Open Joint Stock Company Magnitogorsk Iron & Steel Works and Subsidiaries

Independent Auditors' Report

Consolidated Financial Statements

As of and for the years ended
December 31, 2007 and 2006

OPEN JOINT STOCK COMPANY
MAGNITOGORSK IRON & STEEL WORKS AND SUBSIDIARIES

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT	1
CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006	
Consolidated balance sheets as of December 31, 2007 and 2006	2-3
Consolidated statements of operations and comprehensive income for the years ended December 31, 2007 and 2006	4
Consolidated statements of cash flows for the years ended December 31, 2007 and 2006	5
Consolidated statements of changes in shareholders' equity for the years ended December 31, 2007 and 2006	6
Notes to the consolidated financial statements for the years ended December 31, 2007 and 2006	7-38

Deloitte.

ZAO Deloitte & Touche CIS
Business Center "Mokhovaya"
4/7 Vozdvizhenka St., Bldg. 2
Moscow, 125009
Russia

Tel: +7 (495) 787 0600
Fax: +7 (495) 787 0601
www.deloitte.ru

INDEPENDENT AUDITORS' REPORT

To the Shareholders of OJSC "Magnitogorsk Iron & Steel Works"

We have audited the accompanying consolidated balance sheets of OJSC "Magnitogorsk Iron & Steel Works" and its subsidiaries (the "Group") as of December 31, 2007 and 2006 and the related consolidated statements of operations and comprehensive income, cash flows and changes in shareholders' equity for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

March 12, 2008

OPEN JOINT STOCK COMPANY
MAGNITOGORSK IRON & STEEL WORKS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2007 AND 2006
(Amounts in millions of U.S. dollars)

	Note	December 31, 2007	December 31, 2006
ASSETS			
Current assets:			
Cash and cash equivalents	3	256	338
Short-term bank deposits	4	1,279	228
Short-term investments	5	393	325
Accounts receivable from third parties, less allowance for doubtful accounts of USD 8 and USD 12 as of December 31, 2007 and 2006, respectively	6	1,306	851
Accounts receivable from related parties	24	85	74
Prepaid expenses		13	14
Inventories	7	946	631
Current deferred income tax assets	21	13	19
Total current assets		**4,291**	**2,480**
Property, plant and equipment, net	8	3,879	2,764
Investments in affiliates	9	76	123
Long-term investments	5	993	146
Long-term bank deposits	4	-	109
Long-term deferred income tax assets	21	16	10
Goodwill	10	65	2
Other intangible assets, net	10	46	43
Other long-term assets	11	16	12
TOTAL ASSETS		**9,382**	**5,689**

See notes to the consolidated financial statements.

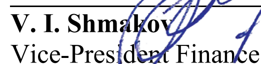
OPEN JOINT STOCK COMPANY
MAGNITOGORSK IRON & STEEL WORKS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (CONTINUED)
AS OF DECEMBER 31, 2007 AND 2006
(Amounts in millions of U.S. dollars)

	Note	December 31, 2007	December 31, 2006
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Bank overdrafts		9	2
Short-term borrowings and current portion of long-term debt	12	1,189	373
Current portion of long-term capital lease obligations	14	26	25
Accounts payable and accrued liabilities	15	673	545
Accounts payable to related parties	24	13	8
Current deferred income tax liabilities	21	11	11
Total current liabilities		**1,921**	**964**
Long-term debt, net of current portion	13	200	577
Long-term capital lease obligations, net of current portion	14	30	29
Employee benefit obligations	16	37	30
Long-term deferred income tax liabilities	21	283	50
Total liabilities		**2,471**	**1,650**
Commitments and contingencies	25,26	-	-
Minority interest	22	**87**	**12**
Shareholders' equity:			
Common stock	17	386	363
Treasury stock, at cost	17	(1)	(85)
Additional paid-in capital	17	1,105	254
Accumulated other comprehensive income	5	614	18
Retained earnings		4,720	3,477
Total shareholders' equity		**6,824**	**4,027**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		**9,382**	**5,689**

See notes to the consolidated financial statements.

The consolidated financial statements were approved and signed on March 12, 2008, by:



V. I. Shmakov
Vice-President Finance

A. S. Batrutdinov
Deputy Chief Accountant

OPEN JOINT STOCK COMPANY
MAGNITOGORSK IRON & STEEL WORKS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006
(Amounts in millions of U.S. dollars, except earnings per share amounts)

	Note	Years ended December 31, 2007	2006
Net revenue	19	8,197	6,424
Cost of products sold (exclusive of depreciation and amortization shown separately below)		(4,912)	(3,619)
Depreciation and amortization		(211)	(188)
Selling and distribution expenses		(551)	(415)
Administrative and other expenses		(278)	(285)
Social expenses			
Social asset construction costs		(7)	(18)
Social and maintenance expenses		(75)	(58)
Taxes other than income tax		(85)	(63)
Loss on disposal of property, plant and equipment		(52)	(52)
Other operating income, net	20	53	39
Income from operating activities		**2,079**	**1,765**
Equity in net losses of affiliates		(7)	(8)
Interest income		133	69
Interest expense		(87)	(63)
Net foreign exchange gain		175	132
Income before income tax and minority interest		**2,293**	**1,895**
Income tax expense	21	(507)	(468)
Income before minority interest		**1,786**	**1,427**
Minority interest	22	(14)	(1)
Net income		**1,772**	**1,426**
Other comprehensive income:			
Unrealized gain on securities classified as available for sale, net of income tax effect of USD 188 and USD 5 for the years ended December 31, 2007 and 2006, respectively	5	596	18
Comprehensive income		**2,368**	**1,444**
Basic and diluted earnings per common share (USD)	18	**0.164**	**0.140**

See notes to the consolidated financial statements.

OPEN JOINT STOCK COMPANY
MAGNITOGORSK IRON & STEEL WORKS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006
(Amounts in millions of U.S. dollars)

	Note	Years ended December 31, 2007	2006
Operating activities:			
Net income		1,772	1,426
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization		211	188
Loss on disposal of property, plant and equipment		52	52
Change in allowance for doubtful accounts receivable		(4)	(8)
Net gain on trading securities		(7)	(2)
Gain on disposal of affiliate	9	(23)	-
Deferred income tax		31	18
Equity in net losses of affiliates		7	8
Minority interest		14	1
Changes in operating assets and liabilities:			
Increase in inventories		(317)	(65)
Increase in trade and other receivables		(410)	(264)
Increase in investments classified as trading securities		(51)	(308)
Increase in trade accounts payable, accrued liabilities and other current liabilities		85	132
Increase in prepaid income tax		(29)	(48)
Net cash provided by operating activities		**1,331**	**1,130**
Investing activities:			
Proceeds from sales of property, plant and equipment		40	25
Proceeds from disposal of subsidiary	27	-	7
Proceeds from disposal of affiliate	9	70	-
Purchases of investments in affiliates		-	(5)
Acquisition of subsidiaries, net of cash acquired		(60)	-
Purchases of property, plant and equipment		(1,240)	(697)
Purchases of intangible assets		(17)	(28)
Net change in bank deposits		(942)	(228)
Loans provided to related parties		(75)	(77)
Loans repaid by related parties		59	3
Purchases of investment securities classified as available for sale		(55)	(122)
Net cash of other investments		(11)	(11)
Net cash used in investing activities		**(2,231)**	**(1,133)**
Financing activities:			
Proceeds from loans		2,075	1,724
Loan principal repaid		(1,647)	(1,387)
Proceeds of share issue, net of issue costs	17	977	-
Net increase in bank overdrafts		7	2
Acquisition of treasury shares		(58)	(24)
Proceeds from re-issuance of treasury shares		39	10
Principal payments on capital lease obligations		(34)	(27)
Dividends paid		(547)	(1,077)
Net cash provided by/(used in) financing activities		**812**	**(779)**
Effect of exchange rate changes on cash and cash equivalents		6	(18)
Net decrease in cash and cash equivalents		**(82)**	**(800)**
Cash and cash equivalents at beginning of the year		**338**	**1,138**
Cash and cash equivalents at end of the year		**256**	**338**
Supplementary information:			
Interest paid		76	30
Income tax paid		505	498
Non-cash investing and financing activities:			
Machinery and equipment acquired under capital leases		27	33

See notes to the consolidated financial statements.

