



MMK FINANCE S.A.

(Incorporated in Luxembourg as a société anonyme with limited liability)

U.S.\$300,000,000 8 per cent. Guaranteed Notes due 2008

unconditionally and irrevocably guaranteed by

OJSC MAGNITOGORSK IRON & STEEL WORKS

(Incorporated in the Russian Federation as an open joint-stock company)

Issue Price: 98.992 per cent.

The U.S.\$300,000,000 8 per cent. Guaranteed Notes due 2008 (the “Notes”) will be issued by MMK Finance S.A. (the “Issuer”) and unconditionally and irrevocably guaranteed (the “Guarantee”) by OJSC Magnitogorsk Iron & Steel Works (“MMK” or the “Company”). Unless previously redeemed or purchased and cancelled, the Notes will be redeemed on 21 October 2008 (the “Maturity Date”) at their principal amount. The Notes are subject to redemption in whole at their principal amount together with interest accrued to but excluding the date of redemption at the option of the Issuer at any time in the event of certain changes affecting taxation in any Relevant Jurisdiction (as defined in the Conditions).

The Notes will bear interest from 21 October 2003 (the “Issue Date”) at the rate of 8 per cent. per annum payable semi-annually in arrear in equal instalments on 21 April and 21 October in each year, commencing on 21 April 2004.

Application has been made to list the Notes on the Luxembourg Stock Exchange.

Except as set forth herein, payments in respect of the Notes will be made without any deduction or withholding for or on account of taxes of any Relevant Jurisdiction (as defined in the Conditions). See “Taxation”.

An investment in the Notes involves a high degree of risk. Prospective purchasers should have regard to the considerations described under “Investment Considerations”. The Notes are of a specialist nature and should only be bought and traded by investors who are particularly knowledgeable in investment matters.

THE NOTES AND THE GUARANTEE HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933 (THE “SECURITIES ACT”) AND THE SECURITIES ARE SUBJECT TO U.S. TAX LAW REQUIREMENTS. SUBJECT TO CERTAIN EXCEPTIONS, NOTES MAY NOT BE OFFERED, SOLD OR DELIVERED WITHIN THE UNITED STATES OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, U.S. PERSONS (AS DEFINED IN REGULATION S UNDER THE SECURITIES ACT (“REGULATION S”)).

The Notes will initially be represented by a temporary global Note (the “Temporary Global Note”), without interest coupons, which will be deposited with a common depository for Euroclear Bank S.A./N.V. as operator of the Euroclear System (“Euroclear”) and Clearstream Banking, *société anonyme* (“Clearstream, Luxembourg”), on or about the Issue Date. Interests in the Temporary Global Note will be exchangeable, in accordance with its terms, for interests in a permanent global Note (the “Permanent Global Note” and, together with the Temporary Global Note, the “Global Notes”). Notes in definitive form will be issued only in the limited circumstances set out in the Global Notes.

Joint Lead Managers

ABN AMRO

UBS INVESTMENT BANK

Senior Co-Lead Manager

ROSBANK SWITZERLAND S.A.

Co-Lead Managers

ALPHA BANK

**RZB – AUSTRIA RAIFFEISEN
ZENTRALBANK ÖSTERREICH**

Co-Managers

PAREX BANK

**TRUST INVESTMENT BANK UBM – UNICREDIT BANCA
MOBILIARE**

Financial Advisers to MMK
INVESTMENT COMPANY “RFC”

The date of this Offering Circular is 14 October 2003.

The Issuer and the Company, each having made all reasonable enquiries, confirm that this Offering Circular contains all information with respect to the Issuer, the Company, and the Company and its subsidiaries and affiliates taken as a whole (the “MMK Group” or the “Group”), the Guarantee and the Notes which is material in the context of the issue and offering of the Notes, the statements contained in it relating to the Issuer, the MMK Group and the Company are in every material particular true and accurate and not misleading, the opinions and intentions expressed in this document with regard to the Issuer, the MMK Group and the Company are honestly held, have been reached after considering all relevant circumstances and are based on reasonable assumptions, there are no other facts in relation to the Issuer, the MMK Group, the Company, the Guarantee or the Notes the omission of which would, in the context of the issue and offering of the Notes and the giving of the Guarantee, make any statement in this document misleading in any material respect and all reasonable enquiries have been made by the Issuer and the Company to ascertain such facts and to verify the accuracy of all such information and statements.

Each of the Issuer and the Company accepts responsibility for the information contained in this Offering Circular relating to it. To the best of their knowledge and belief (having taken all reasonable care to ensure that such is the case), the information relating to themselves contained in this Offering Circular is in accordance with the facts and does not omit anything likely to affect the import of such information.

This Offering Circular is being distributed only to and is directed at (a) persons outside the United Kingdom, (b) persons who have professional experience in matters relating to investments who fall within Article 19(1) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (the “Order”) or (c) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(1) of the Order (all such persons together being referred to as “relevant persons”). The Notes are available only to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such Notes will be available only to or 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.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of the Issuer or the Company or the Managers (as defined in “Subscription and Sale”) to subscribe for or purchase, any of the Notes in any jurisdiction in which such offer or invitation is not authorised or would be unlawful. The distribution of this Offering Circular and the offering of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Issuer, the Company and the Managers to inform themselves about and to observe any such restrictions. None of the Issuer, the Company or the Managers has authorised any offer of Notes to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 (the “Regulations”). Notes may not lawfully be offered or sold to persons in the United Kingdom except in circumstances which do not result in an offer to the public in the United Kingdom within the meaning of the Regulations or otherwise in compliance with all applicable provisions of the Regulations. For a description of certain further restrictions on offers and sales of the Notes and distribution of this Offering Circular, see “Subscription and Sale”.

Neither of the Managers makes any representation, express or implied, or accepts any responsibility, with respect to the accuracy or completeness of any of the information in this Offering Circular. This Offering Circular is not intended to provide the basis of any credit or any other evaluation and should not be considered as a recommendation by any of the Issuer, the Company or the Managers that any recipient of this Offering Circular should purchase the Notes. Each potential purchaser of Notes should determine for itself the relevance of the information contained in this Offering Circular and its purchase of Notes should be based upon such investigation as it deems necessary.

Potential investors should not consider the information in this Offering Circular to be investment, legal or tax advice and should consult their own legal, accountancy and other advisers for legal, tax, business, financial and related advice regarding any investment in the Notes. None of the Issuer, the Company or the Managers is making any representation to any offeree or purchaser of the Notes regarding the legality of, or appropriateness of an investment in, the Notes by such offeree or purchaser under applicable investment or similar laws and regulations.

No dealer, salesperson or other person has been authorised by the Issuer, the Company or either of the Managers to issue any advertisement or to give any information or make any representation in connection with the offering of the Notes other than those contained in this Offering Circular and, if issued, given or made such advertisement, information or representation must not be relied upon as having been authorised by or on behalf of the Issuer, the Company or either of the Managers. The

delivery of this Offering Circular at any time does not imply that there has been no change in the affairs of the Issuer, the Company or the MMK Group since the date hereof or that the information contained in it is correct as at any time subsequent to its date.

None of the Issuer, the Company, the Managers or any of their respective representatives is making any representation to any offeree or purchaser of the Notes regarding the legality of an investment by such offeree or purchaser under appropriate legal investment or similar laws. Each investor should consult with his own advisers as to the legal, tax, business, financial and related aspects of purchase of the Notes.

IN CONNECTION WITH THIS ISSUE, ABN AMRO BANK N.V. (OR ANY PERSON ACTING ON ITS BEHALF) MAY OVER-ALLOT OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE NOTES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL FOR A LIMITED PERIOD AFTER THE ISSUE DATE OF THE NOTES. HOWEVER, THERE MAY BE NO OBLIGATION ON ABN AMRO BANK N.V. (OR ANY PERSON ACTING ON ITS BEHALF) TO DO THIS. SUCH STABILISING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME, AND MUST BE BROUGHT TO AN END AFTER A LIMITED PERIOD.

PRESENTATION OF FINANCIAL AND OTHER INFORMATION

Presentation of Financial Information

This Offering Circular includes audited consolidated financial statements of the Company and its subsidiaries as at and for the years ended 31 December 2002, 2001 and 2000, half-year unaudited consolidated financial statements of the Company and its subsidiaries for 2003 and 2002 and the auditors' review of those statements. The audited consolidated financial statements of the Company and its subsidiaries contained in this Offering Circular have been prepared in accordance with International Financial Reporting Standards ("IFRS") as promulgated by the International Accounting Standards Board ("IASB").

The IFRS financial statements of the Company and its subsidiaries have been audited by the MMK Group's independent auditors, KPMG Limited, Moscow ("KPMG"), independent certified public auditors, located at 11 Gogolevsky Boulevard, 119019 Moscow, Russian Federation. The annual and semi-annual interim IFRS financial statements of the Company and its subsidiaries are set forth elsewhere in this Offering Circular and are available free of charge at the specified office of the Paying Agent in Luxembourg as described in "General Information".

The Company and its subsidiaries prepares IFRS interim consolidated financial statements for the six months to 30 June, and the Company prepares non-consolidated quarterly financial statements in accordance with Russian Accounting and Reporting Rules. KPMG have reviewed the half-yearly consolidated financial statements of the Company and its subsidiaries for the six months ended 30 June 2003 and 2002.

The IFRS consolidated financial statements of the Company and its subsidiaries apply the U.S. dollar as its measurement currency. The Company therefore incurs foreign currency risk on transactions and borrowings that are denominated in a currency other than the U.S. dollar. See "Investment Considerations – Currency of accounts".

The statutory financial statements dated 31 December 2002 of the Issuer have been audited by KPMG Audit Réviseurs d'Entreprises, 31, Allée Scheffer, L-2520 Luxembourg in accordance with Luxembourg law and are incorporated by reference in this Offering Circular. Copies of these accounts are available free of charge at the specified office of the Paying Agent in Luxembourg as described in "General Information". The Issuer does not currently prepare IFRS financial statements.

Currency

In this Offering Circular, the following currency terms are used:

- "U.S. dollar", "dollar", or "U.S.\$" means the lawful currency of the United States;
- "RUR", "Rouble" or "rouble" means the lawful currency of the Russian Federation; and
- "EUR", "euro" or "€" means the lawful currency of the Member States of the European Union that adopted the single currency in accordance with the Treaty of Rome establishing the European

Economic Community, as amended by the Treaty on the European Union, signed at Maastricht on 7 February 1992.

Rounding and Currency Conversions

Some numerical figures included in this Offering Circular have been subject to rounding adjustments. Accordingly, numerical figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that precede them.

This document contains conversions of certain amounts into U.S. dollars solely for the convenience of the reader. The U.S. dollar amounts have been translated from the rouble amounts at the rate published by the Central Bank of Russia (“CBR”) applicable to the particular date, or the average CBR rate applicable to the particular period, to which such rouble figures relate. For the years 2000, 2001 and 2002 the weighted average RUR/U.S.\$ relevant exchange rate was, respectively, RUR 28.12, 29.17 and 31.35: U.S.\$1. No representation is made that the rouble or U.S. dollar amounts referred to herein could have been or could be converted into roubles or U.S. dollars, as the case may be, at these rates, any particular rate or at all.

Market Data

This Offering Circular (including in particular “Overview of the Steel Industry”) includes market data and industry forecasts and projections which have been obtained from internal surveys, market research, publicly available information and industry publications. Industry publications generally state that the information they provide has been obtained from sources believed to be reliable, but that the accuracy and completeness of such information are not guaranteed. The forecasts and projections are based on industry surveys and the preparers’ experience in the industry, and there is no assurance that any of the forecasts or projections will be achieved. Similarly, information taken from surveys and market research has not been independently verified. The Issuer and the Guarantor accept responsibility for the correct extraction and reproduction of such data, forecasts, projections and other information.

FORWARD-LOOKING STATEMENTS

This Offering Circular contains “forward-looking statements” which relate to, without limitation, the Company’s plans, objectives, goals, strategies, future operations and performance. These forward-looking statements are characterised by words such as “anticipates”, “estimates”, “expects”, “believes”, “intends”, “plans”, “may”, “will”, “should” and similar expressions. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause circumstances or the Company’s actual results, performance or achievements to be materially different from any future circumstances, results, performance or achievements expressed or implied by such statements. Such forward-looking statements are inherently based on numerous assumptions regarding, among other things:

- the performance of the Russian economy;
- iron and steel prices;
- the Company’s expansion and acquisition plans;
- the impact of the Company’s expansion on its revenue potential, cost basis and margins;
- the Company’s ability to remain competitive in the iron and steel industry;
- the effects of regulatory and fiscal developments and legal proceedings;
- the Company’s debt and the impact of exchange rate fluctuations; and
- the Company’s ability to meet its obligations and develop and maintain additional sources of financing.

Accordingly, prospective purchasers of the Notes should not place undue reliance on these forward-looking statements. The important factors that could cause the Company’s actual results, performance or achievements to differ materially from those in these forward-looking statements include, but are not limited to, those discussed in “Investment Considerations” and “The MMK Group”. These forward-looking statements speak only as at the date of this Offering Circular. The Company expressly disclaims any obligation or undertaking to disseminate after the date of this Offering Circular any updates or revisions to any forward-looking statements contained herein to reflect any change in its expectation with

regard thereto or any change in events, conditions or circumstance on which any such forward-looking statement is based, unless required to do so by applicable law.

ENFORCEABILITY OF CIVIL LIABILITIES IN RUSSIA

The Company is an open joint-stock company organised under the laws of the Russian Federation (“Russia”). All of the directors and senior executive officers of the Company reside in Russia. As a result, it may not be possible for investors to effect service of process outside Russia upon the Company or such persons. Moreover, substantially all the assets of the Company and of such persons are located in Russia, and it may not be possible for investors to enforce in Russia judgments rendered against them, including judgments obtained in an English court. Judgments rendered by a court in any jurisdiction outside Russia will be recognised by courts in Russia only if an international treaty providing for the recognition and enforcement of judgments in civil cases exists between Russia and the country where the judgment is rendered. If there is such a treaty, Russian courts may nonetheless refuse to recognise and enforce a foreign court judgment on the grounds provided in such treaty and in Russian legislation in effect on the date on which such recognition and enforcement are sought. Furthermore, Russian legislation may be changed, *inter alia*, by way of inserting further grounds preventing foreign court judgments from being recognised and enforced in Russia. No such treaty exists between Russia and the United Kingdom.

The Notes, the Trust Deed, the Paying Agency Agreement and the Subscription Agreement each provides that any dispute between the parties thereto shall, in the absence of a Litigation Election (as defined therein), be finally settled by arbitration in accordance with the Rules of the London Court of International Arbitration, the seat of such arbitration being in London, England. The United Kingdom and the Russian Federation are parties to the United Nations (New York) Convention (the “New York Convention”) on the Recognition and Enforcement of Foreign Arbitral Awards. Consequently, an arbitral award from an arbitral tribunal in the United Kingdom should generally be recognised and enforced in the Russian Federation on the basis of the rules of the New York Convention. See “Investment Considerations – Legal Risks – Difficulty in enforcing foreign court judgments or arbitral awards”.

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SUMMARY OF THE NOTES

The following summary is qualified in its entirety by, and is subject to, the detailed information contained elsewhere in this Offering Circular. Certain terms used in this summary are defined elsewhere in this Offering Circular.

The Notes	U.S.\$300,000,000 8 per cent. Guaranteed Notes due 2008, which are being offered outside the United States to non-U.S. persons in reliance on Regulation S.
Issuer	MMK Finance S.A.
Status of the Notes	The Notes will constitute direct, unconditional and (subject as provided in Condition 3) unsecured obligations of the Issuer and shall at all times rank <i>pari passu</i> with all other outstanding, unsubordinated and unsecured obligations of the Issuer, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.
Guarantor	OJSC Magnitogorsk Iron & Steel Works
Guarantee	The due payment of principal, interest and all other amounts payable by the Issuer in respect of the Notes or under the Trust Deed has the benefit of a direct, unconditional and (subject as provided in Condition 3) unsecured and irrevocable Guarantee from the Company.
Status of the Guarantee	The obligations of the Company pursuant to the Guarantee shall at all times rank <i>pari passu</i> with all other present and future outstanding unsecured and unsubordinated obligations of the Company, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.
Issue Price	98.992 per cent.
Covenants	The Noteholders will have the benefit of certain covenants made by the Issuer and/or the Guarantor, all as fully set out in the Conditions.
Events of Default	For a description of certain events that will permit acceleration of the Notes, see “Terms and Conditions of the Notes – Events of Default”. Upon acceleration of the Notes as a consequence of any such event, the Notes will become immediately due and repayable at their principal amount, together with interest accrued to the date of redemption.
Interest	The Notes bear interest from 21 October 2003 at the rate of 8 per cent. per annum payable semi-annually in arrear in equal instalments on 21 April and 21 October in each year, commencing on 21 April 2004.
Taxation on Interest Payments	Under current law, all payments in respect of the Notes and the Guarantee will be made free and clear of, and without deduction of, or withholding for, any taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of any Relevant Jurisdiction (as defined in the Conditions), unless withholding or deduction is required by law. In such event, additional payments will be made by the Issuer or, as the case may be, the Company subject to customary exceptions as described in “Terms and Conditions of the Notes – Taxation”.
Maturity Date	Unless previously redeemed or purchased and cancelled, the Notes will be redeemed at their principal amount on 21 October 2008.

Tax Redemption	The Issuer may redeem all but not some only, of the Notes at their principal amount, together with interest accrued to the date of redemption, in the event that certain changes in taxation in any Relevant Jurisdiction result in additional payments being required as further described in “Terms and Conditions of the Notes – Taxation”.
Payment, Delivery and Settlement	<p>Payment for and delivery of the Notes is expected to be made on or about 21 October 2003.</p> <p>The Notes will settle against payment in U.S. dollars through the facilities of Euroclear and Clearstream, Luxembourg.</p>
Form of the Notes	<p>The Notes will be in bearer form and will be issued initially in the form of a Temporary Global Note without coupons attached.</p> <p>The Temporary Global Note will be exchangeable in accordance with its terms, for interests in the Permanent Global Note. Notes in definitive form will be issued only in the limited circumstances set out in the Conditions. Notes will be sold to investors in reliance on Regulation S and will be represented by the Global Notes deposited with a common depository for Euroclear and Clearstream, Luxembourg.</p>
Codes	<p>ISIN: XS0177503058</p> <p>Common Code: 017750305</p>
Trustee and Principal Paying Agent	The Bank of New York, London Branch
Paying Agent and Listing Agent	The Bank of New York (Luxembourg) S.A.
Governing Law of the Notes and the Trust Deed	English law. The provisions of Articles 86 to 94-8 of the Luxembourg Law on Commercial Companies of 10 August 1915, as amended, are excluded.
Listing and Market for the Notes	Application has been made to list the Notes on the Luxembourg Stock Exchange.
Rating	Both this issue of Notes and the long-term debt of the Company have been rated at Ba3 (positive) by Moody’s Investors Service, Inc. (“Moody’s”), B (positive) by Standard & Poor’s Ratings Service, a division of The McGraw-Hill Companies, Inc. (“Standard & Poor’s”) and BB- (stable) by Fitch Ratings Ltd (“Fitch”). A rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by Moody’s and/or Standard & Poor’s and/or Fitch. A suspension, reduction or withdrawal of either or both of the ratings assigned to the Notes or the Company may adversely affect the market price of the Notes.
Investment Considerations	Prospective investors should carefully consider certain risks connected with an investment in Notes as discussed under “Investment Considerations”.
Selling Restrictions	United States, United Kingdom, Russian Federation, Republic of Italy and Luxembourg. See “Subscription and Sale”.
Use of Proceeds	The net proceeds of the issue of the Notes by the Issuer are expected to be approximately U.S.\$294,100,000 million after deduction of a management and underwriting and selling concession, and other expenses of the offering of the Notes. The net proceeds will be lent to the Company by the Issuer by way of an intercompany loan (the “Intercompany Loan”) and will be used by the Company to refinance a portion of existing indebtedness incurred by the Company and to finance the Modernisation Programme.

INVESTMENT CONSIDERATIONS

Prior to making an investment decision, prospective purchasers of the Notes should carefully read the entire Offering Circular. Purchasers should consider, amongst other things, certain considerations, including those set out below, with respect to an investment in a Luxembourg company whose obligations under the Notes are guaranteed by a Russian company not normally associated with investments in the securities of issuers incorporated in the United States, the United Kingdom or certain other jurisdictions.

Investment Considerations Relating to the Company

There are a number of risks which may prejudice the Company's business results and affect its ability to pay under the Guarantee.

International market risks and trade barriers

Developments in the international steel market have an impact on the Company's overseas sales. As long as the global economic downturn and the weak situation in the international steel markets prevail, they will impact the Company's business. The existing trade restrictions in, *inter alia*, China, the United States ("U.S.") and European Union ("EU") markets make certain status improvements necessary, such as Russia's admission to the World Trade Organisation ("WTO") and the recognition of Russia as a market economy, in order to strengthen the Company's international position.

There are trade barriers in several countries where the Company operates, and particularly in the European Union and China. The Company does not, at present, have a significant amount of business with the United States, due in part to trade barriers. See "Overview of the Steel Industry – Trade Barriers and Anti-Dumping Regulations". Future developments with respect to trade restrictions may materially reflect the Company's business.

Domestic risks relating to the Company

If the anticipated sustained growth of the Russian economy fails to materialise, there may be certain negative consequences for all Russian steel producing companies. A longer-term decline in international oil or gas prices may lead to alterations to the oil and gas companies' investment plans, which may, for example, result in the reduction of the demand for pipes.

However, in the event that sustained economic growth in Russia occurs, the Company may be adversely affected if the domestic economy and its actual and potential corporate customers do not restructure sufficiently quickly and do not require its higher quality and value-added products.

Exchange rate fluctuations

The Company's export revenues are generally denominated in U.S. dollars or euro, whilst expenditures are generally denominated in roubles. The impact of future exchange rate fluctuations in such currencies may adversely affect the Company's results of operations. Additionally, the rouble may be subject to exchange controls and may not be freely convertible or exchangeable, which may adversely affect the Company's results of operations.

In addition, to the extent that the Company pays in a currency and obtains payment for its products and services in another currency, its profit margins may be affected by exchange rate fluctuations and, to the extent the Company borrows in foreign currency, it will be exposed to any devaluation of the rouble. The Company does not currently use derivatives or other financial instruments to hedge against such risks. See "The MMK Group – Results of Operations", "– Finance" and "– Sales, Marketing and Customer Analysis".

Currency of accounts

The consolidated financial statements of the Company and its subsidiaries which are prepared in accordance with IFRS apply the U.S. dollar as its measurement currency. The Company therefore incurs foreign currency risk on transactions and borrowings that are denominated in a currency other than the U.S. dollar. The currencies giving rise to this risk are primarily the rouble and the euro. The Company mitigates against the devaluation of the rouble by ensuring a rouble denominated net monetary liability position is maintained. This is achieved through ensuring that a significant portion of sales are exported obtaining U.S. dollar receipts, holding these receipts in liquid U.S. dollar cash equivalents, and incurring a significant portion of the MMK Group's costs in roubles. See "The MMK Group – Finance".

Expanding and operating the Company's business

The production of steel is a capital intensive business. The Company will need additional capital to continue the Modernisation Programme and to maintain its business. The Company's ability to fund its strategies depends on its access to the debt and equity markets and its profitability. Significant elements of the Company's business strategy that may require substantial capital expenditures are described herein under "The MMK Group – The Modernisation Programme".

In addition, the Company will need to maintain its existing infrastructure. The costs of expanding and maintaining its infrastructure may exceed projected costs and result in unforeseen deficits. If the Company fails to generate sufficient funds from its operating cash flow and debt or equity financing, it may have to delay the Modernisation Programme. If the Company cannot obtain adequate financing on acceptable terms, it may be unable to take advantage of opportunities or to meet unexpected financial requirements. Additional funds may be raised by the Company through debt or equity financing which may increase its leverage or affect its current share ownership. Medium-term and long-term debt financing in Russia on commercially acceptable terms is currently difficult to obtain, and availability of such financing in the future is uncertain. If the Company cannot obtain adequate funds to satisfy its capital requirements, it may need to limit its operations significantly, which could negatively impact the Company's market share and operating results.

The Company may not be able to meet its planned needs in the event of slower than anticipated revenue growth, regulatory developments or a deterioration in the Russian economy.

The Modernisation Programme

The Company's results of operations have been and will continue to be affected by its ability to implement the Modernisation Programme (see "The MMK Group – The Modernisation Programme"). The Company's existing capacity for certain products (such as high-end and value-added products) may not be sufficient to meet growth in demand if recent trends continue. In addition, the Company continually evaluates opportunities for expanding its range of products and increasing the proportion of value-added products that it produces. The Modernisation Programme generally involves engineering, construction, regulatory, financing and other risks that may delay or prevent the successful completion or operation of these projects or significantly increase construction costs. Accordingly, no assurances can be given that the Company will be able to complete the various projects within the Modernisation Programme at the expected cost or on schedule or that such facilities will operate at design capacity or at expected production cost levels. In addition, no assurance can be given that the Company will be able to sell its increased production of value-added products at favourable prices.

Environmental considerations

The Company is involved in an industry which may be hazardous to the environment and require compliance with more stringent regulatory requirements. The government of the Russian Federation (the "Government") and regulatory authorities in jurisdictions where the MMK Group has operations have the power to take action against the MMK Group companies for failure to comply with applicable environmental regulations, including the imposition of fines or revocation of licences or concessions, as well as the power to impose further significant restrictions or controls on the MMK Group's operations. Although the Company believes that its operations are currently in compliance with applicable regulations, there can be no assurances that the Government or other regulatory authorities will not impose additional regulations which could require significant expenditures to comply with such regulations. See "The MMK Group – Environmental Liabilities".

Environmental regulations are currently under consideration in the Russian Federation and the Company is continually 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.

Variability of financial results

The Company's results of operations are substantially affected by variations in the realised sales prices of its products, which in turn depend both on prevailing prices for metal and demand for particular products. Operating results have been, and in the future will be, affected by numerous factors, including the prices and availability of raw materials, particularly iron ore, coal and steel scrap and scrap substitutes, the demand for and prices of the Company's products, the level of competition, the level of unutilised capacity in the steel industry, the mix of products sold by the Company, the timing and pricing of large

orders, the integration and modification of facilities and other factors. There can be no assurance that these events and circumstances or other events or circumstances, such as seasonal factors like weather, disruptions in transportation, energy or the Company's customers' industries or an economic downturn adversely affecting the metal industry, generally, or the Company, in particular, will not occur, any of which could have a material adverse effect on the Company. See "The MMK Group – Results of Operations".

Maintenance of social and physical infrastructure in the Magnitogorsk area

The Company has been responsible for establishing a large proportion of the social and physical infrastructure in and around the City of Magnitogorsk. Although in recent years the economy of the Magnitogorsk area has become more diversified with the development of other industries, the region remains economically dependent on the Company's business to a significant degree. The Company is by far the largest employer within Magnitogorsk, and it estimates that its payments to Magnitogorsk account for the majority of the City's total budget. The Company expects that the City of Magnitogorsk may continue to rely on the Company for a substantial portion of its budget and that it will continue to need to maintain the social, employment, and welfare infrastructure in the Magnitogorsk area. See "The MMK Group – Social Projects and Commitments in Magnitogorsk".

Raw material and energy consuming industry

Steel production activities consume raw materials such as iron ore, coal, coke, scrap metal, nickel, ferro-manganese and silico-manganese alloys and zinc. Although the Company maintains diversity in its sources of supply and, save for natural gas, keeps stocks sufficient to minimise the impact of potential disruptions in supply, no assurance can be given that its sources of supply will consistently deliver in amounts and on schedule. Any failure of supply could have a material adverse effect on the business and operations of the MMK Group. Raw materials and energy constitute major items of expenditure for the Company.

Key suppliers

While the Company considers its supply of necessary raw materials to be stable, possible supplier alliances could represent a threat to the Company with respect to pricing. Many of the Company's domestic competitors have control over supplies of iron ore and coal. See "The MMK Group – Procurement of Raw Materials and Suppliers". OAO Karelskiy Okatysh (ore supplier), OAO Olenogorskiy GOK (ore supplier) and OAO Kuzbassugol (coke supplier) are controlled by OAO Severstal. Steel manufacturers OAO Mechel and OAO BMK are controlled by the coal company OAO South Kuzbass.

The Company is dependent on its relationships with its core suppliers of iron ore, coal, coke, scrap metal and gas and accordingly structures such relationships in order to minimise such dependence. The Company has contracts (as is usual in Russia, typically of one year) with all principal ore and coal suppliers. Substantially all of the Company's coke is supplied by a wholly-owned subsidiary, ZAO RMK, which processes coal concentrate (purchased in the market by the Company) into coke. Lime and dolomite are mined by a division of the Company. Should the Company's relationships with any of its key suppliers deteriorate or one of its supply contracts terminate early or not be renewed on a timely basis, the Company's ability to operate its business may be adversely affected. See "The MMK Group – Procurement of Raw Materials and Suppliers".

In addition, the pricing policy pursued by the so-called natural monopolies, especially the railways and gas suppliers is regulated by the Government. In the event that railway transportation costs increase, such additional costs will be shared between the Company and its suppliers.

