is converted to semi-finished products. The molten steel is poured and solidified to produce either blooms or billets (which may be transformed into long products), or into slabs (used for flat products).

All semi-finished products are then rolled at high temperatures, a process known as hot rolling. They are drawn and flattened through rollers to give the metal the desired dimensions and metallurgical properties. Some steel products go through an additional step of rolling at ambient temperatures, a process known as cold rolling. For cold rolled applications, coils are placed in the annealing furnace and heated to 1,300 degrees Fahrenheit, then gradually cooled to room temperature over a four-day period. This softens and stress relieves the metal to give it uniform properties for future fabrication. Oil may be applied to the surfaces for protection from rust.

The properties of steel may be modified to render it suitable for its intended future use by the addition at various stages of the production process of small amounts of other metals or metal oxides into the structure of the steel, varying the metal s chemical composition. For example, the carbon content of steel can be varied in order to change its malleability, or other elements can be added to give it new properties, such as adding chrome and nickel to produce more rust-resistant stainless steel. The alloying of steel is different from the process of coating already rolled steel with certain materials to give it additional

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metallurgical and anti-corrosion properties, as with stainless steel cord (cladding), zinc (hot dip or electrogalvanized sheet for the automobile industry) or tin (tin plate for tin and beverage cans).

Business

OVERVIEW

We are a low-cost integrated steel and mining group focused on the production of steel long products, as well as mining products such as coal, iron ore and nickel. In 2003 and in the first half of 2004, we had revenues of $2.05 billion and $1.63 billion, respectively. We are the largest and most comprehensive producer of specialty steels and alloys in Russia, producing 52% of total Russian specialty steel output, over three times as much as our nearest competitor. We are also the second largest producer of long products in Russia.

Our steel business comprises the production and sale of semi-finished steel products, carbon and specialty long products, carbon and stainless flat products and value-added downstream metal products including hardware, stampings and forgings. Our steel business also produces significant amounts of coke, both for internal use and for sales to third parties.

We have substantial coal, iron ore and nickel mining interests in Russia and Kazakhstan, with the flexibility to supply our own steel production or sell to third parties depending on price differentials between purchases from local suppliers and sales to foreign and domestic customers. We are capable of internally sourcing all of the coking coal, 92% of the iron ore and 55% of the nickel requirements of our steel segment, assuming in the case of iron ore that third parties process certain quantities of our iron ore concentrate into sinter and pellets. In addition, we are the only specialty steel manufacturer in the world capable of internally sourcing all three of these raw materials. We were the second largest producer of coking coal in Russia in 2003, with a 12% market share. We also control 24% of the coking coal washing capacity in Russia.

Additionally, we own 17.1% of the common shares of Magnitogorsk Iron and Steel Work OAO, or MMK, Russia s largest producer of flat products, with reported revenues of $3.05 billion and $2.17 billion in 2003 and in the first half of 2004, respectively, under International Financial Reporting Standards.

OUR HISTORY AND DEVELOPMENT

We trace our beginnings to a small coal trading operation in Mezhdurechensk in the southwestern part of Siberia in the early 1990s. Since that time, through strategic acquisitions in Russia and abroad, our founding shareholders have built Mechel into a large, integrated steel and mining group, comprising steel production in Russia, Romania and Lithuania and coke production and coal, iron ore, nickel and limestone mining in Russia. With each of our acquisitions, we implement improved operational and management practices, and we are generally able to realize significant increases in production efficiency and volume with only modest, targeted capital expenditures. We also devote the management, technological and logistical resources necessary to integrate new acquisitions into all aspects of our business, including the supply of raw materials and steel, production methodologies and sales and distribution.

Set forth below are our primary steel and mining acquisitions:

- By 2000, we had acquired most of our coal interests, consisting of seven mining operations and related processing plants, all located within close proximity to each other in Mezhdurechensk in the southwestern part of Siberia. These operations, now consolidated under Southern Kuzbass Coal Company, produced 14.2 million tonnes of coal in 2003.

- In 2001, we acquired:

  Chelyabinsk Metallurgical Plant, an integrated blast furnace and BOF/EAF steel mill which produced 2.6 million tonnes of coke, 4.2 million tonnes of raw steel and 3.3 million tonnes

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Business

of rolled products in 2003 and which is located in Chelyabinsk, in the southern Urals near the border with Kazakhstan; and
Southern Urals Nickel Plant, consisting of two open-pit nickel mines and a nickel processing facility which produced 13,524 tonnes of nickel products in 2003 and which is located in Orsk, in the southern Urals.

Ø In 2002, we acquired:

Vyartsilya Metal Products Plant, a rolling mill which produced 51,670 tonnes of hardware in 2003 and which is located in Sortavala, Karelia, in northwest Russia close to the border with Finland;
Beloretsk Metallurgical Plant, a rolling mill which produced a total of 505,552 tonnes of steel products in 2003, including 244,766 tonnes of wire rod and 260,786 tonnes of hardware and which is located in Beloretsk, in the southern Urals;
Pugachev limestone quarry, consisting of a quarry and processing facility which produced 522,644 tonnes of limestone in 2003 and which is located close to Beloretsk, in the southern Urals; and
COST, a steel mill which produced 441,930 tonnes of raw steel and 285,677 tonnes of rolled products in 2003 and which is located in Targoviste, Romania.

Ø In 2003, we acquired:

Mechel Zeljezara, a Croatian steel mill that produced pipes, which we subsequently shut down in August 2004 due to its high input costs and a persistent weakness in pipe prices;
Urals Stampings Plant, a forging and stamping mill which produced 42,073 tonnes of specialty steel stampings in 2003 and which is located in Chebarkul, in the southern Urals;
Industria Sarmei, a steel mill which produced 260,681 tonnes of raw steel, 124,326 tonnes of rolled products and 70,228 tonnes of hardware in 2003 and which is located in Campia Turzii, Romania;
Korshunov Mining Plant, consisting of three iron ore mines and an iron ore concentrator plant which produced 3.5 million tonnes of iron ore concentrate in 2003 and which is based in Zheleznogorsk-Ilimskiy, in eastern Siberia;
Mechel Nemunas, a hardware plant which produced 22,044 tonnes of products in 2003 and which is located in Kaunas, Lithuania; and
Coal Washing Factory-38, a coal washing plant which produced 4,700 tonnes of coking coal concentrate in 2003 and which is located near Karaganda, Kazakhstan, now Mechel Coal Resources.

Ø In 2004, we acquired:

Port Posiet, a port located in Russia s Far East on the Sea of Japan and which has 1.4 million tonnes of cargo handling capacity and over 120,000 tonnes of warehousing capacity and processed 845,000 tonnes of cargo, mostly coal, metals and ferroalloys, in 2003;
Gorbachev Mine, an underground coal mine located in Kazakhstan; and
Izhstal, a Russian specialty steel producer located in Izhevsk, Udmurtia, west of the Urals, which produced approximately 427,000 tonnes of raw steel, 264,000 tonnes of rolled products, 38,000 tonnes of hardware and 17,000 tonnes of stampings and forgings in 2003.

Business

Our Mechel name, which is derived from a combination of the Russian words Metalurgicheskii (meaning metallurgical) and Chelyabinskii (meaning Chelyabinsk), has been associated with our Chelyabinsk Metallurgical Plant. Chelyabinsk Metallurgical Plant commenced operations in 1943, and is well known in the Russian steel industry.

STRATEGY

Our goal is to expand our position in Russia as a leading supplier of carbon long products and as the leading supplier of specialty long products, to further develop our position as a competitive exporter of these products, to expand our mining business and to capitalize on the synergies deriving from our status as an integrated group. We also intend to leverage our core businesses, where appropriate, with acquisitions of value-added downstream businesses.

The key elements of our strategy include the following:

- Ø *Expand our Position as a Leading Producer of Carbon Long Products in Russia.* We have already built a solid presence in this sector, including a market-leading position in engineering steel and strong sales in rebar and wire rod. We intend to improve these positions further, including through the addition of substantial new production capacity achieved by targeted, cost-effective capital expenditures. We plan to increase our raw steel and rolled steel production capacity from 6.3 million and 5.0 million tonnes in 2004, respectively, to 8.2 million and 7.1 million tonnes in 2007, respectively, primarily at our Chelyabinsk Metallurgical Plant. Additionally, we seek to benefit from the following factors in Russia:

  - If the economy continues to expand, the demand for long products, particularly in the construction industry, should increase, providing us with additional sales opportunities.
  - Substantial infrastructure repairs and industrial upgrade needs should also drive demand for our products.

- Ø *Develop and Expand Our Position as a High-Quality, Low-Cost Producer of Specialty Long Products.* We are Russia s primary producer of specialty long products. We believe that this higher-margin business provides us with substantial opportunities to increase our revenues and profitability for the following reasons:

  - Our low-cost production provides us with a competitive base for expanding our market share in Europe, Asia and the CIS countries.
  - The Russian market for specialty long products has considerable room for growth if demand from domestic engineering and manufacturing sectors recovers from historic post-Soviet lows in the past few years.