OPEN JOINT STOCK COMPANY
MAGNITOGORSK IRON & STEEL WORKS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006
(Amounts in millions of U.S. dollars)

	Note	Common stock	Common treasury stock	Additional paid-in capital	Accumulated other comprehensive income	Retained earnings	Total
Balance as of January 1, 2006		**363**	**(64)**	**247**	**-**	**3,131**	**3,677**
Acquisition of treasury shares		-	(24)	-	-	-	**(24)**
Re-issuance of treasury shares, net of income tax effect of USD 2		-	3	7	-	-	**10**
Revaluation of securities classified as available for sale, net of income tax effect of USD 5	5	-	-	-	18	-	**18**
Dividends	17	-	-	-	-	(1,080)	**(1,080)**
Net income		-	-	-	-	1,426	**1,426**
Balance as of December 31, 2006		**363**	**(85)**	**254**	**18**	**3,477**	**4,027**
Share issue	17	40	-	937	-	-	**977**
Acquisition of treasury shares		-	(58)	-	-	-	**(58)**
Cancellation of treasury shares	17	(17)	125	(108)	-	-	**-**
Re-issuance of treasury shares, net of income tax effect of USD 7		-	17	22	-	-	**39**
Revaluation of securities classified as available for sale, net of income tax effect of USD 188	5	-	-	-	596	-	**596**
Dividends	17	-	-	-	-	(529)	**(529)**
Net income		-	-	-	-	1,772	**1,772**
Balance as of December 31, 2007		**386**	**(1)**	**1,105**	**614**	**4,720**	**6,824**

See notes to the consolidated financial statements.

1. DESCRIPTION OF BUSINESS

The consolidated financial statements of Open Joint Stock Company Magnitogorsk Iron & Steel Works and its subsidiaries (“the Group”) comprise the parent company, Open Joint Stock Company Magnitogorsk Iron & Steel Works (“the Parent Company”), and its 59 subsidiaries. The Parent Company is an open joint stock company as defined in the Civil Code of the Russian Federation. The head office of the Group is located at:

Ulitsa Kirova 93,
455002, Magnitogorsk,
The Russian Federation.

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NEW ACCOUNTING PRONOUNCEMENTS

Basis of presentation

The accompanying consolidated financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America (“U.S. GAAP”). The Group’s Russian entities maintain their accounting records in Russian Rubles (“RUB”) in accordance with the requirements of the Russian accounting and tax legislation.

The accompanying consolidated financial statements differ from financial statements prepared for statutory purposes in the Russian Federation in that they reflect certain adjustments, appropriate to present the consolidated financial position, results of operations and cash flows in accordance with U.S. GAAP.

Principles of consolidation

The consolidated financial statements include the financial statements of the Parent Company as well as entities where the Parent Company has operating and financial control through direct or indirect ownership of a majority voting interest. In addition, in accordance with Interpretation No. 46(R), “Consolidation of Variable Interest Entities, an interpretation of ARB No. 51”, (“FIN 46R”), the Group consolidates variable interest entities for which it is deemed to be the primary beneficiary. All significant intercompany transactions, balances and unrealized gains/(losses) on transactions have been eliminated.

Entities acquired or disposed of during the year are included in the consolidated financial statements from the date of acquisition or to the date of disposal.

Set forth below is a summary of the Group's primary subsidiaries:

Group entity	Registered in	Core business	Effective ownership, % As of December 31, 2007	2006
OJSC Metizno-Kalibrovochniy Zavod "MMK-Metiz"	Russia	Production of hardware products	85.88	85.85
LLC IK RFC	Russia	Investing activities	100.00	100.00
CJSC Stroitelny Fond	Russia	Renting services	100.00	100.00
CJSC A-Kapital (Note 27)	Russia	Investing activities	-	100.00
CJSC Stroitelniy Komplex	Russia	Construction	100.00	100.00
CJSC Ogneupor	Russia	Production of refractory materials	99.50	98.89
CJSC Mekhanoremontny Komplex	Russia	Maintenance of metallurgical equipment	100.00	100.00
CJSC Mechanoremont	Russia	Renting services	98.93	98.93
OJSC MTSOZ	Russia	Production of cement and refractory materials	98.89	98.89
MMK Steel Trade AG	Switzerland	Trading activities	100.00	100.00
MMK Trading AG	Switzerland	Trading activities	99.60	99.60
MMK Finance S.A.	Luxemburg	Financing activities	96.77	96.77
LLC Bakalskoe Rudoupravlenie (Note 22, (a))	Russia	Mining activities	51.00	-
MMK Atakas Metalurji (Note 22, (c))	Turkey	Developing a metal processing facility	50.00	-
CJSC Interkos-IV (Note 22, (d))	Russia	Production of spare parts for the automotive industry	75.00	-
OJSC Bashmetalloptorg (Note 22, (e))	Russia	Trading activities	87.99	-

The effective ownerships indicated in the table above are also the nominal holdings, except for CJSC Ogneupor (54.72% is held by the Parent Company and 45.28% by OJSC MTSOZ as of December 31, 2007 and a 100% was held by OJSC MTSOZ as of December 31, 2006).

Use of estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management of the Group to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Examples of significant estimates include the allowance for doubtful accounts, the recoverability of intangible assets and other long-lived assets and valuation allowances on deferred tax assets. Actual results could differ from those estimates.

Concentration of business risk

The Group's principal business activities are within the Russian Federation. Laws and regulations affecting businesses operating in the Russian Federation are subject to rapid changes, which could impact the Group's assets and operations.

Reporting and functional currencies

The Group follows a translation policy in accordance with Statement on Financial Accounting Standards ("FAS") No. 52, "Foreign Currency Translation", ("FAS 52").

The national currency of the Russian Federation is the RUB, the local currency of the Group's primary operating subsidiaries. The U.S. dollar ("USD") is the functional currency of all of the Group's worldwide operations except for its subsidiary MMK Atakas Metalurji, where the functional currency is the New Turkish Lira ("TRY"). Assets and liabilities of this entity are translated from

TRY to USD at period-end exchange rates; revenue and expenses are translated using the average exchange rate for the reporting period. Resulting translation adjustments are recorded in other comprehensive income in the consolidated statements of operations and comprehensive income.

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

As of December 31, 2007 and 2006, exchange rates of 24.55 RUB and 26.33 RUB to 1 USD, respectively, have been used for remeasurement purposes. The weighted average exchange rates for the years ended December 31, 2007 and 2006 were 25.58 RUB and 27.32 RUB to 1 USD, respectively.

As of December 31, 2007, an exchange rate of 1.17 TRY to 1 USD has been used for remeasurement purposes. The weighted average exchange rate for the year ended December 31, 2007 was 1.25 TRY to 1 USD.

The RUB is not a readily convertible currency outside the territory of the Russian Federation. Accordingly, remeasurement of amounts recorded in RUB into USD should not be construed as a representation that RUB amounts have been, could be, or will in the future be converted into USD at the exchange rate shown or at any other exchange rate.

Other comprehensive income

Accumulated other comprehensive income includes foreign currency translation adjustments, unrealized holding gains and losses on available-for-sale securities and on derivative financial instruments, as well as additional pension liabilities not yet recognized as net periodic pension cost.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances, call deposits and liquid promissory notes with original maturities of ninety days or less at the date of purchase.

Restricted cash

Restricted cash represents legally restricted collateral deposited with various banks as margin for irrevocable letters of credit.

Financial instruments

The Group's financial instruments include cash and cash equivalents, short-term and long-term investments, receivables, payables and debt. Except as described in Note 23, the estimated fair value of such financial instruments approximates their carrying value as reflected in the consolidated balance sheet.

Investment securities

The Group's investment securities include debt and equity securities.

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

Trading and available-for-sale securities are recorded at fair value. Unrealized holding gains and losses on trading securities are included in earnings. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are reported as a separate component of other comprehensive

income until realized. Realized gains and losses from the sale of available-for-sale securities are determined on a specific-identification basis. Held-to-maturity securities are recorded at amortized cost using the effective interest method, adjusted for the amortization or accretion of premiums or discounts.

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

Investments in affiliates and joint ventures

Investments in majority owned affiliates and joint ventures, where control does not exist, and 20% to 50% owned affiliates in which the Group has the ability to exercise significant influence are accounted for under the equity method of accounting whereby the investment is carried at the cost of acquisition, plus the Group's equity in net earnings or losses since acquisition, less dividends received.

Investments in affiliates and joint ventures, over which the Group does not have the ability to exercise significant influence and which have readily determinable fair value, are accounted for at fair value. To the extent that these investments do not have a readily determinable fair value, they are accounted for under the cost method.

The Group periodically reviews all of its investments in affiliates and joint ventures for which fair value is less than cost to determine if the decline in value is other than temporary. If the decline in value is judged to be other than temporary, the cost basis of the investment is written down to fair value. The amount of any write-down is included in the consolidated statement of operations and comprehensive income.