Cost of raw materials

The Company's principal raw materials are (a) iron ore, (b) coal concentrate for coking and (c) scrap iron. The prices for such raw materials are subject to market forces largely beyond the control of the Company, including demand by other international metal producers, freight costs and speculation, which have varied significantly and may vary significantly in the future. In addition, the Company's operations require substantial amounts of other raw materials, including various types of limestone, alloys, refractories, oxygen, fuel and gas, the price and availability of which are also subject to market conditions. The Company may not be able to adjust its product prices, especially in the short term, to recover the costs of increases in iron ore, coal concentrate, scrap and other raw material prices. The Company's future profitability may be adversely affected to the extent it is unable to pass on higher raw material and

energy costs to its customers. As a result of climatic conditions in its area of operations, the Company is required to stockpile certain raw materials during the winter to ensure that the Company can maintain its production through this period. See “The MMK Group – Procurement of Raw Materials and Suppliers”.

Cyclical nature of steel industry and end user markets

The steel industry is highly cyclical in nature and sensitive to general economic conditions. The financial condition and results of operations of companies in the steel industry are generally affected by macroeconomic fluctuations in the local and global economies. The steel market has traditionally shown cyclical trends resulting in particular from the influence of macroeconomic conditions on demand for steel products and the recurrent imbalance between steel production and demand. The Company is particularly sensitive to trends in the construction, automotive, oil and gas industries because these industries are primary markets for the Company’s steel products. See “The MMK Group – Results of Operations” and “– Procurement of Raw Materials and Suppliers” .

Competition

The steel industry is highly competitive. Steel producers are also in competition with producers of substitute materials, particularly in the automotive, construction and packaging industries. The Company competes primarily on the basis of price, quality and the ability to meet customers’ product specifications and delivery schedules. The Company’s competitors include foreign steel producers which are larger, have substantially greater capital resources and experience, and, in some cases, have lower raw material costs than the Company. Domestic competitors may have competitive advantages in terms of location and access to key suppliers and transport routes. See “The MMK Group – Market and Competitors”. The highly competitive nature of the industry, combined with excess capacity in some products, has exerted and may in the future continue to exert downward pressure on demand for certain of the Company’s products. There can be no assurance that the Company will be able to compete effectively in the future. Intensity of competition and cyclical steel markets result in significant variations in economic performance which may lead to a decrease in expected profits and even to losses, which would affect the steelmaking industry as a whole, including the Company.

The Company is operating in recently liberalised markets in a highly competitive industry. The Company expects its competitors continually to improve their products while also reducing their prices. The Company’s success will depend on its ability to compete effectively in this environment.

The Company cannot guarantee that if the competitors start producing the same product range as the Company, the Company will not lose its major customers. Some of the Company’s competitors have substantially greater financial, marketing and other resources than the Company. If the Company’s competitors devote significant resources to entering the Company’s markets, reducing prices or pursuing the Company’s customer base, the Company may not be able to compete effectively.

Heavy industry

The Company operates in an industrial environment where most of its movable assets may be affected by technical problems or accidents which may lead to the interruption of its operations and have a negative impact on production. See “The MMK Group – Insurance” and “– Health and Safety”.

Interested party transactions

The Company and its principal shareholders have engaged in transactions with affiliated parties and the covenants set out in the Conditions permit the Company to continue to do so. For example, the Company has engaged in transactions with certain of its directors and executive officers and companies controlled by them, including, *inter alia*, equity purchases and sales, supply contracts, loan arrangements, guarantees in relation to real property acquisitions and loans. Conflicts of interest may arise between the Company and its affiliates, resulting in the conclusion of transactions on terms that may not be at fair market value. Certain of such transactions constitute “interested party transactions” under Russian law.

Under the Russian Joint-Stock Companies Law, the definition of an “interested party” includes members of the board of directors and members of any management body of a company, a managing company, the CEO of the company and any person that owns, together with that person’s relatives and affiliates, at least 20 per cent. of the company’s voting shares or a person who otherwise has the right to give mandatory instructions to the company if any of the above listed persons, or a close relative or affiliate of such person, is:

- a party to, or a beneficiary of, a transaction with the company, whether directly or as a representative or intermediary; or
- the owner of at least 20 per cent. of the shares in the company that is a counterparty to a transaction, whether directly or as a representative or intermediary, or a beneficiary to a transaction; or
- a member of the board of directors or any management body or managing company of the company that is a counterparty to a transaction, whether directly or as a representative or intermediary, or a beneficiary to a transaction.

Russian law requires approval by a majority vote of “disinterested directors” or of “disinterested shareholders” for interested party transactions. In many cases, it may not be possible for the Company to obtain the necessary approvals. If the Company is unable to obtain necessary approvals for transactions within the Group, such transaction will be voidable and may be challenged in court by the Company or any of its shareholders.

In addition, the concept of “interested parties” is defined with reference to the concepts of “affiliated persons” and “group of persons”, which are subject to different interpretations under Russian law. Moreover, the provisions of Russian law defining which transactions must be approved as “interested party” transactions are subject to different interpretations. It is not certain that the Company’s compliance requirements will not be subject to challenge. Any successful challenge could result in the invalidation of transactions that are important to the Company’s business. Under the Conditions, the Company may continue to engage in transactions on terms that may not be at market value.

Transfer pricing rules

Russian transfer pricing rules entered into force in 1999, giving the tax authorities the right to control prices for transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions, barter transactions or transactions with significant price fluctuations. The transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by tax authorities and arbitration courts. The Company believes that the prices used by the MMK Group are market prices and, therefore, comply with the requirements of Russian tax law on transfer pricing. However, due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge the MMK Group’s prices and propose adjustments. If such price adjustments are implemented, the MMK Group’s future financial results could be adversely affected. Although the Company has accordingly created reserves in its IFRS accounts against such risk, there can be no assurances that these reserves will prove to be adequate.

Privatisation and share ownership

The Company was privatised in 1992. See “The MMK Group – Privatisation and History of Share Ownership”. To the extent that privatisation legislation has been vague, inconsistent and conflicting with other applicable legislation, and with inconsistencies even between federal and local privatisation legislation, most, if not all, privatisations were arguably deficient and therefore were vulnerable to challenge at least on formal grounds.

No action has been taken towards the invalidation of the Company’s status as a privately-owned company and, currently, there are no material pending challenges to the privatisation of the Company. In the event that the Company is subject to challenge as having been improperly privatised and is unable to defeat such claims, the Company might suffer material adverse effects on its business, financial condition and results of operations. The history of the Company’s share ownership is further described in “The MMK Group – Privatisation and History of Share Ownership”.

Current management of the Company indirectly control voting rights in relation to approximately 58 per cent. of the Company’s outstanding ordinary shares, by holdings of shares in the Company by subsidiaries and trust management arrangements in relation to holdings of other shareholders. As a result, the current management of the Company have the ability to exert significant influence over certain actions requiring shareholder approval, including, but not limited to, the election of directors, the declaration of dividends, appointment of management and other policy decisions. For example, although the management of the Company have not done so in the past and the Company does not expect them to do so in the future, the management of the Company could cause the Company to pursue acquisitions and other transactions or to make large dividend payments or other distributions or payments to shareholders that are intended to enhance the value of the equity interests held by the Company, even though such transactions may involve increased risk for Noteholders. The interests of the management may, in some circumstances,

conflict with the interests of the Noteholders, and it may make the Company take actions that materially adversely affect the Noteholders' investment.

The Russian Government has indicated that it wishes to privatise its remaining stake in the Company by the end of 2003. No further official announcement has been made and the terms and conditions of such privatisation are yet to be announced. Furthermore, it is unclear whether the shares will be sold to a single bidder or divided among a series of bidders. To the extent that such privatisation takes place, it is likely that affiliates of the Company will participate in any privatisation process. Whilst the 23.76 per cent. stake of MMK's ordinary share capital being sold does not confer by itself on the holder the right to block qualified majority decisions of the general shareholders' meeting of the Company, there can be no guarantee that, should an existing shareholder or a third party, including a competitor, acquire such stake following the privatisation, such shareholder or third party would not mount a hostile takeover. Further, should such shareholder or third party seek to gain control of the shares currently indirectly controlled by the management of the Company, this could result in litigation and other actions characteristic of hostile takeovers, which may adversely affect the Company's financial position and business. The Conditions contain only limited restrictions on the Company's ability to participate in such activities and do not contain a specific provision relating to a potential change of control of the Company.

Mergers and acquisitions

Whilst there are still a significant number of small companies operating in the steel sector worldwide, the 1990s were marked by an active consolidation process within the steel sector, through mergers and acquisitions including, in particular, the LNM Group, Arcelor, ThyssenKrupp Stahl and JFE. Growing competition worldwide has also led to accentuated conglomeration and consolidation in the Russian steel making industry. An example of this trend is the formation of OOO Evrazholding ("Evrazholding"), which controls such major steel mills as OJSC Nizhny Tagil Iron and Steel plant ("NTMK") and OJSC West Siberian Iron and Steel Plant ("ZapSib"). Such consolidation can be expected to continue. See "The MMK Group – Market and Competitors".

In recent years, the Company has increased its ownership interest in a number of companies and acquired other companies, businesses and production assets, including hardware and machinery subsidiaries. The Company continues to evaluate potential acquisitions and investment opportunities for the future, especially as the iron and steel sector continues to consolidate.

Any acquisition which the Company has completed or does complete is accompanied by the risks commonly encountered with acquisitions of companies, business or production assets, such as the difficulty of integrating the operations and personnel of the acquired business, problems with minority shareholders in acquired companies and their material subsidiaries, the potential disruption of the Company's own business, the assumption of liabilities relating to the acquired assets or businesses, the possibility that indemnification agreements with the sellers of such assets may be unenforceable or insufficient to cover potential liabilities, the imposition and maintenance of common standards, controls, procedures and policies, and the impairment of relationships with employees and counterparties as a result of difficulties arising out of integration. Furthermore, the value of any business the Company acquires or invests in may be less than the amount that the Company pays for it if, for example, there is a decline in the position of that business in the relevant market in which it operates or there is a decline in the market generally.

Such risks could lead to a negative effect on the ratings of the Company or its indebtedness or limit the ability of the Company to satisfy its obligations under the intercompany loans and the Guarantee.

Asset Sales

The Conditions contain certain restrictions on the sale of production assets. Under the Conditions, however, the Company is permitted to sell certain assets, including non-production assets and shares in MMK held by a subsidiary of MMK, which may result in a change in the ownership of MMK's share capital.

Transport

Due to its location in the southern Urals, the Company depends on railway transportation to distribute its products to both the export and domestic markets. Although railway transportation tariffs are subject to anti-monopoly control, historically they have tended to increase. Accordingly, the increase in railway transportation tariffs results in a corresponding increase in the transportation costs and may have an adverse effect on the operations of the Company.

Use of the Russian railway system exposes the Company to risks such as the disruption in transportation schedules due to the declining physical condition of Russian railway facilities and shortage of tank cars, theft of products during transportation, and spills, including those due to poorly maintained tank cars and train collisions. Additional costs and logistical constraints are imposed by the incompatibility of the Russian broad-gauge railway system with the railway systems of neighbouring countries. See “The MMK Group – Transport”.

Compliance with applicable laws

The application of the laws of any particular country is not always clear or consistent. This is particularly so in Russia and other CIS countries where the pace of legislative drafting has not always kept pace with the demands of the marketplace. These countries often have commercial practices and legal and regulatory frameworks that differ significantly from practices in the Western countries. As a result, it is often difficult to hire qualified management and accounting staff who can ensure compliance with changing legal requirements. If the Company or any of its subsidiaries or joint ventures are found to be involved in practices that do not comply with local laws or regulations, then the Company may be exposed, among other things, to significant fines, the risk of prosecution or the suspension or loss of its licences, authorisations or various permissions, any of which could have a material adverse effect on the Company.

Exposure to liabilities not covered by insurance

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. The Company insures its property, plant and equipment, constructions in progress and operational current assets against certain risks (see “The MMK Group – Insurance”). In addition, it insures against certain other risks, including those related to industrial accidents and civil liability but, however, does not insure its stock or against loss of profits. However, in the course of the Company’s business, certain claims may be brought against the Company relating to, amongst other things, personal injury, death or property damage caused by the Company’s operations. Accordingly, the Company may incur uninsured losses of assets and may be subject to a claim which is not covered, or not sufficiently covered, by insurance. Any such loss or claim may have a material adverse effect on the Company’s business, results of operations and financial condition.

Investment Considerations relating to Russia

The Company, and the majority of its subsidiaries, are located in Russia and the majority of the MMK Group’s business is conducted in Russia. There are certain matters relating to Russia, including political and economic considerations, that should be taken into account in forming any investment decision relating to the Notes.

Political Risks

Since 1991, Russia has been evolving from a communist state with a centrally planned economy to a democracy with a market economy. The process of political and economic reform has not been uninterrupted nor has it been completed, and no assurance can be given that the reform process will continue. The Russian political system remains vulnerable to social and ethnic unrest and any significant political instability could adversely affect the value of foreign investments in Russia and the Company’s ability to carry on its business. Until 2000, the Government was characterised by frequent change, having, in addition to the resignation of President Yeltsin on 31 December 1999 and the election of President Putin on 26 March 2000, experienced five changes in prime minister since March 1998. While President Putin has maintained Government stability and pursued policies generally oriented toward the continuation of economic reforms, no assurance can be given that such conditions will continue over time. State Duma elections are to be held at the end of 2003, and presidential elections in 2004. The value of investments in Russia, including investments in the Company, could be reduced if Government instability resumes or if political liberties or market-oriented reforms were to be curtailed.

The delineation of authority among Russia’s many regions, internal republics and the federal government as well as among the branches of Government is often uncertain and at times contested. Lack of consensus between local and regional authorities and the Government over numerous issues, including tax revenues, authority for regulatory matters and regional autonomy, often results in the enactment of conflicting legislation at various levels, and may result in political instability. Conflicts within the regions

or between the regions and the federal government may have negative economic effects on the Company and its ability to meet its financial obligations.

In addition, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions and, in certain cases, military conflict. Russian military and police forces have been engaged in Chechnya in the recent past and continue to maintain a presence there. In addition, groups associated with the Chechen opposition have committed various acts of terrorism in population centres in Russia, resulting in significant loss of life, injury and damage to property. To date, the Company, its premises and business have been geographically remote from these violence affected regions. The spread of violence, or its intensification, could have significant political consequences. These consequences may include the imposition of a state of emergency in some parts or throughout Russia. These events could have a material adverse effect on the investment environment in Russia.

The failure of some Russian public sector entities to pay full salaries on a regular and timely basis, and the failure of Russian public sector employees' salaries and benefits to keep pace with the increasing cost of living, could lead in the future to labour disputes and protests in the outlying regions of the Russian Federation. This may have political, social and economic consequences, such as increased support for a renewal of centralised authority, increased nationalism with restrictions on foreign involvement in the Russian economy and increased violence, any of which could have a material adverse effect on the Company.

Expropriation and nationalisation

The Government has enacted legislation to protect foreign investment and other property against expropriation and nationalisation. In the event that the Company's property is expropriated or nationalised, legislation provides for fair compensation. However, there can be no certainty that such protections would be enforced. This uncertainty is due to several factors, including the lack of state budgetary resources, the lack of an independent judiciary and sufficient mechanisms to enforce judgments and corruption among Government officials.

It is possible that due to a lack of experience in enforcing these provisions or due to political change, these protections may not be enforced in the event of an attempted expropriation or nationalisation. Some Government entities have tried to invalidate earlier privatisations. Expropriation or nationalisation of any of the Company's or its subsidiaries' assets, potentially with little or no compensation, would have a material adverse effect on the Company. The concept of property rights is not well developed in Russia and there is not a great deal of experience in enforcing legislation enacted to protect private property against nationalisation and expropriation. As a result, the Company may not be able to obtain proper redress in the courts, and may not receive adequate compensation if in the future the Government decides to nationalise or expropriate some or all of the Company's assets. If this occurs, the Company's business could be harmed.

Economic Risks

Reform initiatives

Since the late 1980s and early 1990s, the Government has been attempting to implement policies of economic reform and stabilisation. These policies have involved liberalising prices, reducing defence expenditures and subsidies, privatising state-owned enterprises, reforming the tax and bankruptcy systems, and introducing legal structures designed to facilitate private, market-based activities, foreign trade and investment. Despite the implemented reform policies, the Russian economy at times experienced declining industrial production, significant inflation, an unstable but managed currency, rising unemployment and underemployment, high Government debt relative to gross domestic product, high levels of *de jure* and *de facto* corporate insolvency, a weak banking system providing limited liquidity to Russian enterprises, widespread tax evasion and the penetration of organised crime into the economy.

The Russian economy has been subject to abrupt downturns. In particular, the Government's decision in August 1998 temporarily to stop supporting the rouble and servicing certain domestic and foreign debts caused the currency to collapse and led to a severe devaluation of the rouble, a sharp increase in the rate of inflation, the significant deterioration of the country's banking system, significant defaults on hard currency obligations, a dramatic decline in the prices of Russian debt and equity securities, and an inability to raise funds on international capital markets. While the Russian economy has improved in a number of respects since 1998, there can be no assurance that recent trends in the Russian economy will continue or will not be reversed.

Although economic conditions in Russia have recently improved, there is a lack of consensus as to the scope, content and pace of economic and political reform. No assurance can be given that reform policies will continue to be implemented and, if implemented, will be successful, that Russia will remain receptive to foreign trade and investment, or that the economy in Russia will continue to improve. Any failure of the current policies of economic reform and stabilisation could have a material adverse effect on the operations of the Company.

It is possible that Russia may default on its domestic or foreign debt in the future or take other actions that could adversely affect its financial stability. Further, the Government's failure to maintain access to funding from the International Monetary Fund ("IMF") or the World Bank could cause further financial strain and negatively impact the Company's business. If no IMF or World Bank financing is made available or if no agreement is reached with the Paris Club of sovereign creditors, the Government may not receive further financial support from other international organisations and foreign governments and may not be able to repay its debts. This is anticipated to be a particular concern later this year, when a significant increase will occur in the amount due to be repaid by the Government. Operating in such an economic environment makes it more difficult for the Company to obtain and maintain credit facilities, access international capital markets and obtain other financing to satisfy the Company's future capital needs.

Exchange rates, exchange controls and repatriation restrictions

In recent years, the rouble has experienced a significant depreciation relative to the U.S. dollar and there has been significant instability in the rouble exchange rate, particularly following the financial crisis of August 1998. Before August 1998, the Central Bank of Russia ("CBR") had been trying to support the rouble within a certain band. However, after the significant August 1998 devaluation of the rouble, the band was cancelled. The ability of the Government and the CBR to reduce the volatility of the rouble will depend on many political and economic factors, including their ability to control inflation and the availability of foreign currency. According to Government estimates, inflation in Russia was 20 per cent. in 2000, 19 per cent. in 2001 and 14 per cent. in 2002. The Government expects inflation to be in the 12-14 per cent. range for 2003. Although the rate of inflation has been declining, any return to heavy and sustained inflation could lead to market instability, new financial crises, reductions in consumer buying power and erosion of consumer confidence. Any one of these events could lead to a decreased demand for the Company's products.

The rouble is generally not convertible outside of Russia. A market exists within Russia for the conversion of roubles into other currencies, but it is limited in size and is subject to rules limiting such conversion. Currently, 25 per cent. of foreign currency revenues from export sales must be converted into roubles. The relative stability of the exchange rate of the rouble against the U.S. dollar since 1999 has mitigated risks associated with forced conversion. There can be no assurance that a relatively stable market will continue indefinitely. Current Russian law permits the Company to convert its roubles into foreign currency to make payments to meet its financial obligations, but there can be no guarantee that such conversion will be permitted in the future. Although the Company's export revenues are largely denominated in U.S. dollars, it may suffer exchange rate risks, especially in the light of the recent strengthening of the euro against the U.S. dollar. The Company does not use forwards and other currency hedging instruments. See "The MMK Group – Finance".

Russia's physical infrastructure continues to deteriorate

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 by, and subject to, disruption are rail and road networks, power generation and transmission systems, communication networks and building stock on which the Company's business depends. The Government is actively considering plans to reorganise the nation's rail, electricity and telephone systems. Any such reorganisation may result in increased charges and tariffs while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems. The continued deterioration of Russia's physical infrastructure will harm the national economy, disrupt the transportation of goods and supplies, add costs to doing business in Russia and may interrupt business operations, all of which could have a material adverse effect on the Company's business.

International sources of funding

Russia in the past has received substantial funding from several foreign governments and international organisations and through international capital markets transactions. After the events of August 1998, none of the above sources of financing was immediately available to Russia. While the Company is not aware of any effort by the Government to secure new funding, the value of investments in Russia could be adversely affected if the Government were to fail in an attempt to regain access to international sources of funding or the international capital markets. The occurrence of one or more of these factors could have a material adverse effect on the Company's ability to raise additional sources of external funding.

Restrictions on investments outside of Russia

Currency regulations established by the CBR restrict investments by Russian companies outside of Russia and in most hard-currency-denominated instruments in Russia, and there are only a limited number of rouble-denominated instruments in which the Company may invest its excess cash. Any balances maintained in roubles will give rise to losses if the rouble devalues against the U.S. dollar.

Banking transactions

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. Whilst the Company monitors the credit risks of all banks that it does business with on a continuous basis, there can be no assurance that such banks will remain solvent. A portion of the Company's funds are deposited with OAO Credit Ural Bank (see "The MMK Group – Certain Transactions"), which is an affiliate of the Company. The Company also deposits cash with other leading Russian banks and also invests in OAO Credit Ural Bank's promissory notes. Even where risks are reinsured in the international markets there can be no assurance that the Company's local insurers will have the financial resources to cover all claims made by the Company under its insurance policies.

Fluctuations in the global economy

Russia's economy could be adversely affected by market downturns and economic slowdowns elsewhere in the world. As has happened in the past, financial problems outside Russia 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. Additionally, because Russia produces and exports large amounts of oil, the Russian economy is particularly sensitive to the price of oil on the world market, and a decline in the price of oil could slow or disrupt the Russian economy. These developments could severely limit the Company's access to capital and could adversely affect the purchasing power of the Company's customers and thus the Company's business.

Lack of reliable official data

Official statistics and other data published by Russian federal, regional and local governments, and federal agencies are substantially less complete or reliable than those of Western countries, and there can be no assurance that the official sources from which certain of the information set forth herein has been drawn are reliable or complete. Official statistics may also be produced on different bases than those used in Western countries. Any discussion of matters relating to Russia herein may therefore be subject to uncertainty due to concerns about the completeness or reliability of available official and public information.

Taxation

Taxes payable by Russian companies are substantial and include value added tax, excise duties, profit taxes, payroll-related taxes, property taxes and other taxes. Historically, the system of tax collection has been relatively ineffective, resulting in the imposition of new taxes in an attempt to increase Government revenues. However, the Government has initiated reforms of the tax system that have resulted in some improvement in the tax climate.

Russia's tax laws and regulations are subject to frequent change, varying interpretations and inconsistent enforcement. In some instances, even though unconstitutional, Russian tax authorities have applied certain taxes retroactively. In addition to the usual tax burden imposed on Russian taxpayers, these conditions complicate tax planning and related business decisions. In addition, tax laws are unclear with respect to the deductibility of certain expenses. The uncertainty could possibly expose the Company to

significant fines and penalties and to enforcement measures despite its best efforts at compliance, and could result in a greater than expected tax burden.

In addition, transfer pricing legislation became effective in Russia on 1 January 1999. Under the Russian Tax Code, the tax authorities have the right to control prices of transactions of various types (“controlled transactions”) and impose additional tax liabilities, calculated on the basis of market prices and interest. Controlled transactions include transactions with related parties, barter transactions, international trade contracts and transactions between unrelated parties where the price deviates from the market price by more than 20 per cent. for identical goods within a short period of time, including transactions involving the trading of securities and derivatives. To date, there has been no formal guidance as to how these rules will be applied. If the tax authorities imposed significant additional tax liabilities as a result of transfer pricing adjustments, it could have a material adverse impact on the Company. Russia’s largely ineffective tax collection system and continuing budget requirements increase the likelihood that Russia will impose arbitrary or onerous taxes and penalties in the future, which could have a material adverse effect on the Company’s business, financial condition and results of operations.

It is expected that Russian tax legislation will become more sophisticated and introduce additional revenue – raising measures. Although it is unclear how these provisions will operate, introduction of these provisions may affect the Company’s overall tax efficiency and may result in significant additional taxes becoming payable. Although the Company will undertake to minimise such exposures with effective tax planning, it cannot offer any assurance that additional tax exposure will not arise while the Notes are outstanding. Additional tax exposure could cause its financial results to suffer.

Legal Risks

Weaknesses relating to the Russian legal system and Russian legislation

Russia is still developing the legal framework required by a market economy. Several fundamental Russian laws have only recently become effective. The recent nature of much of Russian legislation and the rapid evolution of the Russian legal system place the enforceability and underlying constitutionality of laws in doubt and result in ambiguities, inconsistencies and anomalies in their application. In addition, Russian legislation often leaves substantial gaps in the applicable regulatory regime. The following are some of the risks associated with the current Russian legal system:

- since 1991, Soviet law has been largely, but not entirely, replaced by a new legal regime as established by the 1993 Federal Constitution, the Civil Code and by other federal laws, and by decrees, orders and regulations issued by the President, the Government and federal ministries, which are, in turn, complemented by regional and local rules and regulations. These legal norms, at times, overlap or contradict one another;
- limited judicial and administrative guidance exists on the interpretation and application of Russian legislation;
- judges are relatively inexperienced in interpreting Russian legislation;
- a high degree of discretion exists on the part of Governmental authorities; and
- bankruptcy procedures are not well developed and are subject to abuse.

All of these factors could affect the Company’s ability to enforce its rights under contracts or to defend itself against claims by others.

Russian bankruptcy law

Russian bankruptcy legislation is new and developing and is subject to varying interpretations. As a result of limited court practice it is not possible to predict with certainty how claims of Noteholders against the Company would be resolved in the event of bankruptcy. In addition, the obligations of the Company to Noteholders would be subordinated to the following claims (“Priority claims”): (i) claims of the individual clients arising out of deposit and bank account agreements; (ii) workplace injury and moral damages obligations; severance pay, employment-related obligations and royalties.

In accordance with the Federal Law On Bankruptcy (Insolvency) dated 26 October 2002, claims of secured creditors are satisfied from the proceeds from the sale of the pledged assets in priority to unsecured creditors’ claims. Claims of creditors secured by pledges are subordinated to Priority claims if such claims arose prior to the creation of pledge; any obligations of secured creditors remaining unsatisfied following the sale of the pledged assets would be ranked as claims of unsecured creditors. These provisions, however, contradict the Civil Code, and their implementation remains untested.

In the event of the insolvency of the Company, Russian bankruptcy law could adversely affect the ability of the Trustee or the Noteholders to recover sums owed by the Company.

Difficulty in enforcing the Company's rights

The current status of the Russian legal system makes it uncertain whether the Company would be able to enforce its rights in disputes with the Company's joint venture partners or other parties. Furthermore, the dispersion of regulatory power among a number of Government agencies in Russia has resulted in inconsistent or contradictory regulations and unpredictable enforcement. The Government has rapidly introduced laws and regulations and has changed its legal structures in an effort to make the Russian economy more market-oriented, resulting in considerable legal confusion. No assurance can be given that local laws and regulations will become stable in the future. The Company's ability to operate in Russia could be adversely affected by difficulties in protecting and enforcing its rights and by future changes to local laws and regulations. Further, its ability to protect and enforce such rights is dependent on the Russian courts which are underdeveloped, inefficient and, in places, corrupt. Judicial precedents generally have no binding effect on subsequent decisions. Enforcement of court orders can in practice be very difficult in Russia. Additionally, court orders are not always enforced or followed by law enforcement agencies.

Difficulty in enforcing foreign court judgments or arbitral awards

The Russian Federation is not a party to any multilateral or bilateral treaties with most Western jurisdictions for the mutual enforcement of court judgments. Consequently, should a judgment be obtained from a court in any of such jurisdictions it is highly unlikely to be given direct effect in Russian courts. The Russian Federation (as successor to the Soviet Union) is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Accordingly, the Trust Deed (containing the Conditions) contains a provision allowing for arbitration of disputes. A foreign arbitral award obtained in a state which is party to that convention should be recognised and enforced by a Russian court (subject to the qualifications provided for in the convention and compliance with Russian civil procedure regulations and other procedures and requirements established by Russian legislation). It is possible that Russian procedural legislation will be changed, *inter alia*, by way of introducing further grounds preventing foreign court judgments and arbitral awards from being recognised and enforced in Russia. In practice, reliance upon international treaties may meet with resistance or a lack of understanding on the part of a Russian court or other officials, thereby introducing delay and unpredictability into the process of enforcing any foreign judgment or any foreign arbitral award in the Russian Federation.

Lack of independence of the judiciary

The independence of the judicial system and its immunity from economic, political and nationalistic influences in Russia remain largely untested. The court system is understaffed and underfunded. Judges and courts are generally inexperienced in the area of business and corporate law. Russia is a civil law jurisdiction and, as such, judicial precedents have no binding effect on subsequent decisions. In addition, most court decisions are not readily available to the public. All of these factors make judicial decisions in Russia difficult to predict and effective redress uncertain. Additionally, court claims are often used in furtherance of political aims. The Company may be subject to such claims and may not be able to receive a fair hearing. Additionally, court judgments are not always enforced or followed by law enforcement agencies. These uncertainties also extend to protection of property rights.