- Ø *Expand our Mining Business.* We intend to build on our substantial mining experience to achieve the following goals:

  - Develop our existing coal and iron ore reserves, particularly in order to sell more high-quality coking coal and iron ore concentrate to third parties. We plan to increase our coal production from approximately 15.2 million tonnes in 2004 to 16.6 million tonnes in 2007, and our iron ore concentrate production from approximately 4.0 million tonnes in 2004 to 5.0 million tonnes in 2007.
  - Make selective acquisitions of coal and other mining enterprises, including new subsoil licenses, particularly in Russia and other CIS countries, as strategic opportunities present themselves.

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Maintain our flexibility to internally source raw-material inputs for our steel-making business, depending on price differentials between purchases from local suppliers and sales to foreign and domestic customers.

Ø *Enhance our Position as a Low-Cost Producer.* We intend to further increase our efficiency and reduce our manufacturing costs by:

Selectively investing in technology and capital improvements, including expanding our use of continuous casters in our steel-making.
Preserving our cost advantages in our labor, raw materials and energy inputs.
Achieving additional savings by fully integrating recent acquisitions into our operations.

Ø *Further Capitalize upon Synergies between our Core Businesses.* In addition to synergies deriving from our status as an integrated group, we believe that additional cost savings and opportunities will arise as we benefit from economies of scale and continue to integrate recent acquisitions, in particular by implementing improvements in working practices and operational methods. We regularly evaluate the manner in which our subsidiaries source their raw material needs and transfer products within the group in order to operate in the most efficient way, and we expect to identify and take advantage of further synergies between our core businesses.

Ø *Selectively Expand our Downstream Capacity.* We intend to continue to selectively acquire value-added downstream businesses such as hardware, stampings and forgings producers to help us reach our customer base, including in new markets. This downstream integration:

Is a logical extension of our specialty and low-carbon long product lines, representing a higher-margin, next value-added step for products that we already manufacture.
Is in a market less cyclical than the upstream market, reducing our exposure to market downturns.
Moves us closer to our final customers, enabling us to better understand customer needs, influence buyer behavior and respond quickly to change.

Ø *Selectively Expand our Internal Logistics Capabilities.* We intend to selectively expand our internal logistics capabilities, currently centered on our railway freight and forwarding company, and enhanced by our recent acquisition of Port Posiet, located on the Sea of Japan, to help us optimize our transportation expenses.

Ø *Maintain Strong Export Sales.* We intend to maintain our strong relationships with our significant export customers. Although we are focused on maintaining our market position within Russia, export sales, which constituted 55% of our total sales in the first half of 2004, allow us to diversify our sales and reduce our reliance on the Russian market in the event that it were to experience a downturn.

Implementation of these strategies is subject to a number of risks. See Risk Factors for a description of these risks.

COMPETITIVE STRENGTHS

Our main competitive strengths are the following:

- *Low-Cost Producer.* Our base of operations in Russia and integrated status allow us to take advantage of a number of cost advantages vis-à-vis foreign producers.

Low-cost raw materials. We internally source all of the coking coal and a significant portion of the iron and nickel requirements of our steel segment. Our mines, processing facilities and steel production facilities have long and established operating histories, and we continue to find additional cost savings through internally sourcing these raw materials. Having the ability to internally source also gives us a better bargaining position with our outside suppliers and allows us to control our raw material costs.

Inexpensive energy. We internally satisfy about 38% of our electricity needs from our own co-generation facilities, and purchase most of the remainder at low, regulated prices. We also purchase natural gas from Gazprom at low, regulated prices for our electrical and other production needs. See Risk Factors Risks Relating to Our Business and Industry Increasing tariffs and restructuring in the energy sector could materially adversely affect our business.

Low labor costs. Russia has very low labor costs, including few, if any, pension obligations, as compared to the United States, Western Europe, Japan and South Korea.

Cost management. We view strict cost management and increases in productivity as fundamental aspects of our day-to-day operations, and continually reassess and improve the efficiency of our mining and steel-making operations. With our acquisition and successful integration of Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant, Southern Urals Nickel Plant and Korshunov Mining Plant in the past few years, we have established a track record of turning around underperforming steel-making and mining products facilities by implementing improved operational and management practices, leading to reductions in production costs and improved product quality.

Ø *Ability to Source Internally Significant Amounts of Raw Materials.* We are capable of internally sourcing 100% of the coking coal, 92% of the iron ore and 55% of the nickel requirements of our steel segment, assuming in the case of iron ore that third parties process certain quantities of our iron ore concentrate into sinter and pellets, which comprise the ultimate form of iron ore feed into the steel making process. We are also currently expanding our iron ore processing capability so that we will be able to internally process more of our iron ore concentrate into sinter, making us capable of being 80% fully self-sufficient in our iron ore feed requirements, assuming current capacities and production levels. While other steel producers have certain captive raw-materials suppliers, we are the only steel manufacturer in the world with its own nickel production facilities. We believe that our captive supply of coking coal, iron ore and nickel provides us significant advantages over other steel producers, such as higher stability of operations, better control of quality of end products, reduced production costs, improved flexibility and planning latitude in the production of our steel and value-added steel products and the ability to respond quickly to market demands and cycles. Moreover, in recent years, the supply of iron ore and coal, the two primary raw-materials inputs into the steel-making process, has been increasingly concentrated among fewer companies, resulting in weaker bargaining positions for steel makers. Our integration strategy has allowed us to minimize the adverse effect of such concentration, and keep our raw-materials costs down. In addition, our ability to source raw materials internally and within Russia means that we are not exposed to the expected shortages in worldwide shipping capacity.

Ø *Ability to Improve Cost Efficiency with Relatively Modest Capital Expenditures.* We believe that relatively modest capital improvements will allow us to decrease our production costs and improve our margins. For example, we expect the further introduction of continuous casting at our plants to result in substantial improvements in our cost efficiency.

- Ø *Ability to Increase Current Production Cost Effectively.* We believe that we have a significant competitive advantage over our competitors in our ability to increase our production capacity relatively cost effectively because our substantial existing infrastructure can accommodate new facilities and production lines through brownfield development. Moreover, due to our integration, experience and location in Russia, which has some of the largest reserves of coal and iron in the world, we are better positioned than our European competitors to secure raw materials for any increases in steel production. For example, we plan to increase Chelyabinsk Metallurgical Plant s raw steel and rolled steel production capacity from 5.0 million and 4.0 million tonnes, respectively, in 2004 to 6.5 million and 5.8 million tonnes, respectively, in 2007.

- Ø *Significant Domestic Market Shares in Specialty Steel and Carbon Long Products.* Russia is our most important market and we have significant domestic market shares in all our key specialty steel and carbon long products. We believe we have established a strong reputation and brand image for Mechel within Russia and certain of our key export markets.

- Ø *Established Export Market Presence*. We export a substantial portion of our products through our sales and distribution network in 10 countries and agents in 28 additional countries. These export sales, which constituted 55% and 45% of our total sales in the first half of 2004 and in 2003, respectively, allow us to diversify our sales, provide us with additional growth opportunities and reduce our reliance on the Russian market in the event that it were to experience a downturn.

- Ø *Well-Situated for Construction Market*. The location of our primary steel manufacturing facility, Chelyabinsk Metallurgical Plant, in the southern Urals makes it better situated, compared to our primary competitor in this market, to serve the Russian construction market, which we estimate constituted approximately 17% of our steel segment sales in 2003.

- Ø *Value-Added Product Line.* We produce long products for a broad range of end uses, including forgings and stampings, wire rod for metal cord production and a wide range of hardware (wires, nails, nets, ropes and rope products). Downstream production provides us with higher-margin opportunities.

- Ø *Track Record of Successful Acquisitions.* Building upon our success in turning around the coal operations of Southern Kuzbass Coal Company in the late 1990s and following our acquisition and revitalization of Chelyabinsk Metallurgical Plant, a specialty steel manufacturer that was one of our primary customers of coking coal, in the last few years we have acquired other metal finishing and hardware manufacturing operations that we can supply with our steel. With each of our acquisitions, we implement improved operational and management practices, and we are generally able to realize significant increases in production efficiency and volume with only modest, targeted capital expenditures. For example, at Chelyabinsk Metallurgical Plant, COST, Beloretsk Metallurgical Plant, Southern Urals Nickel Plant and Vyartsilya Metal Products Plant, shipment volumes in 2003 increased by 17%, 21%, 40%, 63% and 392% as compared to shipments in the year prior to our acquisition. We also devote the management, technological and logistical resources necessary to integrate new acquisitions into all aspects of our business, including the supply of raw materials and steel, production methodologies and sales and distribution. We have a good track record of using existing workforces and maintaining excellent relations with the local communities where we operate.