Trade and other receivables

Accounts receivable are stated at their net realizable value after deducting an allowance for doubtful accounts. The allowance for doubtful accounts is the Group's best estimate of the amount of probable credit losses in the Group's existing accounts receivable balances. The Group reviews its allowance for doubtful accounts monthly. Account balances are written off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

Value-added tax

Value-added tax ("VAT") related to sales are payable to the tax authorities upon issuance of invoices to the customer. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales. VAT related to purchase transactions not reclaimable as of the balance sheet dates is recorded as VAT receivable in the consolidated financial statements.

Inventories

Inventories are stated at the lower of purchase price, manufacturing cost or market value. The cost of inventories is determined on the weighted average basis and includes all costs in bringing the inventory to its present location and condition.

The elements of cost include direct material, labour and manufacturing overheads. Costs of production in process and finished goods include the purchase costs of raw materials and conversion costs such as direct labour and an allocation of fixed and variable production overheads. Raw materials are valued at purchase cost inclusive of freight and other shipping costs.

Market value is the estimated price at which inventories can be sold in the normal course of business after allowing for cost of completion and sale.

Property, plant and equipment

Owned assets

Property, plant and equipment are stated at historical cost less accumulated depreciation and impairment losses. Capitalized production costs for internally developed assets include materials, direct labor costs and manufacturing overhead costs. When construction activities are performed over an extended period, interest costs incurred during construction are capitalized. Construction-in-progress and equipment held for installation are not depreciated until the constructed or installed asset is substantially ready for its intended use.

The costs of planned major maintenance activities are recorded as costs as incurred. Costs for activities that lead to the prolongation of useful life or to expanded future use capabilities of an asset are capitalized. Maintenance and repair costs are expensed as incurred.

Leased assets

Capital leases are recorded at the lower of the fair market value of the asset or the present value of future minimum lease payments, less accumulated depreciation and impairment losses. The discount rate used in determining the present value of the minimum lease payments is the Group's incremental borrowing rate, unless (1) it is practicable to obtain the implicit rate computed by the lessor and (2) the implicit rate is less than the Group's incremental borrowing rate. If both of those conditions are met, the interest rate implicit in the lease is used. Amounts due within one year are classified as short-term lease liabilities and the remaining balance as long-term lease liabilities.

Mineral licenses

Mineral licenses to develop mineral reserves and resources are stated at historical cost less accumulated amortization. Mineral licenses are presented as a separate component of property, plant and equipment in the consolidated balance sheet.

Depreciation

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

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

Buildings	33-44 years
Machinery and equipment	17-32 years
Transportation equipment	8-22 years
Fixtures and fittings	8-14 years

Mineral rights are amortized using the straight-line basis over the license term assuming constant production during the period of license.

Goodwill and other intangible assets

Goodwill represents the excess of the cost of businesses acquired over the fair value of identifiable net assets at the date of acquisition.

Goodwill and intangible assets acquired in business combinations that have an indefinite useful life are not amortized. Goodwill is reviewed annually for impairment or whenever it is determined that impairment indicators exist. The Group determines whether an impairment has occurred by assigning goodwill to the reporting unit identified, and comparing the carrying amount of the reporting unit to

the fair value of the reporting unit. If goodwill impairment has occurred, the Group recognizes a loss for the difference between the carrying amount and the implied fair value of goodwill.

Intangible assets, that primarily represent production licenses and various purchased software costs, with finite useful lives are amortized over their respective estimated useful lives to their estimated residual values and are reviewed periodically for impairment.

Debt issuance costs

Debt issuance costs are amortized using the effective interest method over the terms of the related loans.

Impairment of long-lived assets

The Group periodically evaluates the recoverability of the carrying amount of its long-lived assets. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Group compares undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, the Group records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets.

Accrued and contingent liabilities

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

Borrowing costs

Borrowing costs are recognized as an expense in the period in which they are incurred. Borrowing costs for assets that require a period of time to get them ready for their intended use are capitalized and amortized over the related assets' estimated useful lives.

Employee benefits

Defined contribution plans

The Group's Russian subsidiaries are legally obliged to make defined contributions to the Russian Federation State Pension Fund (a defined contribution plan financed on a pay-as-you-go basis). The Group's contributions to the Russian Federation State Pension Fund relating to defined contribution plans are charged to income in the period to which they relate.

In the Russian Federation all state social contributions, including contributions to the Russian Federation State Pension Fund, are collected through a unified social tax ("UST") calculated by the application of a regressive rate from 26% to 2% of the annual gross remuneration of each employee. UST is allocated to three state social funds, including the Russian Federation State Pension Fund, where the rate of contributions to that fund vary from 20% to 2%, depending on the annual gross remuneration of each employee.

The Group's obligations for contributions to other defined contribution plans are recognized as an expense as incurred.

Defined benefit plans

The Group accounts for the cost of defined benefit plans using the projected unit credit method. Under this method, the cost of providing pensions is charged to the consolidated statement of operations and comprehensive income, so as to attribute the total pension cost over the service lives

of employees in accordance with the benefit formula of the plan. The Group's obligation in respect of defined retirement benefit plans is calculated separately for each defined benefit plan by discounting the amounts of future benefits that employees have already earned through their service in the current and prior periods. The discount rate applied represents the yield on government bonds that have maturity dates approximating the terms of the Group's obligations.

Revenue recognition

Revenue is recognized on an accrual basis when earned and realizable, which generally occurs when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, pervasive evidence of an arrangement exists and the sales price is fixed or determinable.

Revenue is recognized net of applicable provisions for discounts, allowances, associated value-added taxes and export duties.

Income taxes

Current income tax

Current income tax has been computed in accordance with the respective national tax laws. The Group's liability for current income tax is calculated using tax rates that have been enacted by the balance sheet date.

Income tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of operations and comprehensive income as it excludes certain items of income or expense that are taxable or deductible in other periods or excludes items that are not taxable or deductible.

Income tax paid or payable by the seller on intercompany profits on transfers of assets such as sales of inventory or depreciable assets within the Group is deferred upon consolidation as prepaid income tax and is not recorded until the inventory or other asset is sold to an unrelated third party.

In July 2006, the Financial Accounting Standards Board ("the FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes", ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FAS No. 109, "Accounting for Income Taxes", ("FAS 109") and prescribes a recognition threshold and measurement attributes for financial statement recognition and measurement of tax positions taken or expected to be taken on a tax return. FIN 48 also requires entity to make explicit disclosures at the end of each reporting period about uncertainties in their income tax positions, including a detailed rollforward of tax benefits taken that do not qualify for financial statement recognition. The Group adopted the provisions of FIN 48 on January 1, 2007, which did not have a significant impact on the Group's consolidated financial position or results of operations.

Deferred income tax

Deferred income tax is accounted for under the liability method and reflects the tax effect of all significant temporary differences between the tax bases of assets and liabilities and their reported amounts in the consolidated financial statements. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment date. Deferred income tax assets and liabilities arising in different tax jurisdictions are not offset.

Deferred tax assets and liabilities are not recognized for temporary differences arising from the remeasurement of assets and liabilities from the local currency into the functional currency using historical exchange rates. Additionally, deferred tax assets or liabilities are not recognized for the effects of tax indexation of property, plant and equipment.

A valuation allowance is provided for deferred tax assets if it is more likely than not that the deferred tax assets will not be realized. In making this assessment, the Group's management considers all available evidence, including the scheduled reversal of deferred income tax liabilities, projected future taxable income and tax planning strategies.

Derivative financial instruments and hedging activities

Derivative instruments, consisting primarily of foreign currency forward and option contracts, are utilized by the Group to manage its exposure to fluctuations in foreign exchange rates. The Group does not enter into foreign currency hedging contracts related to its investment in affiliated companies.

All derivatives are recorded as either assets or liabilities in the consolidated balance sheets and measured at their respective fair values.

The accounting for changes in the fair value of derivative financial instruments depends on whether it has been designated and qualifies as an accounting hedge and further, on the type of hedging relationship. If a derivative is designated as a fair value hedge, the changes in the fair value of the derivative and the hedged item are recognized in earnings. If a derivative is designated as a cash flow hedge, changes in the fair value of the derivative are recorded in other comprehensive income and are recognized in the statement of operations and comprehensive income when the hedged item affects earnings. For a derivative not designated as a hedging instrument, the gain or loss is recognized in earnings in the period of change.

Distributions to shareholders

Distributable retained earnings of the Group are based on amounts recorded in the statutory financial statements of individual entities and may significantly differ from amounts calculated on the basis of financial statements, prepared in accordance with U.S. GAAP.