Shareholder liability under Russian legislation

The Civil Code and the Federal Law on Joint-Stock Companies generally provide that shareholders in a Russian joint-stock company are not liable for the obligations of the company and bear only the risk of loss of their investment. However, under Russian law, the Company may be jointly and severally liable for any obligations of its subsidiary or joint venture entity under a transaction if the Company has the ability to issue mandatory instructions to its subsidiary or joint venture entity and that ability is provided for by the charter of the subsidiary or joint venture entity or in a contract between the Company and them and the subsidiary or joint venture entity concluded the transaction pursuant to the Company's mandatory instructions.

In addition, the Company may have secondary liability for any obligations of its subsidiary or joint venture entity if the subsidiary or joint venture entity becomes insolvent or bankrupt due to the Company's actions or the Company's failure to act and the Company has the ability to make decisions for

the subsidiary or joint venture entity as a result of its ownership interest, the terms of a contract between the Company and them, or in any other way.

In either of these circumstances, the shareholders of the subsidiary or joint venture entity may seek compensation from the Company for the losses sustained by the subsidiary or a joint venture entity if the Company knew that the action taken pursuant to its instructions or the failure to act would result in loss. This type of liability could result in significant obligations and adversely affect the Company's business.

Unlawful or arbitrary government action

Government authorities have a high degree of discretion in Russia and at times exercise their discretion arbitrarily, without hearing or prior notice, and sometimes in a manner that is contrary to law. 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 or arbitrary Government actions have included withdrawal of licences, sudden and unexpected tax audits, criminal prosecutions and civil actions. Federal and local government entities have also used common defects in matters surrounding the documentations of financing activities as pretexts for court claims and other demands to invalidate such activities and/or to void transactions, often for political purposes. Unlawful or arbitrary Government action, if directed at the Company, could have a material adverse effect on its business and on the value of the Notes.

Regulation of Russian capital markets

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. Disclosure and reporting requirements, anti-fraud safeguards, insider trading restrictions and fiduciary duties are relatively new to Russia and are unfamiliar to most Russian companies and managers. In addition, Russian corporate and securities rules and regulations can change rapidly, which may adversely affect the Company's 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 the Company. As a result, the Company may be subject to enforcement measures, which could adversely affect the Company's business.

Shareholder rights provisions under Russian law

Russian law provides that shareholders of a company that vote against or abstain from voting on certain matters have the right to sell their shares to such company at market value, as determined in accordance with Russian law. The decisions that trigger this right to sell shares include:

- a reorganisation;
- the approval by shareholders of a "major transaction", which, in general terms, is a transaction involving property worth more than 25 per cent. of the book value of such company's assets calculated according to Russian accounting standards, regardless of whether the transaction is actually consummated; and
- the amendment of such company's charter in a manner that limits shareholder rights.

The obligation to purchase the shares is limited to 10 per cent. of such company's net assets calculated, according to Russian accounting standards, at the time the matter at issue is voted upon. Obligations of the Company or its subsidiaries to purchase shares in these circumstances could have an adverse effect on the Company's cash flow and its ability to service its indebtedness.

Investment Considerations Relating to an Investment in the Notes

The Company's indebtedness could adversely affect its financial condition

The Company's ability to make payments on and to finance its debt will depend on its ability to generate cash in the future. The ability to generate cash is, to a certain extent, beyond the Company's control. Accordingly, the Company cannot provide any assurance that it will generate sufficient cash from operations or additional financing activities to meet debt service obligations and liquidity needs in the future or that subsidiaries of the Company will be able to transfer assets to the Company for such debt obligations and liquidity needs. In addition, future borrowings may not be available to the Company in an

amount sufficient to enable it to fund its liquidity needs or to make the required payments on its debt in the future.

The Company may need to refinance all or a portion of its existing indebtedness, as well as the Notes, on or before maturity. The Company may not be able to refinance existing indebtedness and, even if it can, the terms of such refinancing might be less favourable than the terms of existing indebtedness, which could have a material adverse effect on the Company's business, results of operations or financial condition.

Both the Company and the Issuer are dependent on intercompany cash flow

The Issuer is a special purpose financing entity with no business operations other than the issuance of debt securities, including the Notes, and the lending of the proceeds of such offerings by it under the intercompany loans (or similar agreements to be concluded in the future). Intercompany loans (and similar agreements to be concluded in the future) and payments by the Company thereunder comprise the only significant assets of the Issuer. Accordingly, the Issuer will rely on payments the Company must make under intercompany loans to provide the necessary funds for it to pay principal and interest on the Notes and to pay its other expenses. Therefore, the Issuer is subject to all risks to which the Company is subject, to the extent such risks could limit the ability of the Company to satisfy its obligations under the intercompany loans and perform its obligations under the Guarantee.

If the Company forfeits any of its CBR licences, breaches any of the terms of such licences or fails to receive such licences, it could suffer cash flow difficulties

Many transactions involving foreign currencies require transaction-specific licences from the CBR. The application process for a CBR licence is potentially burdensome and time-consuming. The CBR may impose additional requirements or deny an application for such licences, which could harm the Company's business. A CBR licence may be required for certain financing activities, such as for the issuance of a guarantee in favour of a foreign third party or to create a foreign subsidiary, including finance subsidiaries. Such CBR licence has been obtained in connection with the offering of the Notes. The loss of a CBR licence, the breach of the terms of a CBR licence or the Company's failure to obtain CBR licences in the future could result in significant delays in purchasing equipment, cash flow difficulties and fines and penalties, and could result in a default by the Issuer on the Notes and a default by the Company under the Intercompany Loan. The loss of CBR licences relating to the offering of the Notes would affect, amongst other things, the Company's ability to meet its obligations under the Intercompany Loan and the Guarantee.

A CBR licence is required for the payment by the Company of amounts in U.S. dollars in respect of the Guarantee. The licence was issued to the Company on 23 September 2003. However, its effectiveness is subject to a written confirmation from the CBR. Although the Company expects to receive this confirmation within a relatively short period of time following the date of this Offering Circular, no assurance can be given in this regard, and, as at the date of this Offering Circular, the CBR licence has not become effective. If and for so long as the Company does not receive the written confirmation of licence effectiveness from the CBR, the licence will not be valid and effective so as to permit the Company to make payments under the Guarantee in U.S. dollars, and any payments under the Guarantee would be permitted to be made only in Roubles.

CBR regulations also restrict investments in most foreign currency-denominated instruments. Consequently, there are a limited number of low-risk instruments in which the Company can invest its excess cash. Putting its excess cash at risk could interfere with the Company's ability to conduct operations and could adversely affect its business.

The Company will have the ability to incur more debt, and this could increase the risks described above

The Company may decide to incur additional debt in the future. While the Conditions contain certain restrictions on its ability to incur additional debt, they nonetheless permit the Company to incur additional debt. If new debt is added to the Company's current debt levels, the magnitude of the related risks described above could increase, and the foregoing factors could have an adverse effect on the Company's ability to pay amounts due in respect of the Intercompany Loan and the Guarantee and, therefore, ultimately the Issuer's ability to pay amounts due in respect of the Notes.

Subordination of payments under the Guarantee

As of 31 December 2002, less than 15 per cent. of the total indebtedness of MMK and its subsidiaries was held by the consolidated subsidiaries of MMK. In general, claims of a subsidiary's creditors, including trade creditors, secured creditors and unsecured creditors holding indebtedness and guarantees issued by such subsidiary, will have priority with respect to the assets and earnings of that subsidiary over the claims of the creditors of its parent company (including holders of the Notes) as a shareholder, except to the extent that the parent is a valid creditor of that subsidiary under Russian law. The Guarantee, therefore, will effectively be subordinated to creditors, including trade creditors, of each of MMK's subsidiaries. In addition, the Guarantee will be subordinated to the claims of secured creditors of MMK who will have priority with respect to the assets and earnings of MMK over the claims of the unsecured creditors. Any additional indebtedness that MMK and/or its subsidiaries can raise under the Conditions may therefore be secured indebtedness and/or effectively senior to the claims of holders of the Notes. See "The MMK Group – Finance".

Limitations on the Company's ability to borrow and invest and to engage in certain transactions could impair its ability to expand or finance its future operations

The agreements that govern the Company's debt instruments, including the Conditions, contain certain restrictions limiting its flexibility in operating its business. Such restrictions limit or may limit its ability to:

- create liens;
- borrow money;
- sell or otherwise dispose of assets; and
- engage in mergers or consolidation.

These restrictions could hinder the Company's ability to carry out its business strategy, the Company's ability to make payments on the Intercompany Loan or Guarantee and the Issuer's ability to make payments of principal or interest on the Notes.

In addition, a breach of the Conditions or the terms of other debt instruments could cause a default under the terms of the Company's other financing arrangements, causing all debt under those financing arrangements to become due. No assurance can be given that if the indebtedness under the Notes were to be accelerated, the assets of the Company would be sufficient to generate the funds necessary to repay the Notes in full in satisfaction of its obligations under the Intercompany Loan or the Guarantee.

Insolvency and administrative laws in Russia and Luxembourg could negatively affect the ability of Noteholders to enforce their rights

Russian bankruptcy law may prohibit the Company from making payments pursuant to the Intercompany Loan or the Guarantee under certain circumstances. Specifically, Russian bankruptcy law provides that transactions or payments entered into or made at or after the time when a company becomes unable to pay its debts may be declared void by a Russian bankruptcy court. After such time, the subject company is prohibited from paying any debts outstanding prior to the bankruptcy proceedings, subject to specified exceptions. After the company becomes insolvent, creditors of that company may not pursue any legal action to obtain an order for payment of indebtedness, to set aside a contract for non-payment or to enforce the creditor's rights against any asset of the debtor. Contractual provisions, such as those contained in the Conditions, which would accelerate the payment of the debtor's obligations upon the occurrence of certain bankruptcy events, are not enforceable under Russian law. In addition, an administrator may renounce or set aside executory contracts, including the Conditions.

Additionally, if a bankruptcy court orders a judicial reorganisation, it can prohibit the sale of an asset that it deems to be essential to the continued business of the debtor and can postpone the payment of debts owed by the debtor. Russian bankruptcy law assigns priority to the payment of certain creditors, including employees, secured creditors and post-petition creditors. If any of these laws are applied to the Company, holders of the Notes may not be able to enforce their rights under the Guarantee.

The Issuer is incorporated under the laws of Luxembourg. Generally, insolvency laws in Luxembourg could negatively affect the ability of Noteholders to enforce their rights under the Notes by application of preference period rules and stays of proceedings broadly similar to those described above.

No prior market for the Notes

Prior to their issue, there was no public market for the Notes. Although application has been made to list the Notes on the Luxembourg Stock Exchange, an active trading market in the Notes may not develop or be maintained after listing. If an active trading market does not develop or cannot be maintained, this could have a material adverse effect on the liquidity and the trading price of the Notes. In addition, the stock markets, in recent years and, in particular, in recent months, have experienced significant price fluctuations. These fluctuations were often unrelated to the operating performance of the companies whose securities are traded on such stock markets. Market fluctuations as well as adverse economic conditions have negatively affected the market price of many securities and may affect the market price of the Notes.

Investment Considerations Relating to the Taxation of the Notes

Payments under the Guarantee may be subject to Russian withholding tax

Payments under the Guarantee to a Noteholder who is not a tax resident of Russia might, due to the lack of clarity in the law, be characterised as Russian source income that would be subject to a 30 per cent. withholding tax (if a holder is an individual) or a 20 per cent. withholding tax (if a holder is not an individual) at source of payment in Russia, subject to any applicable double tax treaty relief. It is not expected that the Trustee will, or will be able to, claim a withholding tax exemption under any double tax treaty.

If the payments under the Intercompany Loan and/or the Guarantee are subject to any withholding of Russian tax, the Company is obliged to increase payments as may be necessary so that the net payments received by the Noteholders will not be less than the amounts they would have received in the absence of such withholding. It should be noted, however, that gross-up provisions may not be enforceable under Russian law.

The Issuer may, at its option, redeem the Notes if: (i) the Issuer (or, if the Guarantee was called, the Company) would or will become obliged to pay additional amounts, as provided or referred to in the Conditions, as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after 14 October 2003 and (ii) such obligation cannot be avoided by the Issuer (or the Company, as the case may be) taking reasonable measures available to it. If the Issuer redeems the Notes under such circumstances, the redemption price will be equal to 100 per cent. of the principal amount of the Notes plus any interest and additional amounts due. See Condition 6 “Redemption and Purchase” in “Terms and Conditions of the Notes” and “Taxation”.

Tax might be withheld on disposals of the Notes, reducing their value

If an individual tax non-resident Noteholder sells Notes within Russian territory, there is a risk that the proceeds from such disposal may be subject to a withholding tax on any gain realised, subject to any available double tax treaty relief. There is no assurance that advance double tax treaty relief would be granted, and obtaining a refund can involve considerable practical difficulties. The withholding tax rate applicable to proceeds from the sale of Notes to a purchaser within Russia by an individual tax non-resident holder is 30 per cent. The imposition or possibility of imposition of this withholding tax could adversely affect the value of the Notes. See “Taxation”.

Other taxation risks

Payments made by the Company to foreign legal entities or corporations (including payments of interest), may be treated as a Russian source income. Accordingly, such payments should be subject to a withholding at the rate of up to 20 per cent., subject to reduction or elimination further to the provisions of any applicable double tax treaty. (See also “Taxation”.)

Other Risks

The Company has not independently verified information regarding its competitors, nor has it independently verified official data from Russian government agencies. It has derived substantially all of the information contained in this document concerning its competitors from publicly available information, including press releases, and it has relied on the accuracy of this information without independent verification. In addition, some of the information contained in this document has been derived from official data of Russian government agencies. The official data published by Russian federal, regional and local governments may be substantially less complete or researched than those of Western

countries. Official statistics may also be produced on different bases than those used in Western countries. Any discussion of matters relating to Russia in this document must, therefore, be subject to uncertainty due to concerns about the completeness or reliability of available official and public information.

The veracity of some official data released by the Government may be questionable. In the summer of 1998, the Director of the Russian State Committee on Statistics and a number of his subordinates were arrested and charged in connection with their misuse of economic data.

USE OF PROCEEDS

The net proceeds of the issue of Notes by the Issuer are expected to be approximately U.S.\$294,100,000 million after deduction of the management and underwriting and selling concession and other expenses of the offering of the Notes. The net proceeds will be lent to the Company by the Issuer by way of the Intercompany Loan and will be used by the Company to refinance a portion of existing indebtedness incurred by the Company and to finance the Modernisation Programme.

CAPITALISATION AND INDEBTEDNESS

The following table shows the unaudited, consolidated capitalisation and indebtedness of MMK and its subsidiaries as at 30 June 2003:

	<u>As at 30 June 2003</u> <i>(U.S.\$ million)</i>
Shareholders' equity	
Share capital	363
Treasury shares.....	(22)
Additional paid in capital	21
Asset revaluation reserve	122
Retained earnings.....	1,630
	2,114
Long-term:⁽¹⁾	
Non-current liabilities	
Loans and borrowings	313
Deferred tax liabilities.....	287
Other non-current liabilities	36
	636
Short-term:⁽²⁾	
Current liabilities	
Loans and other borrowings ⁽³⁾	231
Trade and other payables	366
	597
Total Capitalisation and Indebtedness	3,347

Notes:

- (1) Long-term liabilities comprise those liabilities with an initial maturity or tenor of 12 months or more. The above table does not include the U.S.\$300,000,000 8 per cent. Guaranteed Notes due 2008 now being issued.
- (2) Short-term liabilities comprise those liabilities with an initial maturity or tenor of less than 12 months.
- (3) Short-term loans include an amount of U.S.\$49 million comprising bank overdrafts.

Except as disclosed in this Offering Circular, there has been no material change in the capitalisation and indebtedness of MMK and its subsidiaries since 30 June 2003.

THE MMK GROUP

Incorporation and History

Open Joint-Stock Company Magnitogorsk Iron & Steel Works (“MMK”) was established as a state-owned enterprise in February 1932 near to the city of Magnitogorsk in the Chelyabinsk region of the Russian Federation. The location was selected due to its proximity to a major iron deposit discovered at Mount Magnitnaya at the start of the 20th century.

MMK first cast pig iron in February 1932, began smelting steel in 1933 and became an integrated steel mill in 1934 on commencing production of rolled steel. MMK’s production of new steel grades and armoured plate started in 1941 and in 1969 cold-rolled sheet was first produced by MMK’s 2500mm cold-rolling mill. By 1990, MMK had commissioned its first basic oxygen furnace (“BOF”) converter.

As part of the Russian Federation’s privatisation programme, MMK was incorporated as an open joint-stock company on 17 October 1992, under the laws of the Russian Federation for an unlimited period of time. See “– Share Capital and Principal Shareholders – Privatisation and History of Share Ownership” for a full description of the share capital of MMK.

MMK and its subsidiaries (the “MMK Group”) have their head office at Ulitsa Kirova 93, 455002 Magnitogorsk, Russia. MMK is registered by a decree of the Mayor of Magnitogorsk No. 211-P dated 17 October 1992 (certificate of registration No. 186).

General

MMK is a single-site integrated steel making facility, which was ranked by *The Metal Bulletin* as at 31 December 2002, as the world’s 15th largest steel-making company and as Russia’s largest in terms of total rolled steel output, producing the broadest range of products of any steel producer in Russia and the CIS. For the year ended 31 December 2002, MMK’s annual output of commercial steel amounted to 9.67 million tons, an increase on the output of 9.01 million tons during 2001, and was 4.96 million tons for the six months ended 30 June 2003, compared to 4.76 million tons for the six months ended 30 June 2002. MMK estimates that it is capable of producing 12 million tons of steel a year from its current facilities.

MMK is also the exclusive supplier of high quality cold-rolled band and tin-plate in the CIS and has the highest sales of any Russian steelmaking enterprise, with total revenues of U.S.\$1,733 million in the year ended 31 December 2001, increasing to U.S.\$2,065 million for the year ended 31 December 2002. As at 30 June 2003, MMK had total revenues for the preceding six month period of U.S.\$1,478 million, compared to U.S.\$896 million for the same period in 2002. Net profit for the year ended 31 December 2001 was U.S.\$144 million, compared to U.S.\$115 million for the year ended 31 December 2002. As at 30 June 2003, net profit for the preceding six months was U.S.\$307 million, compared to a loss of U.S.\$12 million for the same period in 2002.

MMK exported approximately 56.7 per cent. of its products to the international market for the year ended 31 December 2002, including, in particular, products from MMK’s BOF converters, long products mills and strip mills. MMK’s principal international markets for export are South-East Asia and China, Africa, Eastern Europe and the CIS, in particular, Belarus, the Ukraine and Kazakhstan. MMK intends to increase the proportion of its domestic sales and to focus on its value-added products, such as galvanised steel and other finished products. See “– Strategy”.

At the end of the 1980s, MMK implemented a major modernisation and investment programme (the “Modernisation Programme”), intended to modernise MMK’s production facilities and enable it to enhance the downstream processing of steel and the quality and diversity of its products. MMK believes that the Modernisation Programme is crucial to MMK’s ability to compete in the steel production market. See “– The Modernisation Programme”.

Principal Activities

The MMK Group is currently involved in the following activities:

- mining operations;
- preparation of mining raw materials for reprocessing, consumption and sale;
- production and sale of ferrous metal products;
- production and sale of machine-building products;

- stocking and sale of ferrous and non-ferrous metal scrap;
- implementation of investment projects;
- production and sale of consumer goods;
- industrial, housing and utilities construction and provision of construction services;
- production and sale of construction materials and building structures and recycling of waste;
- production, processing and sale of agricultural products;
- transportation of steel and steel products by trucks and railways;
- provision of various industrial and non-industrial services, such as equipment maintenance and repairs, to companies, organisations, establishments and the public;
- foreign economic and trading activities; and
- medical assistance and disease prevention services.

Competitive Advantages

MMK believes that it benefits from the following strengths:

Size

According to *The Metal Bulletin*, the three largest Russian steel mills, including MMK, accounted for approximately 47 per cent. of Russia's rolled steel output as at 31 December 2002. MMK accounted for 19 per cent. of Russia's rolled steel output, making it Russia's largest rolled steel producer. MMK was ranked 15th by *The Metal Bulletin* among the world's steel making companies in terms of output as at 31 December 2002, producing 9.01 million tons of commercial steel in 2001 and 9.67 million tons of commercial steel in 2002. MMK produced 4.76 million tons of commercial steel for the six months ended 30 June 2003 compared to 4.40 million tons for the six months ended 30 June 2002. MMK believes that it has the broadest product mix of any Russian steel mill and has a mature and diverse base of consumers and suppliers.

Competitive Cost Structure

MMK maintains low labour costs, with the Russian market permitting the payment of lower salaries than in many other jurisdictions in which MMK's competitors are based, and benefits from access to competitively priced iron ore and coal. Based on figures supplied by OOO Chermet (an independent research company), MMK's productivity on a per employee basis is the highest in Russia as compared with other Russian steel mills (see "– Market and Competitors"). In addition, MMK's in-house power generation means that generation costs are lower than the market price. MMK has its own limestone pits, which it estimates contain approximately 173 million tons of extractable deposits, which at current production levels MMK estimates will meet its annual industrial demand for limestone for approximately the next 60 years. See "– Procurement of Raw Materials and Suppliers".

Healthy and growing domestic demand

As at 31 December 2002, the three largest steel mills in Russia controlled 47 per cent. of the domestic market (see "– Size" above). As such, MMK believes that growth in domestic demand in the automotive, pipe and machine building sectors in Russia will lead to growth in the domestic demand for MMK's products.

Diversified revenue sources

MMK, selling into the export markets through major trading entities, benefits from a diverse customer base, with no reliance on any single large consumer. As at 30 June 2003, the 10 largest Russian consumers of MMK's products accounted for approximately 34 per cent. of MMK's total domestic sales. See "Sales, Marketing and Customer Analysis – Analysis of Domestic and Export Sales". In addition, MMK's consumer base is diversified across region and sector, allowing MMK to sustain a broad product mix. As at 31 December 2002, MMK's consumer base comprised approximately 7,000 sale contracts.

Skilled management

To date, the Modernisation Programme has been implemented both on schedule and within budgeted costs. MMK's management has received recognition within the steel sector as being both innovative and sound. MMK has also historically maintained good relations with employees and its trade union. See “– Employees”.

Financial Policy

MMK's main strategic goals are to continue to implement the Modernisation Programme, to maintain the long-term flexibility of its capital structure and to control the incurrence of debt. See “– Strategy”. MMK has previously achieved these goals by pursuing a conservative financial policy and has sought to finance the major part of its capital investments, including the Modernisation Programme, from its own funds.

The Modernisation Programme

Over recent years MMK has significantly modernised its production facilities and has installed equipment based on proven processes from internationally recognised equipment manufacturers. See “– The Modernisation Programme”.

Strategy

MMK has developed a “Strategic Programme for the development of MMK to 2010”, taking into account market conditions and the financial resources of MMK.

MMK's key strategic goal is to maintain its long-term competitive position in the international rolled products market. Achieving this aim will depend on several important factors, including:

- achieving a leading position in the development and implementation of new technologies;
- improving product quality and diversifying into new products to cater for the current and future needs and expectations of consumers. MMK intends to develop the production and sales of its value-added products, such as galvanised steel. These products allow for greater margins of profit than traditional slab and billet production. MMK estimates that, as of 31 December 2002, the profitability of value-added products such as cold-rolled products, tin and galvanised steel exceeded the profitability of traditional products such as billets by 40 per cent., 90 per cent. and 180 per cent., respectively.
- maintaining and expanding existing markets. MMK intends to continue to increase the proportion of its products sold domestically as prices in Russia and the CIS are currently higher than worldwide prices for steel and transportation costs for MMK are lower for domestic sales than export, which allows greater profits to be obtained on domestic sales. In addition to strengthening its position in the Urals industrial region, MMK intends to increase sales to industrial centres within the European part of Russia (see “– Sales, Marketing and Customer Analysis”);
- raising production efficiency and curbing environmental pollution (see “– The Modernisation Programme”);
- planning the development of its own supplies of key raw materials, in particular iron ore and coal, to reduce its dependence on third party suppliers. As part of such plans, MMK is considering the further development of the ore deposits in Malyi Kuzbass, Podotvalnoye and Techenskoye (in particular, the possibility of doubling the quantity of grey iron ore mined). In respect of coal, MMK is considering participating in new prospective coking coals fields located in the Kemerovo region (see “– Procurement of Raw Materials and Suppliers”); and
- planning the diversification of its business to counter the cyclical and seasonal nature of the steel industry. MMK is currently studying the cyclicity of certain industries to develop a diversification plan by June 2004. However, MMK does not intend to affect its key business areas or to move away from the production of steel and ferrous metal products as its core business.

Current Privatisation Plans

Although to date no formal auction has been declared, The Ministry of Property Relations of the Russian Federation announced in April 2003 that the Russian Federation's stake of 23.76 per cent. in the ordinary share capital of MMK will be privatised by auction during the fourth quarter of 2003. Price estimates released by the Ministry in February 2003 valued such shares at approximately U.S.\$175 million. See “Investment Considerations – Privatisation and Share Ownership”.

THE MODERNISATION PROGRAMME

MMK implemented the Modernisation Programme at the end of the 1980s, based on technology proven in the international market and co-operation with internationally recognised engineering firms. The pace of MMK's modernisation strategy has largely been dictated by the availability of internally generated funds. Between 1992 and 2000, MMK's annual capital expenditure (investments including those in intangible assets) was between approximately U.S.\$46 and U.S.\$290 million (the precise amount each year depending on the level of available financing and the cost of scheduled projects), and for each of the years ended 31 December 2001 and 2002, the MMK Group invested U.S.\$287 million and U.S.\$204 million, respectively (calculated in accordance with IFRS). In aggregate, from 1992 to 2002, MMK has invested approximately U.S.\$1.6 billion as part of the Modernisation Programme and has budgeted approximately U.S.\$160 million for projects to be completed during 2003. The main projects scheduled for 2003 are set out below.

Initially, MMK focused on modernising its iron-making facilities, with 30 out of 35 open-hearth furnaces being replaced by three BOF converters as at 31 December 2002. As at the date of this Offering Circular, MMK has replaced all but two of such furnaces. The commissioning of the third BOF converter was part of a plan to phase out MMK's obsolete Martin-Siemens open-hearth furnaces. With its start-up, output of steel at MMK rose to almost 10 million tons. Modern control equipment supplied by Siemens and Voest-Alpine has made it possible to improve significantly the quality of steel (reducing defects in hot-rolled coils of steel used to make pipes by approximately 2.00 per cent.) and enabled MMK to produce any commercial steel grades that are in demand in the markets that MMK serves, including 07GBU, 06GFBA and 09GSF grades. MMK now expects the focus of the Modernisation Programme to shift to the rolling and finishing cycle.

Other key achievements to date are the:

- renovation of continuous casting machine ("CCM") 3 to increase casting capacity (in 2003 a similar renovation was conducted for CCM 2). Both CCMs rank among the most productive machines in the world with an annual production of approximately three million cast slabs each;
- commissioning in the coating shop of a continuous hot-dip galvanising line with a capacity of 500 thousand tons of galvanised sheet. MMK believes that after commissioning this unit, MMK became the largest Russian producer of galvanised steel sheet for the automotive industry;
- renovation of equipment in the cold-rolling shop to improve the quality of rolled products and putting in operation a double-stand reverse mill with an annual capacity of 800 thousand tons;
- renovation of sintering plants 9, 11 and 12 to improve the quality of sinter and increase production by 15 per cent.;
- installation of a ladle furnace designed to improve steel quality;
- enhanced quality testing and the introduction of a fourth treatment stage (including the downstream production of electrodes and packaging tools); and
- commissioning of power units (boiler 7, turboblower 4) and renovation of oxygen plant 6 to increase MMK's independence in respect of power and utilities generation.

Completion of New Major Facilities over the five years ended 31 December 2002

Project	Investment (U.S.\$ million)	Completed
Renovation of blast furnace (No.1).....	45.8	Dec-98
Reconstruction of KS furnace into shaft furnace 1 bis.....	1.2	Jul-98
Coke gas treatment plant (No.2).....	214	May-98/Dec-99
Oxygen converter (No.3)	28.1	Dec-99
Renovation of blast furnace (No.2).....	10.7	Jul-00
Construction of rotary furnaces (No.4, 5)	9.9	Dec-00
Manganese-dolomite refractory shop (first phase)	8.6	Dec-00
Construction of ladle furnace.....	16.7	Jan-01
Reconstruction of sintering plants (No.9, 11, 12)	7.5	Apr-01
Electrode production facility	6.0	Jul-01
Reconstruction of blast furnace (No.7)	9.4	Oct-01
Construction of slitting line (No.8)	5.7	2001
Wire rod mill 300 3 "Kocks"	23.2	Jun-01
Slitting line No.8.....	5.5	Sep-01

Project	Investment (U.S.\$ million)	Completed
Reconstruction of CCM No.3	35.8	Dec-01
Continuous hot-dip galvanising line	124.9	July-02
Double-stand reverse cold-rolling mill	48.2	July-02
Renovation of oxygen unit No.6	11.2	2002
Renovation of the exit section of pickling line No.1	8.2	2002
Electrode production facility (second phase)	8.9	2002

Main Objects of the Modernisation Programme for the five years commencing 1 January 2003

In 2001, MMK established a long-term development plan covering the period to 2010 with key phases in 2005, 2007 and 2010. Under this plan, MMK plans to invest an additional U.S.\$1,200 million (predominantly from internally generated cash flow) in upgrading its existing facilities and expanding its downstream capacities. In particular, the plan provides for:

- the further development of the production of cold-rolled sheet at Rolling Shop No.5, including the reconstruction of the thermal section, replacement of a number of existing furnaces with new bell-type hydrogen annealing furnaces for oils, construction of the hydrochloric acid regeneration plant and the reconstruction of technological and entry sections of pickling line Nos. 1 and 2 and cold-rolling skin-pass mills 1700 and 2500;
- the development of the coke and chemical by-products division, including the construction of a new coke battery No.11-bis;
- the phased renovation of hot-rolling mill 2500 in Rolling Shop No.4; the first phase being the modernisation of process automation systems and renovation of the mill's mechanical equipment;
- the reconstruction of the open-hearth shop, including the gradual installation of furnace-ladle machines and two new continuous casting machines (with an aggregate capacity of 2 million tons of billets per year) and the replacement of the open-hearth furnaces with new steel making machines;
- the further development of the production of coated steel, including the installation of a chrome-plating machine designed to chromeplate rolls produced by the continuous hot-dip galvanising line and cold-rolling mills and the construction of a colour coating line in the coating shop;
- the phased renovation of the long products facilities. Various options are currently under review, including the possibility of renovating the existing long product mills or constructing new facilities;
- further reconstruction of sinter production;
- the reconstruction and development of tin production within Rolling Shops No.3 and No.6;
- the production of low-alloyed steel grades with a decreased sulphur content for manufacturing large diameter pipes, and IF-steel for high-quality cold-rolled steel; and
- small scale targeted improvements in areas such as the creation of small heating furnaces for reheating processes (for example in electric arc furnaces for the purpose of reducing energy consumption and the introduction of ultrasound testing).