- Ø *Increasing Control over Logistics*. Our increasing internal logistics capabilities, currently centered on our railway freight and forwarding company, and enhanced by our recent acquisition of Port Posiet, located on the Sea of Japan, help us to optimize our transportation expenses.

Business

- *Strong and Focused Management Team.* Our current management team has significant experience in all aspects of our businesses and has successfully transformed us from a small coal trading operation to a large, integrated steel producer. Our two founding shareholders remain significantly involved in the management of our business, with Mr. Zyuzin serving as our Chairman and Mr. Iorich serving as our Chief Executive Officer and a member of our board. Our Chief Operating Officer, Alexey Ivanushkin, has significant experience from his previous positions at Glencore International and as chief executive officer at Chelyabinsk Metallurgical Plant. Many of our directors and officers began their careers in floor jobs or in mines and moved up into management positions over the course of their careers.

STEEL BUSINESS

Our steel business comprises production and sale of semi-finished steel products, carbon and specialty long products, carbon and stainless flat products, and value-added downstream metal products including hardware, stampings and forgings. Within these product groups, we are further able to tailor steel grades to meet specific end-user requirements. Our steel business is supported by our mining business, which includes coal (steam and coking coal), iron ore, nickel and limestone. Our mining business also sells substantial amounts of raw materials to third parties. See Mining Business.

Our production

The following table sets out our production volumes by primary steel product categories and main products within these categories.

Production	6 months 2004	2003	2002
	(in thousands of tonnes)		
Coke	1,462	2,617	2,552
Coking Products	103	127	97
Pig Iron	1,857	3,153	2,965
Semi-Finished Steel Products, including:	780	982	1,005
Carbon and Low-Alloyed Semi-Finished Products	730	934	989
Long Steel Products, including:	1,398	2,434	1,898
Stainless Long Products	4	14	6
Alloyed Long Products	67	113	86
Rebar	655	1,281	1,008
Wire-rod	401	597	455
Low-Alloyed Engineering Steel	270	310	257
Flat Steel Products, including:	189	356	289
Stainless Flat Products	17	47	45
Carbon and Low-Alloyed Flat Products	172	309	244
Forgings, including:	48	86	59
Stainless Forgings	2	6	4
Alloyed Forgings	1	16	10
Carbon and Low-Alloyed Forgings	37	63	45
Forged Alloys		1	1
Stampings	31	26	

Hardware, including:	262	375	157
Wire	188	276	121
Ropes	26	45	19

Business

In the first half of 2004 and in 2003, with the exception of our foreign subsidiaries, we manufactured almost all of our steel products using internally-sourced coke, pig iron, raw steel and semi-finished steel products. We purchase small quantities of semi-finished steel products from local steel producers when economically justified. In 2003, we purchased under 10,000 tonnes of semi-finished steel products from third parties.

Sales of steel products

The following table sets forth our revenues by primary steel segment product categories and our main products within these categories (including as a percentage of total steel segment revenues) for the periods indicated. Steel segment sales data presented in Steel Business does not include intercompany sales to the mining segment.

Revenues	6 months 2004 amount	6 months 2004 % of revenues	2003 amount	2003 % of revenues	2002 amount	2002 % of revenues	2001[1] amount	2001[1] % of revenues
	(in millions of U.S. dollars, except for percentages)							
Coke	22.6	2%	29.5	2%	22.9	4%	117.1	17%
Coking Products	8.0	1%	15.3	1%	11.7	1%		
Pig Iron	37.4	3%	15.4	1%	9.7	1%		
Semi-Finished Steel Products,[2] including:	183.7	14%	99.5	6%	127.6	12%	122.0	18%
Carbon and Low-Alloyed Semi-Finished Products	181.1	14%	98.4	6%	121.1	11%		
Long Steel Products, including:	612.2	48%	750.5	46%	428.7	44%	143.4	21%
Stainless Long Products	8.8	1%	22.2	1%	7.0	1%		
Alloyed Long Products	36.7	3%	43.9	3%	31.5	3%		
Rebar	282.6	22%	359.2	22%	209.5	20%		
Wire-rod	159.4	13%	174.8	11%	90.4	11%		
Carbon and Low-Alloyed Engineering Steel	97.3	8%	107.2	7%	70.9	7%		
Flat Steel Products, including:	122.1	10%	172.9	11%	117.4	12%	3.8	1%
Stainless Flat Products	44.1	3%	83.2	5%	69.0	7%		
Carbon and Low-Alloyed Flat Products	78.2	6%	89.5	5%	48.2	5%		
Forgings, including:	42.2	3%	67.6	4%	37.6	4%	0.4	0%
Stainless Forgings	5.1	0%	12.8	1%	6.2	1%		
Alloyed Forgings	8.9	1%	15.6	1%	7.8	1%		
Carbon and Low-Alloyed Forgings	22.2	2%	28.5	2%	15.9	2%		
Forged Alloys	5.9	1%	10.7	1%	7.6	1%		
Stampings	35.0	3%	23.5	1%				
Hardware, including:	152.5	12%	154.0	9%	71.2	7%	4.6	1%
Wire	100.2	8%	103.6	6%	53.1	5%		

Ropes	21.7	2%	27.0	2%	12.7	1%		
Other[3]	51.8	4%	308.0	19%	184.7	18%	288.4	42%
Total	1,267.8	100%	1,636.1	100%	1,011.5	100%	679.8	100%

(1) Product subcategory revenue data for 2001 is unavailable.

Business

(2) The decline in our semi-finished steel product sales in 2003 relates to our acquisition in 2002 of Beloretsk Metallurgical Plant. Prior to the acquisition, our sales of semi-finished steel to Beloretsk Metallurgical Plant were sales to third parties, whereas after the acquisition these sales are considered intercompany sales and thus are eliminated in our consolidated results. The acquisition contributed to the increases in our sales of long steel products and hardware, which Beloretsk Metallurgical Plant manufactured from semi-finished steel supplied from Chelyabinsk Metallurgical Plant.

(3) Our resales of MMK products, primarily plates, coils and galvanized sheets, constituted a majority of these other sales. Specifically, in 2003, 2002 and 2001, our resales of MMK products were $223.1 million, $154.9 million and $205.8 million, comprising 13.6%, 15.3% and 30.3% of our steel segment revenues, respectively, during these periods. Starting in January 2004, we stopped reselling MMK products. Also included are sales of tubes, which amounted to $21.0 million in the first half 2004 and $26.0 million in 2003. In August 2004, we terminated production at our tube factory, Mechel Zeljezara.

The following table sets forth by percentage of sales the regions in which our steel segment products were sold for the periods indicated.

Region(1)	6 months 2004	2003	2002	2001
Russia	42.0%	47.4%	47.1%	35.1%
Other CIS	2.9%	0.5%	1.9%	0.0%
Europe	31.4%	29.4%	24.8%	32.6%
Asia	20.0%	17.9%	24.3%	21.6%
Middle East	1.7%	3.3%	1.6%	7.7%
United States	0.7%	0.6%	0.2%	0.03%
Other	1.1%	1.0%	0.1%	3.0%
	100.0%	100.0%	100.0%	100.0%

(1) The regional breakdown of sales is based on the geographic location of our customers, and not on the location of the end users of our products, as our distributor customers resell and, in some cases, further export our products.

During the first half of 2004 and in 2003, our steel segment sales outside of Russia were principally to Europe and Asia. Sales in Europe accounted for 31.4% and 29.4% of our total steel segment sales during these periods, respectively. European sales during these periods were largely to Switzerland (10.1% and 11.7%), followed by Romania (6.9% and 7.2%), Austria (2.2% and 2.9%) and Germany (1.0% and 1.5%). Swiss sales consisted of mostly sales to Glencore International (see below). Sales in Asia accounted for 20.0% and 17.9% of our total steel segment sales during these periods, respectively, consisting of China (7.3% and 10.0%), followed by Vietnam (4.4% and 4.2%) and Taiwan (1.9% and 1.0%). Middle East sales during these periods accounted for 1.7% and 3.3% of our total steel segment sales during these periods, respectively. The three largest markets were Israel (0.4% and 1.1%), United Arab Emirates (0.5% and 0.9%) and Iran (0.5% and 0.5%).

Sales of our steel products to Glencore International in Europe comprised 10%, 12%, 18% and 23% of our total steel segment sales in the first half of 2004 and in 2003, 2002 and 2001, respectively, which we record as European sales. Glencore International resells these steel products primarily to customers in the Middle East and Asia. In the first half of 2004 and in 2003, customers in the Middle East accounted for 25% and 44%, respectively, of these sales, with most of these sales being to Iran, and customers in Asia accounted for 63% and 34%, respectively, of these sales. See Marketing and Distribution Export Sales below for a further description of our steel product sales to Glencore.