Guarantees

A liability is recorded for the fair value of a guarantee issued by the Group which is equal to the present value of the expected loss. The Group determines the expected loss by multiplying the creditor's default rate by the guarantee amount reduced by the expected recovery, if applicable, for each future period the guarantee will be outstanding. If at inception of a guarantee, the Group determines there is a probable related contingent loss, a liability for the greater of (a) the fair value of the guarantee as described above or (b) the probable contingent loss amount will be recognized. Subsequent to initial measurement and recognition, the fair value assigned to the guarantee would be adjusted and recognized in the consolidated statement of operations and comprehensive income as the Group is released from risk under the guarantee, as appropriate. All other guarantees are disclosed as a contingency in the consolidated financial statements.

Segment information

Segment reporting follows the internal organizational and reporting structure of the Group. The Group operates in a single business segment, which is composed of the manufacturing of semi-finished and finished steel products. The revenues from the sale of these products constitute more than 95 percent of total revenues. All significant assets, production and management and administrative facilities are located in the city of Magnitogorsk, Russian Federation.

New and recently adopted accounting pronouncements

In December 2007, the FASB issued FAS No. 141(R), "Business Combinations", ("FAS 141(R)"), which replaces FAS No. 141, "Business Combinations". FAS 141(R) applies to all transactions in which an entity obtains control of one or more businesses, including mergers and combinations achieved without the transfer of consideration. FAS 141(R) applies to all business entities, including mutual entities that previously used the pooling-of-interests method of accounting for some business combinations. FAS 141(R) requires the acquiring entity in a business combination to recognize all assets acquired and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed and requires the acquirer to disclose certain information related to the nature and financial effect of the business combination. FAS 141(R) also establishes principles and requirements for how an acquirer recognizes any noncontrolling interest in the acquiree and the goodwill acquired in a business combination. Additionally, FAS 141(R) changes the way entities account for business combinations achieved in stages by requiring the identifiable assets and liabilities to be measured at their full fair values. Also, contractual contingencies and contingent consideration shall be measured at fair value at the acquisition date and acquisition-related transaction costs are to be expensed in the period incurred. FAS 141(R) is effective on a prospective basis to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited. Depending on the terms, conditions and details of the business combination, if any, that take place subsequent to December 15, 2008, FAS 141(R) may have a material impact on the Group's consolidated financial statements. FAS 141 (R) also amends FAS 109, such that adjustments made to deferred taxes and acquired tax contingencies after December 15, 2008, even for business combinations completed before this date, will impact net income. The Group is currently evaluating the impact of the adoption of FAS 141(R) on its consolidated financial position and results of operations.

In December 2007, the FASB issued FAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of Accounting Research Bulletin No. 51", ("FAS 160"). FAS 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. FAS 160 requires entity to report noncontrolling interests in subsidiaries (also known as minority interest) as a separate component of equity in the consolidated statement of financial position, to clearly identify consolidated net income attributable to the parent and to the noncontrolling interest on the face of the consolidated statement of income and to provide sufficient disclosure that clearly identifies and distinguishes between the interest of the parent and the interests of noncontrolling owners. FAS 160 also establishes accounting and reporting standards for changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. FAS 160 is effective for the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited. The Group is currently evaluating the impact of the adoption of FAS 160 on its consolidated financial position and results of operations.

In February 2007, the FASB issued FAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FAS No. 115", ("FAS 159"). FAS 159 provides entities with an option to measure, at specified election dates, certain financial instruments and other items at fair value that are not currently measured at fair value. An entity that adopts FAS 159 will report unrealized gains and losses on items for which the fair value option has been elected in its consolidated financial results during each subsequent reporting date. FAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. FAS 159 is effective for the first annual reporting period beginning on or after November 15, 2007. The Group does not plan to elect the fair value measurement option to any additional assets or liabilities not already required to be measured at fair value.

In September 2006, the FASB issued FAS No. 157, "Fair Value Measurements", ("FAS 157"). FAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. FAS 157 applies under

other accounting pronouncements that require or permit fair value measurements and, accordingly, does not require any new fair value measurements. FAS 157 was initially effective for the first annual reporting period beginning on or after November 15, 2007. In February 2008, the FASB issued a FASB Staff Position ("FSP") No. FAS 157-2, "Effective Date of FASB Statement No. 157", delaying the effective date of FAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. FSP deferred the effective date of FAS 157 to annual reporting period beginning on or after November 15, 2008, and interim periods within those annual reporting period for items within the scope of this FSP. The Group is currently assessing the impact of the adoption of FAS 157.

Reclassifications

Certain reclassifications of prior year amounts have been made to conform to the presentation adopted for the year ended December 31, 2007. Revenue, net income or net assets were not affected by these reclassifications.

3. CASH AND CASH EQUIVALENTS

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

	December 31,	
	2007	**2006**
Bank accounts, RUB	98	75
Bank accounts, USD	63	52
Bank accounts, Euro ("EUR")	14	6
Bank accounts, TRY	10	-
Bank accounts, Swiss Franc	-	1
Bank deposits, USD	3	8
Bank deposits, RUB	2	148
Bank promissory notes, RUB	66	44
Cash equivalents, RUB	-	4
	256	**338**

As of December 31, 2007 and 2006, the weighted average interest rates on bank deposits with original maturities less than ninety days were 10.80% and 6.43%, respectively.

As of December 31, 2007 and 2006, the weighted average interest rates on bank promissory notes were 7.81% and 7.50%, respectively.

4. SHORT-TERM AND LONG-TERM BANK DEPOSITS

	December 31,	
	2007	**2006**
Short-term bank deposits		
Bank deposits, RUB	1,279	228
Long-term bank deposits		
Bank deposits, RUB	-	109

As of December 31, 2007 and 2006, the weighted average interest rates on short-term bank deposits with original maturities exceeding ninety days were 9.82% and 10.08%, respectively.

As of December 31, 2006, the long-term cash deposits were placed in a Russian bank and were due to mature on December 15, 2009. However during 2007, the long-term cash deposits were withdrawn before the due date by agreement with the bank. The weighted average interest rate on long-term bank deposits was 6.50%.

5. SHORT-TERM AND LONG-TERM INVESTMENTS

	December 31,	
	2007	**2006**
Short-term investments		
Trading equity securities	321	30
Trading debt securities	59	78
Share in mutual investment fund	12	5
Trading promissory notes	1	212
	393	**325**
Long-term investments		
Equity securities classified as available for sale	**993**	**146**

Trading equity securities are liquid publicly traded shares of Russian companies. They are reflected at period-end market value based on trade prices obtained from investment brokers.

Trading debt securities and trading promissory notes are liquid publicly traded bonds and notes of Russian companies and banks. They are reflected at period-end market value based on trade prices obtained from investment brokers.

Net gains on trading securities for the years ended December 31, 2007 and 2006 were USD 7 million and USD 2 million, respectively. Those gains are included in other operating income in the consolidated statement of operations and comprehensive income (refer to Note 20).

In 2007, the Group ceased to accept trading promissory notes as payment for metal sales in order to reduce its credit risk exposure.

Long-term equity securities classified as available for sale represent investments in equity securities of a foreign entity, where the Group has less than a 20% equity interest and no significant influence. As of December 31, 2007 and 2006, unrealized holding gains on these securities were USD 614 million and USD 18 million, respectively, net of related income tax effect of USD 193 million and USD 5 million, respectively. These gains are reported as a separate component of other comprehensive income.

6. ACCOUNTS RECEIVABLE FROM THIRD PARTIES

	December 31,	
	2007	2006
Trade accounts receivable	699	422
Value-added tax receivable	244	191
Advances paid	80	137
Loans provided	72	14
Interest receivable	70	23
Prepaid income tax	65	36
Other receivables	84	40
	1,314	863
Allowance for doubtful accounts	(8)	(12)
	1,306	**851**

7. INVENTORIES

	December 31,	
	2007	2006
Raw materials	439	303
Work-in-progress	133	124
Finished goods and goods for resale	374	204
	946	**631**

8. PROPERTY, PLANT AND EQUIPMENT, NET

	Gross carrying value	Accumulated depreciation	Net carrying value
Land and buildings	1,623	(734)	889
Mineral licenses	43	(1)	42
Machinery and equipment	3,704	(2,036)	1,668
Transportation equipment	184	(117)	67
Fixtures and fittings	132	(63)	69
Construction-in-progress	790	-	790
Advance payments for property, plant and equipment	354	-	354
Balance as of December 31, 2007	**6,830**	**(2,951)**	**3,879**
Land and buildings	1,395	(714)	681
Mineral licenses	23	-	23
Machinery and equipment	3,551	(1,961)	1,590
Transportation equipment	173	(109)	64
Fixtures and fittings	107	(44)	63
Construction-in-progress	243	-	243
Advance payments for property, plant and equipment	100	-	100
Balance as of December 31, 2006	**5,592**	**(2,828)**	**2,764**

In December 2006, the Group acquired at a state auction an exploration and development license for the Prioskolskoe iron ore deposit located in the Kurskaya region, Russian Federation, expiring in 2026. The carrying value of this license was USD 23 million as of December 31, 2007 and 2006. As of December 31, 2007, the construction of mining facilities at Prioskolskoe iron ore deposit was in process.