The projected cost and completion dates for major projects within the Modernisation Programme are as follows:

Major Project	Investment/ (U.S.\$ million) ⁽¹⁾⁽²⁾	Expected completion ⁽²⁾
Reconstruction of cold-rolling mill	103.6	2004
Reconstruction of open-hearth furnaces (first stage)	59.4	2004
Construction of a polymer and colour coating unit	42.9	2004
Reconstruction of hot-rolling mills (first stage)	42.1	2005
Reconstruction of the long products shop	160.0	2006
Construction of coke battery 11-bis	124.0	2007
Projects for energy savings	93.0	2003-2007
Total	625.0	

Notes:

(1) Includes customs duties for imported equipment and VAT.

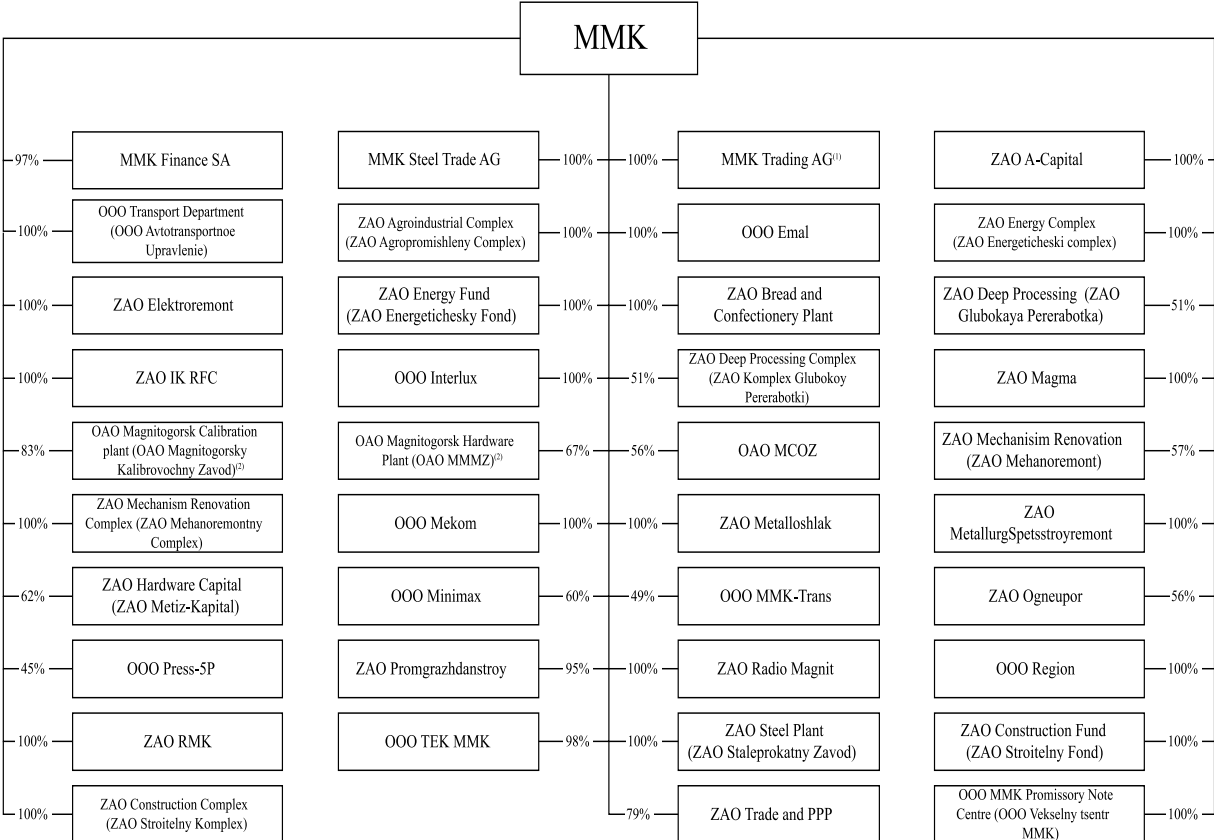
(2) Figures are budgeted estimates only. Actual expenditure and timing will vary depending on external factors and MMK's ability to generate funding for the projects from cash flows.

As a result of the Modernisation Programme, MMK’s manufacturing and production efficiency has steadily improved over recent years. Together with other measures taken to increase productivity (such as reductions in headcount and the production of increased levels of electricity within the MMK Group), MMK believes that the Modernisation Programme has resulted in MMK becoming the most efficient steel producer in Russia and, along with other cost-cutting programmes, has led to a saving of approximately U.S.\$30 million annually.

In addition, new technologies and automation processes, such as those operating in the continuous hot-zinc galvanising line, have allowed MMK to expand the range of products created and distributed and to concentrate on “high-end” value-added products. See “— Key Products”.

ORGANISATION OF THE MMK GROUP

The following chart illustrates the effective ownership of MMK in its major subsidiaries as at 30 June 2003:



- Notes:
 (1) Established during 2002.
 (2) Acquired during 2002.

MMK is the parent company of the MMK Group. MMK is a vertically-integrated company covering the full technological cycle and producing commodity and value-added ferrous metal products. In addition to these core activities, MMK operates a variety of support and ancillary activities through a network of 70 directly- or indirectly-held subsidiaries and affiliates. The majority of these subsidiaries are located in or proximate to the head office of the MMK Group in Magnitogorsk.

The majority of MMK’s subsidiaries are instrumental to the MMK Group’s output, including, in particular, ZAO RMK, which produces coke; OAO Magnitogorsk Cement and Refractory Plant, which supplies cement and dolomite to MMK; ZAO Ogneupor, which operates refractory plants; ZAO Construction Complex, which carries out industrial construction; transportation companies and companies conducting technical maintenance.

In 2000, MMK established MMK Steel Trade AG, an international trade company based in Switzerland and which, in turn, controls the Issuer. From their acquisition during 2002, the MMK Group also includes OAO Magnitogorsk Hardware Plant and OAO Magnitogorsk Calibration Plant, which produce hardware and fasteners, respectively. In addition, the MMK Group includes a number of companies that render professional services, such as customs processing, securities processing and printing services.

RESULTS OF OPERATIONS

The following table and discussion is a summary of MMK's consolidated results of operations for the six month periods ended 30 June 2003 and 2002 and the years ended 31 December 2002, 2001 and 2000:

	Year ended 31 December (audited)			Six months ended 30 June (unaudited)	
	2002	2001	2000	2003	2002
	<i>(U.S.\$ millions)</i>				
Revenues	2,065	1,733	1,713	1,478	896
Cost of sales	(1,516)	(1,333)	(1,160)	(914)	(725)
Gross profit	549	400	553	564	171
Operational costs, including	(304)	(305)	(920)	(178)	(155)
Distribution expenses	(92)	(86)	(59)	(53)	(41)
General and administrative expenses	(165)	(120)	(110)	(85)	(71)
Social costs	(35)	(48)	(56)	(10)	(21)
Other taxes (except profit tax)....	(65)	(45)	(94)	(26)	(27)
Impairment and reversal of property, plant and equipment, net	150	34	(584)	-	-
Revaluation of property, plant and equipment	(88)	-	-	-	-
Impairment of investment in associates	-	(11)	-	-	-
Other operating expenses (net) ..	(9)	(29)	(17)	(4)	5
Profit/(loss) from operations	245	95	(367)	386	16
Net financing costs	(43)	(12)	(28)	(11)	(25)
Profit/(loss) before tax and minority interest	202	83	(395)	375	(9)
Income tax (expense)/benefit, including.....	(86)	58	61	(66)	-
Current tax (expense)/benefit.....	(64)	(47)	(101)	(101)	(10)
Deferred tax (expense)/benefit ..	(22)	105	162	35	10
Profit/loss before minority interest	116	141	(334)	309	(9)
Minority interest.....	(1)	3	(4)	(2)	(3)
Net year profit/(loss) for the period	115	144	(338)	307	(12)

Revenue

Total revenue generated by MMK and its subsidiaries increased significantly from U.S.\$1,733 million in 2001 to U.S.\$2,065 million in 2002. During 2002, MMK was able to take advantage of a significant improvement in the world demand for steel, particularly in the South-East Asian region. The average export price achieved by MMK increased from U.S.\$150 per ton in the first six month period of 2002 to U.S.\$198 per ton for the second six month period of 2002. The second half of 2002 also saw the decrease and subsequent elimination of Russian export duties on steel products.

The MMK Group was also able to increase production of higher quality and value added products with the completion of major projects including the reconstruction of the oxygen converter and implementation of the double-stand reverse cold-rolling mill and the continuous hot dip galvanising plant. The MMK Group's revenues in 2002 also benefited from the acquisition of subsidiaries Magnitogorsk Calibration Plant and Magnitogorsk Hardware Plant.

The revenue of MMK and its subsidiaries continued to increase in the six months to 30 June 2003. Total revenue for the six month period to 30 June 2003 was U.S.\$1,478 million, compared to U.S.\$896 million for the same period in the prior year. Major factors contributing to this continued growth in revenue were strong export prices in the early months of the period, the consequential effect of increased export prices on domestic prices, and full benefits being obtained from the production of higher quality and value added products. The average export price achieved by MMK for the six month period to 30 June 2003

increased to U.S.\$235 per ton. The average domestic price increased from U.S.\$215 per ton for the six month period to 31 December 2002, to U.S.\$296 per ton for the six month period to 30 June 2003.

Cost of sales

Cost of sales steadily increased from U.S.\$1,160 million in 2000 to U.S.\$1,333 million in 2001, and to U.S.\$1,516 million in 2002. Cost of sales for the six months ended 30 June 2003 continued to increase to U.S.\$914 million, compared to U.S.\$725 million for the same period in the prior year. Key drivers impacting the increase in cost of sales, included increased production and in particular production of value added products, and increases in material, labour and energy production costs. The production related depreciation charge also increased during the period due to significant additions from the implementation of the Modernisation Programme.

Despite increasing production costs, the MMK Group was able to significantly improve its gross margin as a percentage of sales. For the six months to 30 June 2003, the gross margin percentage was 38 per cent., compared to 27 per cent. and 23 per cent. for the years ended 31 December 2002 and 2001, respectively.

Operating profits

Net operating profit increased from a loss of U.S.\$367 million for the year ended 31 December 2000, to profits of U.S.\$95 million and U.S.\$245 million for 2001 and 2002, respectively. Net operating profit further increased to U.S.\$386 million for the six months ended 30 June 2003, compared to U.S.\$16 million for the same period in the prior year.

In 2000, net operating profit was significantly impacted by the introduction of a new international accounting standard which required impairment testing of property, plant and equipment to be determined by discounting the estimated future net cash flows generated. Previously, the discounting of future estimated cash flows had not been required by IFRS, and as a result of an independent review commissioned by the management of MMK, an impairment charge of U.S.\$584 million was recognised.

At 31 December 2002, the management of the MMK Group adopted an alternative accounting treatment which resulted in the property, plant and equipment of the MMK Group being recorded at its fair value rather than at depreciated historical cost. Management commissioned an internationally recognised independent appraiser to determine the depreciated replacement cost of major assets of the MMK Group and additionally performed an impairment assessment. As a result of the analysis a revaluation decrease of U.S.\$88 million was recognised, and a reversal of U.S.\$150 million of the impairment losses previously recognised were recorded in the income statement. This had a net positive impact of U.S.\$62 million on the net operating profit of the MMK Group for the year ended 31 December 2002.

The impairment of investments recorded in 2001 of U.S.\$11 million reflects the difference between the consideration paid for a 26 per cent. stake in Kuzbassugol in 2001 and the expected recoverable amount of the investment at 31 December 2001.

Other factors impacting the net operating profit of the MMK Group include the steady increase in distribution, general and administration expenses, and reduction in other taxes.

Distribution expenses increased from U.S.\$59 million for the year ended 31 December 2000 to U.S.\$86 million for 2001 and U.S.\$92 million for 2002 due to growth in transportation costs and expenses for services to third party organisations. For the six month period ended 30 June 2003, distribution expenses were U.S.\$53 million, compared to U.S.\$41 million for the same period in 2002.

General and administration expenses, without taking into account other taxes (except profit tax), increased from U.S.\$110 million in 2000, to U.S.\$120 million and U.S.\$165 million in 2001 and 2002, respectively, driven primarily by increased wage and salary costs of U.S.\$7 million and U.S.\$15 million in 2002 and 2001, respectively, and an increase in insurance premiums of U.S.\$13 million paid for more comprehensive insurance coverage.

Other taxes (except profit tax) reduced by U.S.\$49 million in 2001, due to a significant reduction in road users tax and the cancellation of housing tax. In 2002, other taxes (except profit tax) increased by U.S.\$20 million due to the impact of increased revenues and acquisitions of property, plant and equipment which increased the tax bases used for calculation of road users, land and property taxes.

Net profit after tax

Additional factors impacting the net profitability of the MMK Group include increased net financing costs and increased income tax expenses.

Net financing costs increased to U.S.\$43 million in 2002 from U.S.\$12 million in 2001 after falling from U.S.\$28 million in 2000 primarily due to the increased levels of debt and borrowings obtained by the MMK Group. The increase in 2002 reflected the increase in interest expense arising primarily from the €100 million eurobond issued by the Issuer in February 2002 and the US\$26 million credit obtained from Westdeutsche Landesbank Girozentrale. Net financing costs decreased by U.S.\$16 million in 2001, mainly due to a net foreign exchange gain of U.S.\$5 million in 2001 compared to a net loss of U.S.\$ 10 million in 2000. The interest expense recognised by the MMK Group increased from U.S.\$19 million in 2001, to U.S.\$38 million in 2002. For the six months ended 30 June 2003, total interest expense was U.S.\$23 million, compared to U.S.\$17 million for the same period in 2002.

The income tax benefits of U.S.\$61 million and U.S.\$58 million for the years ended 31 December 2000 and 2001, respectively, were primarily due to the deferred tax benefits related to the tax effect of the aforementioned impairment charge in 2000 and the enactment of a decrease in the profits tax rate from 35 per cent. to 24 per cent. in 2001. The current tax expense decreased in 2001, primarily due to the lower taxable profit. In 2002, the current tax expense was positively affected by the aforementioned decrease in the rate of taxation that came into effect in 2002.

KEY BUSINESS ACTIVITIES

MMK produces a wide range of ferrous metal products and is also a supplier of high-quality cold-rolled band and tin-plate. It is able to offer various customised steel grades. MMK's installed capacity for steel production currently amounts to approximately 12 million tons per year and actual output of commercial steel products was 9.67 million tons in 2002, an increase of 7.3 per cent. compared to 9.01 million tons during 2001 and was 4.96 million tons for the six months ended 30 June 2003 compared to 4.76 million tons for the six months ended 30 June 2002. In total for the year ended 31 December 2002, 11.03 million tons of steel were smelted, a 6.4 per cent. growth from the figure of 10.32 million tons achieved in 2001.

Selected Production Figures

	Year ended 31 December			Six months ended 30 June	
	2002	2001	2000 ⁽¹⁾	2003	2002
	<i>(in thousand tons)</i>				
Iron ore	1,258.4	1,242.5	1,189.6	652.4	625.1
Sinter	9,336.2	9,117.6	8,624.7	4,910.1	4,671.5
Coke (6% moist) – MMK.....	5,187.8	4,918.3	5,002.4	2,723.5	2,561.6
Pig iron.....	9,263.7	8,861.9	8,467.0	4,817.8	4,584.6
Steel-total.....	11,027.9	10,323.9	10,014.1	5,689.7	5,452.1
Rolled Products (as rolled)	10,168.4	9,468.9	9,199.8	5,192.6	4,999.1
Rolled Products (as shipped)	9,890.4	9,234.2	8,905.5	5,047.4	4,874.2
Commercial steel products	9,667.4	9,011.4	8,678.3	4,962.0	4,761.6
of which:					
Billets and slabs	927.5	1,232.4	879.5	365.7	418.8
Long products	1,372.0	1,290.9	1,284.8	713.2	649.6
Flat products	6,242.2	5,569.1	5,639.0	3,191.4	3,152.9
Downstream products	1,125.7	919.0	875.1	691.8	540.4
Export					
Steel Products	5,482.2	4,812.9	5,145.9	2,692.2	2,694.6
% of export	56.7	53.4	59.3	54.3	56.6

Note:

(1) 2000 production figures include joint venture activities.

MMK produces commodity products such as long products (including billets, bars, wire rod, strips and beams) and flat products (including slabs, hot and cold-rolled coils, hot-rolled sheets and plates) and high-value products including galvanised steel and tin-plate.

MMK intends to further increase the output of value-added and downstream products (which includes galvanised steel sheet), which rose from 875,100 tons in 2000 to 1.13 million tons in 2002. Within "Flat products", shipments of cold-rolled metal fell from 1.47 million tons in 2001 to 1.42 million tons in 2002 due to an increase in the use of cold-rolled steel in the production of coated steel, which is more profitable for MMK. In addition, production of billets and slabs fell from 1.2 million tons in 2001 to 927 thousand tons in 2002, a 25 per cent. decrease matching the corresponding 23 per cent. increase in the amount of goods intended for further processing (downstream products). See "— Strategy". While the quality of MMK's crude steel and commodity products is considered by MMK to be in line with international standards, MMK is continuing to strive to reach further quality improvements for its value-added products.

Following a long-term agreement with Gazprom concluded in September 2001, MMK supplies Gazprom with specially constructed pipes usable in environments of low temperatures (down to minus 60°C). Sales have amounted to approximately half a million tons per year. In return, Gazprom, through OOO Mezhregiongaz, supplies MMK with gas in a value equal to such deliveries of pipes. This arrangement will be effective until 2005 and each delivery under the contract is settled in cash. See "— Procurement of Raw Materials and Suppliers – Gas". In addition, MMK expects that the increasing demand for armoured steel and the governmental programme to integrate more Russian towns and settlements into the national gas supply network (gas being supplied through pipes of small diameter) as well as the road construction programme, which requires metallic side panels, will open new markets for MMK.

MMK's key clients are steel plants, pipe manufacturers, construction companies, machinery plants (including car manufacturers) and oil and gas energy companies. See "— Sales, Marketing and Customer Analysis" for further details of MMK's most important domestic and export consumers.

PROCUREMENT OF RAW MATERIALS AND SUPPLIERS

The main raw materials which MMK has to source for its metallurgical processing activities (see "— Process") are iron ore, coal, scrap and ferroalloys. In addition, MMK takes limestone from its own pits and produces electricity that covers all of its consumption needs. MMK also provides heating power to the City of Magnitogorsk and provides the city with its water supply. MMK uses natural gas for heating in different plants and a long-term agreement with Gazprom provides stable gas deliveries and sources its own water.

Availability of Raw Materials

Coking coal reserves in Russia stood at approximately 50.6 billion tons as at 31 December 2002, of which recoverable reserves were 6.8 billion tons as at that date.¹ Traditionally, 90 per cent. of all coking coal required by MMK has been supplied from the Kuznetsk Coal Basin in Russia and the Karaganda Coal Basin in Kazakhstan. MMK's annual consumption of coking coal in 2002 was 6.9 million tons and in 2003 is expected to be approximately 7.2 million tons.

As at 31 December 2002, Russia's proven iron ore reserves totalled 55.6 billion tons, with 3.85 billion tons of recoverable reserves as at that date¹. MMK's principal supplier of iron ore is Kazakhstan's Sokolovski mine operated by the Sokolovsko-Sarbaisky Ore Dressing Plant ("OAO SSGPO") which is located 300km from Magnitogorsk in Kazakhstan. Practically all of Russia's and the CIS's significant iron ore deposits are controlled (whether by way of ownership or agreement) by the leading steel producing groups, with the exception of two deposits located in Kazakhstan, controlled by members of the Kazakhstani government, OAO Mikhailovsky GOK (Kursk Region) and OAO SSGPO, which supplies its iron ore mainly to MMK.

In 2002, Russia produced 59.8 million tons of steel, while the estimated demand for scrap amounted to 22.5 million tons, including 12.3 million tons of steel scrap from outside suppliers¹. As Russian scrap exports amounted to 6.56 million tons in 2002 (according to the State Customs Committee), Russia's ferrous scrap market is currently estimated at the level of 18.86 million tons per annum. Thus, supply on the Russian ferrous scrap market significantly exceeds steel producers' demand for scrap, offering a stable availability of scrap for metallurgical processing.

Natural gas is supplied to MMK by Gazprom, through OOO Mezhhregiongaz, from West Siberia's natural gas deposits.

MMK's sources its own limestone, water and electricity.

MMK's Procurement of Key Raw Materials

The following table sets out the main raw material suppliers of MMK:

	2002		2001		2000	
	Share	Weighted average prices	Share	Weighted average prices	Share	Weighted average prices
	(%)	(U.S.\$ per ton)	(%)	(U.S.\$ per ton)	(%)	(U.S.\$ per ton)
Iron-ore Sinter	100	22.78	100	23.24	100	21.60
OAO SSGPO	61.2	24.15	54.6	23.35	66.6	23.71
Mikhailovsky GOK ..	18.7	19.00	36.6	22.92	31.9	17.68
Iron-ore Pellets	100	27.94	100	27.87	100	28.90
OAO SSGPO	83.4	28.31	83.9	27.94	89.3	29.48
Kachkanarsky ODP ..	5.5	22.39	7.8	24.29	6.7	23.91
Mikhailovsky GOK ..	8.4	19.00	6.1	30.98	—	—
Coal	100	39.61	100	40.38	100	29.97
Kuznetsk, Kuzbass, Russia	97.7	39.33	88.9	39.73	96.3	29.59
Karaganda, Kazakhstan	2.3	46.44	10.5	45.39	1.07	48.66

¹ Figures according to the State Balance Sheet of Natural Resources Reserves of the Russian Federation.

Iron Ore

MMK uses approximately 14 million tons of iron ore per year. The majority of the iron ore raw materials (sinter, concentrate, pellets) that MMK requires is supplied from OAO SSGPO. MMK is OAO SSGPO's main client and the exclusive buyer in the territory of the Russian Federation of raw iron ore produced by OAO SSGPO, purchasing approximately 60 per cent. of OAO SSGPO's total iron ore output. MMK's alternative sources for such raw materials are ore dressing plants located in the central part of Russia and the Urals, with which MMK also has concluded annual supply contracts on usual market terms.

MMK estimates that its iron-ore reserves at open-cast mines near Mount Magnitnaya and in Malyi Kuzbass will not be fully depleted until 2013. MMK plans to further develop the Malyi Kuzbass open-cast mines and the Podotvalnoye ore deposit and estimates that iron-ore reserves in the Urals region will to provide supplies for between 32 to 190 years, depending on the nature of the particular deposit and iron-ore mineralogy.

MMK's current one year supply contract with OAO SSGPO was entered into in December 2002 and provides for both barter arrangements and settlements in cash. MMK believes that, due to its position as the exclusive buyer in Russia of OAO SSGPO's product, it is able to obtain iron ore from OAO SSGPO more cheaply than from similar sources within Russia, as the price set by the current contract is approximately 10 per cent. lower than the average annual price on Russia's domestic market. MMK has a long-standing relationship with OAO SSGPO and, due to its status as OAO SSGPO's main customer, MMK believes that OAO SSGPO offers a stable supply of iron ore for MMK's future business, both in duration and in quantities needed. However, MMK considers that, should it be required to do so, it would be able to obtain sufficient iron ore from alternative suppliers with no material impact on MMK's production or business.

Coal

MMK uses approximately 7 million tons of coking coal concentrate per year. Almost all of MMK's current coking coal concentrate supplies come from Kuzbass, Russia. Coal is sold to MMK at prices comparable with average global prices. In 2001 MMK purchased a stake in Kuzbassugol jointly with OAO Severstal (see “– Market and Competitors”). However, MMK and Severstal were unable to agree on a structure for the joint operation of Kuzbassugol and in 2002 MMK sold its stake in Kuzbassugol to Severstal, whilst continuing to obtain substantially all of its coking coal concentrates from the Kuzbass region. In order to meet the demand for coking coal concentrate in full, MMK has also purchased coal from the Karaganda coal basin in Kazakhstan, which is owned by Ispat, an Indian steel company. MMK signs contracts of one year duration with its major suppliers and prices are set, payable in cash, in accordance with market conditions.

Limestone

MMK sources all of its limestone from MMK's own mines, located 30km from Magnitogorsk, which allows MMK to control supply and is less expensive than purchasing equivalent suppliers on the market. The net cost of lime production was U.S.\$2.16 per ton for 2002 and MMK has reserves estimated at 172.7 million tons. MMK's approximate yearly consumption of limestone is 2.7 million tons.

Electric Power

MMK consumes approximately 430 TWh of electricity per year. MMK generates 100 per cent. of its electric power requirement at its own generating plants using coal, natural gas and blast-furnace gas as fuel. MMK estimates that it is able to generate electricity for a cost that is approximately 30 per cent. lower than the price MMK would be required to pay should it need to purchase electricity from CheliabEnergo, the electricity supplier for the Chelyabinsk region.

Ferroalloys

MMK is able to meet almost its entire annual ferroalloys requirement of approximately 11,000 tons by supplies from within Russia (OAO ChEMK, OAO Satkinsky Cast Iron Plant), Ukraine (Nikopol Ferroalloy Plant) and Georgia (Zestafon Ferroalloy Plant) at market prices.

Scrap

The majority of MMK's scrap is supplied by ZAO Profit, an affiliate of MMK. See “— Certain Transactions – ZAO Profit”. MMK, together with ZAO Profit, has developed a programme to create its own network of companies procuring and supplying scrap. Currently, this network involves two

companies (OAO Chelyabchermet and OAO Bashvtormet), six sites in the Kurgan region and three sites in each of the Omsk and Tyumen regions.

In 2002, the amount of scrap supplied by MMK's own network exceeded 50 per cent. of the total scrap supplies procured by MMK. Apart from arranging supplies from its own sites, ZAO Profit has operated as a purchaser of "transit scrap". Conditions on the Russian scrap market directly depend on the situation on European exchanges.

As part of the Modernisation Programme, MMK intends to replace its open-hearth furnaces with electric arc furnaces, which would require considerable amounts of scrap. MMK currently estimates that its requirements for scrap could in such case grow to 4.5 million tons per year. As Russia is an exporter of iron-and-steel scrap, in the event of installing electric arc furnaces, the required amounts of scrap will be purchased on the domestic market.

Water

MMK has its own watercatchment at its site in Magnitogorsk, which supplies MMK with all of its water requirement.

Gas

MMK consumes approximately 4 million cubic metres of natural gas per year, supplied by Gazprom, through OOO Mezhhregiongaz, under a long-term supply contract described above (see "— Key Business Activities") at a price (including pipeline transportation to MMK) of U.S.\$25 per 1,000 cubic metres of natural gas (excluding VAT).

Seasonality

In view of its geographical location in a zone of harsh climate, MMK requires additional winter provisioning of iron ore, coal and scrap covering the supply needed for approximately one month of production, as extreme low temperatures significantly limit MMK's capability to prepare supplies for its production process. MMK's policy is to maintain at all times an adequate reserve of raw materials to safeguard the business operations of MMK for a period of one month in the event of supplies being interrupted. MMK maintains standing norms (measured in days) for such reserves, which it believes are consistent with market practice. During winter, additional reserves of certain raw materials are prepared.