Business

The following table sets forth information on our domestic and export sales of our primary steel product categories for the periods indicated. We define export sales as sales by our Russian and foreign subsidiaries to customers located outside their respective countries. We define domestic sales as sales by our Russian and foreign subsidiaries to customers located within their respective countries.

Products	6 months 2004	2003	2002	2001
	(in millions of U.S. dollars, except for percentages)			
Coke	22.6	29.5	22.9	117.1
Domestic (%)	100%	100%	100%	100%
Export (%)				
Coking Products	8.0	15.3	11.7	
Domestic (%)	100%	100%	100%	
Export (%)				
Pig Iron	37.4	15.4	9.7	
Domestic (%)	36%	93%	80%	
Export (%)	64%	7%	20%	
Semi-Finished Steel Products	183.7	99.5	127.6	122.0
Domestic (%)	7%	24%	26%	
Export (%)	93%	76%	74%	100%
Long Steel Products	612.2	750.5	428.7	143.4
Domestic (%)	53%	61%	58%	46%
Export (%)	47%	39%	42%	54%
Flat Steel Products	122.1	172.9	117.4	3.8
Domestic (%)	49%	67%	70%	
Export (%)	51%	33%	30%	100%
Forgings	42.2	67.6	37.6	0.4
Domestic (%)	50%	64%	71%	
Export (%)	50%	36%	29%	100%
Stampings	35.0	23.5		
Domestic (%)	88%	94%		
Export (%)	12%	6%		
Hardware	152.5	154.0	71.2	4.6
Domestic (%)	73%	78%	79%	100%
Export (%)	27%	22%	21%	
Other[1]	51.8	308.0	184.7	288.5
Domestic (%)	51%	25%	6%	18%
Export (%)	49%	75%	94%	82%
Total	1,267.8	1,636.2	1,011.5	679.8
Domestic (%)	50%	55%	49%	35%
Export (%)	50%	45%	51%	65%

(1) Our resales of MMK products, primarily plates, coils and galvanized sheets, constituted a majority of these other sales. Specifically, in 2003, 2002 and 2001, our resales of MMK products were $223.1 million, $154.9 million and $205.8 million, comprising 13.6%, 15.3% and 30.3% of our steel segment revenues, respectively, during these periods. All of our resales of MMK products were exports. Starting in January 2004, we stopped reselling MMK products. Also included are sales of tubes, which amounted to $21.0 million in the first half of 2004 and $26.0 million in 2003. In August 2004, we terminated production at our tube factory, Mechel Zeljezara.

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The end users of our steel products vary. Our rebars are principally used in the construction industry. The main end users of our wire rods are small wire-drawing operations. Our carbon sheet is used in construction (covers, floor plates), the automotive industry (spare parts) and pipe manufacturing and shipbuilding (non-critical applications). Our high-quality round bars are used in various moving parts manufactured by the automotive industry (spare parts, gear boxes), the machinery industry (hydraulic devices, drill bits), the shipbuilding industry (forged parts), the basic materials industry (molds, balls for crushing) and other industries. Our forgings and stampings are primarily used in the automotive, aerospace, petrochemical, textile and food and consumer goods sectors.

The following table sets forth by percentage a breakdown of our shipment volumes of all products produced in Russia by industry sector within the Russian market in 2003.

Use by Industry	Metal Works, Hardware Plants	Pipe Factories	Construction	Engineering	Railway Construction, Repair	Power Generation	Other Industries(1)
Semi-Finished Steel Products		59%	5%	32%			4%
Long Steel Products	6%	5%	52%	32%	1%		4%
Flat Steel Products	4%	7%	7%	71%		1%	8%
Forgings		21%		72%			7%
Stampings				47%			53%
Hardware	7%	1%	23%	21%	23%		26%

(1) Including the defense, aerospace, petrochemical, textile, food and consumer goods sectors.

Marketing and Distribution

We use flexible sales strategies that are tailored to our customers and the markets we serve. Mechel Trading House, headquartered in Moscow, coordinates our Russian sales and has six sales branch offices. Mechel Trading AG, headquartered in Zug, Switzerland, together with its subsidiaries, including Mechel Metal Supply Limited, headquartered in Schaan, Liechtenstein, coordinates all export sales of our steel products and operates representative offices in each of our core international markets.

Our overall sales strategy is to develop long-term, close partnerships with the end users of our products. As part of our end-user strategy, we research sales to distributors to identify the end user and directly market our steel capabilities and products to these customers. With respect to our largest end-user customers, we have established working committees, composed of our manufacturing engineers and customer personnel. These committees meet quarterly to monitor the performance of our products and ensure that our customers specifications and quality requirements are consistently met. These committees also provide customers the opportunity to discuss their future needs with us. Our sales force also regularly follows up with these and many of our other customers. We attend industry conferences and advertise in industry periodicals to market our products and capabilities. Through these efforts, we have established a strong reputation for Mechel within Russia and other countries of the CIS, Central and Eastern Europe, Southeast Asia and the Middle East.

Domestic sales

The Moscow headquarters of Mechel Trading House serves as the central domestic sales office for all our products. Our Moscow office provides additional customer service for, and collects feedback from, our largest and most important customers, and the information gathered is directly provided to senior management. The Moscow office, by virtue of its location, is also well suited to develop new customers by approaching large Russian manufacturers headquartered in Moscow or those companies that have centralized purchasing offices in Moscow. The Moscow office is also involved in responding to tenders or requests for proposals, which is the most common method by which Russian companies procure the supply of raw materials.

Our domestic steel production facilities are located in large industrial areas and have long-standing relationships dating from Soviet times with local end-user customers. Mechel Trading House s six sales branches in Chelyabinsk, Beloretsk, Vyartsilya, Ufa, Chebarkul and St. Petersburg service and develop these long-standing customer relationships. By virtue of their proximity both to production and to customers, our local sales forces provide highly specialized and technical sales and service support to our Russian customers.

We also operate warehouses near our production facilities in Chelyabinsk, Ufa and Mezhdurechensk and in Moscow, St. Petersburg, Ekaterinburg and Rostov-Don, where we sell our steel products to wholesalers on a walk-in basis. We realize higher margins on these sales compared to our other sales, and we intend to open such warehouses in other large Russian metropolitan areas in the future. Through these sales, we also identify potential new end-user customers of our products and market our production capabilities and products directly to them.

Mechel Trading House has a salaried sales force of approximately 293 employees.

Export sales

Most of our international steel sales are made to independent distributors, which then sell our products in smaller quantities to end users. Mechel Trading and its subsidiaries operate offices or representative offices in the following 10 countries:

Asia		Europe		North America
China	Taiwan	Austria	Belgium	United States
Philippines	Vietnam	Liechtenstein	Romania	
		Switzerland		

We also work with agents in 28 additional countries. We have an internationally-oriented sales force which facilitates communications between our production facilities and the end users of our products, keeping in mind local and international customs in business dealings, including language requirements. Our use of a centralized international sales organization offers comprehensive and coordinated logistical and financial services to our international customers.

Most of our distributor customers are based in one location close to end users. We service these customer relationships employing local sales forces and maintaining local sales offices, which makes us familiar with the markets in which end-users of our products are located.

Glencore International is the largest customer of our exported steel segment products. During the first half of 2004 and in 2003, 2002 and 2001, we sold $126.1 million, $189.9 million, $177.9 million and $155.8 million in steel products to Glencore, respectively, comprising 10%, 12%, 18% and 23% of our total steel segment sales, respectively, during these periods. Steel sales to Glencore, to whom we also sell all of our nickel exports, are made pursuant to monthly contracts that set forth the price, quantity and quality of the steel to be purchased. The products purchased by Glencore consist of wire rod, rebar, billets, hot-rolled sheet and coil, which are then resold by Glencore abroad, principally to purchasers in Asia and the Middle East.

Business

Mechel Trading and its subsidiaries also sell steel products to wholesalers on a walk-in basis through large open and covered warehouse areas in the following locations:

Antwerp, Belgium. We use open and covered areas in the Port of Antwerp. At this port, we primarily stock both rolled and forged bars, and intend to expand the product offering to cover other products such as wire rods and nails.

Ho Chi Minh City, Vietnam. We have leased a 12,000 square meters plot of land in Ho Chi Minh City for a 47-year term, and intend to construct a 1,000-2,000 square meters warehouse on this property. We intend to stock a wide range of our products at this location, which will enable us to increase higher-margin sales to end users of our products. We may also expand the warehouse to include a steel service center, offering value-added services.

Mechel Trading also researches and collects information about the steel market and the latest technology and equipment in order to understand and anticipate new developments in the steel industry and deliver current information on the state of international steel markets to our management. Mechel Trading and its subsidiaries have approximately 93 employees.