In January 2007, the Group acquired mineral licenses for USD 20 million as a result of the acquisition of LLC Bakalskoe Rudoupravlenie (refer to Note 22, (a)).

Depreciation expense for the years ended December 31, 2007 and 2006 amounted to USD 197 million and USD 177 million, respectively.

Capitalized borrowing costs for the years ended December 31, 2007 and 2006 amounted to USD 15 million and USD 8 million, respectively.

Management did not identify any indicators of impairment relating to the Group's investments in long-lived assets during the years ended December 31, 2007 and 2006.

9. INVESTMENTS IN AFFILIATES

The Group's equity method investments in affiliates as of December 31, 2007 and 2006 comprised the following:

		Investment carrying value		Ownership and voting interest, %	
		December 31,		December 31,	
Affiliate	**Registered in**	**2007**	**2006**	**2007**	**2006**
Carrying value of investment					
CJSC Kazankovskaya Mine	Russia	26	33	50%	50%
LLC MMK Trans	Russia	4	5	50%	50%
LLC M-Port	Russia	-	46	-	50%
Loans provided to affiliate					
CJSC Kazankovskaya Mine	Russia	46	39		
		76	**123**		

As of December 31, 2007 and 2006, the Group provided CJSC Kazankovskaya Mine with a total of USD 46 million and USD 39 million in unsecured RUB-denominated loans, respectively, with maturity in December 2013. These loans bear interest at 10% per annum. As of December 31, 2007 and 2006, the outstanding amount of loans provided included accrued interest of USD 8 million and USD 4 million, respectively.

During the year ended December 31, 2006, the Group received dividends of USD 3 million from LLC MMK Trans.

In August 2007, the Group sold its 50% share in LLC M-Port for a total cash consideration of USD 70 million. The gain on disposal of USD 23 million was included in other operating income in the consolidated statement of operations and comprehensive income (refer to Note 20).

10. GOODWILL AND OTHER INTANGIBLE ASSETS, NET

Goodwill

The change in the carrying value of goodwill for the year ended December 31, 2007 was as follows:

Balance as of December 31, 2006	**2**
Goodwill arising on acquisitions (Note 22)	63
Balance as of December 31, 2007	**65**

Other intangible assets

As of December 31, 2007 and 2006, other intangible assets comprised the following:

	Gross carrying value	Accumulated amortization	Net carrying value
Licenses	36	(11)	25
Purchased software	35	(19)	16
Other intangibles	8	(3)	5
Balance as of December 31, 2007	**79**	**(33)**	**46**
Licenses	33	(9)	24
Purchased software	24	(10)	14
Other intangibles	6	(1)	5
Balance as of December 31, 2006	**63**	**(20)**	**43**

Amortization expense for licenses, purchased software and other intangibles for the years ended December 31, 2007 and 2006 amounted to USD 14 million and USD 11 million, respectively.

The estimated amortization expense for each of the next five years and thereafter is as follows:

Year ended December 31,	
2008	12
2009	9
2010	6
2011	2
2012	2
Thereafter	15
	46

Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

No impairment of goodwill and other intangible assets was recognized in the years ended December 31, 2007 and 2006.

11. OTHER LONG-TERM ASSETS

	December 31,	
	2007	2006
Loans provided	11	6
Restricted cash	4	5
Loans to employees	1	1
	16	**12**

12. SHORT-TERM BORROWINGS AND CURRENT PORTION OF LONG-TERM DEBT

	Type of interest rate	Annual interest rate (actual as of December 31, 2007)	December 31, 2007	December 31, 2006
Short-term borrowings:				
Secured loans, USD	Floating	6%	495	226
Secured loans, EUR	Floating	6%	62	-
Secured loans, RUB	Fixed	7%	125	6
Unsecured loans, RUB	Floating	8%	12	17
Unsecured loans, RUB	Fixed	9%	16	1
			710	250
Current portion of long-term debt:				
Unsecured corporate bonds, USD	Fixed	9%	303	4
Secured loans, RUB	Fixed	14%	1	1
Unsecured loans, USD	Floating	5%	118	98
Unsecured loans, RUB	Floating	7%	12	10
Unsecured loans, RUB	Fixed	9%	38	7
Unsecured loans, USD	Fixed	5%	4	2
Unsecured loans, EUR	Fixed	7%	3	1
			479	123
			1,189	**373**

The weighted average interest rate of the RUB-denominated short-term borrowings as of December 31, 2007 and 2006 was 8% and 9%, respectively. The weighted average interest rate of the USD-denominated short-term borrowings as of December 31, 2007 and 2006 was 7% and 6%, respectively. The weighted average interest rate of the EUR-denominated short-term borrowings as of December 31, 2007 was 6%.

As of December 31, 2007 and 2006, short-term borrowings were secured by the Group's property, plant and equipment with a net carrying amount of USD 2 million and USD 1 million, respectively, and inventory of USD 6 million and USD 9 million, respectively.

13. LONG-TERM DEBT, NET OF CURRENT PORTION

	Type of interest rate	Annual interest rate (actual as of December 31, 2007)	December 31, 2007	December 31, 2006
Unsecured corporate bonds, USD	Fixed	9%	-	299
Secured loans, RUB	Fixed	13%	5	1
Unsecured loans, USD	Floating	5%	145	257
Unsecured loans, USD	Fixed	5%	13	10
Unsecured loans, RUB	Fixed	10%	22	5
Unsecured loans, EUR	Fixed	7%	5	3
Unsecured loans, RUB	Floating	7%	10	2
			200	**577**

Credit facilities

The most significant bank financing comprised credit line facilities from certain Russian and foreign banks. As of December 31, 2007 and 2006, the total unused element of all credit facilities was USD 94 million and USD 246 million, respectively.

The information provided below refers to total long-term debt, including its current portion, identified in Note 12.

Corporate bonds

In October 2003, MMK Finance S.A., a wholly-owned subsidiary of the Group, issued on the Luxembourg Stock Exchange USD 300 million of 8% notes at an issue price of 98.99 percent. The notes are fully, unconditionally and irrevocably guaranteed by the Parent Company. Interest payments on the notes are due semi-annually in equal installments on April 21 and October 21 of each year, commencing April 21, 2004. The notes are subject to certain restrictive covenants including, but not limited to, limitations on the incurrence of additional indebtedness, restrictions on mergers or consolidations, limitations on liens and dispositions of assets and limitations on transactions with affiliates. For the years ended December 31, 2007 and 2006, interest payments on these notes amounted to USD 24 million per annum. The notes and outstanding interest payable are due to be repaid in October, 2008.

Loans

In 2006, foreign banks provided USD-denominated loans, bearing interest at LIBOR+1.00% (5.86% as of December 31, 2007) per annum with maturity in June 2009. As of December 31, 2007 and 2006, the outstanding balance was USD 108 million and USD 144 million, respectively.

In 2005, foreign banks provided USD-denominated loans, bearing interest at LIBOR+0.25% (4.90% as of December 31, 2007), LIBOR+0.30% (4.95% as of December 31, 2007) and 4.05% per annum, repayable from 2009 to 2011. The commitment fees on these loans are from 0.07% to 0.08% per annum on the undrawn facilities. As of December 31, 2007 and 2006, the outstanding balance of these loans was USD 67 million and USD 70 million, respectively.

In 2004, foreign banks provided USD-denominated loans, bearing interest at LIBOR+0.18% (4.83% as of December 31, 2007) and LIBOR+0.25% (4.90% as of December 31, 2007) per annum, repayable from 2010 to 2011. The commitment fees on these loans are from 0.08% to 0.10% per annum on the undrawn facilities. As of December 31, 2007 and 2006, the outstanding balance of these loans was USD 81 million and USD 103 million, respectively.

In 2003, foreign banks provided USD-denominated loans, bearing interest at LIBOR+0.30% (4.95% as of December 31, 2007), LIBOR+0.45% (4.65% as of December 31, 2007) and LIBOR+0.75% (5.89% as of December 31, 2007) per annum, repayable from 2008 to 2011. The commitment fees on these loans are from 0.10% to 0.20% per annum on the undrawn facilities. As of December 31, 2007 and 2006, the outstanding balance of these loans was USD 25 million and USD 48 million, respectively.