Stock turnover

The following table sets out the stock turnover in number of days (rounded up to the next whole number) for MMK's key raw materials during the years ended 31 December 2002, 2001 and 2000, which MMK believes is typical for the Russian steel industry:

	Year ended 31 December		
	2002	2001	2000
	<i>(in days)</i>		
Iron Ore (Sinter)	40	47	53
Iron Ore (Pellets).....	7	5	9
Coal	16	21	5
Tin.....	20	43	21
Zinc.....	12	14	5
Ferrous alloys.....	23	25	21
Aluminium.....	14	28	40
Scrap.....	14	20	16

FACILITIES, PROCESS AND OUTPUT

The following table sets out production capacity and output for each of the years ended 31 December 2002, 2001 and 2000 at each of MMK's facilities:

Plant	Equipment	Maximum capacity (thousand tons/year achieved)	Actual output		
			Year ended 31 December (in thousand tons)		
			2002	2001	2000
Lime and Dolomite production	Rotary kiln No. 1	143.1 (2002)	143.1	139.3	128.5
	Rotary kiln No. 2	138.9 (2002)	138.9	138.9	134.6
	Rotary kiln No. 4	171.7 (2002)	171.7	155.1	57.4
	Rotary kiln No. 5	166.2 (2001)	164.6	166.2	10.7
	Shaft furnace No. 1 bis. No. 2 bis	73.5 (1999)	73.1	70.3	58.5
Magnitogorsk Refractory Plant	Rotary kiln No.1 (dolomite)	157.0 (2002)	153.0	158.1	–
	Rotary kiln No.2 (clinker)	101.0 (2002)	116.1	131.5	–
	(dolomite)	92.0 (2002)	84.1	65.5	–
	Rotary kiln No.3 (dolomite)	151.0 (2002)	158.1	146.5	–
Iron Ore Dressing Production	Sinter shop				
	Sintering plant No.2	3,092.4 (1989)	3,104	3,161	3,053
	Sintering plant No.3	2,602.9 (2001)	2,977	2,602.9	2,295.5
	Sintering plant No.4	3,680.3 (1989)	3,253.9	3,353.3	3,276.1
	TOTAL		9,334.9	9,117.2	8,624.6
	Iron-Ore Dressing Plant -5				
	MMS-2	1,896 (2001)	1,811.8	1,896.1	1,639.6
	ROF-2	983.6 (2001)	872.3	983.6	888.6
	ROF-3	2,252.3 (1989)	1,112.0	1,048	1,012.4
	ROF-4	1,244.0 (1998)	693.6	628.9	636.5
	VFU	280.1 (1989)	244.6	191.9	104.0
	Sinter Furnace Charge Preparation Shop				
	Compartment No.1	10,611.0 (1989)	7,436.0	6,189.8	5,629.2
Compartment No.2	12,294.0 (1989)	10,498.5	11,544.3	9,843.7	
Chemical Recovery Plant	Battery No.1	590.0 (2000)	482.7	468	548.4
	Battery No.2	483.0 (2002)	482.6	467.8	52.4
	Battery No.3	561.1 (1999)	429.0	420.5	531.8
	Battery No.4	609.1 (1989)	486.6	478.0	535.7
	Battery No.7	961.7 (1989)	787.4	766.2	831.1
	Battery No.8	961.5 (1989)	753.0	740.9	765.6
	Battery No.9	956.6 (1989)	866.8	827.6	836.1
	Battery No.13	696.7 (1989)	534.1	539.7	589.7
	Battery No.14	656.4 (1989)	558.7	546.9	892.8
	TOTAL		5,381.97	5,255.5	5,283.6
	Magnesia-Dolomite Refractory Shop	1st stage	13.9	13.9	10.6
2nd stage		0.6	0.6	–	0
Blast Furnace	Blast furnace No.1	1,311.1 (2001)	1,296.4	1,311.1	1,261.6
	Blast furnace No. 2	1,250.5 (2001)	1,210.3	1,250.5	564.6
	Blast furnace No.4	1,214.0 (1989)	1,128.1	808.8	975.2
	Blast furnace No.6	1,100.6 (1989)	781.1	1,019.0	1,047.1
	Blast furnace No.7	1,039.3 (1989)	820.7	0	767.0
	Blast furnace No.8	1,127.4 (1989)	1,105.7	1,127.4	1,080.7
	Blast furnace No.9	1,735.3 (1989)	1,599.8	1,609.0	1,214.5
	Blast furnace No.10	1,729.3 (1989)	1,322.2	1,536.1	1,556.2
	TOTAL		9,263.0	8,661.9	8,467

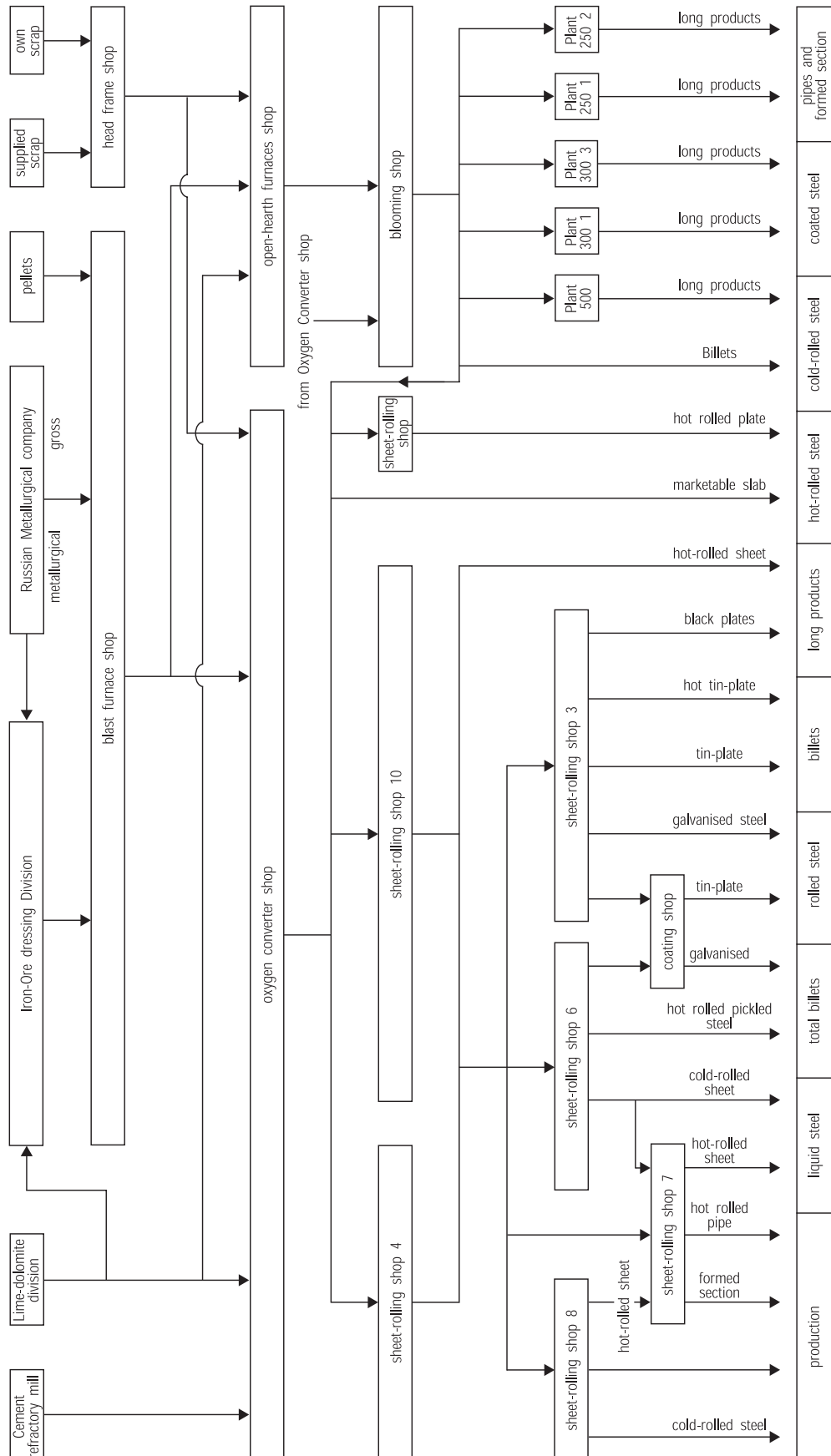
Plant	Equipment	Maximum capacity (thousand tons/year achieved)	Actual output		
			Year ended 31 December (in thousand tons)		
			2002	2001	2000
Open-Hearth Furnace¹	Open-hearth furnace No.26	277.3 (1989)	148.1	225.3	214.2
	Open-hearth furnace No.27	172.8 (2001)	175.4	172.8	140.7
	Open-hearth furnace No.28	463.8 (1989)	200.1	224.6	228.4
	Open-hearth furnace No.29	1,133.6 (1989)	853.4	854.8	887.7
	Open-hearth furnace No.32	1,145.2 (1989)	789.2	950.3	942.0
	TOTAL		2,166.3	2,427.8	2,412.9
Oxygen Converter Shop	Converter No.1	2,960.1 (1998)	2,925	2,690	2,279
	Converter No.2	3,062.6 (2002)	3,063	2,476	2,508
	Converter No.3	2,855.6 (2002)	2,856	2,750	2,812
	TOTAL		8,843	7,915.3	7,599.8
	Continuous Billet Casting Machine -1	2,266.8 (2002)	2,267	2,168	2,127
	Continuous Billet Casting Machine -2	1,991.8 (2002)	1,992	1,943	1,754
	Continuous Billet Casting Machine -3	2,786.9 (2002)	2,787	1,976	2,124
	Continuous Billet Casting Machine -4	1,827.5 (2001)	1,797	1,828	1,595
TOTAL		8,842	7,915.3	7,599.8	
Blooming	Blooming	4,062.0	1,905.7	2,139.1	2,135.4
Rolling Shop-1	Mill 4500	470.0	150.8	182.3	137.1
	Mill 2350	612.0	270.4	271.6	234.0
Rolling Shop-2	Mill 300-1	784.0	413.1	408.3	402.2
	Mill 300-3	137.0	137.1	74.0	–
	Mill 250-1	422.0	224.7	154.7	157.0
	Mill 250-2	613.0	176.3	195.2	302.7
	TOTAL		1,458.4	1,331.8	1,293.2
Rolling Shop-3	Mill 1200	513.2 (1989)	398.2	421.0	429.2
	2-stand mills: No.1	539.7 (1989)	183.1	186.9	199.8
	No.2 (2 mills)		208.1	213.0	211.2
	Slitting machine -2	207.9 (1989)	11.5	6.8	4.3
	Slitting machine -3	176.0 (1989)	2.0	6.5	44.5
	Hot-Dip Galvanising line	151.0 (1989)	142.5	147.0	145.7
	Electrolytic Tinning Line	105.9 (1989)	94.3	97.1	96.1
	Hot-Dip Tinning Line	119.4 (1989)	18.5	18.8	21.0
	Continuous Annealing Line	112.5 (1989)	95.0	92.8	93.3
	Line-1	155.2 (1989)	106.9	118.6	114.4
	Line-2	123.1 (1989)	100.5	85.3	103.2
	Line-3	152.0 (1989)	83.5	104.1	96.3
	Cowl furnace	437.7 (1989)	296.9	318.0	324.8
	20 rollers mill	3.8 (1989)	do not operate		
	Continuous Pickling Line-1	404.8 (1989)	301.3	289.3	317.5
Continuous Pickling Line-3	431.4 (1989)	274.1	276.8	275.2	
3-stand mill 1450	416.5 (1989)	152.7	139.9	136.8	
Rolling Shop-4	Hot-rolling Mill 2500	5,076.0 (1989)	2,912.3	1,962.1	1,933.9
	Slitting machine-1	760.7 (1989)	478.9	465.2	354.7
	Slitting machine-2	568.5 (1989)	392.8	378.0	380.0
	Slitting machine-3	546.3 (1989)	20.9	17.3	68.7
	Slitting machine-5		9.6	14.6	3.3

¹ As at the date of this Offering Circular, MMK has decommissioned all but two of its remaining open-hearth furnaces. See “— The Modernisation Programme”.

Plant	Equipment	Maximum capacity (thousand tons/year achieved)	Actual output		
			Year ended 31 December (in thousand tons)		
			2002	2001	2000
Rolling Shop-5	NTA No. 1, 2	2,201.8 (1989)	1,553.9	1,521.2	1,532.8
	Cold-Rolling Mill 2500	1,653.7 (1989)	1,470.3	1,440.9	1,395.5
	Reversing mill	–	102.1	–	–
	Dressing mill 2500 and 1700 Thermal compartment (cowl furnaces)	1,608.2 (1989)	1,464.4	1,500.0	1,476.1
	Slitting machine 1	1,622.5 (1989)	1,487.7	1,509.2	1,471.4
	Slitting machine 2-3	–	–	11.7	72.3
	Slitting machine 4-5	959.3 (1989)	631.9	691.1	707.4
	Slitting machine 8	611.1 (1999)	569.6	688.1	690.5
Coating Shop	Hot-Dip Galvanising Line	–	96.5	–	–
Rolling Shop-6	Electrolytic Tinning Line	219.6 (1989)	201.7	199.0	205.1
Rolling Shop-7	Mill 1-4	139.8 (1989)	12.9	12.4	13.0
	Mill 2-8	263.0 (1989)	59.8	66.4	79.5
	Mill 0.5-2.5	210.4 (1989)	12.3	14.2	14.1
	Mill 1-5	174.8 (1989)	18.9	16.7	15.1
	Slitting machine	485.4 (1989)	355.5	336.3	370.8
	Mill «10-60»	12.0 (1998)	19.0	43.4	–
	Mill «20-114»	35.3 (2002)	35.3	–	–
	Mill «40-140»	60.7 (1999)	40.1	–	–
	Galvanising Line	6.9 (2001)	5.9	1.6	–
Rolling Shop-8	Coils Welding Unit	419.2 (2002)	419.2	413.6	416.6
	Continuous Pickling Machine	414.6 (2002)	414.6	406.7	409.3
	Mill 630	393.5 (1999)	349.0	393.7	396.6
	Thermal compartment	422.8 (2002)	422.8	417.0	417.5
	Dressing mill 630	392.9 (2002)	392.9	367.0	369.8
	Slitting Machine 1-5	380.8 (2002)	380.8	373.0	378.5
Rolling Shop-10	Hot-Rolling Mill 2000	4,690.7 (2000)	4,439.03	4,479.4	4,690.7

Process

The current steel production process at MMK can be summarised as follows:



MMK's machinery is housed within various "Shops", each of which contains specific equipment. For instance, the Oxygen Converter Shop contains all three of MMK's BOF converters and the various Long Products Shops contain the mills and other plant which MMK uses to produce its range of long products.

In MMK's eight blast furnaces, coke and sinter (i.e., iron ore that is crushed, homogenised and mixed with limestone and coke breeze and then cooked in MMK's Sintering and Dressing Shops) react together under a hot air flow to form liquid iron, which is then converted into steel in MMK's Oxygen Converter Shop, which contains three BOF converters (MMK's BOF converters have the largest capacity of any similar facility in the world).

This molten steel is then either (i) cast into slabs by one of MMK's four continuous casting machines located within the Oxygen Converter Shop and cut into various lengths or (ii) formed into ingots for subsequent rolling and finishing. Slabs have a rectangular cross section and are used as a starting material in the production process of different steel products in the various Rolling Shops (both hot and cold).

Alternatively, the liquid iron obtained from the blast furnaces is diverted to MMK's two remaining open-hearth furnaces and then to MMK's Blooming Shop, where it is processed into slabs or billets. Under the Modernisation Programme, MMK is scheduled to close its remaining open-hearth furnaces by 2004. Slabs originating from the continuous casting machines can also be processed in the Blooming Shop. The slabs obtained in the Blooming Shop are then used in the Hot-Rolling Shop and are processed into hot-rolled plate.

Billets produced by MMK are used in the various Long Products Shops and are converted into a whole range of long products, after being processed in different mill types. Products obtained through this process include beams, channels, round bars, square bars, steel angles, strips, mine supports, debars, hexagonal bars and wire rod.

During hot-rolling in the various Sheet Rolling Shops, several products are fabricated from slabs: in the hot-rolling shop, hot-rolled plate is produced by using two different mills. In Rolling Shop No.10, hot-rolled coil is made after passing through hot-rolling mill 2000, on which solidified steel preheated to a high temperature is continuously rolled between rotating cylinders. In Rolling Shop No.4, hot-rolled sheets, hot-rolled coil and hot-rolled strip are produced after passing through a hot-rolling mill and a cutting (sheets) or slitting line (coil, strip). Different types of finished products require different types of rolling mill equipment in this and the following production phases.

In the subsequent Rolling Shops (Nos. 3, 5, 6, 7 and 8), hot-rolled coil (produced in Rolling Shop No.4 and No.10) is converted into various products through a series of intermediate processing phases, in which several processing methods and machines are used, depending on the final end product to be obtained. These processing methods and machines include pickling, (cold) rolling and (cold) forming mills, cutting and slitting lines, tinning, electrolytic tinning or zinc galvanising lines, stamping and electric welding pipe production. End products obtained in these Rolling Shops are hot-rolled pickled sheets, cold-rolled coils and strip, cold-rolled sheets, pipes, roll-formed sections, road barrier sections, die-rolled sections, corrugated floor panels, black plate, hot dipped tin-plate, electrolytic tin-plate, galvanised sheets and a number of long and flat products.

Machinery introduced by MMK as part of the Modernisation Programme such as the hot-dip galvanising line and the polymer and colour coating unit allow MMK to produce value-added products for specialist industries such as automotive manufacture, canning for foodstuffs and containers.

KEY PRODUCTS

MMK's main products can be divided into four main groups: long products, flat products, coated rolled products and cold formed sections.

Long products

Long products are used in all industrial sectors, particularly in the construction and engineering industries, and are divided into heavy long products, light long products and wire-drawn products. MMK produces an extensive range of long products, briefly described in the following paragraphs.

Billets are semi-finished rolled steel products, which can be either rolled or continuously cast, and are further processed by rolling to produce finished products such as wire rod. MMK produces square billets and rectangular billets for re-rolling.

Square bars are produced in two varieties: square-rolled products without surface treatment for cold cutting (commodity output) and square-rolled products for further hot-rolling.

MMK produces wire rods for: wire drawing, packing, strapping and other uses, manufacturing thin wire and steel ropes, and telegraph lines.

Three types of round bars are produced, being (i) those without surface treatment, for cold cutting (commodity output) and further hot-rolling, (ii) those for cold drawing and (iii) low-alloyed high strength round-rolled products for welded structures.

Hexagonal bars can be used for the manufacture of fastenings.

Deformed bars are used by the construction industry to reinforce concrete structures.

MMK produces two types of steel angles; equal and unequal angles for welded, bolted and riveted structures.

MMK produces hot-rolled U-channels with flanged internal sides slanted for welded, bolted and riveted structures.

Beams are used for construction structures.

Flat products

Flat products are a type of steel produced by rolls with smooth surfaces and in a range of sizes, varying in thickness. The products briefly described below are all part of MMK's flat product range.

Concast slabs are used for hot re-rolling.

The following types of hot-rolled coils are produced by MMK: (i) general purpose hot-rolled coils, (ii) hot-rolled coils for welded pipes, (iii) hot-rolled coils for cold-rolling, (iv) hot-rolled coils for welded, bolted and riveted structures, (v) hot-rolled coils of structural steel for construction purposes and (vi) hot-rolled coils for fabrication by forming, bending and welding.

MMK produces hot-rolled sheets and plates for: (i) general purpose hot-rolled plates, (ii) hot-rolled plates for welded, bolted and riveted structures, (iii) high-strength hot-rolled plates for welded, bolted and riveted structures, (iv) structural hot-rolled plates for construction purposes, (v) hot-rolled plates for fabrication by forming, bending and welding, (vi) hot-rolled plates for engine building and (vii) hot-rolled plates for boilers and pressure vessels.

Three types of hot-rolled narrow strips in coils are produced by MMK: (i) general purpose hot-rolled narrow strips, (ii) hot-rolled narrow strips for cold re-rolling and (iii) hot-rolled narrow strips for welded pipe manufacturing.

Cold-rolled coils are produced in two varieties: (i) carbon cold-rolled strip of prime and ordinary quality for general purpose uses, machines and mechanisms, and cold stamping and (ii) low carbon prime grade cold-rolled strip for general purpose uses, machines and mechanisms, and cold stamping.

Cold-rolled sheets are also produced in two varieties: (i) carbon cold-rolled sheets of prime and ordinary quality for general purpose uses, machines and mechanisms, and cold stamping and (ii) low carbon prime grade cold-rolled sheets for general purpose uses, machines and mechanisms, and cold stamping.

Black plate is produced in three varieties: (i) black plate of canning quality (ChZhK) in coils for manufacturing tin-plate of canning quality, (ii) various purpose black plate (ChZhR) and (iii) general purpose black plate (ChZhON).

Cold-rolled narrow strips are also produced in three varieties: (i) low carbon cold-rolled steel strips for fabrication by bending and stamping (and used in the manufacture of pipes/tubes), cored wire and bearing components, (ii) cold-rolled strips of carbon structural steel for manufacturing machines' and structures' components and (iii) cold-rolled strips of tool and spring steel for manufacturing products such as springs and measuring tapes.

Coated rolled products

Steel can be coated either through a heat process or through electrolysis with a layer of substance to protect the base metal against corrosion. The most commonly used material is zinc which can be applied either using the heat process (hot-dip galvanising) or using electrolysis (electro-galvanising). The zinc-coated steel is often referred to as "galvanised steel". MMK produces two main types of coated rolled products, described below.

Galvanised steel is produced in four varieties by MMK: (i) hot galvanised steel sheets for cold stamping (HSh), (ii) hot galvanised steel sheets for cold shaping (HP), (iii) hot galvanised steel sheets for paint coating (PK) and (iv) general purpose hot galvanised steel sheets (ON).

Tin-plate is produced in the following varieties: (i) electrolytic tin-plate of canning quality (EZhK) for manufacturing containers, vessels, cans and lids, (ii) electrolytic tin-plate for various purposes other than manufacturing cans and lids for foodstuffs (EZhR), (iii) electrolytic tin-plate of canning quality and for various purposes with different coating (EZhK-D and EZhR-D), (iv) general purpose electrolytic tin-plate (EZhON), (v) hot-dipped tin-plate of canning quality (GZhK) for manufacturing containers, cans and lids and (vi) hot-dipped tin-plate for various purposes other than manufacturing cans and lids for foodstuffs (GZhR).

Cold formed sections

MMK produces the following cold formed sections for welded, bolted and riveted structures: (i) Mill 1x4x50-300, (ii) Mill 2-8x100-600, (iii) Mill 0.5-2.5x300-1500 and (iv) Mill 1-5x300-1650. In addition, MMK also produces cold formed sections for roadside railing.

TRANSPORT

At present, due to its location in the southern Urals, all of MMK's products are transported by rail to customers or to ports for onward transportation by ship. The Government owned railway system currently has a monopoly on rail transportation in Russia and, although railway transportation tariffs are subject to anti-monopoly control, historically they have tended to increase. In the future, MMK intends to export products under CIF and FOB conditions to its customers. MMK currently owns approximately 2,300 rail cars, which it uses to transport approximately 20 per cent. of its products, and also to provide transportation services to other businesses. The remaining 80 per cent. is transported by rail cars owned by the national rail network. Cargo transportation within MMK is carried out through MMK's own locomotive depot and technology transportation through MMK's own freight car depot.

SALES, MARKETING and CUSTOMER ANALYSIS

General

MMK has a diversified customer base in both domestic and international markets. MMK sells domestically throughout Russia, and principally to the following regions: the Urals, the Povolzhsky region, the Volgo-Vyatsky region, the Central region and the North Caucasian region. The Urals region accounts for up to 50 per cent. of all domestic sales. MMK's international sales are primarily made to the following markets: South-East Asia and China, the Far East, the Middle East and Scandinavia.

The following table sets out the regions in which the products of the MMK Group were sold to end consumers for the years ended 31 December 2002, 2001 and 2000 and the six month periods ended 30 June 2003 and 2002:

Regions	Year ended 31 December			Six months ended 30 June	
	2002	2001	2000	2003	2002
			(%)		
Russia and the CIS	43	47	41	46	43
Asia.....	27	27	25	27	28
Middle East.....	15	14	18	15	15
Europe	10	11	13	11	11
Other	5	1	3	1	3
	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>

MMK has been active in the international steel market since 1989, continually increasing the proportion of its exports (MMK included the CIS countries within the 'export' category until 2001) to about 65 per cent. of total shipments by the end of the 1990s. Since then, this proportion has gradually decreased, due to the improvements in the Russian economy and the resulting increase in domestic demand. MMK's management has decided to maintain the export volume at its present level (see below), but to increase the share of domestic deliveries with the objective of reaching a ratio of 52:48 (domestic: export) by the end of 2004. During 2000, MMK's export share was 59 per cent., with 69 per cent. of flat products and 15 per cent. of billets and slabs being exported. In 2001 and 2002, MMK's export share was 53 per cent. and 57 per cent., respectively.

The following table sets forth information on MMK's products by type and market for the three years ended 31 December 2002, 2001 and 2000 and the six month periods ended 30 June 2003 and 2002:

	Year ended 31 December			Six months ended 30 June	
	2002	2001	2000 ⁽¹⁾	2003	2002
	<i>(thousands tons)</i>				
Billets	927	1,232	880	366	419
Domestic market	103	116	115	58	20
Export	825	1,116	765	307	399
CIS countries.....	–	–	–	–	–
Section rolled products	1,372	1,291	1,285	713	650
Domestic market	976	919	858	488	467
Export	326	360	427	182	159
CIS countries.....	70	12	–	43	24
Flat products	6,242	5,569	5,638	3,191	3,153
Domestic market	2,319	2,571	2,075	1,262	1,199
Export	3,900	2,994	3,563	1,903	1,944
CIS countries.....	23	4	–	26	10
Downstream processing	1,126	919	876	692	540
Domestic market	659	574	485	359	333
Export	431	342	391	299	193
CIS countries.....	36	2	–	33	14
Total	9,667	9,011	8,678	4,962	4,762
Domestic market	4,057	4,181	3,532	2,167	2,019
Export	5,482	4,813	5,146	2,692	2,695
CIS countries.....	129	17	–	103	48

Note:

(1) 2000 production figures include joint venture activities.

MMK's flexibility, based on the level of quality and the wide range of its products, enabled it to switch part of the shipments from the South-East Asian market to North America when the financial crisis of 1997 affected Asian economies. When the devaluation of the rouble by more than 40 per cent. in 1998 increased the competitiveness of Russian steel products in the international markets, Russian steel producers sought to increase their exports to North America and EU-markets, benefiting from the solvency of these markets. However, in 2000, anti-dumping rulings in the U.S. and trade restrictions terminated MMK's exports to the U.S. while the nascent recovery in South-East Asia again encouraged and enhanced sales to this region. See "An Overview of the Steel Industry — Trade Barriers and Anti-Dumping Regulations".

The following table sets out the export sales of MMK by region of the end consumer for each of the three years ended 31 December 2002, 2001 and 2000 and the six month periods ended 30 June 2003 and 2002:

Region	Year ended 31 December			Six months ended 30 June	
	2002	2001	2000	2003	2002
	<i>(in thousand tons)</i>				
South-East Asia (incl. China).....	2,656	2,422	2,172	1,332	1,347
Africa	154	76	141	56	44
Middle East.....	1,460	1,274	1,567	740	712
Eastern Europe.....	194	111	124	99	113
Western Europe and Scandinavia ..	711	713	903	401	359
North America (incl. Canada)	176	40	56	–	69
Central and South America	29	38	80	11	7
Baltic States and former Soviet Union	102	139	103	53	44
Total	5,482	4,813	5,146	2,692	2,695

Prices in the domestic market for rolled steel are more favourable as compared with export markets and for the two years ended 31 December 2002 pricing dynamics were generally positive. MMK's most important clients are steel plants, pipe plants, machinery plants including car-makers, construction and oil, gas and energy companies.

The following table sets out the main consumers of MMK's steel products in the domestic market for each of the three years ended 31 December 2002, 2001 and 2000 and the six month periods ended 30 June 2003 and 2002:

Domestic sales	Year ended 31 December			Six months ended 30 June	
	2002	2001	2000	2003	2002
			(%)		
OAo Magnitogorsk Calibration Plant ⁽¹⁾	5.9	1.1	1.2	8.0	N/A ⁽²⁾
OAo Seversky Pipe Mill	4.8	4.3	5.8	5.1	4.7
OOO Viz-Stal	3.3	4.5	4.6	4.4	2.9
OAo Uraltrubprom.....	2.6	1.1	0.7	2.4	2.7
OAo Chelyabinsk Pipe Rolling Mill	2.5	2.7	2.5	3.5	2.6
OAo Borsky Pipe Mill	1.9	1.8	0.6	0.0	1.7
OAo Magnitogorsk Hardware Plant ⁽¹⁾	1.9	1.4	1.3	3.8	1.5
OAo Volzhsky Pipe Mill	1.8	4.6	2.2	1.5	4.6
OAo Avtovaz.....	1.5	1.3	1.6	1.8	1.4
OAo Taganrog Steel Plant	1.3	1.7	0.5	3.7	1.0

Notes:

(1) Became a subsidiary of MMK in 2002.

(2) Breakdown of OAo Magnitogorsk Calibration Plant sales for the six months ended 30 June 2002 not available.

The greatest share of MMK's export shipments consists of sheet steel products, both hot-rolled and cold-rolled. These products made up 71 per cent. of export shipments in the year ended 31 December 2002. However, the share of billets in the overall volume of product sales is steadily decreasing such that in the year ended 31 December 2001 billets accounted for more than 26 per cent. of exports, but for the year ended 31 December 2002 this figure had fallen to approximately 15 per cent. MMK expects that the proportion of billets within total exports for the year ended 31 December 2003 will not exceed 6 per cent.