Distribution

Rail transportation is used for nearly all shipments from our production facilities and warehouses to our end customers, wholesale warehouses or sea ports. Overall, approximately 75% of our products are delivered by rail and 25% by ships. Deliveries from warehouses and ports to customers is partially done by trucks. Since 2002, Mechel Trading House has operated its wholly-owned subsidiary, Mecheltrans, a railway freight and forwarding company that also arranges warehousing for our stock. Mecheltrans owns its own rolling stock consisting of 93 open cars and 208 pellet cars, and also leases an additional 200 cars. The company transported domestically approximately 25 million tonnes of our cargo in 2003, approximately 80% of which was comprised of coal and iron ore.

In addition, in February 2004, we acquired Port Posiet, located in Russia s Far East on the Sea of Japan. The port has 1.4 million tonnes of cargo handling capacity and over 120,000 tonnes of warehousing capacity and processed 845,000 tonnes of cargo, mostly coal, ferroalloys and metals, in 2003. We ship primarily coking coal concentrate and steam coal to Asia from this port.

Market share and competition

In our core international markets we primarily compete with Russian and Ukrainian producers, as the leading global steel manufacturers focus more on value-added and higher-priced products. The principal competitive factors include price, distribution, product quality and customer service.

In the Russian market, we compete on the basis of price and quality of steel products, their added value, product range and service, technological innovation and proximity to customers. The Russian steel industry is characterized by relatively high concentration of production, with the five largest integrated steel producers, including us, accounting for 82% of overall domestic steel output in 2003.

Following is a brief description of Russia s other four largest steel producers:

EvrazHolding, which consists of Nizhny Tagil Metallurgical Plant, Zapadno-Sibirsky Metallurgical Plant (ZapSib), and Kuznetsky Metallurgical Plant, is effectively the largest producer in Russia on a consolidated basis, accounting for 21% of Russia s total rolled products output in 2003. Like us, EvrazHolding focuses on the production of long products (including rebars, beams and rails).

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MMK accounted for 20% of Russian rolled steel production in 2003. MMK s product mix is comprised mostly of flat products, representing 81% of its commercial steel products output. Domestically, MMK is a significant supplier to the oil and gas and automotive sectors. MMK exported 55% of its output in 2003, with Asia accounting for 46% and the Middle East for 16% of its total exports. In addition to its core business, the company has also acquired two producers of hardware, and has its own iron ore mining business. Its production facilities are located in Magnitogorsk in the southern Urals. We own 17.1% of the common and 12.2% of the preferred shares of MMK.

Severstal had an 17% market share of Russian rolled steel production in 2003. The company specializes in flat products and is a leading manufacturer of strip, cold-rolled sheet and galvanized sheet. Domestic sales accounted for 60% of Severstal s output in 2003, with the oil and gas industry as its leading customer, closely followed by the automotive sector. Severstal also controls UAZ, a domestic off-road car-maker, Vorkuta-Ugol and Kuzbassugol, which completely satisfy Severstal s coking coal requirements.

NLMK produces primarily hot-rolled and cold-rolled flat steel, galvanized steel, color-coated steel, pipes and other steel products. Exports accounted for 65% of the company s shipments in 2003, which were comprised primarily of slabs. Domestically, NLMK s largest customers are in the construction and pipe industries, followed by companies in the automotive sector. NLMK had a 16% market share of Russian rolled steel production in 2003. The company s facilities are located in Lipetsk, to the southeast of Moscow.

These five companies, including us, can be divided into two groups by product type. MMK, Severstal and NLMK focus mainly on flat products, while EvrazHolding and we produce primarily long products. We are the largest and most comprehensive producer of specialty steels and alloys in Russia, producing 52% of total Russian specialty steel output, over three times as much as our nearest competitor, according to Metall-Expert. We are also the second largest producer of long products in Russia after EvrazHolding, with significant market shares in both carbon and specialty steel long products, according to Metall-Expert.

In the Russian carbon long market segment, our primary products and our market positions are as follows, according to Metall-Expert:

Reinforcement bar In rebar, we compete in the 6 40 millimeters range. In 2003, the rebar market was dominated by Mechel (41%) and EvrazHolding (45%). At present, the Russian domestic market for rebar is protected from Ukrainian imports by a 21% import tariff, introduced in August 2002 for three years.

Wire rod There were four major producers of wire rod in Russia in 2003: EvrazHolding (35%), Mechel (26%), Severstal (18%) and MMK (10%). We produce some of the highest quality and widest ranges of wire rod (5 10 millimeters) among Russian producers.

We were the leader in the domestic specialty long product market in 2003, producing 52% of the total Russian output. Our production was more than the combined output of our three nearest competitors in this market: OEMK (17%), ZMK (9%) and Electrostal (8%). We had significant market shares in high-speed steel (68%), stainless long products (39%) and tool steel (47%) in 2003.

OEMK, an integrated steel mill specializing in long carbon and specialty steel products and our nearest speciality steel competitor, is located in the southwest of Russia and serves customers in the pipe, engineering and ball-bearing industries. Other Russian specialty steel producers, like Electrostal lag significantly behind us in terms of overall specialty steel production, according to Metall-Expert.

We were also the largest producer of engineering long steel products in Russia (21%) in 2003. Our other main competitors in this market were OEMK (20%), Severstal (11%) and Serov Metallurgical Plant

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(11%). In 2003, we were the leader in the production of alloyed engineering steel (25%) and nickel- containing engineering steel (32%), where we were ahead of our nearest competitors, Petrostal (7% and 23%, respectively), ZMK (10% and 15%, respectively), Serov Metallurgical Plant (13% and 7%, respectively) and Red October Metallurgical Plant (6% and 12%, respectively), according to Metall-Expert.

We were also Russia s largest producer of stainless flat products, with an 80% share of domestic production in 2003, according to Chermet.

We were the third largest producer of hardware in Russia in 2003 with a 12% market share, following Severstal (36%) and MMK (22%), according to MetalTorg.ru. For hardware products in which we specialize, however, our share was substantially higher. For example, according to information from MetalTorg.ru and our estimates, we had a 57% share of the spring wire market and a 51% share of the high-endurance wire market during 2003.

Raw materials

The principal raw materials we use in the making of steel are coke (produced from coking coal), iron ore, nickel, ferrous scrap and limestone. The following table sets forth the percentage of our raw material requirements that we satisfied internally during 2003:

Product	Internal sourcing
Coking Coal	100%
Iron Ore[(1)]	39%
Nickel	55%

(1) Based on Korshunov Mining Plant, which we only started consolidating in October 2003.

We are 100% self-sufficient in our requirements of coking coal, with Southern Kuzbass Coal Company having supplied 3.4 million tonnes of coking coal concentrate to Chelyabinsk Metallurgical Plant in 2003. We process coking coal concentrate into coke at Chelyabinsk Metallurgical Plant. Coke is used in both steel-making operations at Chelyabinsk Metallurgical Plant and our nickel smelting operations at Southern Urals Nickel Plant. In 2003, we produced and internally used 2.2 million tonnes of coke in our production facilities and produced and sold another 0.4 million tonnes of coke to third parties. Our internal steam coal requirements are not material.

Our steel making operations use iron ore in the form of pellets, sinter, concentrate and sinter ore. The ultimate form of the iron ore feed into the steel making process, however, consists of pellets and sinter only. In 2003, our steel making operations used 5.5 million tonnes of iron ore feed, approximately 49% in the form of pellets, 51% in the form of sinter, and we internally sourced 39% of our total iron ore feed requirements during this period. We are capable of internally sourcing 92% of the iron ore requirements of our steel segment, assuming that third parties process certain quantities of our iron ore concentrate into sinter and pellets. Our Korshunov Mining Plant supplied us with 1.4 million tonnes of iron ore concentrate in 2003, which accounted for 100% of our total iron ore concentrate needs in this period. Iron ore concentrate is converted into sinter at Chelyabinsk Metallurgical Plant. We purchase most of the remaining part of our iron ore feed, mainly in the form of pellets, from domestic suppliers such as Mikhailovsky Mining Plant and Lebedinsky Mining Plant, under annual contracts on market terms.

In 2003, we used approximately 8,807 tonnes of nickel in the production of stainless and other specialty steels. We sourced approximately 55% of our nickel requirements in 2003 from our nickel mining and smelting operations at Southern Urals Nickel Plant. We source other nickel grades from Norilsk Nickel, Ufaleinickel and other smaller nickel producers.

Our steel making technology is primarily based on the basic oxygen furnaces, accounting for over half of our raw steel production. Ferrous scrap represents just 22% of feedstock, and we are 42% self-sufficient in this raw material, sourcing the balance from various scrap traders. Electric arc furnaces are the primary method of steel-making at COST and Industria Sarmei, our Eastern European facilities.

We source most of our limestone requirements from third parties and a portion from our Pugachev quarry. In 2003, we used approximately 0.9 million tonnes of limestone in the production of steel, of which approximately 33,930 tonnes was supplied by Pugachev.