In 2002, a foreign bank provided a USD-denominated loan, bearing interest at LIBOR+0.80% (5.91% as of December 31, 2006) per annum with maturity in June 2007. As of December 31, 2006, the outstanding balance of this loan was USD 3 million. In 2007, the loan was fully repaid.

The Group also has RUB-denominated loans, provided by Russian banks, bearing interest rate from 5.00% to 14.00% per annum, repayable from 2008 to 2012. As of December 31, 2007 and 2006, the outstanding balance of these loans was USD 88 million and USD 26 million, respectively.

The bank loans are subject to certain restrictive covenants, including, but not limited to:

- The ratio of consolidated debt to consolidated EBITDA should not exceed 3.5:1; and
- The ratio of consolidated EBITDA to consolidated debt service should not be less than 3:1.

As of December 31, 2007 and 2006, the Group was in compliance with all of its debt covenants.

As of December 31, 2007 and 2006, long-term loans were secured by the Group's property, plant and equipment with a net carrying amount of USD 1 million and USD 2 million, respectively, and inventory of USD 2 million and USD 2 million, respectively.

Debt repayment schedule

Year ended December 31,	
2008 (presented as current portion of long-term debt, Note 12)	479
2009	108
2010	55
2011	27
2012 and thereafter	10
	679

14. CAPITAL LEASE OBLIGATIONS

The following table presents future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2007 and 2006:

	December 31,	
	2007	2006
Year ended December 31,		
2007	-	31
2008	33	18
2009	22	10
2010	7	4
2011	5	2
2012	1	-
Total minimum lease payments (undiscounted)	**68**	**65**
Less amount representing interest	(12)	(11)
Present value of net minimum lease payments	**56**	**54**
Less current portion of long-term capital lease obligations	(26)	(25)
Long-term capital lease obligations	**30**	**29**

As of December 31, 2007 and 2006, the weighted average discount rate for capital lease obligations was 16%.

As of December 31, 2007 and 2006, leased assets with a net carrying amount of USD 76 million and USD 72 million, respectively, were included in property, plant and equipment as follows:

	Gross carrying value	Accumulated depreciation	Net carrying value
Machinery and equipment	86	(13)	73
Construction-in-progress	3	-	3
Balance as of December 31, 2007	**89**	**(13)**	**76**
Machinery and equipment	76	(12)	64
Construction-in-progress	8	-	8
Balance as of December 31, 2006	**84**	**(12)**	**72**

15. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	December 31,	
	2007	2006
Trade accounts payable	326	225
Advances from customers	160	191
Salary payable	76	53
Other taxes payable	42	37
Dividends payable	11	20
Other current liabilities	58	19
	673	**545**

16. EMPLOYEE BENEFITS

Defined contribution plans

Payments to the Russian Federation State Pension Fund amounted to USD 95 million and USD 59 million for the years ended December 31, 2007 and 2006, respectively.

In addition, the Group makes monthly contributions to a non-government pension fund, Sotsialnaya Zashchita Starosti, where its employees have individual accumulation agreements with the fund. The Group has the ability to exercise significant influence over the financial and operating policy decisions of the fund through representation on the Board of Directors of the fund. The monthly contribution made by the Group is equal to the employee's contribution, unless the employee is a male aged between 55 and 60, or a female aged between 50 and 55, in which case the contribution is 1.5 times the employee's contribution. For the years ended December 31, 2007 and 2006, the maximum monthly contributions by the Group for each employee were RUB 6,000 (USD 235) and RUB 6,000 (USD 221), respectively. The Group's total contributions to the fund amounted to USD 6.1 million and USD 5.5 million for the years ended December 31, 2007 and 2006, respectively.

Defined benefit plan

The Group has a defined benefit plan in favour of employees who retired prior to April 1, 2001. Effective April 1, 2001, employees retiring after that date are not allowed to participate in the plan. Pensions from this defined benefit plan are administered by the independent charity fund BOF Metallurg.

Entitled employees receive lifetime pension payments, which in July 2007 increased by 20% and vary from RUB 300 (USD 11.73) to RUB 540 (USD 21.11) per month depending on the employee's actual years of service and qualifications.

For the years ended December 31, 2007 and 2006, the Group made monthly payments to the fund of RUB 466 (USD 18.23) and RUB 389 (USD 14.30), respectively, per fund member, which were then distributed to the individual members.

As of December 31, 2007 and 2006, the principal actuarial assumptions used in determining the projected benefit obligations and net periodic pension expense were as follows:

	December 31,	
	2007	**2006**
Discount rate	9.0%	9.0%
Future pension benefit increases	8.4%	8.4%
Average life expectancy of members from date of retirement	10.1	10.4

The change in the projected benefit obligations is presented in the following table:

	2007	**2006**
Projected benefit obligations at beginning of the year	30	26
Interest cost	3	2
Actuarial losses	5	3
Benefit payments during the year	(4)	(3)
Foreign exchange losses	3	2
Unfunded status of the plan at end of the year	**37**	**30**

The fund does not hold any assets set aside for the benefit of retirees under this plan.

The accumulated benefit obligations as of December 31, 2007 and 2006 were as follows:

	December 31,	
	2007	**2006**
Accumulated benefit obligations	**37**	**30**

The components of the net periodic benefit costs for the years ended December 31, 2007 and 2006 were as follows:

	2007	**2006**
Interest cost	3	2
Actuarial losses	5	3
Foreign exchange losses	3	2
	11	**7**

Net periodic benefit costs were recognized as part of administrative expenses in the consolidated statement of operations and comprehensive income.

The future benefit payments to retirees under the defined benefit plan are expected to be as follows:

Year ended December 31,	
2008	4
2009	3
2010	3
2011	3
2012	3
2013-2017	10
Thereafter	11
	37

17. SHAREHOLDERS' EQUITY

Common stock

	December 31,	
	2007	**2006**
Issued and fully paid common shares with a par value of RUB 1 each	**11,174,330**	**10,630,222**

In April 2007, minority shareholders of the Parent Company acquired 2,603 thousand common shares in accordance with their pre-emptive rights. Also in April 2007, the Parent Company completed an initial public offering ("IPO") of 1,040,000 thousand shares in the Russian Federation and on the London Stock Exchange in the form of common shares and global depository receipts ("GDRs"), with each GDR representing 13 newly issued common shares. The offer price was USD 0.96 per common share and USD 12.50 per GDR. Proceeds from the share issuance above totalled USD 977 million, net of issuance costs of USD 25 million. Of the total proceeds, USD 40 million represented the nominal value of the common shares issued.

In December 2007, the Parent Company cancelled 498,495 thousand common shares it held as treasury stock. The cancellation resulted in a decrease of share capital of USD 17 million and a decrease of additional paid-in capital of USD 108 million.

Treasury stock

As of December 31, 2007 and 2006, the Group held 4,457 thousand and 485,062 thousand, respectively, issued common shares of the Parent Company as treasury stock.

All treasury stock is recorded at cost.

Shareholders' voting rights

The shareholders of fully paid common stock are entitled to one vote per share at the annual general shareholders' meeting of the Parent Company.

Dividends

Year ending December 31, 2007

On August 30, 2007 the Parent Company declared an interim dividend of RUB 0.418 (USD 0.016) per common share in respect of the six months ended June 30, 2007 representing a total dividend of USD 189 million. Of this total, USD 8 million was attributable to Group entities.

Year ending December 31, 2006

On March 30, 2007, the Parent Company declared a final dividend of RUB 0.891 (USD 0.034) per common share in respect of the year ended December 31, 2006 representing a total dividend of USD 364 million. Of this total, USD 16 million was attributable to Group entities.

On November 28, 2006, the Parent Company declared an additional interim dividend of RUB 0.910 (USD 0.035) per common share in respect of the nine months ended September 30, 2006 representing a total dividend of USD 366 million. Of this total, USD 16 million was attributable to Group entities.

On August 29, 2006, the Parent Company declared an additional interim dividend of RUB 0.815 (USD 0.030) per common share in respect of the six months ended June 30, 2006 representing a total dividend of USD 324 million. Of this total, USD 14 million was attributable to Group entities.

On May 26, 2006, the Parent Company declared an interim dividend of RUB 0.593 (USD 0.022) per common share in respect of the three months ended March 31, 2006 representing a total dividend of USD 233 million. Of this total, USD 10 million was attributable to Group entities.

Year ending December 31, 2005

On April 21, 2006, the Parent Company declared a final dividend of RUB 0.532 (USD 0.019) per common share in respect of the year ended December 31, 2005 representing a total dividend of USD 206 million. Of this total, USD 9 million was attributable to Group entities.