One of MMK's main objectives is to increase domestic sales to at least 25 per cent. of the Russian rolled metal products market from MMK's existing 19 per cent. market share. In order to do so, MMK is working to improve its integration in the national economy of Russia, taking into account the structural changes that have taken place. MMK has already begun creating vertical marketing systems, by forming holding companies with iron and steel hardware and sizing plants and performing deeper refinement of metals.

The following table sets out a breakdown of MMK's shipments of rolled metal products by industry sector within the domestic market for the year ended 31 December 2002:

Industrial sector	Billets	Long products	Hot-rolled sheet steel	Cold-rolled sheet steel	Downstream products	Total
			(%)			
Metallurgy	11.8	21.5	60.9	17.9	1.0	35.3
<i>including Hardware ...</i>	<i>11.8</i>	<i>21.3</i>	<i>12.6</i>	<i>0.2</i>	<i>0.4</i>	<i>11.2</i>
<i>Pipe manufacture</i>	<i>0.0</i>	<i>0.2</i>	<i>48.4</i>	<i>17.8</i>	<i>0.6</i>	<i>24.1</i>
Machine-building	88.2	20.7	14.8	51.3	31.9	25.3
<i>including Automotive..</i>	<i>0.1</i>	<i>2.8</i>	<i>4.6</i>	<i>25.5</i>	<i>15.4</i>	<i>8.3</i>
<i>Ship-building</i>	<i>0.0</i>	<i>1.1</i>	<i>0.8</i>	<i>0.0</i>	<i>0.0</i>	<i>0.6</i>
<i>Transport</i>	<i>86.5</i>	<i>5.2</i>	<i>2.1</i>	<i>6.0</i>	<i>0.8</i>	<i>5.2</i>
<i>Industrial machine-</i>						
<i>building</i>	<i>1.6</i>	<i>11.7</i>	<i>7.4</i>	<i>19.8</i>	<i>15.7</i>	<i>11.1</i>
Bridge construction	0.0	0.6	2.1	0.0	0.0	1.1
Other construction	0.0	8.3	2.3	4.1	5.8	4.5
Food industry	0.0	0.0	0.0	0.0	26.6	4.3
Energy	0.0	4.0	2.6	0.8	0.7	2.4
Retail	0.0	44.9	17.2	25.9	34.0	27.2
Total	100.0	100.0	100.0	100.0	100.0	100.0

To increase MMK's sales of value added and quality metal products, MMK has begun to implement a programme to establish its own service and sales network in Russia. MMK expects that this will enable MMK to increase its share in the domestic market of rolled metal products. MMK plans to attract new customers by continually improving the quality of its products and its marketing strategy.

Analysis by Type of Product

The following table sets out revenues by principal product for the years ended 31 December 2002, 2001 and 2000 and the six month periods ended 30 June 2003 and 2002:

Revenues	Year ended 31 December			Six months ended 30 June	
	2002	2001	2000 ⁽¹⁾	2003 ⁽²⁾	2002 ⁽³⁾
	<i>(in millions of U.S. dollars)</i>				
Rolled steel	1,174	973	926	857	530
Assorted rolled products	191	225	208	119	90
Galvanised steel	82	–	–	123	–
Tin-plated steel	133	199	191	91	80
Slabs	112	89	65	46	51
Band	94	85	96	49	39
Tubes	19	28	43	11	8
Other	260	134	184	182	98
	2,065	1,733	1,713	1,478	896

Notes:

- (1) Average U.S.\$ exchange rate for 2000 was U.S.\$1 = RUR 28.12.
- (2) Average U.S.\$ exchange rate for the six months ended 30 June 2002 was U.S.\$1 = RUR 31.02.
- (3) Average U.S.\$ exchange rate for the six months ended 30 June 2003 was U.S.\$1 = RUR 31.27.

Analysis of Domestic and Export Sales

The following is an analysis of the domestic and export sales of MMK, the parent company of the MMK Group.

Domestic sales

The main domestic sales of MMK are directed at industrially developed regions, namely the Urals, Volga and Central regions, which have the highest demand for steel products. The following table sets out the domestic sales of MMK by region of the Russian Federation for each of the three years ended 31 December 2002, 2001 and 2000 and for the six month periods ended 30 June 2003 and 2002:

Domestic sales	Year ended 31 December			Six months ended 30 June	
	2002	2001	2000	2003	2002
	<i>(%)</i>				
Central	16.6	19.5	19.6	13.3	17.9
Central Black Soils	1.9	1.4	1.7	1.4	2.0
Volgo-Vyatsky	7.8	8.0	4.9	4.9	7.1
East Siberia	1.8	1.9	1.7	2.1	2.3
Far East	0.6	0.6	0.6	0.6	0.8
West Siberia	4.7	4.8	4.3	5.5	4.6
West	0.2	0.1	0	0.05	0.2
Volga	14.8	15.1	13.2	13.6	18.5
North	0.5	0.4	0.4	0.7	0.4
North West	1.2	1.7	1.4	1.0	1.4
North Caucasus	5.0	4.1	2.8	6.2	5.4
Belorussia	–	0.7	0.4	0.8	0.5
The Urals	44.9	41.7	49.0	49.9	38.9
	100	100	100	100	100

Recent Developments

On 15 September 2003, MMK entered into a strategic partnership agreement with ZAO Pipeline Metallurgical Company, which controls the Volzhsky, Sinarsky, Seversky and Taganrog pipe mills in Russia and the Artram pipe mill in Romania. These companies produce over 40 per cent. of Russian pipes, including 60 per cent. of the total pipe works completed for the oil and gas industry.

Exports

MMK sells its steel products in more than 80 countries through large and internationally recognised traders, who on-sell to various end consumers. Total export sales (by volume) increased from 1.9 million tons in 1992 to 4.8 million tons in 2001 and 5.5 million tons in 2002. MMK's export sales are adversely affected by the protective quota and duties introduced by a number of countries in respect of a range of MMK's products. See "An Overview of the Steel Industry – Trade Barriers and Anti-Dumping Regulations".

The following table sets out the main purchasers of MMK's products in the export market for each of the three years ended 31 December 2002, 2001 and 2000 and the six month periods ended 30 June 2003 and 2002:

Foreign Market	Year ended 31 December			Six months ended 30 June	
	2002	2001	2000	2003	2002
			(%)		
MMK Metal LTDA.....	41	30	29	54	36
MMK Steel Trade AG ⁽¹⁾	30	29	19	22	33
Conares Trading AG ⁽²⁾	11	18	14	12	11
Noble Resources Ltd.....	5	6	0	3	7
MMK Trading AG ⁽¹⁾	5	0	0	6	0
MMK Steel Trade and Investments N.V.	0	0	31	0	0
Other	8	17	7	3	13

Notes:

(1) Subsidiaries of MMK.

(2) Affiliate of MMK (see "– Certain Transactions").

RESEARCH AND DEVELOPMENT

MMK operates a central laboratory and a technical division and has contracts for research in place with various scientific and technological establishments. Total expenses on research and development amounted to approximately U.S.\$1.46 million for the year ended 31 December 2002.

MMK's research and development activity is aimed at maximising the development of value-added products and semi-finished products (cold-rolled and hot-rolled sheet steel, tin-plated steel, galvanised sheet steel, cold-rolled narrow strips) and achieving sustainable environmental improvement.

MMK's concentration on research and development activities is aimed at developing competitive products based on:

- the implementation of new technologies at metallurgical treatment plants and the deep refining of metals;
- expanding the range of its product lines (sheet and grade); and
- the reduction and optimisation of production costs.

Work associated with improving the technological processes in the blast furnace, the oxygen converter plant and the rolling mill accounted for the majority of research and development activity (approximately 70 per cent.) carried out at MMK in 2002.

Eight applications for the protection of intellectual property were submitted to the patent agency based on the results of research and development work, and three utility model certificates were received. The patent holder on all applications is MMK. See "– Intellectual Property".

MMK's other capital expenditure commitments are set out under "– The Modernisation Programme" above.

INTELLECTUAL PROPERTY

As at 31 December 2002, MMK had 98 patents for inventions, 29 certificates and patents for useful patterns, 33 know-how patents and one trade mark (Certificate No. 21618 of 17 April 1962). MMK maintains all necessary licences (including those for the production of steel in converters, the production of pig iron and construction and materials production licences) that it requires to operate its business. See “Overview of the Steel Industry – Licensing”. MMK’s department for innovations, inventions and patents is responsible for the upkeep and maintenance of MMK’s intellectual property rights.

INFORMATION TECHNOLOGY

On 7 July 2003, MMK entered into an agreement with Oracle for the establishment of a corporate integrated information technology system, based on the Oracle E-Business Suite, for the acquisition of Oracle software products and for technical support in respect thereof. The system is expected to be fully commissioned by the end of 2004. The system includes business modules such as operations management, human resources and payroll management, finance and accounts, inventory and stock management, sales management, budgeting and financial analysis, client relationship management, maintenance management and project management (investments and construction).

MMK believes that the commissioning of this system will reduce costs and improve MMK’s competitive position.

MARKET AND COMPETITORS

Competition

In the domestic market MMK faces competition from OAO Severstal (“Severstal”), OAO Novolipetsk Steel Mill (“Novolipetsk”) and OAO Nosta for flat products; and from Severstal, Evrazholding and OAO Mechel for long products. In addition, in the domestic market MMK has experienced competition from the producers of rolled steel in the Ukraine and Kazakhstan.

The following table sets out the shares of MMK and its main competitors in the Russian market for the years ended 31 December 2002, 2001 and 2000 (the source for market share and imports based on the volume of rolled steel output being *Metal Expert*)⁽¹⁾:

	Year ended 31 December		
	2002	2001	2000
		(%)	
MMK	19	18	16
Severstal.....	19	18	16
Novolipetsk	10	10	10
Others (Russia and CIS).....	46	45	50
Import	6	9	8
	100	100	100

Note:

(1) The above table does not include the combined holdings of the Evrazholding group, which controls, *inter alia*, NTMK and ZapSib.

Whilst there are still a significant number of small companies operating in the steel sector worldwide, the 1990s were marked by an active consolidation process within the steel sector, through mergers and acquisitions including, in particular, the LNM Group, Arcelor, ThyssenKrupp Stahl and JFE.

According to data provided by the International Iron and Steel Institute in 1998 the 20 largest steel companies produced 33.6 per cent. of the world’s steel as compared to 28 per cent. in 1996. In 2002 the 10 leading steel producers accounted for 26 per cent. of the world’s steel output (234 million tons). Growing competition worldwide has also led to accentuated conglomeration and consolidation in the Russian steelmaking industry. An example of this trend is the formation of Evrazholding, which controls such major steel mills as NTMK and ZapSib.

MMK’s two main competitors in Russia are Severstal and Novolipetsk. Whilst Evrazholding’s combined production is large and they compete with MMK in the long products market, MMK does not consider them to be as significant a competitor as Severstal and Novolipetsk. Geographically, each of these principal competitors has different strengths. Severstal is located relatively close to the ports of the North West region, allowing it to save costs on shipments to the international markets. Novolipetsk is situated within the Kursk iron ore deposit area, giving it an advantage in terms of iron ore transportation costs. MMK is closest to consumers of flat-rolled steel based east of the Urals.

Whilst Severstal benefits from its ownership of extensive iron ore deposits, MMK has a long-term relationship with OAO SSGPO (see “– Procurement of Raw Materials and Suppliers”), benefiting MMK as its iron smelting process is specially adapted to the characteristics of OAO SSGPO’s raw material, allowing MMK to both extend the life of its equipment and reduce maintenance costs.

In terms of labour productivity, MMK is the industry leader within Russia on the basis of data provided as at 30 June 2003 by OOO Chermet, producing 24.8 tons of rolled steel per worker per month, against 21.7 tons at Severstal and 15.5 tons at Novolipetsk for the six month period ended 30 June 2003.

MMK believes that the quality and range of its plant and equipment and products gives it a competitive advantage over its domestic competition. MMK has eight blast furnaces, enabling it to repair them by turns without any significant cuts in production. Severstal has five blast furnaces, one of which accounts for 45 per cent. of total capacity, and Novolipetsk also has five blast furnaces.

Severstal and Novolipetsk have previously benefited from newer machinery in terms of both plant and equipment, which were 25-30 years younger than MMK’s. However, the Modernisation Programme has led to MMK renewing and renovating its machinery. MMK’s aggregate expenditure for reconstruction and technology renewal from 1992 to 2002 has been approximately U.S.\$1.6 billion, which allows MMK to maintain high production efficiency levels (see “– The Modernisation Programme”).

FINANCE

MMK engages in various activities that support its main business, including insurance and finance.

General

Cash flow management at MMK is carried out based on short-term budgeting and on cash flow forecasts for two to three years. Financial planning is performed on the basis of an estimation of external factors (such as currency exchange rates, inflation, prices of natural monopolies and world market conditions).

MMK's operations are financed out of MMK's own, as well as borrowed, funds (including bank loans, bond issues and borrowings from other companies). MMK takes out borrowed funds to finance its current operations and investments. Long-term and medium-term borrowed funds (one to seven years) are used to finance capital investments.

In 2001, the capital expenditure of the MMK Group totalled U.S.\$287 million and borrowings spent on investments amounted to U.S.\$64 million (or 22.3 per cent.). In 2002, capital expenditures amounted to a total of U.S.\$204 million, whilst borrowings spent on investments grew to U.S.\$72 million, or 35.3 per cent. In the first six months of 2002, capital expenditures amounted to U.S.\$86 million, whilst borrowings spent on investments grew to U.S.\$70 million. In the first six months of 2003, capital expenditures amounted to U.S.\$114 million, and no borrowings were made.

Currency Risk

MMK considers the risk of rouble devaluation and growth in the euro rate in relation to the U.S. dollar (MMK's reporting currency), as the major currency risks to which it is exposed. MMK reduces these risks by maintaining a negative rouble position. MMK obtains a substantial portion of its export proceeds in U.S. dollars and a significant portion of the MMK Group's expenses are in roubles.

MMK is exposed to currency risk as it has assets and liabilities denominated in foreign currencies. As MMK does not currently use forward contracts, derivatives and other financial instruments to hedge currency risk, the main method used by MMK to control currency risk is the estimation and monitoring of MMK's foreign currency denominated assets to liabilities ratio. By minimising its open currency position, MMK is able to reduce the level of currency risk that it is exposed to. MMK also monitors exchange rate fluctuations for the purpose of quantitative estimation of its open currency position risk. In 2004, MMK intends to establish limits for the volume of its currency position, and where these limits are exceeded, to use currency risk hedging instruments.

Secured Borrowings

The following table sets out information on MMK's obligations under loans and credits secured by pledge, as of 30 June 2003:

Lender	Outstanding indebtedness in currency of loan	Pledge/Obligation amount	Type of security	Repayment Date
		<i>(in thousands)</i>		
Russian Bank	U.S.\$7,625	U.S.\$9,150	Goods in circulation	31 March 2004
Russian Bank	U.S.\$20,000	U.S.\$25,000	Pledge of rights to receive the proceeds under export contracts	29 June 2004
Russian Bank	RUR 1,249,459 (U.S.\$41,171)	RUR 2,715,046 (U.S.\$105,660)	Fixed assets	20 February 2006
		RUR 988,419 (U.S.\$31,098) RUR 198,750 (U.S.\$8,391)	Goods in circulation Ordinary shares in ZAO SPZ	
Russian Bank	RUR 1,470,000 (U.S.\$48,438)	RUR 3,150,181 (U.S.\$159,374)	Fixed assets	26 July 2006
		RUR 374,000 (U.S.\$57,326)	Goods in circulation	
German Bank	U.S.\$32,300	U.S.\$89,100	Assignment of rights under export contracts	29 November 2004

Credit facilities

As at 30 June 2003, the MMK Group had signed agreements in respect of various long term credit lines, amounts under which may be drawn down subject to the satisfaction of certain conditions. In particular, the MMK Group has signed a seven year secured facility with Citibank N.A. (London) in the amount of U.S.\$32 million to purchase equipment which will be pledged as security for the facility (as of 14 October

2003, no drawdowns under this facility had been made), a four year unsecured facility with Bank Austria Creditanstalt AG (Vienna) in the amount of U.S.\$15.4 million to purchase equipment (as of 14 October 2003, drawdowns under this facility amounted to U.S.\$6.6 million), a five year unsecured facility with BNP Paribas (Frankfurt-am-Main) in the amount of €6.8 million to purchase equipment (as of 14 October 2003, no drawdowns under this facility had been made), a five year unsecured facility with ABN AMRO Bank N.V. (Frankfurt-am-Main) in the amount of €29 million to purchase equipment (as of 14 October 2003, no drawdowns under this facility had been made) and a 1 year secured credit facility with a Russian bank in the amount of U.S.\$7 million, secured by a pledge over inventory in circulation (as of 14 October 2003, drawdowns under this facility amounted to U.S.\$5.6 million).

Domestic Bonds

MMK issued its first domestic bonds in the Russian market in March 2000. As at 30 June 2003, MMK had issued 17 such bonds in a total aggregate amount of RUR 2.9 billion (U.S.\$98.3 million), approximately RUR 1.2 billion (U.S.\$39.5 million) of which were outstanding as at that date.

Eurobonds

On 18 February 2002, the MMK Group issued €100 million 10 per cent. Guaranteed Notes due 2005 (the “2005 Notes”). The 2005 Notes constitute unsecured and unsubordinated obligations of the Issuer and rank *pari passu* with all other unsecured and unsubordinated present and future obligations of the Issuer. MMK provided an unconditional, unsecured and unsubordinated guarantee for the 2005 Notes.

LITIGATION AND OTHER CONTINGENT LIABILITIES

Litigation

In 2002, the MMK Group released U.S.\$10.8 million of a U.S.\$17.3 million provision previously recognised for litigation initiated by the Polish bank Polska Kasa Opieki S.A. against MMK in relation to an assignment to Tokobank, which went into bankruptcy in 1999. On 29 May 2002, the International Commercial Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation reduced the amount of the claim and ruled that MMK must pay an amount of U.S.\$6.5 million to Polska Kasa Opieki S.A. However, this judgement was cancelled by the ruling of the Federal Arbitration Court of the Moscow Circuit on 28 August 2003.

Save for the above, unresolved claims and litigation against the MMK Group as at 31 December 2002 amounted to U.S.\$8 million as compared with U.S.\$4 million in 2001. These include a large number of small claims and litigation relating to sales made to domestic customers and purchases of goods and services from suppliers. Based on experience in resolving such matters, MMK believes that these will be resolved without a material impact on the MMK Group.

Taxation Contingencies

The taxation system in the Russian Federation is relatively new and is characterised by numerous taxes and frequently changing legislation, which is often unclear, contradictory and subject to interpretation. Often, differing interpretations exist among the numerous taxation authorities and jurisdictions. Taxes are subject to review and investigation by a number of authorities, who are able by law to impose severe fines, penalties and interest charges.

This background may create tax risks in Russia substantially more significant than in other countries. MMK believes that it has adequately provided for all tax liabilities based on its interpretation of the tax legislation. However, the relevant authorities may have differing interpretations and the effects could be significant.

MMK pays amounts of tax due and payable both in time and in full. For the years ended 31 December 2002, 2001 and 2000, taxes paid amounted to RUR4,487 million (U.S.\$143,131), RUR3,897 million (U.S.\$133,606) and RUR7,272 million (U.S.\$258,595), respectively. For the six month periods ended 30 June 2003 and 2002, taxes paid amounted to RUR4,772 million (U.S.\$152,635) and RUR2,031 million (U.S.\$65,466), respectively.

REGULATION, TRADE BARRIERS AND ANTI-DUMPING REGULATIONS

The regulations applicable to MMK as a Russian steel producer are summarised in “An Overview of the Steel Industry”.

ENVIRONMENTAL LIABILITIES

Steelmaking activities require large quantities of raw materials and energy and have, by their very nature, an impact as regards environmental matters. Within the Russian Federation, where all of MMK's activities and sites are located, MMK is subject to regulation regarding, in particular, the handling of major accidents, the disposal of waste products such as industrial waste and waste water, air and water pollution and the protection of sites. See "An Overview of the Steel Industry – Environmental Requirements".

The MMK Group is obliged to undertake certain environmental remediation activities to ensure site restoration of a large iron ore quarry in the Magnitogorsk region. In accordance with the permission granted by the Natural Resources Ministry, the MMK Group uses 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 treated by licensed specialists. The future costs associated with the restoration of the iron ore quarry are not expected by MMK to be material. These costs, and other environmental compliance costs associated with air and water pollution, are included in the normal operating expenses of the MMK Group as they are incurred and amounted to U.S.\$2.4 million for the year ended 31 December 2002, compared to U.S.\$1.9 million for the year ended 31 December 2001.

Under existing legislation, MMK believes that there are no material environmental liabilities or contingencies that are not recorded within MMK's audited financial statements, which could have a material adverse effect on the operating results or financial position of the MMK Group. The total environmental payments to be made by MMK during 2003 under existing regulations (see "Overview of the Steel Industry – Environmental Requirements") for environmental pollution are approximately U.S.\$3.5 million.

The technical upgrading of MMK's equipment and facilities as part of the Modernisation Programme has resulted in the adoption of low-waste production processes. MMK has also sought to implement modern environmental installations and to reconstruct its existing facilities in line with applicable environmental requirements. As at 30 June 2003, MMK had 45 water-treatment installations, 342 dust and gas collecting installations and six complexes for slag and scrap treatment. MMK spends more than RUR 800 million (U.S.\$25.5 million) annually on maintenance and reconstruction.

In 2002, MMK performed approximately 80 operations designed to lower MMK's waste production and otherwise benefit the environment and implemented various other measures aimed at reducing detrimental effects on the environment to acceptable levels. These measures are now an integral part of MMK's Modernisation Programme and the Environmental Programme of the Chelyabinsk region (in compliance with which MMK has implemented nine measures within the Modernisation Programme). MMK's environmental department, which reports directly to the Technical Director/Chief Engineer, is responsible for monitoring and controlling MMK's compliance with environmental regulation. MMK's ecological monitoring conforms to Russian Federation standards. As a result of the environmental activities of MMK and the Modernisation Programme, from 1992 to 2002:

- the gross volume of emissions of pollutants into the air has decreased by approximately 1.8 times;
- the specific volume of emissions of pollutants into the air per ton of steel produced has decreased by approximately 1.8 times;
- the gross volume of emissions of pollutants into the water basin has decreased by approximately 35 per cent.;
- the specific volume of emissions of pollutants into the water basin per ton of steel produced has decreased by approximately 1.4 times; and
- consumption of industrial water has decreased by approximately 6.2 million cubic metres.

MMK is currently working on compliance with the ISO 14001 standard for environmental management systems and a certification audit is planned for May 2004.

MMK believes that its relations with environmental regulators are good and that it is in material compliance with all applicable environmental laws and regulations, based on its interpretation of such laws and regulations. Since 1998 MMK has incurred only two fines related to environmental activity in a total amount of RUR 85,000 (U.S.\$2,700).

QUALITY ASSURANCE PROGRAMME

MMK's current quality assurance system was commenced in 1999 by the General Director of MMK and is responsible for ensuring that all incoming and outgoing material meets or exceeds the required standard of quality for producing steel. In 2002 MMK was issued with certificates of compliance with ISO 9001:2000 and GOST R ISO 9001:2001 with respect to the design and production of continuous casting slabs for hot-rolling, hot-rolled coils, cold-rolled coils and sheets and cold-rolled narrow strips.

Compliance with ISO and GOST standards is monitored by an independent division of MMK which reports to the Deputy General Director for Production and Construction. Quality requirements for high-alloy steel products by end-users have generally become more stringent, and MMK believes that product quality will continue to be an important competitive factor. MMK uses advanced testing equipment for on-line quality control at different stages of production. In addition to MMK's own inspection systems, the quality of engineering steel is often verified by a representative of the buyer at MMK's facilities before shipment. Further certifications are planned and the next supervisory audit of MMK is scheduled for February 2004.

INSURANCE

The MMK Group maintains risk insurance on all of its properties and equipment through various Russian insurance companies, including principally OAO Sk "SKM" ("SKM"), an MMK affiliate, (see "– Certain Transactions"), in amounts that are consistent with customary industry practices both in Russia and internationally. In particular, the MMK Group maintains insurance of its property, plant and equipment, construction in progress and operating current assets as described in the table below. The MMK Group also insures against certain other risks including risks of industrial accidents and civil law liability. The MMK Group's property, plant and equipment is insured in accordance with its replacement cost as determined by American Appraisal (ARR) Inc. and other licensed appraisers.

For the year ended 31 December 2002 the total cost of maintaining mandatory insurance pursuant to applicable Russian legislation constituted 21.14 per cent. of the total amount spent by MMK on insurance and voluntary insurance maintained by MMK constituted the remaining 78.86 per cent.

The following table sets out the categories of mandatory insurance and voluntary insurance maintained by MMK:

<u>Mandatory insurance</u>	<u>Voluntary insurance</u>
Accident insurance of gas-rescuers	Accident insurance for employees
Accident insurance of Special Department employees such as security guards	Additional non-state pension provision for employees
Accident insurance of helicopter crew	Medical insurance
Insurance of liability to third parties when operating dangerous production facilities	Property insurance (fire and associated risks, machinery, mechanisms and equipment breakages and theft and robbery)
Third party liability insurance for motorists	Vehicle insurance (carjacking, accident and fire)
Civil liability insurance for companies that operate facilities consuming atomic energy ⁽¹⁾	Constructing-and-mounting risks insurance
Civil liability insurance in case of damage resulting from waterworks breakdown	
Civil liability insurance of aircraft operators	

Note:

(1) Mandatory insurance for all Russian companies which have access to power provided by nuclear fuel. MMK does not currently consume atomic energy.

All of MMK's production assets are insured to the extent set out above, with the exception of "social assets" providing recreational facilities for employees such as the aqua parks and ski-centre. See "– Social Projects and Commitments in Magnitogorsk". MMK does not insure its stock or against loss of profits.

The insurance premiums payable under MMK's insurance contracts meet the applicable Russian statutory requirements and rules set out by insurance companies.

SOCIAL PROJECTS AND COMMITMENTS IN MAGNITOGORSK

MMK funds or contributes to a number of social and community projects, spending RUR 505.7 million (U.S.\$17.33 million) in 2001 and RUR 864.4 million (U.S.\$27.52 million) in 2002. MMK plans to spend a further RUR 546.5 million (U.S.\$17.83 million) (including RUR 430 million (U.S.\$14 million) of its net profits) in 2003.

MMK, in co-operation with the administration of the city of Magnitogorsk, finances ANO (autonomous non-profit organisation) MSCh, spending approximately RUR 67 million (U.S.\$2.1 million) annually. The medical unit consists of two polio clinics, a hospital (with 635 beds), 65 ambulances on the shop floors, a diagnostic centre (conducting 70,000 examinations per year) and a cardiology centre (124 places).

MMK has established a comprehensive programme of leisure activities and recreation for its employees. Major projects include a sports and recreation centre Abzakovo and rest centres “Yubileyniy”, “Metallurg” and “Yuzhniy”. Approximately 15,000 MMK employees and members of their families rested and undertook treatment at these facilities during 2002.

In 2003, MMK established two summer recreation centres which over 4,000 children will visit annually. In 2002, two aqua parks were put into operation: one in the sports and recreation centre “Abzakovo” (80 visitors an hour) and the other in the centre of Magnitogorsk (350 visitors an hour). MMK also maintains four sports schools for children and teenagers.

MMK assists its employees to buy houses and apartments on hire-purchase for a period of up to nine years. In 2002, four blocks of apartments (360 apartments) were built and MMK employees have already moved in. In 2003, a further two blocks of apartments (160 apartments) will be constructed and employees will move in during September and October 2003. Construction has begun on a further four blocks of apartments (390 apartments) which are expected to be completed in the fourth quarter of 2004.

MMK supports old-age pensioners and veterans through its charitable foundation “Metallurg”, financed from net profit. “Metallurg” is involved in a number of charity projects and is responsible for the monthly payment of pensions of 25,500 pensioners and veterans of MMK. In 2002, MMK spent RUR 67 million (U.S.\$2.1 million) to finance charity projects through “Metallurg” and “Metallurg” plans to spend a further RUR 101 million (U.S.\$3.29 million) in 2003. See “– Pensions”.

In the future MMK’s priority will be to increase employees’ salaries. As these salaries are increased, MMK expects to decrease gradually levels of financing for other additional benefits such as the above. The pension levels of non-working pensioners and veterans are now growing as a result of the Russian Government’s commitment and once they exceed the living standard of pensioners, MMK intends to reduce the levels of additional charitable support of non-working pensioners and veterans.

EMPLOYEES

As at 30 June 2003, and in respect of the previous year, MMK had an average of 34,309 employees and other companies in the MMK Group had an average of 28,224 employees in 70 enterprises, including:

ZAO RMK	3,398
OOO Magnitogorsk Calibration Plant	4,560
OOO Magnitogorsk Hardware Plant	4,073
ZAO Mechanism Renovation Complex.....	6,156

The following table sets out MMK’s employees (averages for the relevant periods) as at 30 June 2003 and 2002, and as at 31 December 2002, 2001 and 2000:

30 June 2003	34,309
30 June 2002	34,074
31 December 2002	34,270
31 December 2001	33,837
31 December 2000	33,431

To date neither MMK nor any MMK Group company has experienced any strikes, labour disputes, work stoppages or actions that have materially affected the operation of their business and MMK considers its relationship with employees and the trade union to be good.