Steel making requires significant amounts of electricity to power electric arc furnaces and rolling mills and to convert coal to coke. In 2003, our steel making operations consumed approximately 4.8 billion kWh of electricity, of which 2.3 billion kWh was used at Chelyabinsk Metallurgical Plant, 1.7 billion kWh was used at other Russian facilities and 0.8 billion kWh was used at our Eastern European plants. Chelyabinsk Metallurgical Plant has a cogeneration power facility, which produced 1.8 billion kWh of electricity for internal consumption in 2003, yielding 75% self-sufficiency at that plant and 38% self-sufficiency overall for the group, including mining operations. The balance was purchased from local utilities. Substantially all of our power-generating facilities work on blast furnace and coke gas, which are by-products of our steel-making operations, and natural gas, which we purchase from Gazprom. In 2003, we consumed 5.0 billion cubic meters of blast furnace gas, 1.1 billion cubic meters of coke gas and 2.3 billion cubic meters of natural gas.

Large amounts of water are also required in the production of steel. Water serves as a solvent, a catalyst and a cleaning agent. It is also used to cool the steel, to carry away waste, to help produce and distribute heat and power and to dilute liquids. One of the principal sources of water is rivers, and many of our facilities recirculate a portion of water used for their production needs. For example, Chelyabinsk Metallurgical Plant uses 130,000 cubic meters of river water and 70,000 cubic meters of water from recycling ponds daily. Vyartsilya Metal Products Plant sources all of its water needs from a local river. Urals Stampings Plant obtains 70% of its water from the public water supplies. Southern Urals Nickel Plant sources most of its water needs through recycling. COST sources all of its production water needs from the local utility.

Transportation costs are a significant component of our production costs and a factor in our price-competitiveness in the export markets. Rail transportation is our principal means of transporting raw materials from our mines to processing facilities and products to domestic customers and to ports for shipment overseas. For a description of our railway freight and forwarding subsidiary, see Steel Business Marketing and Distribution Distribution above.

For a description of how seasonal factors impact our use and reserve levels of raw materials see Seasonality below.

Steel production facilities

We generally own, lease or have a right of perpetual use of the properties on which our steel production facilities are located. Most of the land on which Chelyabinsk Metallurgical Plant and Vyartsilya Metal Products Plant are located is used pursuant to a right of perpetual use. The land on which Beloretsk Metallurgical Plant, Izhstal, Urals Stampings Plant and Mechel Nemunas are located is leased. The land on which COST and Industria Sarmei are located is owned.

The main manufacturing processes at Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant, Urals Stampings Plant, Izhstal, Industria Sarmei and COST are ISO 9001:2000 certified through 2006.

Chelyabinsk Metallurgical Plant

Our raw steel production in Russia takes place at Chelyabinsk Metallurgical Plant. Chelyabinsk Metallurgical Plant is an integrated blast furnace and BOF/EAF steel mill that produces coke, semi-finished steel products, carbon and specialty steel products and forgings. Its customer base is largely comprised of steel producers and tube manufacturers, and customers from the construction, engineering and ball-bearing industries. The plant sources all of its coking coal needs from our Southern Kuzbass Coal Company and a portion of its iron ore and nickel needs from our Korshunov Mining Plant and our Southern Urals Nickel Plant, respectively.

Chelyabinsk Metallurgical Plant s principal production lines include a BOF workshop equipped with three converters; two EAF workshops equipped with two electric arc ovens; three comprehensive steel treatment machines; an argon-oxygen refining machine; three continuous billet-casters; blooming with continuous rolling mill for 200-320 millimeters and 80-180 millimeters square billets; three long product mills for 8-190 millimeters diameter round bar and 75-156 millimeters square bar, 6.5-10 millimeters wire rod, rebar steel, bands and shaped beams; a hot-rolled flat product workshop with a thick sheet continuous rolling mill for hot-rolled sheets of up to 1,800 millimeters wide and up to 20 millimeters thick; a semi-continuous rolling mill for up to 1,500 millimeters wide and up to 6 millimeters thick hot-rolled coils; a cold-rolled product workshop for 0.3-4 millimeters cold-rolled stainless sheet; and a forging and pressing workshop equipped with five presses and forging machines of 1,250-2,000 tonnes and seven coking batteries.

The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for each of Chelyabinsk Metallurgical Plant s principal production areas.

Production Areas	Capacity in 2003	Capacity Utilization Rate in 2003	Planned increase (2004-2007)
Sintering	2,200,000	100%	4,200,000
Pig Iron	3,300,000	95%	2,000,000
Steel-making	4,600,000	91%	1,940,000
Rolling	3,300,000	94%	2,550,000
Forging and pressing	72,000	93%	13,000
Coking	3,400,000	76%	100,000

Beloretsk Metallurgical Plant

Beloretsk Metallurgical Plant is a hardware plant that produces wire rod and a broad range of hardware from semi-finished steel products supplied by Chelyabinsk Metallurgical Plant. Its customers are largely from the construction and engineering industries.

Beloretsk Metallurgical Plant s principal production lines include a steel-rolling workshop equipped with a wire mill for production of wire rod of 5.5-12 millimeters diameter and a number of hardware workshops equipped with drawing, winding, unwinding, rewinding, polishing and rope machines and thermal treatment ovens.

The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for each of Beloretsk Metallurgical Plant s principal production areas.

Production Areas	Capacity in 2003	Capacity Utilization Rate in 2003	Planned increase (2004-2007)
Rolling	520,000	99%	130,000
Hardware	260,000	99%	151,000

Vyartsilya Metal Products Plant

Vyartsilya Metal Products Plant is a hardware plant that produces low carbon, welding and structural wire, zinc-plated nails, and steel and polymeric-coated nets, from wire rod supplied by Chelyabinsk Metallurgical Plant. The plant s customers are largely from the construction, automotive and furniture industries.

Vyartsilya Metal Products Plant s principal production facilities include drawbenches and wire-nail and mesh-weaving machines.

The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for Vyartsilya Metal Products Plant s principal production area.

Production Areas	Capacity in 2003	Capacity Utilization Rate in 2003	Planned increase (2004-2007)
Hardware	68,000	76%	4,000

Urals Stampings Plant

Urals Stampings Plant is Russia s largest producer of stampings from specialty steels and heat-proof and titanium alloys for the aerospace, oil and gas, heavy engineering, railway transportation, power and other industries. Urals Stampings Plant sources its specialty steel needs from Chelyabinsk Metallurgical Plant.

Urals Stampings Plant s principal production facilities include 1.5-25 tonne swages, hydraulic presses and inker machines.

The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for Urals Stampings Plant s principal production area.

Production Areas	Capacity in 2003	Capacity Utilization Rate in 2003	Planned increase (2004-2007)
Stamping	100,000	42%	

COST

COST is a major Romanian EAF steel mill that produces specialty and carbon long products, forgings, and hardware. COST is the largest producer of long products (including rebars) and hardware in Romania and the second largest producer of raw steel in Romania, according to Siderom. The plant s customers are largely from the engineering, automotive, tool, ball-bearing, tube, hardware and construction industries.

COST s principal production lines include two EAF workshops equipped with electric arc ovens of 10-12 tonne capacity and of 75 tonne capacity; steel vacuum processing and treatment machines; a continuous billets caster; a blooming machine for 80-400 millimeters square and 90-145 millimeters round billets; two continuous long products rolling mills for 20-80 millimeters round bars, 24-57 millimeters hexagonal bars, 60-70 millimeters square bars, 6-12 millimeters thick and 60-120 millimeters wide bands, 12-26 millimeters bundle rod and reinforcing steel; a forging and pressing workshop; and a calibration workshop.

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The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for each of COST s principal production areas.

Production Areas	Capacity in 2003	Capacity Utilization Rate in 2003	Planned increase (2004-2007)
Steel-making	527,000	84%	93,000
Rolling	780,000	40%	
Forging and pressing	37,400	53%	
Hardware	67,000	39%	

COST experienced low capacity utilization rates due to high production costs and uncompetitive product quality. We plan to lower production costs and improve product quality.

Industria Sarmei

Industria Sarmei is a Romanian EAF steel mill and a leading domestic hardware plant that produces long steel products, including carbon and alloyed wire rod, rebar and hardware, including various types of wire, ropes, nets, electric cables and nails, as well as carbon and low-alloyed billets. The plant s customers are largely from the construction and engineering industries.

Industria Sarmei s principal production lines include an EAF steel-making workshop equipped with one 75-tonne and one five-tonne oven; blooming with a continuous rolling mill for 80 millimeters square and 120-150 millimeters round billets; one wire-rolling mill and two medium-sized rolling mills for 6-14 millimeters wire rod, 12-36 millimeters round, square and hexagonal bars, bundle rod and bands; and several hardware workshops equipped with drawing, nail-making and zinc-plating machines.

The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for each of Industria Sarmei s principal production areas.