18. EARNINGS PER COMMON SHARE

Basic net income per common share is based on the weighted average number of common shares outstanding during the period. Diluted net income per common share assumes the exercise of stock options, the vesting of restricted stock and the conversion of preferred stock, provided in each case the effect is dilutive.

The calculation of basic and diluted earnings per common share for the years ended December 31, 2007 and 2006 was as follows:

	2007	2006
Net income applicable to common stock	1,772	1,426
Weighted average number of common shares outstanding (in thousands):		
Basic and diluted	10,830,276	10,160,990
Earnings per common share (USD):		
Basic and diluted	0.164	0.140

There were no dilutive securities issued as of December 31, 2007 and 2006.

19. NET REVENUE

By product	2007	2006
Rolled steel	4,555	3,752
Assorted rolled products	833	604
Slabs	472	107
Galvanized steel	373	377
Wire, sling, bracing	299	30
Band	273	251
Hardware products	213	283
Galvanized steel with polymeric coating	191	168
Tin plated steel	170	254
Formed section	168	127
Coking production	124	113
Tubes	54	49
Others	472	309
	8,197	**6,424**

By customer destination	2007	2006
Russian Federation and the CIS	66%	62%
Turkey	7%	8%
Iran	7%	5%
Italy	5%	5%
India	2%	2%
USA	1%	3%
China	-	1%
Others (countries each representing less than 2% of total net revenue)	12%	14%
	100%	**100%**

20. OTHER OPERATING INCOME, NET

	2007	2006
Gain on disposal of affiliate	23	-
Net gains on sales of other assets	11	24
Net gains on trading securities (Note 5)	7	2
Change in allowance for doubtful accounts receivable	4	8
Other operating gains, net	8	5
	53	**39**

21. INCOME TAXES

The Group's provision for income taxes attributable to different tax jurisdictions for the years ended December 31, 2007 and 2006 was:

	2007	2006
Current provision for income tax:		
Russian Federation	475	449
Switzerland	1	1
Deferred income tax expense:		
Russian Federation	31	18
Total income tax expense	**507**	**468**

The provision for income taxes is different from that which would be obtained by applying the Russian Federation statutory income tax rate of 24% to net income before income tax and minority interest. The items causing this difference are as follows:

	2007	2006
Statutory rate applied to income before income tax and minority interest	550	455
Adjustments due to:		
Expenses not deductible and income not taxable for tax purposes, net	8	33
Effect of dividends paid within the Group	2	4
Adjustments of prior years' income taxes	(12)	(2)
Currency exchange and translation differences	(35)	(22)
Other permanent differences	(6)	-
Income tax expense	**507**	**468**

Deferred income tax assets and liabilities were comprised of differences arising between the tax and accounting bases of the following assets and liabilities:

	December 31,	
	2007	**2006**
Accounts payable	20	12
Loans	9	15
Inventories	-	1
Accounts receivable	-	1
Gross deferred income tax assets	29	29
Investments	(207)	(8)
Property, plant and equipment	(76)	(41)
Inventories	(8)	(10)
Accounts receivable	(3)	(2)
Gross deferred income tax liabilities	(294)	(61)
Net deferred income tax liabilities	**(265)**	**(32)**

As of December 31, 2007 and 2006, deferred income tax liabilities arising on differences in valuation of investments included USD 193 million and USD 5 million, respectively, related to unrealized holding gains on long-term equity securities classified as available for sale (refer to Note 5).

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

	December 31,	
	2007	**2006**
Current deferred income tax assets	13	19
Current deferred income tax liabilities	(11)	(11)
Long-term deferred income tax assets	16	10
Long-term deferred income tax liabilities	(283)	(50)
Net deferred income tax liabilities	**(265)**	**(32)**

For the years ended December 31, 2007 and 2006, statutory retained earnings of the Group's foreign subsidiaries amounted to USD 35 million and USD 21 million, respectively, on which deferred income tax of USD 2 million and USD 1 million, respectively, has not been recognised because remittance of the earnings has been indefinitely postponed through reinvestment and, as a result, such amounts are considered to be permanently invested.

Based upon historical taxable income and projections for future taxable income over the periods in which deferred income tax assets are deductible, management of the Group believes it is more likely than not that Group will realize the benefits of the deductible differences. Accordingly, no valuation allowances have been provided against deferred tax assets as of December 31, 2007 and 2006.

22. ACQUISITIONS AND MINORITY INTEREST

Acquisitions

(a) LLC Bakalskoe Rudoupravlenie

On January 31, 2007, the Group acquired a 51% share in LLC Bakalskoe Rudoupravlenie, a mining company located in the Chelyabinsk region, Russian Federation, for a cash consideration of USD 15 million.

This acquisition was accounted for using the purchase method. The excess of the fair value of the net assets acquired over the purchase price has been allocated as a pro rata reduction of USD 2 million of the amounts that otherwise would have been assigned to property, plant and equipment. The purchase price allocation for the acquisition is as follows:

Current assets	3
Non-current assets	29
Deferred income tax	(7)
Current liabilities	(6)
Non-current liabilities	(2)
Minority interest	(2)
Purchase price	**15**

(b) LLC UK RFTs-Kapital

On January 9, 2007, the Group acquired a 100% stake in LLC UK RFTs-Kapital, an investment company located in the Russian Federation, for a cash consideration of USD 2 million. The excess of the fair value of the net assets acquired over the purchase price in amount of USD 1 million has been included in other operating income.

(c) MMK Atakas Metalurji

In July 2007, the Group acquired a 50% plus 1 share in the Turkish company Atakas Metalurji for a total cash consideration of USD 104 million. Atakas Metalurji was subsequently renamed MMK Atakas Metalurji. This acquisition was made with the intention of establishing a metal processing facility in Turkey.

This acquisition was accounted for using the purchase method. The Group has determined the fair values of identifiable assets, liabilities and contingent liabilities of the acquired company at the date of acquisition on a provisional basis. The provisional purchase price allocation for the acquisition is as follows:

Current assets	105
Non-current assets	22
Goodwill	36
Deferred income tax	(3)
Current liabilities	(1)
Minority interest	(55)
Purchase price	**104**

The purchase price allocation for this acquisition will be finalized during 2008.

(d) CJSC Interkos-IV

In August 2007, the Group acquired a 75% share in CJSC Interkos-IV, a manufacturer of spare parts for the automotive industry, located in Saint-Petersburg, Russian Federation, for a total cash consideration of USD 20 million.

This acquisition was accounted for using the purchase method. The Group has determined the fair values of identifiable assets, liabilities and contingent liabilities of the acquired company at the date of acquisition on a provisional basis. The provisional purchase price allocation for the acquisition is as follows:

Current assets	4
Non-current assets	6
Goodwill	17
Deferred income tax	(1)
Current liabilities	(4)
Non-current liabilities	(1)
Minority interest	(1)
Purchase price	**20**

The purchase price allocation for this acquisition will be finalized during 2008.

(e) OJSC Bashmetalloptorg

In August 2007, the Group acquired a 25.67% share in OJSC Bashmetalloptorg, a wholesale trader of metal products, located in Bashkortostan republic, Russian Federation, for a total cash consideration of USD 2 million. In October 2007, the Group acquired an additional 62.32% share in OJSC Bashmetalloptorg for a total cash consideration of USD 15 million.

This acquisition was accounted for using the purchase method. The Group has determined the fair values of identifiable assets, liabilities and contingent liabilities of the acquired company at the date of acquisition on a provisional basis. The provisional purchase price allocation for the acquisition is as follows:

Current assets	1
Non-current assets	11
Goodwill	10
Deferred income tax	(3)
Current liabilities	(2)
Purchase price	**17**

The purchase price allocation for this acquisition will be finalized during 2008.

Minority interest

Changes in the carrying value of minority interest for the year ended December 31, 2007 were as follows:

Balance as of December 31, 2006	**12**
Acquisitions (as disclosed above in this Note)	58
Minority interest recognised on issue of new shares of other subsidiaries of the Group	3
Minority's share in income from operations of the Group's subsidiaries	14
Balance as of December 31, 2007	**87**

23. FAIR VALUE OF FINANCIAL INSTRUMENTS AND CREDIT RISK

Fair value of financial instruments

The estimated fair value of certain financial instruments have been determined using available market information or other valuation methodologies that require considerable judgment in interpreting market data and developing estimates. Accordingly, the estimates applied are not necessarily indicative of the amounts that the Group could realize in a current market exchange. The use of different assumptions and/or estimation methodologies may have a material impact on the estimated fair values.

As of December 31, 2007, the estimated fair value of financial instruments, consisting of cash and cash equivalents, accounts receivable and accounts payable, approximates their carrying value due to the short-term nature of these instruments. As of December 31, 2007, USD 300 million of corporate bonds due in 2008 have a fair value of 101.09% or USD 303 million. The fair value of other fixed-rate debt including capital lease obligations and floating-rate debt approximate their carrying values.