As of 30 June 2003, 99 per cent. of MMK’s employees belonged to one trade union (the Mining and Smelting Union of Russia). The activities of the trade union include the handling of issues connected with leisure, recovery after illness, the conclusion of the collective bargaining agreement of MMK (the core

contract between employees and the trade union, including negotiation of wages, concluded every year) and the conclusion of the tariff agreement.

The average monthly wage of employees (based on data for the six months ended 30 June 2003) was RUR 10,154 (U.S.\$323). MMK also plans to increase wages subject to any change in the rate of inflation and subject to a rise in labour productivity.

Notwithstanding the absence of any employee share ownership plans, MMK's employees are entitled to benefits, the amount of which depends on their monthly productivity, quality of performance, cost-savings and other economic indicators.

Health and Safety

MMK's policy on industrial and occupational safety is based on the obligation to constantly improve the quality of work in the area of industrial and occupational safety, as well as the obligation to ensure that the system for industrial and occupational safety corresponds with Russian legislation on industrial and occupational safety and accordingly MMK introduced a new standard for the Management system of industrial and occupational safety in 2002.

Together with the Academy of Labour and Social Relations, MMK has begun to develop a new "Management system of industrial and occupational safety", as well as MMK's industrial and occupational safety standards, both of which meet the requirements of international standard OHSAS 18001-99 "Occupational safety and prevention of work-related illness" for subsequent certification.

MMK provides compensation to employees injured by industrial accidents or work-related illness in accordance with current Russian legislation and, in circumstances where Russian legislation does not specify the amount of compensation due to such employees, MMK independently determines the appropriate amount and makes the payment to the injured employees and dependent relatives.

PENSIONS

Defined Contribution Obligations

Non-state pension fund "Social Protection of Senior Citizens"

The MMK Group makes monthly pension contributions to a non-state pension fund "Social Protection of Senior Citizens" where individual accumulation accounts are opened for employees.

The MMK Group has the ability to exercise influence over the financial and operating policy decisions of the fund through positions that certain employees of the MMK Group have on the highest management body, the pension board of the fund.

The monthly pension contribution amount of the MMK 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 amount of the MMK Group will be 1.5 times the employee's contribution. The annual pension contributions by the MMK Group for any one employee may not exceed RUR 2,000 (U.S.\$63) per employee. In 2002, pension contributions (relating to staff costs) by the MMK Group to the fund were U.S.\$3 million.

Russian Federation State Pension Fund

The MMK Group pays into the Russian Federation State Pension Fund a percentage of each employee's wage based on a scale established by the Russian Tax Code. In 2002, payments made to the Russian Federation State Pension Fund totalled U.S.\$28 million (2001: U.S.\$27 million). These amounts are expensed when incurred and are recorded by MMK in its IFRS accounts as taxes related to personnel expenses.

New Pension Programmes

Additionally, MMK intends from 2004 to transfer funds from the accrued portion of the pension of MMK Group employees from the Russian Federation State Pension Fund to the non-state pension fund "Social Protection of Senior Citizens" in accordance with laws of the Russian Federation.

From 2005 MMK intends to arrange the professional pension system on the basis of the non-state pension fund "Social Protection of Senior Citizens", which will include arrangements for accruals and the payment of professional pensions to the MMK Group in accordance with Russian law.

MMK also funds the "Metallurg" pension fund. See "– Social Projects and Commitments in Magnitogorsk".

MANAGEMENT

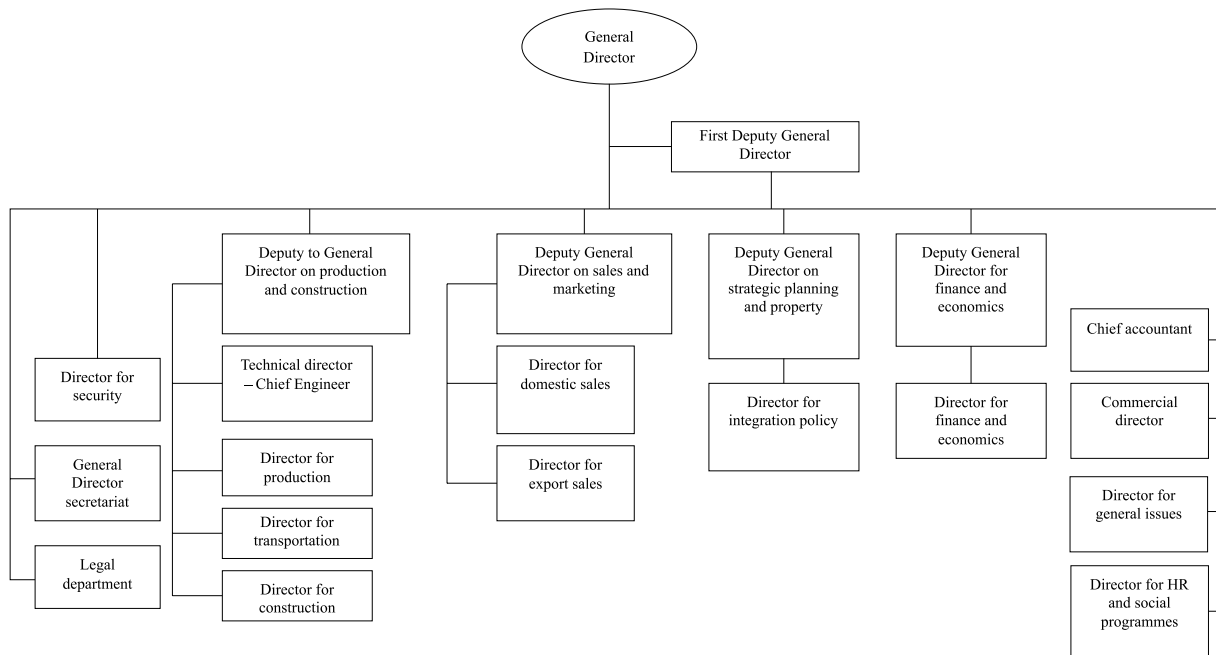
Management Structure

In accordance with the Russian Joint Stock Companies Law, the Civil Code of the Russian Federation and the Charter of MMK, the management bodies of MMK are the General Shareholders' Meeting, the Board of Directors, the Management Board (the collegiate executive body) and the General Director (the individual executive body).

MMK has a three-tier management structure. The highest management body is the General Shareholders' Meeting. The Board of Directors carries out the general management of MMK's business and the Management Board and the General Director are responsible for the day-to-day management of MMK.

MMK's Organisational Structure

MMK manages its operations under the following structure and is organised into the following divisions:



The General Shareholders' Meeting

The General Shareholders' Meeting is the highest management body of MMK. The General Shareholders' Meeting takes place annually, usually in May. The Charter provides that certain issues can only be resolved by the General Shareholders' Meeting including, *inter alia*, any amendments and additions to MMK's Charter or any approval of a new version of the Charter, the liquidation of MMK, appointment of the liquidation commission and approval of the interim and final liquidation balance sheets, increase of the charter capital by way of increasing the nominal amount of shares, reduction of the charter capital, approval of transactions (with a value of over 50 per cent. of the value of MMK's assets) and transactions involving interested parties and the appointment of the sole executive body – the General Director. Similarly, the General Shareholders' Meeting cannot consider or take decisions on issues which do not fall within its competence.

Board of Directors

The Board of Directors is responsible for the general management of MMK's activities except for those matters which, by law and under MMK's Charter, are within the exclusive power of the General Meeting of Shareholders. The Board of Directors has certain powers within its jurisdiction. These include, *inter alia*, the power to determine the priorities of MMK's operations, call the General Shareholders' Meeting and determine the agenda for such meeting, increase charter capital, issue bonds or other securities, appoint the collective executive body - the Management Board, recommend the size and manner of payment of share dividends, establish branch offices, open representative offices and decide on

transactions involving property with a value of between 25 per cent. and 50 per cent. of the book value of MMK's assets.

Under MMK's Charter, the Board of Directors consists of 10 members who are elected by the General Shareholders' Meeting through a system of cumulative voting. Members of the Board of Directors are elected for a period ending upon the occurrence of the next annual General Shareholders' Meeting. The General Shareholders' Meeting may also terminate early the authority of all members of the Board of Directors. Members of the Management Board may not comprise more than one-quarter of the Board of Directors. The Board of Directors is headed by the Chairman who is entitled to cast a tie-breaking vote. The Chairman of the Board of Directors is elected by the members of the Board of Directors from among them by a majority vote of those members of the Board of Directors present at a meeting and may be re-elected at any time by a majority vote of those members of the Board of Directors present at a meeting. The Chairman of the Board of Directors cannot simultaneously serve as the sole executive body – the General Director. In 2002, there were 15 meetings of the Board of Directors.

At present, the Board of Directors consists of the following members who were elected by the annual General Shareholders' Meeting on 30 May 2003:

Name	Other positions and principal outside activities
Alexander V. Borodin	Director of the Department of Property, Industry, Construction, Transportation and Communication of the Russian Federation's Ministry of Property Relations
Vyacheslav N. Egorov	Director of ZAO RMK
Vladimir F. Iorikh	President of Conares Trading AG
Serguei V. Krivoshchekov	MMK Deputy General Director for Strategic Planning and Ownership
Victor A. Kutishchev	MMK Commercial Director
Serguei G. Mitin	Deputy Minister of Industry, Science and Technology of the Russian Federation
Andrey A. Morozov	MMK First Deputy General Director
Victor F. Rashnikov	MMK General Director
Guennadi S. Senichev	MMK Deputy General Director for Finance and Economy
Rafkat S. Takhautdinov	MMK Deputy General Director for Production and Construction

Brief biographies of MMK's directors are set out below:

Alexander V. Borodin: Mr Borodin is the Director of the Department of Property, Industry, Construction, Transportation and Communication of the Russian Federation's Ministry of Property Relations and was first elected as a Director of MMK on 17 May 2002 by the Ministry of Property Relations as a shareholder of MMK.

Vyacheslav N. Egorov: Mr Egorov was appointed Director of ZAO RMK in 1995. He also holds the position of Chairman of the Board of Directors of MMK to which he was appointed in 1998. He joined MMK in 1970 as a gas worker and since then has held various posts including Senior Production Engineer and Executive Director of OAO MMK Complex. He holds a degree in engineering-chemical-technology.

Vladimir F. Iorikh: Mr Iorikh is the President of Conares Trading AG and was first elected as a member of the Board of Directors on 18 May 2001.

Serguei V. Krivoshchekov: Dr Krivoshchekov supervises Strategic Planning and Property for MMK. Dr Krivoshchekov has held the post of Deputy General Director of MMK since 2002. He joined MMK in 1983 as an operator. He has held various posts, including Director for Immovables and Securities, Deputy Director for Finances and Economy, Deputy Director of the Trading House for Marketing and Coordination of Administration and Deputy Director for Administration. He holds a degree in non-cutting shaping of metals and a doctorate in economics. He has also completed a course in the Management School; supervised by the General Director.

Victor A. Kutishchev: Dr Kutishchev supervises the Commercial Service of MMK. Dr Kutishchev has held the post of Commercial Director since 1998. He joined MMK in 1980 as a gas worker. He has held various posts, including membership of the Auditing Committee of MMK and Senior Engineer of Production. He holds a degree in chemical technology of solid fuel and a doctorate in engineering sciences.

Serguei G. Mitin: Mr Mitin is the Deputy Minister of Industry, Science and Technology of the Russian Federation and was first elected as a member of the Board of Directors on 17 May 2002.

Andrey A. Morozov: Dr Morozov supervises the Administration of MMK. Dr Morozov was promoted to the post of First Deputy General Director of MMK in 1998. He joined MMK in 1974 as a brigade-leader. He has held various posts, including Executive Director of the Trading house of MMK and Director of Administration of UFR. He holds a degree in non-cutting shaping of metals and doctorates in engineering sciences and economics.

Victor F. Rashnikov: Dr Rashnikov was nominated General Director of MMK in 1997. He joined MMK in 1968 as a metalworker and since then has held various posts including Senior Engineer, First Deputy General Director, Director of the Trading house, Director for Production and Trading and Chairman of the Managing Board. He holds a degree in non-cutting shaping of metals and a doctorate in engineering sciences. He is an honorary professor at the Moscow Institute of Steel and Alloys, having published dozens of scientific research works. Dr Rashnikov is a member of the Board of Directors of Joint Stock Commercial Bank Rosbank.

Guennadi S. Senichev: Mr Senichev supervises finances and economy in the administration of MMK. Mr Senichev was appointed Deputy General Director in 2002. He joined MMK in 1970 as a worker. Amongst other posts, he has been Director for the Economy of Joint Stock Company MMK. He has also held the positions of Chairman of the Board of Directors of ZAO "SKM-Invest" and First Deputy General Director of OAO TsK FPG "Magnitogorsk Steel". He acted as an Economic Adviser to the Administration of the City of Magnitogorsk in 1997. Before his appointment, he had served as Deputy General Director for Prospective Development and Capital Building. He holds a degree in non-cutting shaping of metals.

Rafkat S. Takhautdinov: Dr Takhautdinov supervises Production and Construction in the Administration of MMK. Dr Takhautdinov was appointed Deputy General Director in 2002. He joined MMK in 1980 as a metal founder. Before his appointment, he held the posts of Director for Production and Deputy General Director for Production. He has a degree in metallurgy of ferrous metals and a doctorate in engineering sciences.

Management Board

The Management Board and the General Director are the executive bodies of MMK which oversee the running of MMK's day-to-day affairs. Members of the Management Board are appointed by the Board of Directors who have the right to terminate early the authority of the Management Board and appoint a new Management Board at any time.

The powers and jurisdiction of the Management Board include determination of the Company's short-term market policies, implementation of decisions taken by the General Shareholders' Meeting or the Board of Directors and approval of transactions related to the acquisition or disposal of property with a value from 2.5 per cent. to 25 per cent. of the value of MMK's assets (including loans, pledges, guarantees) concluded in the normal course of business. Decisions at the Management Board meetings are taken by the majority of the votes of the Management Board members present at a given meeting. Meetings of the Management Board are convened by the General Director who signs all documents on behalf of MMK and minutes of meetings of the Management Board and acts without a power of attorney on behalf of MMK in accordance with decisions of the Management Board adopted within its competence. In the absence of the General Director, the functions of the Chairman of the Management Board are fulfilled by a person appointed to act as General Director of MMK. Meetings of the Management Board are held not less than once a week.

As at the date of this Offering Circular, the Management Board consists of the following members, who are appointed until the date of the next annual General Shareholders Meeting:

Name	Position within MMK
Vladimir I. Andriyanov	Director for Railway Transportation – Head of the railway transport department
Valentin V. Antonjuk	Director for Construction
Vladimir Z. Bliznyuk	Chairman of MMK Trade Union
Yuriy A. Bodyaev	Technical Director – Chief Engineer
Lyubov T. Gamper	Head of Legal Administration
Marina A. Zhemchueva	Chief Accountant
Boris A. Dubrovsky	Director for Internal Market Sales
Evgeniy V. Karpov	Director of OAO Magnitogorsk Calibration Plant
Nikolai V. Lyadov	Director for Security
Alexander L. Mastruev	Director for Personnel and Social Programmes
Andrey A. Morozov	First Deputy General Director
Victor F. Rashnikov	General Director
Alexey A. Rudchenko	Director for Integration Policy
Vladimir L. Terentev	Director for Production
Ivan F. Timoshenko	Director for General Affairs
Alexander V. Titov	Director of OAO Magnitogorsk Hardware Plant
Alexander A. Ushakov	Deputy General Director for Sales and Marketing
Arkadiy V. Chernov	Head of General Director Personnel, secretary of the Management Board

Brief biographies of the members of the Management Board of MMK are set out below:

Vladimir I. Andriyanov: Mr Andriyanov supervises Railway Transportation in MMK. Mr Andriyanov was nominated Director in 2000. He joined MMK in 1975 as an electrician. He previously held the post of Head of the Railway Transportation Administration. He holds a degree in electrical engineering sciences.

Valentin V. Antonjuk: Mr Antonjuk supervises construction in the directorate of MMK. Mr Antonjuk was nominated Director in 2001. He joined MMK in 1979 as an assistant to the excavator operator. Previously, he has served as Head of Production of GOP and Head of the Agglo-Blast Furnace Complex of MMK. He has also held the post of Head of TsPASH. He holds a degree in mine engineering.

Vladimir Z. Bliznyuk: Mr Bliznyuk has served in his post since 1992. He joined MMK in 1958 as a gas worker. Previously, he held the post of Deputy Chairman of the Trade Union Committee of MMK. He holds a degree in metallurgy of ferrous metals.

Yuriy A. Bodyaev: Mr Bodyaev was appointed Technical Director and Chief Engineer of MMK in April 2002. He joined MMK in 1986 as a metal founder's assistant and has served in numerous posts, including Senior Metallurgist and Senior Steel Founder. He holds a degree in metallurgy of ferrous metals.

Lyubov T. Gamper: Dr Gamper supervises the Legal Administration of MMK. Dr Gamper was appointed Head of Administration in 1993. She joined MMK as a Claims Inspector. She held the post of Department Head before her present appointment. She holds a degree in jurisprudence and a doctorate in jurisprudence.

Marina A. Zhemchueva: Dr Zhemchueva was appointed Senior Accountant of MMK in 1994. She joined MMK in 1981 as an accountant after working in Magnitogorsk Central Savings Bank. Previously, she held the post of Deputy Senior Accountant of MMK's Chief Accounting Section. She holds a degree in accounting and analysis of economic activity and a doctorate in economics.

Boris A. Dubrovsky: Mr Dubrovsky supervises sales on the internal market in the directorate of MMK. Mr Dubrovsky was appointed Director in 2003 after holding the post of Technical Director/Senior Engineer and Director of OAO Magnitogorsk Hardware Plant. He has also held the post of Deputy

Commercial Director. He joined MMK in 1976 as a controller's apprentice. He holds a degree in non-cutting shaping of metal.

Evgeniy V. Karpov: Mr Karpov was appointed Director of MMK in 2001. Previously, he held the post of Senior Engineer and Workshop Supervisor. He joined MMK in 1977 as a crane operator. He holds a degree in non-cutting shaping of metal.

Nikolai V. Lyadov: Mr Lyadov supervises the security in the directorate of MMK. Mr Lyadov was appointed Director in 2002. He joined MMK in 1978 as a train dispatcher. Before his appointment, he held the posts of Deputy Director of the Foreign Trading Establishment and a Director of the Self-Supporting Subdivision of Vneshtransservis. He also served as Head of the Transport and Shipping Administration of the Trading House. He holds a degree in organised shipment and transport management.

Alexander L. Mastruev: Mr Mastruev supervises Personnel Development and Social Programmes in the Administration of MMK. Mr Mastruev was appointed Director in 1995. Before joining MMK as a trains preparator in 1975, he worked in the Nijniy-Tagil Integrated Metallurgical Plant. During his career with MMK, he has held numerous posts, including Head of the Department of Scientific Labour Organisation and Remuneration, Director of the Centre of Labour Economy and Social Protection and Deputy General Director for Administration of Labour Resources and Social Programmes. He holds degrees in metallurgy of ferrous metals and organisation of production management.

Andrey A. Morozov: See Mr Morozov's biography under "Board of Directors".

Victor F. Rashnikov: See Mr Rashnikov's biography under "Board of Directors".

Alexey A. Rudchenko: Mr Rudchenko supervises Integration Politics at the Directorate for Integration Politics. Mr Rudchenko was appointed Director in 2000. He joined the Legal Department of MMK as a legal counsel in 1975. During his career with MMK, he has held several key posts, including Deputy General Director for External Economic Relations, Deputy Director-Head of the External Economic Relations Administration of the Trading House and Director for External Economic Activity and Investments of MMK. He also served as a Counsel to the General Director for Investments. He holds a degree in jurisprudence.

Vladimir L. Terentev: Dr Terentev supervises Production in the Directorate of MMK. Dr Terentev was appointed Director in 2002. He joined MMK in 1977 as operator of the weighing wagon. Before his appointment, he held the post of Senior Metallurgist at MMK and head of the blast furnace workshop. He holds a degree in metallurgy of ferrous metals and a doctorate in engineering sciences.

Ivan F. Timoshenko: Mr Timoshenko supervises General Issues in the Administration of MMK. Mr Timoshenko was appointed Director in 1997. He joined MMK in 1969 as a moulder and previously held the posts of assistant to the General Director of MMK and Head of Administration. He holds a degree in metallurgy of ferrous metals.

Alexander V. Titov: Mr Titov holds the post of Director of OAO Magnitogorsk Hardware Plant. Mr Titov was promoted to the post of Director in 2003. He joined MMK in 1975 as a metalworker and was afterwards appointed to the position of head of various workshops. He has held the post of Head of Production at ZAO Staleprokatniy Zavod and Deputy General Director for Production at MMK. He holds a degree in non-cutting shaping of metals.

Alexander A. Ushakov: Mr Ushakov supervises sales in the administration of MMK. Mr Ushakov was appointed Deputy General Director in 2003. He joined MMK in 1985 as a roller-calibrator. He was soon promoted to the post of Leading Engineer and then became head of the Export Department and head of Marketing Administration. He holds a degree in non-cutting shaping of metals.

Arkadiy V. Chernov: Mr Chernov was appointed Head of the General Director Personnel in 2002 after serving as an assistant to the General Director. He joined MMK in 1976 as a heat-treater and later took the post of Leading Engineer with "Metallugimport". He also served as Head of the Department of Coordination of External Economic Activity and the Department of Transaction Planning and Expertise. He holds a degree in physical metallurgy, equipment and technology of heat treatment of metals.

General Director

The General Director is the sole executive body of MMK. The General Director is elected by the General Shareholders' Meeting for a term of five years and may be re-elected an indefinite number of times. The General Director has authority to act in the name of MMK without power of attorney. He

may represent MMK's interests in transactions with a value of less than 2.5 per cent. of the value of MMK's assets, approve staff schedules and appointments, issue orders and decrees and other internal documents. At present, the General Director of MMK is Victor F. Rashnikov who was appointed on 17 May 2002 for a five-year term.

Compensation of members of the Board of Directors and members of the Management Board

Total aggregate compensation, including salary and bonuses and other deferred compensation, paid to Directors in 2002 was RUR 26,724,500 (U.S.\$852,728) and to members of the Management Board in 2002 was RUR 53,517,100 (U.S.\$1,707,629). No loans are provided to, and no guarantees are granted in respect of obligations of, Directors and members of the Management Board of MMK.

Auditing Committee

The financial and economic activities of MMK are monitored by MMK's Auditing Committee, MMK's Chief Accountant and MMK's Auditor, KPMG.

Inspections (audits) of MMK's financial and economic results are conducted by the Auditing Committee based on the annual results of MMK's activities, and may be conducted at any time on its own initiative or at the request of the General Shareholders' Meeting, the Board of Directors or a shareholder owning a total of a least 10 per cent. of MMK's voting shares.

Based on the results of the inspection (audit), the Auditing Committee or MMK's auditor prepares a report which contains:

- confirmation of the authenticity of data in reports and other financial documents of MMK; and
- information on violations of procedures for conducting accounting operations and submitting financial reports established by Russian law with respect to financial and economic activities.

This report must be submitted to the Board of Directors not later than 30 days prior to the annual General Shareholders Meeting. Under MMK's Charter, the Auditing Committee consists of five members elected at the General Shareholders Meeting for a term ending on the date of the next shareholders' meeting.

The present members of the Auditing Committee (who under applicable Russian law are all independent of MMK's management) are:

<u>Name</u>	<u>Position</u>
Vitaliy V. Galkin	Deputy Head of the Department of industrial and construction property of the Ministry of Property of the Russian Federation and member of Auditing Committee
Ekaterina N. Efimova	member of Auditing Committee
Nadezhda M. Kalimullina	member of Auditing Committee
Alla A. Kuznetsova	member of Auditing Committee
Anna V. Podjacheva	member of Auditing Committee

MMK's Auditor is KPMG. KPMG carries out inspections of MMK's financial and economic activities in accordance with the laws of the Russian Federation and pursuant to a contract with KPMG executed by the General Director on behalf of MMK. The appointment of KPMG as the statutory auditors of MMK is approved by the General Shareholders' Meeting of MMK. KPMG are appointed as the auditors of the IFRS consolidated financial statements of MMK by the Board of Directors of MMK.

SHARE CAPITAL AND PRINCIPAL SHAREHOLDERS

Share Capital

As at 30 June 2003, the authorised and issued share capital of MMK amounted to RUR 10,630,221,600 (U.S.\$363,000,000) and comprised 7,972,665,600 ordinary shares and 2,657,556,000 non-redeemable non-cumulative preference shares. All shares have a nominal value of RUR 1 (U.S.\$0.03). There were no unpaid shares as at such date. All shares rank equally with regard to MMK's residual assets.

Treasury Shares

As at 30 June 2003, MMK through its subsidiaries held 2,417,532,000 of its own ordinary shares and 57,914,000 of its own preference shares. As at such date MMK also controlled the voting rights over a further 2,176,932,000 of its own ordinary shares and 1,893,233,000 of its own preference shares, which subsidiaries of MMK held in a trustee capacity under trust management agreements. Dividends accrue to the beneficial owners of these shares. Transactions with the shares held under the trust management agreements can only be performed after receipt of express written instructions from the founder of the trust.

As at 26 August 2003, a further 406,740,000 ordinary and 48,241,000 preference treasury shares had been re-issued for aggregate amounts of U.S.\$21 million and U.S.\$397,000, respectively. These shares are currently held in a trustee capacity by a subsidiary of MMK under a trust management arrangement with the same terms as discussed above.

Dividends

Holders of non-redeemable non-cumulative preference shares are entitled to receive a fixed dividend of 10 per cent. of profit after tax and other deductions calculated in accordance with Russian legislation. The amount of the dividend per one preference share may not be less than the amount of dividend per one ordinary share.

Dividends declared for 2000 (RUR 9.94 (U.S.\$0.34) per share in a total amount of RUR 88,053,668.92 (U.S.\$3,018,638)) and 2001 (RUR 10.16 (U.S.\$0.32) per share in a total amount of RUR 90,002,542.88 (U.S.\$2,870,895)) were paid in full to shareholders as required. The General Shareholders' Meeting of 30 May 2003 adopted a decision to pay dividends in the amount of RUR 0.011 (U.S.\$0.0003) per ordinary share and RUR 0.033 (U.S.\$0.001) per preference share in a total amount of RUR 175,664,425.20 (U.S.\$5,733,173). Such dividends are required to be paid within 150 days following the adoption of such decision.

Voting Rights of Shareholders

The holders of fully paid ordinary shares are entitled to one vote per share at the general shareholder meetings of MMK. Shareholders that own fully paid preference shares may participate in the general meeting of shareholders with the right to vote only on issues of reorganisation or liquidation of MMK, and issues concerning amendments to MMK's charter that would restrict their rights.

According to legislation in the Russian Federation, non-cumulative preference shareholders have the same voting rights as ordinary shareholders in the event of non-payment of dividends due to preference shareholders. This right commences from the General Shareholders' Meeting following the annual meeting at which the decision was made resulting in non-payment of the preference dividend, and terminates from the moment the preference dividends are paid in full. As at the date of this Offering Circular, preference shareholders of MMK have not been granted such additional rights.

Principal Shareholders

The following table sets out the ownership of MMK's ordinary and preference share capital as at 30 June 2003:

	Number of Ordinary Shares	Per cent.	Number of Preference Shares	Per cent.
The State Property Ministry of Russia ⁽¹⁾	1,894,208,400	23.76	0	0
ZAO A-Capital ⁽³⁾	2,370,105,600	29.73	0	0
Fulwell Investments Limited ⁽²⁾	1,316,091,600	16.51	312,787,200	11.77
OOO Mekom ⁽³⁾	1,311,715,200	16.45	1,396,507,800	52.55
ZAO IK RFC ⁽³⁾	882,378,720	11.07	509,766,760	19.18
Individual shareholders ⁽⁴⁾	141,368,800	1.77	363,620,940	13.68
Other legal entities ⁽⁴⁾	56,797,280	0.71	74,873,300	2.82
Total	7,972,665,600	100	2,657,556,000	100

Notes:

- (1) Two of the members of MMK's Board of Directors are representatives of the Government. See "– Privatisation and History of Share Ownership".
- (2) Affiliated with the Mechel Steel Group. See "Privatisation and History of Share Ownership" below.
- (3) These entities are all companies within the MMK Group and serve as trustees for the MMK Group's shares. See "– Privatisation and History of Share Ownership" below.
- (4) Consists primarily of 40,000 minority shareholders.

Privatisation and History of Share Ownership

Privatisation and Share Capital

On 17 October 1992, when MMK was first privatised, the authorised capital of MMK was RUR 8,858,518,000 (U.S.\$21,345,826.5)¹, consisting of 6,643,888 registered ordinary shares each with a nominal value of RUR 1,000 (U.S.\$2.41)¹ and 2,214,630 registered preference shares each with a nominal value of RUR 1,000 (U.S.\$2.41)¹. All such preference shares, representing in total 25 per cent. of the capital of MMK, were allocated to MMK's employees. In addition, MMK's employees acquired 768,299 ordinary shares, representing 8.67 per cent. of the capital of MMK, in the course of the closed subscription (which ran from 25 October to 2 November 1992). In accordance with the Privatisation Plan of MMK, 442,926 ordinary shares, representing 5 per cent. of MMK's capital, were allocated to MMK's management between 15 October 1992 and 30 June 1993. A further 885,852 ordinary shares, representing 10 per cent. of MMK's capital, formed an Employees Shareholding Fund and were acquired by MMK employees between 30 October 1992 and 30 April 1993.