Production Areas	Capacity in 2003	Capacity Utilization Rate in 2003	Planned increase (2004-2007)
Steel-making	363,000	72%	17,000
Rolling	330,000	67%	15,000
Hardware	100,000	71%	44,000

Mechel Nemunas

Mechel Nemunas is a Lithuanian hardware plant that produces wire, calibrated steel products, nails, rods and nets. Its customers are primarily from the construction, engineering and furniture industries.

Mechel Nemunas s principal production facilities include drawing mills, and nail-making, threading, net-weaving, net-wicking and contact-welding machines.

The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for Mechel Nemunas s principal production area.

Production Areas	Capacity in 2003	Capacity Utilization Rate in 2003	Planned increase (2004-2007)
Hardware	90,300	24%	

Mechel Nemunas experienced low capacity utilization rates due to high production costs and uncompetitive product quality. We plan to lower production costs and improve product quality by modernizing drawing equipment, replacing an old air compressor, and installing new annealing-zinc plating equipment.

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Izhstal

Izhstal is a Russian specialty steel producer located in the city of Izhevsk, Udmurtia, west of the Urals. Its customer base is largely comprised of companies from the aircraft, defense, automotive, agricultural, power, engineering, oil and gas and construction industries.

Izhstal s principal production lines include six EAF of 25 to 28 tonnes each; three open hearth furnaces of 130-135 tonnes each; blooming machine for 100-220 millimeters square billets; three medium-sized long products rolling mills for 30-120 millimeters round bars, 30-90 millimeters square bars, bands and hexagonal bars; and one continuous small long products wire mill for 5.5-29 millimeters round, 12-28 millimeters square and 12-27 millimeters hexagonal light sections, reinforced steel and bands. It also has a hardware workshop, equipped with various drawing mills, a pickling line and a forging workshop, equipped with a number of sledge hammers and press-cutters.

The following table sets forth the capacity and the capacity utilization rate for each of Izhstal s principal production areas.

Production Areas	Capacity in 2003	Capacity Utilization Rate in 2003	Planned increase (2004-2007)
Steel-making	800,000	54%	
Rolling	1,000,000	26%	
Hardware	98,000	17%	
Forging and stamping	60,000	63%	

Izhstal experienced low capacity utilization rates due to high production costs and the resulting uncompetitive products. We plan to lower production costs through supplying Izhstal with our semi-finished products, pig iron and nickel, as well as through capital expenditures for targeted purposes we expect to identify as we continue to integrate this new acquisition into our operations.

Significant investments

MMK

We own 17.1% of the common and 12.2% of the preferred shares of MMK. MMK accounted for 20% of Russian rolled steel production in 2003 and has 12 million tonnes of steel-making capacity. See Market Share and Competition for a description of MMK s business.

Of the remaining common shares, the government of the Russian Federation owns 23.8%, and according to MMK, its management controls, directly or indirectly, approximately 58%, including approximately 30% in the form of treasury shares which the management votes. The government has repeatedly announced its intention to privatize the shares that it owns, although each year the privatization has been delayed. Current press reports indicate that the privatization may occur in the end of 2004 or during 2005. In August 2004, the government took a significant step towards allowing the privatization by removing MMK from a list of strategic assets. In the event that the government moves ahead with a privatization tender for the shares it owns, we will review the terms of the tender and our strategy with respect to our stake in MMK and make a determination at that time whether and to what extent we should participate in the tender or otherwise deal with our stake in MMK.

Business

The following table sets forth key production and financial data for MMK.

MMK	6 months 2004	2003	2002	2001
	(in millions of tonnes)			
Rolled steel production	5.1	10.2	9.7	9.0
	(in millions of U.S. dollars)			
Revenues(1)	2,166	3,047	2,065	1,733
Net profit(1)	524	630	115	144
EBITDA(1)	793	991	429	312

Source: MMK Internet website and public sources

(1) Under International Financial Reporting Standards.

Management services

Hammer and Sickle OAO

In July 2004, we were engaged by Hammer and Sickle OAO, a specialty steel producer located in Moscow, to manage the company for a one-year term, subject to substantial oversight by Hammer and Sickle s Board of Directors.

Trade restrictions

Trade restrictions in the form of tariffs, duties and quotas are widespread in the steel industry. However, we are less exposed than most other Russian steel producers since restrictions on Russian exports have mainly been directed against flat products, whereas most of our exports consist of long products, such as wire rods and rebars. In addition, the abolition by the Russian government of steel export duties in 2002 has also effectively improved the Russian steel export market.

In 2003, approximately 80% of our steel segment revenues were derived from sales of steel products that were subject to import restrictions. We describe below the main applicable trade restrictions in our key markets.

European Union

Our steel sales to the EU constituted approximately 20% of our total steel segment exports in 2003. The Russian government and the European Coal and Steel Enterprise have an export quota system in place whereby Russian exports to the EU are limited to a certain stipulated amount for each product category until the end of 2004. We expect that this quota system will continue after 2004. The quota by product category is distributed between the Russian producers based on a procedure developed by the Ore Mining and Smelting Trade Union of Russia. The procedure provides that for each product category, a company s export quota allocation is calculated on the basis of shipments by the company of the particular product over the past three years to the EU market (which is given a 70% weighting), and on the company s market share in domestic production of the particular product (which is given a 30% weighting). After the quotas are calculated, the Russian Ministry of Industry and Energy then confirms formal quota allocations, and the Russian Ministry of Economic Development and Trade issues export licenses for these quotas. In 2003, the quota covered approximately 85% of our steel segment products exported to the EU, although in 2004, we may increase the sales of products that are not subject to the quota.

In 2004, the total EU quota for Russian steel was set at 1,822,101 tonnes, and we received 104,934 tonnes of the total quota. In 2003, the total EU quota for Russian steel was 1,270,858 tonnes, we received 70,240 tonnes of the total quota, and we used approximately 96% of our quota. As quotas are granted by product category, usage of our individual quotas varied. For example, usage of our 2003

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quota with respect to long products other than beams and wire rod was at 88%, while usage for our wire rod quota was at 98%. In 2004, the total quota was increased by 551,243 tonnes, and we received a special allocation of 42,240 tonnes with respect to export of wire rod to Mechel Nemunas, our hardware plant in Lithuania, and a regular increase of 28,454 tonnes. We started exporting wire rod to this hardware plant in the fall of 2003, around the time we acquired it. We received this special allocation because Lithuania joined the EU in May 2004, and steel exports to Lithuania thus became subject to the EU export quota system. We expect that our Lithuanian quota will be sufficient for the next few years. See Risk Factors Risks Relating to Our Business and Industry We face numerous protective trade restrictions in the export of our steel products.

In addition, an antidumping duty in the amount of 50.7% is applicable for export to the EU of steel ropes and cables manufactured by Beloretsk Metallurgical Plant until August 2006. There are no restrictions on the exports of our Romanian products to the EU.

China

In 2003, our sales of cold-rolled steel products to China comprised approximately 4% of our total steel segment revenues, 10% of our steel segment exports and 43% of our total steel segment exports to China. In January 2004, China introduced anti-dumping duties of up to 29% on cold-rolled steel imports from Russia. The duties are retroactive to September 2003 and will last for five years. Currently, none of our steel segment exports to China are subject to these duties.

United States

The United States has a quota system in place with respect to certain Russian steel imports (hot-rolled flat-rolled carbon quality steel products and certain cut-to-length carbon steel plate). The intergovernmental quota agreement provides for quotas and reference prices on Russian exports of hot-rolled flat-rolled carbon-quality steel products to the United States and is currently under sunset review. A distribution of quotas between specific Russian producers and the execution of export licenses is carried out in accordance with the same procedure that applies to exports to the EU market. In 2003, we have not exported our products governed by this agreement to the United States. There are no trade restrictions applicable to the export of our Romanian or Lithuanian products to the United States.

The United States also had a quota system in place with respect to imports of pig-iron, cold-rolled steel, slabs, zinc-plated sheets and some other products from Russia which expired on July 12, 2004. We intend to attempt to expand our steel product exports to the U.S. market, and have established a U.S. subsidiary for this purpose. We expect, however, that depending on market conditions, the United States may impose new anti-dumping duties or other types of trade restrictions which might force us to decrease our exports to the United States below current levels. In December 2003, the United States also withdrew safeguard measures in the form of tariffs on most Russian steel exports to the United States after the WTO s Appellate Body had determined them to be inconsistent with the requirements of the WTO.

MINING BUSINESS

Our mining business supports our steel business, and it also sells substantial amounts of coal, iron ore and nickel to third parties.

Our products

Our main products comprise coking coal concentrate, steam coal, steam coal concentrate, ferro nickel and iron ore concentrate. Among the key advantages of our mining business is the high quality of our coking coal, the low level of volatile matters in our steam coal and our modern coal washing facilities, primarily built during the 1970s and 1980s, including facilities built as recently as 2001-2002.