For the years ended December 31, 2007 and 2006, no derivatives were designated as hedges. A net gain of USD 0.7 million and a net loss of USD 0.4 million, respectively, relating to a change in the fair value of derivative instruments was included in net foreign exchange gain in the consolidated statement of operations and comprehensive income.

Credit risk

Credit risk represents the accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted and from movements in interest rates and foreign exchange rates. The Group does not anticipate non-performance by counterparties. The Group generally does not require collateral or other security to support financial instruments with credit risk.

Financial instruments that potentially subject the Group to significant credit risk primarily consist of cash and cash equivalents, bank deposits and accounts receivable.

The Group has bank accounts, held in OJSC Credit Ural Bank (“OJSC CUB”), a related party of the Group. In addition the Group classifies promissory notes, purchased from OJSC CUB, as cash equivalents. Also the Group holds significant amounts of cash in bank deposits in Russian banks. To reduce risk the Group performs credit risk exposure evaluations for all banks in which the Group holds bank deposits on a monthly basis.

The Group sells its products to a number of customers globally. The Group grants credit to its customers based on an evaluation of each customer’s financial position, in certain cases, without requiring guarantees or letters of credit, and thereafter monitors the exposure of potential losses from granting credit. To reduce risk the Group routinely assesses the financial strength of its customers and as a consequence, believes that its accounts receivable credit risk exposure is limited.

The maximum credit risk exposure is represented by the carrying amount of each financial asset and the contractual amounts of the financial guarantees and disclosed in Note 26.

24. RELATED PARTY TRANSACTIONS

Related parties include shareholders, key management personnel, affiliates and entities under common ownership, and entities over which the Group has the ability to exercise a significant influence.

Issuance of guarantees in favor of related parties is disclosed in Note 26.

The following companies are considered to be related parties to the Group:

CJSC Profit

CJSC Profit, a company affiliated with the Group's controlling shareholders, purchases scrap metal from third parties and Group entities, reprocesses it and sells reprocessed scrap metal to the Group.

LLC MEK

LLC MEK, a company affiliated with the Group's controlling shareholders, sells electric power to the Group.

OJSC CUB

The Group holds certain deposits and current accounts in OJSC CUB, a commercial bank affiliated with the Group's management. The Group receives financing from OJSC CUB in the form of loans for the Group's operating activities.

LLC MMK Trans

LLC MMK Trans, the Group's affiliate, provides transportation and forwarding services to the Group.

OJSC SKM

OJSC SKM, an insurance company affiliated with the Group's controlling shareholders and the Group's management, provides insurance services to the Group.

CJSC Kazankovskaya Mine

CJSC Kazankovskaya Mine, the Group's affiliate, holds a license to explore and mine coal deposits located in Kemerovo region, Russian Federation. The Group provides loans to CJSC Kazankovskaya Mine.

CJSC SKM-Invest

CJSC SKM-Invest, a leasing company affiliated with the Group's management, provides assets under capital lease to the Group.

Transactions	2007	2006
Revenue		
CJSC Profit	136	125
LLC MEK	1	-
LLC MMK Trans	-	1
Total	137	126
Purchases		
CJSC Profit	1,235	716
LLC MEK	139	-
LLC MMK Trans	27	24
Total	1,401	740
Loans provided		
CJSC Profit	75	55
CJSC Kazankovskaya Mine	-	20
OJSC SKM	-	2
Total	75	77
Loans repaid		
CJSC Profit	59	-
OJSC SKM	-	2
Other	-	1
Total	59	3
Bank charges		
OJSC CUB	5	12
Loans and overdrafts obtained		
OJSC CUB	85	36
Loans and overdrafts repaid		
OJSC CUB	84	40
Insurance payments		
OJSC SKM	28	37
Lease payments		
CJSC SKM-Invest	17	15

Balances	December 31, 2007	2006
Cash and cash equivalents		
OJSC CUB	115	151
Loans and overdraft facilities		
OJSC CUB	8	6
Loans provided		
CJSC Profit	78	57
CJSC Kazankovskaya Mine	45	39
Total	123	96
Accounts receivable		
CJSC Profit	1	13
LLC MMK Trans	6	4
Total	7	17
Accounts payable		
CJSC Profit	8	5
OJSC SKM	2	1
LLC MMK Trans	3	2
Total	13	8
Lease payable		
CJSC SKM-Invest	22	25

25. COMMITMENTS

In the course of carrying out its operations and other activities the Group enters into various agreements, which requires the Group to invest in or provide financing to specific projects or undertakings. In the opinion of the Group's management, these commitments are entered into under standard terms, which are representative of each project's feasibility and should not result in unreasonable losses for the Group.

As of December 31, 2006, the Group executed non-binding purchase agreements of approximately USD 2,834 million to acquire in future periods through 2007 – 2012 property, plant and equipment, coking coal, zinc and aluminum. As of December 31, 2007, the Group executed non-binding purchase agreements of approximately USD 16,689 million to acquire in future periods through 2008 – 2017 property, plant and equipment, coking coal, zinc, aluminum, iron ore and natural gas. Penalties are payable or receivable under these agreements in certain circumstances and where supply terms are not adhered to. Management does not expect such conditions to result in a loss to the Group.

In 2007, the Group executed a non-binding framework purchase agreement with its related party, CJSC Profit, to acquire in future periods through 2007 – 2011 metal scrap. The volume and prices are defined on a monthly basis.

In the past the Group has transferred social assets to local municipal authorities. The Group's management expects that the Group will continue to partly fund those social operations in the foreseeable future. These costs are recognized in the consolidated statement of operations and comprehensive income as incurred.

Operating leases

The land in the Russian Federation on which the Group's production facilities are located is owned by the State. The Group pays land tax based on the total area and the location of the land occupied. The amounts of land tax for the years ended December 31, 2007 and 2006 were approximately USD 26 million and USD 23 million, respectively.

The Group leases land through operating lease agreements, which expire in various years through 2054. Future minimum lease payments due under non-cancelable operating lease agreements as of December 31, 2007 were as follows:

Due in one year	2
Due in the second year	1
Due thereafter	5
	8

26. CONTINGENCIES

Issued guarantees

As of December 31, 2007 and 2006, the Group has provided financial guarantees for loans obtained by certain related and third party suppliers of the Group. The amounts related to the Group's financial guarantees were as follows:

	December 31,	
	2007	**2006**
Non-current		
Related parties	145	200
Third parties	76	37
	221	**237**
Current		
Related parties	40	1
Third parties	8	7
	48	**8**
Total	**269**	**245**

The Group's estimated maximum exposure to credit risk in the event of non-performance by other parties to these financial guarantees is represented by the contractual amounts disclosed above. The Group's management believes that the likelihood of material payments being required under these agreements is remote.

As of December 31, 2007 and 2006, the Group did not have any contractual commitments to extend financial guarantees, credit or other assistance.

Litigation

As of December 31, 2007 and 2006, the Group was subject to various lawsuits, claims and proceedings related to matters incidental to its business. In the opinion of the Group's management, there were no material unresolved adverse claims or other matters.

Russian business environment

As an emerging market, the Russian Federation does not possess a fully developed business and regulatory infrastructure including stable banking and judicial systems, which would generally exist in a more mature market economy. The economy of the Russian Federation is characterized by a currency that is not freely convertible outside of the country, currency controls, low liquidity levels for debt and equity markets, and continuing inflation. As a result, operations in the Russian Federation involve risks that are not typically associated with those in more developed markets. Stability and success of the Russian economy and the Group's business mainly depends on the effectiveness of economic measures undertaken by the government as well as the development of legal and political systems.

Tax contingencies

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

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

Environmental liabilities

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

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

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

27. DISPOSAL OF SUBSIDIARIES

On March 10, 2006, the Group disposed of its shareholding in CJSC Shakhtouchastok Uregolskiy, a subsidiary of the Group, to OJSC Coal Company Yuzhniy Kuzbass for a cash consideration of USD 7 million. The net assets of CJSC Shakhtouchastok Uregolskiy comprised property, plant and equipment with a net carrying amount of USD 7 million.

In December, 2007, CJSC A-Kapital, a wholly owned subsidiary of the Group, was liquidated due to a restructuring of the Group.

28. SUBSEQUENT EVENTS

In February 2008, Russian banks provided short-term RUB-denominated loans of USD 81 million, bearing interest of 6.15% per annum with maturity in August 2008.

In February and March 2008, Russian banks provided short-term USD-denominated loans of USD 204 million, bearing interest of 4.70% per annum with maturity in 2008.