The following table sets forth third party sales of our mining products (by volume) for the periods indicated.

Product	6 months 2004	2003	2002	2001
	(in thousands of tonnes)			
Coking coal concentrate	2,275	4,034	3,631	4,128
Steam coal	3,026	5,069	4,849	5,598
Nickel	5	10	8	
Iron ore concentrate	980	671		

The following table sets forth revenues by product, as further divided between domestic sales and exports (including as a percentage of total mining segment revenues) for the periods indicated.

	6 months 2004		2003		2002		2001	
Product	amount	% of revenues	amount	% of revenues	amount	% of revenues	amount	% of revenues
	(in millions of U.S. dollars, except for percentages)							
Coking coal concentrate	155.3	43%	180.1	43%	123.8	41%	134.9	40%
Domestic Sales (%)	38%		92%		82%		91%	
Export (%)	62%		8%		18%		9%	
Steam coal	90.2	25%	120.0	29%	101.5	34%	104.2	31%
Domestic Sales (%)	25%		29%		25%		43%	
Export (%)	75%		71%		75%		57%	
Iron ore concentrate	48.4	13%	20.1	5%			46.6	14%
Domestic Sales (%)	11%		100%				100%	
Export (%)	89%							
Nickel	56.9	16%	80.1	19%	51.4	17%	20.8	6%
Domestic Sales (%)							49%	
Export (%)	100%		100%		100%		51%	
Other[1]	11.5	3%	13.6	4%	26.0	10%	33.5	10%
Total	362.3	100%	413.9	100%	302.6	100%	340.0	100%

Domestic Sales (%)	27%	55%	50%	76%
Export (%)	73%	45%	50%	24%

(1) Includes revenues from transportation, distribution, construction and other miscellaneous services provided to local customers.

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Marketing and distribution

Our mining products are marketed domestically through Mechel Trading House and internationally through Mechel Trading in a manner similar to our steel products. The following table sets forth by percentage of sales the regions in which our mining segment products were sold for the periods indicated.

Region[(1)]	6 months 2004	2003	2002	2001
Russia	27.4%	54.9%	50.4%	75.9%
Other CIS	12.2%	0.1%	1.0%	0.6%
Europe	48.9%	43.7%	41.1%	19.3%
Asia	5.1%		5.8%	3.9%
Middle East				
United States	6.4%			
Other		1.2%	1.7%	0.3%
	100.0%	100.0%	100.0%	100.0%

(1) The regional breakdown of sales is based on the geographic location of our customers, and not on the location of the end users of our products, as our distributor customers resell and, in some cases, further export our products.

Domestic sales

We generally do not involve intermediaries in the domestic distribution of our mining products. Our domestic coking and steam coal and iron ore customers are generally located in large industrial areas and have had long-standing relationships with us. We do not sell our nickel products within Russia.

In 2003, MMK was the largest customer of our mining business, accounting for 33.8% of the revenues of our mining segment. MMK purchased mostly coking coal and iron ore concentrate. Starting January 2004, we stopped selling raw materials to MMK.

We ship our coking coal concentrate from our coal washing facilities, located near our coal mines and pits, by railway directly to key customers, including steel producers. Our largest domestic customer for our coking coal concentrate is Urals Steel (NOSTA), accounting for 22.8% of our total coking coal concentrate sales and 9.8% of our total mining segment sales in the first half of 2004. We conclude sales contracts with these customers on an annual basis, and sell about 10% of our coking coal on the spot market.

Our internal consumption of steam coal is negligible, and we sell substantially all of our steam coal to third parties. Mosenergo, Moscow s electricity generating and distribution company and a subsidiary of RAO UES, is our largest domestic customer of steam coal, accounting for 6.4% and 10.2% of our total steam coal sales and 1.6% and 3.0% of our total mining segment sales in the first half of 2004 and in 2003, respectively. We ship our steam coal from our warehouses by railway directly to key customers, which are predominantly electric power stations. Sales contracts for steam coal are concluded with customers on an annual basis.

Iron ore concentrate is shipped via railway directly from Korshunov Mining Plant to customers. Our largest domestic customer, ZapSib, accounted for 6.9% of our total iron ore concentrate sales and 0.9% of our total mining segment sales in the first half of 2004. Prices are set quarterly.

Export sales

Among our mining products, we export ferro nickel, coking coal, steam coal concentrate, low bituminous and anthracite steam coal and iron ore concentrate.

Business

In the first half of 2004, our largest customer was Glencore, accounting for 24.9% of the revenues of our mining segment. In the years ended December 31, 2003, 2002 and 2001, Glencore accounted for 19.7%, 16.8% and 3.1% of the revenues of our mining segment, respectively. Glencore purchases mostly nickel, coking coal concentrate and iron ore concentrate.

We export our coking coal concentrate primarily to Ukraine and Japan. In the first half of 2004, Mitsui & Co. was our largest foreign customer of coking coal concentrate, accounting for 10.1% of our total coking coal revenues and 4.3% of our total mining segment revenues. US Steel Kosice in Slovakia was our largest foreign customer of iron ore concentrate in 2003, accounting for 15.6% of our total coking coal concentrate revenues and 6.8% of our total mining segment revenues. Shipments are made by railway and by ship.

In February 2004, we acquired Port Posiet, located in Russia s Far East on the Sea of Japan. The port has 1.4 million tonnes of cargo handling capacity and over 120,000 tonnes of warehousing capacity and processed 845,000 tonnes of cargo, mostly coal and ferroalloys, in 2003. We plan to ship primarily our coking coal concentrate, as well as steel products, to Asia from this port.

Our exports of steam coal are primarily to Belgium, Slovakia, Turkey and the United Kingdom, which together accounted for 68.3% and 66.2% of our total steam coal sales and 17.0% and 19.2% of our total mining segment sales in the first half of 2004 and in 2003, respectively. Most of these sales are to long-standing customers, such as two Slovakian power stations, under annual contracts with prices reviewed monthly. We also sell to traders. Steam coal is shipped to customers from our warehouses by railway and, in some cases, by ship from Russian and Ukrainian ports.

We also began to export iron ore concentrate to China during 2004. Sales to China accounted for 61.7% of total iron ore concentrate sales and 8.2% of our total mining segment sales in the first half of 2004. We ship iron ore concentrate to China by rail and by sea.

We sell all of our nickel that we do not use internally to Glencore International on the basis of nickel prices quoted by LME, less a certain discount. See Certain Transactions Material Contracts Glencore Contract. The nickel is delivered by railway from Southern Ural Nickel Plant to either the port of St. Petersburg or the port of Kaliningrad, and it is then forwarded on by Glencore to end users.

Market share and competition

Coal

As a result of mergers and acquisitions undertaken primarily by steel producers, the number of domestic coal producers has decreased from 250 in the mid-1990s to less than 100 in 2003. Over the last few years, domestic coal mining companies have generally enjoyed a relatively stable customer base.

We are the second largest coking coal producer in Russia, with a 12% market share, and we have a 5% market share with respect to overall Russian coal production, according to Rosinformugol. We also control 24% of the coking coal washing capacity in Russia, according to Rosinformugol. The principal CIS coal producers we compete with are:

Kuzbassrazrezugol, located in Kuzbass, which accounted for 7% of Russia s coking coal and 15% of Russia s total coal output in 2003 and is controlled by Ural Mining-Metallurgical Company, a Russian non-ferrous metals producer.

Kuzbassugol, located in Kuzbass, which accounted for 5% of Russia s coking coal and 1% of Russia s total coal output in 2003 and, according to press reports, is controlled by Severstal and the MDM Group through its subsidiary, SUEK. Kuzbassugol satisfies 40% of Severstal s coking coal requirements.

Business

Yuzhkuzbassugol, located in Kuzbass, which accounted for 19% of Russia s coking coal and 6% of Russia s total coal output in 2003 and is controlled by EvrazHolding through its subsidiary, Kuznetskugol.

Raspadskaya Mine, located in Kuzbass, which accounted for 12% of Russia s coking coal and 3% of Russia s total coal output in 2003 and is 20% owned by EvrazHolding.

Mezhdurechye, located in Kuzbass, which accounted for 5% of Russia s coking coal and 2% of Russia s total coal output in 2003 and, according to press reports, is affiliated with Russian groups Sibuglemet and Bagomes. We own 13.1% of Mezhdurechye.

Ispat-Karmet, located in Kazakhstan and controlled by LNM Group, primarily produces coking coal, which is supplied to MMK.

Source: Rosinformugol

In the domestic coal market, we compete primarily on the basis of price, as well as on the basis of the quality of coal, which depends upon the quality of our production assets and the quality of our mineral reserves. Competition in the steam coal market is also affected by the fact that most steam power stations were built near specific steam coal sources and had their equipment customized to utilize the particular type of coal produced at the relevant local source. Outside of Russia, competition in the steam coal marke