As a result of an auction held on 25 August 1994 (the "Public Auction") by the Property Fund of Chelyabinsk Oblast, a further 2,698,548 shares, representing 30.46 per cent. of MMK's capital, were distributed to 1,051 legal entities and individuals. Another auction in respect of 269,756 shares, representing 3.05 per cent. of the capital of MMK, was held on 25 August 1995 and such shares were acquired by AOOT Magnitogorsk Steel. 1,578,507 ordinary shares, representing 17.82 per cent. of MMK's total capital (ordinary and preference shares), remained under federal ownership.

In 2002, in accordance with a resolution of the general shareholders' meeting of MMK, MMK's capital was increased 1,200 times (by way of an increase of the nominal value of the shares) to RUR 10,630,221,600 (U.S.\$363,027,606.00). This increase was part of MMK's strategy to access the international capital markets and attract major investment from international investors by way of unsecured bond issues and loan facilities. The increase was followed by a share split, which resulted in the nominal value of one share falling from RUR 1,000 to RUR 1. As of 30 June 2003, MMK's total capital consisted of 7,972,665,600 ordinary shares, each with a nominal value of RUR 1 (U.S.\$0.032) and 2,657,556,000 preference shares, each with a nominal value of RUR 1 (U.S.\$0.032).

¹ Converted at the average rate published by the CBR for 1992, being RUR 415: U.S.\$1.

Principal Shareholders

From 1997 until the date of this Offering Circular, companies within the MMK Group have purchased MMK's shares in the open market. As of 30 June 2003, the MMK Group (which includes persons connected with the current management of MMK) controlled, directly or indirectly, approximately 58 per cent. of MMK's ordinary share capital.

Fulwell Investments Limited, a company established in Cyprus, is another major shareholder of MMK. A portion of its stake comprising shares representing 10.19 per cent. of the MMK's capital, was acquired by a number of Russian companies (Prime Leasing, Proxy Delta and Lyntra) in the secondary market following the Public Auction. At the beginning of 1998 this stake was transferred to Wanion Investments Ltd, Strongman Holdings Ltd, Becassine Investments Ltd. and Greenslade Trading and Investments Ltd, each of which being controlled by the TWG Group. In March 2000, this 10.19 per cent. stake was acquired by Fulwell Investments Limited.

During 2001 and 2002, certain MMK shares were acquired in the secondary market by Uglemet Trading and Arshan, companies affiliated with the South Kuzbass Group. These shares were subsequently transferred to Fulwell Investments Limited. As of 30 June 2003, companies affiliated with South Kuzbass Group (which was subsequently integrated into the Mechel Steel Group) owned 16.51 per cent. of MMK's ordinary share capital.

Magnitogorsk Steel

In 1994, MMK established a financial and industrial group as part of MMK's strategy to modernise their production facilities, launch new competitive products and finalise the construction of a hot- and cold-rolling plant. This establishment was approved by a Presidential Decree (No. 1089 dated 27 May 1994) and AOOT Magnitogorsk Steel ("Magnitogorsk Steel") was established on 14 July 1994. Magnitogorsk Steel's founder members were car making companies, steel making plants, energy, construction and machinery making companies, banks and certain other companies. On 7 June 1995 Magnitogorsk Steel was granted the status of a Russian financial and industrial group.

On establishment, Magnitogorsk Steel's capital was RUR 47,600,000,000 (U.S.\$13,408,450.7)¹, consisting of 47,600 ordinary shares each with a nominal value of RUR 1,000,000 (U.S.\$281.69)¹. MMK had a majority interest in Magnitogorsk Steel (63.3 per cent. of the total capital). MMK's contribution comprised mainly MMK shares acquired by MMK in the secondary market (2,325,916 ordinary shares representing 35 per cent. of MMK's capital and 244,581 preference shares representing 11 per cent. of MMK's outstanding preference shares). MMK intended that this contribution would constitute security for loan facilities to be obtained for MMK's investment projects.

However, in February 1997, the Board of Directors of Magnitogorsk Steel approved the establishment of three subsidiaries (OOO MSPZ-1, OOO MSPZ-2 and OOO MAGSI), and transferred to such subsidiaries 485,000, 485,000 and 994,067 ordinary shares of MMK respectively as a capital contribution. As a result of this transfer, the MMK shares (constituting a controlling stake in MMK) contributed by MMK as majority shareholder to Magnitogorsk Steel could no longer be used by MMK as security for proposed investment financings.

MMK regained control over these transferred shares in March 1998 after a series of law suits. However, such litigation was public and received extensive coverage in the international financial press and as a result of this MMK's initial plans to make secured borrowings through Magnitogorsk Steel were no longer feasible.

Despite this, MMK still required funding to implement the Modernisation Programme and execute the Credit Facility Agreement between MMK and EBRD. Therefore, the Board of Directors of Magnitogorsk Steel approved the transfer of the 30 per cent. stake in MMK to a new subsidiary, ZAO A-Capital, which was established to implement the Modernisation Programme, followed by an exchange of Magnitogorsk Steel shares into ZAO A-Capital shares, as a result of which, Magnitogorsk Steel's shareholders retained control over the MMK shares. Subsequently, the MMK Group bought out ZAO A-Capital's shares from the other shareholders and it currently controls 100 per cent. of ZAO A-Capital. Due to the persistent attempts of certain companies to gain control over the MMK shares, the shares were retained in ZAO A-Capital.

¹ Converted at the average rate published by the CBR for 1994, being RUR 3,350: U.S.\$1.

As Magnitogorsk Steel was no longer engaged in any business relevant to its status as a financial and industrial group, the general shareholders' meeting of Magnitogorsk Steel resolved in March 1999 to wind up its business. In the course of these liquidation procedures, it was established that the assets of Magnitogorsk Steel were not sufficient to satisfy all of the creditors and accordingly the general shareholders' meeting of Magnitogorsk Steel approved the initiation of a bankruptcy filing to be made with the arbitration court. The bankruptcy procedure was completed in September 2000 and was followed by the liquidation of Magnitogorsk Steel.

CERTAIN TRANSACTIONS

Interested Party Transaction under Russian Law

Russian law requires a company that enters into transactions with certain types of its affiliates that are referred to as “interested party transactions” to comply with special approval procedures. Under Russian law, an “interested party” includes (i) members of the board of directors or the collegial executive body of the company, (ii) the CEO of the company (including a managing organisation or manager), (iii) any person that owns, together with that person’s affiliates, at least 20 per cent. of the company’s voting shares or (iv) a person who on legal grounds has the right to give mandatory instructions to the company, if any of the above listed persons, or a close relative or affiliate of such person, is:

- a party to a transaction with the company, whether directly or as a representative or intermediary, or a beneficiary of the transaction;
- the owner of at least 20 per cent. of the shares in a company that is a party to a transaction with the company, whether directly or as a representative or intermediary, or a beneficiary of the transaction; or
- a member of the board of directors or the collegial executive body or the CEO of a company that is a party to a transaction with the company, whether directly or as a representative or intermediary, or a beneficiary of the transaction or an officer of the managing organisation of such company.

Transactions between members of a consolidated corporate group may be considered to be interested party transactions in certain circumstances, even when the companies involved are wholly-owned by the parent company.

Under applicable Russian law, interested party transactions are to be approved by a majority of the disinterested independent members of the board of directors of the company. Where all the directors are interested, or are not independent, or if the subject matter of the transaction exceeds 2 per cent. of the balance sheet assets of the company determined under Russian accounting principles (with certain exceptions for share placements), a majority vote of the disinterested shareholders of the company is required. The consequence of not having obtained the appropriate approval is that the transaction in question may be declared invalid upon a claim by the company or any of its shareholders.

MMK has put in place procedures to monitor interested party transactions. In particular, MMK maintains a register of such transactions in accordance with its internal regulations. The following interested parties and their related transactions, all of which MMK considers to be transactions carried out at arm’s length for a fair market value, are considered to be significant to the MMK Group.

MMK’s subsidiaries are subject to the same (or similar) legal requirements regarding the approval of interested party transactions.

OAo Credit Ural Bank (“CUB”)

At 31 December 2002, MMK and its subsidiaries held funds and their equivalents of U.S.\$23 million (31 December 2001: U.S.\$46 million) with CUB, which is controlled through the aggregate possession of a controlling financial interest by members of the Board of Directors and the Management Board of MMK. As shareholders of CUB, these directors act solely for the benefit of CUB and not in the interests of the MMK Group.

In 2002, MMK and its subsidiaries expenditure on services provided by CUB amounted to U.S.\$9 million (2001: U.S.\$9 million) and interest paid by MMK and its subsidiaries on loans and overdrafts during 2002 amounted to U.S.\$2 million (2001: U.S.\$2 million).

During 2002, CUB made loans and overdrafts to MMK and its subsidiaries in the total sum of U.S.\$249 million (2001: U.S.\$201 million) and MMK and its subsidiaries repaid loans and overdrafts in the sum of U.S.\$241 million (2001: U.S.\$179 million). By 31 December 2002, the sum of outstanding loans amounted to U.S.\$14 million (2001: U.S.\$3 million), including overdrafts of U.S.\$2 million (2001: zero). At 30 June 2003, loans outstanding to members of MMK and its subsidiaries from CUB amounted to approximately U.S.\$21 million, including overdrafts of U.S.\$4 million.

As at 31 December 2002, CUB also had outstanding loans with related parties and third persons totalling U.S.\$5 million and U.S.\$2 million respectively, in respect of which MMK and its subsidiaries have issued guarantees.

Conares Trading AG (“Conares”)

A principal shareholder of MMK has appointed a representative to the Board of Directors of MMK. The appointed director also has a controlling financial interest in Conares, an export customer of the MMK Group. During 2002, MMK and its subsidiaries made sales of U.S.\$106 million (2001: U.S.\$118 million) to Conares. As at 31 December 2002, Conares owed MMK and its subsidiaries U.S.\$3 million (2001: U.S.\$5 million).

The Government

The Government owned 23.76 per cent. of the ordinary shares of MMK as at 30 June 2003 (31 December 2002: 23.76 per cent.). The Government plans to sell its financial interest in MMK during 2003. See “– Privatisation and History of Share Ownership”.

The Government also owns, controls or has influence over the operations of many other significant companies and enterprises in the Russian Federation and has significant influence on the national economy. The MMK Group’s activities are closely linked to companies owned or controlled by the Government. The MMK Group has substantial influence in the local community and with local and regional Government authorities.

MMK considers such trading relationships to be usual in conducting business in the Russian Federation and believes that these relationships will continue for the foreseeable future.

ZAO Profit (“Profit”)

Profit is an intermediary trader that supplies scrap to the MMK Group. MMK and its subsidiaries have the ability to exercise significant influence over the financial and operating policy decisions of Profit through immediate family relationships which exist between senior directors of MMK and Profit.

In 2002, MMK and its subsidiaries purchased scrap metal totalling U.S.\$86.4 million (2001: U.S.\$63 million) from Profit, representing approximately 92 per cent. of the MMK Group’s scrap metal purchases. For the six months ended 30 June 2003, MMK and its subsidiaries purchased scrap metal totalling U.S.\$93 million from Profit, representing approximately 97 per cent. of the MMK Group’s scrap metal purchases for such period. Total accounts payable as at 31 December 2002 amounted to U.S.\$4.6 million (2001: U.S.\$7.9 million). In addition, MMK and its subsidiaries sold U.S.\$6.3 million (2001: U.S.\$6.8 million) of metal products to Profit, of which an amount of U.S.\$232,000 was outstanding at 31 December 2002.

In 2001, MMK and its subsidiaries pledged scrap metal with a book value of U.S.\$8 million as security for a loan obtained by Profit. The pledge agreement expired during 2002.

In 2002, MMK and its subsidiaries guaranteed a U.S.\$16.2 million credit facility obtained by Profit. As at 31 December 2002 Profit had drawn down an amount of U.S.\$2 million against this facility.

OAO SKM (“SKM”)

SKM is an insurance company that provides insurance-related services to the MMK Group. MMK and its subsidiaries have the ability to exercise significant influence over the financial and operating policy decisions of SKM through members of the Board of Directors of MMK’s controlling financial interest in OAO Trust Capital-M, a company in which MMK and its subsidiaries have no ownership.

MMK and its subsidiaries insured a significant portion of its risks through SKM, including the property, plant and equipment of MMK. SKM reinsured its property risks with internationally recognised insurance companies, and other risks with OAO National Insurance Group (“NIG”), a Russian legal entity.

In 2002, total insurance expense incurred by MMK and its subsidiaries with SKM amounted to U.S.\$26 million (2001: U.S.\$20 million), of which U.S.\$10 million related to co-insurance contracts primarily with NIG. Payments made by MMK to SKM totalled U.S.\$39 million (2001: U.S.\$20 million). As at 31 December 2002, MMK and its subsidiaries had recorded U.S.\$13 million of insurance prepayments to SKM (2001: Nil). SKM received a commission of approximately 13 per cent. for the provision of these insurance services.

A summary of major transactions with these parties for the six months ended 30 June 2003 and 2002 is provided below:

Related party	Transaction	Six months ending 30 June,	
		2003	2002
		<i>(U.S.\$ million)</i>	
OA0 Credit Ural Bank	Loans and overdrafts received	136	89
OA0 Credit Ural Bank	Loans and overdrafts repaid	129	84
OA0 Credit Ural Bank	Bank commissions	5	5
SKM	Insurance payments	16	13
Conares Trading	Export	78	45
MMK Louch	Domestic market	18	8
Leasing-M	Leasing payments	5	–
ZAO Vostokprominvest	Purchase of raw materials	–	18
ZAO Profit	Purchase of raw materials	93	18

THE ISSUER

Incorporation and Seat

MMK Finance S.A. (the “Issuer”) was incorporated in the Grand Duchy of Luxembourg on 19 November 2001 under the laws of the Grand Duchy of Luxembourg as a joint-stock company (*société anonyme*) for an unlimited period of time. It has its statutory seat in Luxembourg where it is registered in the Trade and Company Register of Luxembourg under number B84464. Its registered office is at 8-10 rue Mathias Hardt, L-1717 Luxembourg. Its Articles of Incorporation were first published in the *Mémorial C, Journal Officiel du Grand-Duché de Luxembourg, Recueil des Sociétés et Associations* No. 382 on 8 March 2002 on pages 18326 to 18333. They were modified on 11 January 2002 to correct some erroneous wording, such modification having been published in the *Mémorial C, Journal Officiel du Grand-Duché de Luxembourg, Recueil des Sociétés et Associations* No. 689 on 4 May 2002 on pages 33065 to 33066.

Objects

The object of the Issuer, pursuant to Article 3 of its Articles of Incorporation, is the holding of participations, in any form whatsoever, in Luxembourg companies and foreign companies, and any other form of investment, the acquisition by purchase, subscription, or in any other manner as well as the transfer by sale, exchange or otherwise of securities of any kind, and the administration, control and development of its portfolio. The Issuer has no subsidiaries.

The Issuer is authorised to finance other companies in the MMK Group and to issue bonds of any nature and of any currency.

The Issuer may carry out any commercial, industrial or financial operation which it may deem useful in accomplishment of its purposes in accordance with the Law of 10 August 1915 on Commercial Companies, as amended.

During February 2002, the Issuer issued EUR 100 million notes guaranteed by the Company subdivided into 100,000 notes in the principal of EUR 1,000 at an issue price of 99.75 per cent. These notes bear interest of 10 per cent. per annum and the interest is payable annually in arrears on 18 February in each year. The notes mature on 18 February 2005. As at 31 December 2002 accrued interest on these notes amounted to EUR 8,689,676.

The Company has unconditionally and irrevocably guaranteed the EUR 100,000,000 10 per cent. notes due 2005.

The Issuer entered into a non-interest bearing loan agreement with MMK Metal Limited on 18 February 2002 for EUR 2,100,000 for a period of three years.

Capital Stock and Ownership

The authorised capital amounts to EUR 31,000 and is divided into 31 shares of EUR 1,000 each. All shares are fully paid up. One share is held by Mr Guy Harles while the remaining 30 shares are held by MMK Steel Trade AG, Zug, Switzerland, which in turn is wholly owned by the Company.

Capitalisation

The following table shows the audited capitalisation of the Issuer as at 31 December 2002, being the most recent practical date such information is available, calculated in accordance with Luxembourg legal and regulatory requirements:

	31 December 2002
	<u>(EUR)</u>
Shareholders equity	
Issued capital.....	31,000
Retained earnings.....	(366,482)
	<u>(335,482)</u>
Non-current Liabilities	
EUR 100,000,000 10% notes of 2002/2005.....	100,000,000
Loan	2,100,000
	<u>102,100,000</u>
Current Liabilities	
Accrued Interest.....	8,689,676
Provision for liabilities and charges	6,926
Total Capitalisation	<u>110,461,120</u>

Except as disclosed herein, there has been no material change in the capitalisation of the Issuer since 31 December 2002.

Management

Board of Directors

At present, the Board of Directors consists of the following members:

A Directors

Vladimir I. Chmakov, residing at Kuibysheva St. 28, Apt. 41, Magnitogorsk, Russia

Oleg V. Fedonin, residing at Gorkogo St. 28, Apt. 28, Magnitogorsk, Russia

B Director

Guy Harles, *maitre en droit*, residing at 8-10, rue Mathias Hardt, L-1717, Luxembourg

General Meeting of Shareholders

The annual general meeting of shareholders is held in Luxembourg at the registered office of the Issuer, or at such other place in Luxembourg as may be specified in the notice of meeting, on 1 August at 10.30 a.m. If such day is a legal holiday, the annual general meeting is held on the previous business day. The first annual general meeting of shareholders was held in August 2003.

Independent Auditors

The independent auditors of the Issuer are KPMG Audit Réviseurs d'Entreprises, 31, Allée Scheffer, L-2520 Luxembourg.

Financial Year

The financial year of the Issuer begins on 1 January of each year and terminates on 31 December of the same year.

The first financial year began on the date of the formation of the Issuer and terminated on 31 December 2002. The Issuer does not prepare interim financial information.

Summary Financial Statements

The following table shows a summary of the audited balance sheet and income statement of the Issuer as at and for the period ended 31 December 2002 prepared in accordance with Luxembourg legal and regulatory requirements, and should be read in conjunction with, and is qualified in its entirety by, the financial statements of the Issuer incorporated by reference herein:

	As at 31 December 2002
	<u>(EUR)</u>
Balance Sheet	
Assets	
Formation expenses	1,725
Financial assets	100,000,000
Current assets	
Debtors becoming due and payable within one year	8,965,593
Cash at bank	12,557
Prepayments	1,481,245
Loss for the period.....	366,482
	<u>110,827,602</u>
Liabilities	
Capital and reserves	
Subscribed capital.....	31,000
Provisions for liabilities and charges.....	6,926
Creditors	
becoming due and payable within one year	8,689,676
becoming due and payable after one year	102,100,000
	<u>110,827,602</u>
	Period from 19 November 2001 to 31 December 2002
	<u>(EUR)</u>
Profit and loss account	
Charges	
External charges	44,864
Value adjustments in respect of formation expenses	525
Interest payable and similar charges.....	9,286,420
Other operating charges	266
	<u>9,332,075</u>
Income	
Other interest receivable and similar income <i>and derived from an affiliated undertaking</i>	8,965,593
Loss for the financial period.....	366,482
	<u>9,332,075</u>

TERMS AND CONDITIONS OF THE NOTES

The following, subject to amendment and save for the italicised text, are the Terms and Conditions of the Notes, substantially as they will appear in the trust deed constituting the Notes.

The U.S.\$300,000,000 8% Notes due 2008 (the “**Notes**” which expression shall, unless the context otherwise requires, include any further notes issued pursuant to Condition 15 and forming a single series with the Notes) of MMK Finance S.A. (the “**Issuer**”) are (a) constituted by, subject to and have the benefit of, a trust deed dated 21 October 2003 (as amended or supplemented from time to time, the “**Trust Deed**”) between the Issuer, Open Joint Stock Company Magnitogorsk Iron & Steel Works (the “**Guarantor**”) and The Bank of New York, London Branch as trustee (the “**Trustee**”, which expression includes all persons for the time being appointed as trustee or trustees under the Trust Deed) and (b) are the subject of an agency agreement dated 21 October 2003 (as amended or supplemented from time to time, the “**Agency Agreement**”) between the Issuer, the Guarantor, The Bank of New York, London Branch as principal paying agent (the “**Principal Paying Agent**”, which expression includes any successor principal paying agent appointed from time to time in connection with the Notes), each paying agent named therein (together with the Principal Paying Agent, the “**Paying Agents**”, which expression includes any successor or additional paying agents appointed from time to time in connection with the Notes) and the Trustee.

The payment of all amounts in respect of the Notes has been unconditionally and irrevocably guaranteed by the Guarantor pursuant to the terms of the Trust Deed.

Certain provisions of these Conditions are summaries of the Trust Deed or the Agency Agreement and are subject to their detailed provisions. The holders of the Notes (the “**Noteholders**” which expression shall be construed in accordance with Condition 1.4 and the holders of the interest coupons appertaining to the Notes (the “**Couponholders**” and the “**Coupons**” respectively)) are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and those provisions of the Agency Agreement applicable to them. Copies of the Trust Deed and the Agency Agreement are available for inspection by Noteholders during normal business hours at the Specified Offices (as defined in the Agency Agreement) of each of the Paying Agents, the initial Specified Offices of which are set out below. Copies are also available for inspection by Noteholders during normal business hours at the registered office for the time being of the Trustee, being at the date hereof One Canada Square, Canary Wharf, London E14 5AL.

1. FORM, DENOMINATION AND TITLE

1.1 *Form and Denomination*

The Notes are in bearer form, serially numbered, in the denominations of U.S.\$1,000, U.S.\$10,000 and U.S.\$100,000. Notes of one denomination will not be exchangeable for Notes of any other denomination.

1.2 *Global Notes*

The Notes are initially represented by a temporary global note (the “**Temporary Global Note**”) in bearer form, without interest coupons attached, deposited on behalf of the persons entitled to the Notes with a common depositary (the “**Common Depositary**”) for Euroclear Bank S.A./N.V. as operator of the Euroclear System (“**Euroclear**”) and Clearstream Banking, société anonyme (“**Clearstream, Luxembourg**”) on 21 October 2003. Upon deposit of the Temporary Global Note, Euroclear or Clearstream, Luxembourg, as the case may be, will have credited each such person as aforesaid with a principal amount of Notes equal to the principal amount thereof to which such person was entitled. Not earlier than 1 December 2003 the Temporary Global Note is exchangeable for a permanent global note in bearer form, without interest coupons attached (the “**Permanent Global Note**”). Exchanges of interests in the Temporary Global Note for interests in the Permanent Global Note will be effected only upon certification as to non-U.S. beneficial ownership. Save as provided in the Temporary Global Note, a beneficial owner must exchange his interest in the Temporary Global Note for an interest in the Permanent Global Note before payments of principal or interest on the Notes can be collected. The Temporary Global Note and the Permanent Global Note are together referred to as the “**Global Notes**”. The Permanent Global Note will be exchangeable for definitive Notes with Coupons attached only in the circumstances described in Condition 1.5 below. Title to each Global Note will pass by delivery (without prejudice to Conditions 1.3 and 1.4 below). Subject to Conditions 1.3 and 1.4 below, the bearer of a Global Note shall (to the fullest extent permitted by applicable laws) be treated as its absolute owner for all

purposes (whether or not such Global Note shall be overdue and notwithstanding any notice of ownership or writing on such Global Note or any notice of previous loss or theft of such Global Note).

1.3 Transfers

For so long as any of the Notes are represented by one or both of the Global Notes, such Notes will be transferable only in accordance with the rules and procedures for the time being of Euroclear or Clearstream, Luxembourg as appropriate. Title to the definitive Notes and the Coupons issued in the limited circumstances described in Condition 1.5 below will pass by delivery.

1.4 Title

Each person who is for the time being a holder of a Note and, whilst the Global Notes remain outstanding, each person who is shown in the records of Euroclear or Clearstream, Luxembourg as the holder of a particular principal amount of Notes (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the principal amount of the Notes standing to the account of any person shall be conclusive and binding for all purposes) shall be treated by the Issuer, the Guarantor, the Trustee, the Paying Agents and the bearer of the relevant Global Note as the holder of such principal amount of Notes (and the expression “**Noteholder**” and references to “**holding of Notes**” and to “**holder of Notes**” shall be construed accordingly), for all purposes other than, whilst the Global Notes remain outstanding, with respect to the payment of principal and interest on such Notes, the right to which is vested, as against the Issuer and the Guarantor, solely in the bearer of the relevant Global Notes and except that, for the purposes of receiving requests or directions from the holders of Notes, the Trustee need only have regard to the requests or directions of Euroclear or Clearstream, Luxembourg as holder on behalf of its accountholders.

1.5 Definitive Notes

The Permanent Global Note will be exchangeable in whole but not in part (free of charge to the holder) for definitive Notes only (i) if any Event of Default (as defined in Condition 9) occurs and is continuing or (ii) if either Euroclear or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so and, in any such case, no alternative clearing system satisfactory to the Trustee is available or (iii) if the Issuer would suffer a disadvantage as a result of a change in laws or regulations (taxation or otherwise) or as a result of a change in the practice of Euroclear and/or Clearstream, Luxembourg which would not be suffered were the Notes in definitive form and a certificate to such effect signed by two Directors of the Issuer is given to the Trustee. Thereupon (in the case of (i) and (ii) above) the holder of the Permanent Global Note or the Trustee may give notice to the Issuer, and (in the case of (iii) above) the Issuer may give notice to the Trustee and the Noteholders, of its intention to exchange the Permanent Global Note for definitive Notes on or after the Exchange Date (as defined below).

On or after the Exchange Date (as defined below) the holder of the Permanent Global Note may or, in the case of (iii) above, shall surrender the Permanent Global Note to or to the order of the Principal Paying Agent. In exchange for the Permanent Global Note the Issuer will deliver, or procure the delivery of, an equal aggregate principal amount of definitive Notes (having attached to them all Coupons in respect of interest which has not already been paid on the Permanent Global Note), security printed in accordance with any applicable legal and stock exchange or other relevant authority requirements and in or substantially in the form set out in the Trust Deed. On exchange of the Permanent Global Note, the Issuer will procure that it is cancelled and, if the holder so requests, returned to the holder together with any relevant definitive Notes.

“**Exchange Date**” means a day specified in the notice requiring exchange falling not less than 60 days after that on which such notice is given being a Business Day and a day on which banks are open for business in the city in which the relevant clearing system is located.

References to Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits, be deemed to include a reference to any successor operator and/or successor clearing system and/or any additional or alternative clearing system approved by the Issuer, the Principal Paying Agent and the Trustee.

1.6 Third Party Rights

Unless otherwise provided herein, no person shall have any right to enforce any term or condition of the Notes or the Coupons under the Contracts (Rights of Third Parties) Act 1999.

2. STATUS AND GUARANTEE

2.1 Status of the Notes

The Notes and the Coupons are direct, unconditional and (subject as provided in Condition 3) unsecured obligations of the Issuer and rank and will at all times rank *pari passu* without any preference among themselves and at least *pari passu* with all other present and future outstanding unsecured and unsubordinated obligations of the Issuer, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

2.2 Status of the Guarantee

The payment obligations of the Guarantor under the Trust Deed constitute direct, unconditional and (subject as provided in Condition 3) unsecured obligations of the Guarantor which rank and will at all times rank at least *pari passu* with all other present and future outstanding unsecured and unsubordinated obligations of the Guarantor, save for such obligations as may be preferred by provisions of law that are both mandatory and of general application.

3. COVENANTS

For so long as any Note remains outstanding (as defined in the Trust Deed) the Issuer and/or the Guarantor, as the case may be, undertakes to comply with each of the following covenants.

3.1 Limitation on Liens

The Guarantor shall not, and the Guarantor shall not permit any of its Material Subsidiaries to, directly or indirectly, create, incur, assume or suffer to exist any Lien, other than a Permitted Lien, on any of its assets, now owned or hereafter acquired, or any income or profits therefrom, securing any Indebtedness unless, at the same time or prior thereto, the Notes (a) are secured equally and rateably therewith to the satisfaction of the Trustee or (b) have the benefit of such other security or other arrangement as the Trustee in its absolute discretion shall deem to be not materially less beneficial to the Noteholders or as shall be approved by an Extraordinary Resolution (as defined in the Trust Deed).

3.2 Financial Covenant

The Guarantor shall not, and the Guarantor shall not permit any of its Subsidiaries to, incur any Indebtedness, other than Indebtedness in circumstances where, (a) no Event of Default shall have occurred and be continuing at the time, or would occur as a consequence, of the incurrence of such Indebtedness, and (b) after giving effect to the incurrence of such Indebtedness on a pro forma basis and the receipt and application of the proceeds therefrom, the ratio of Consolidated Indebtedness to Consolidated EBITDA (determined by reference to the most recent publicly available annual or interim financial statements of the Guarantor prepared in accordance with International Financial Reporting Standards, or such other international financial reporting standards as may be adopted from time to time by the Guarantor) is 3.5: 1 or lower.

3.3 Asset Sales

The Guarantor will not, and the Guarantor will not permit any of its Material Subsidiaries to, consummate any Asset Sale, unless the proceeds received by the Guarantor or such Material Subsidiary, as the case may be, are at least equal to the Fair Market Value of the assets sold or disposed of (as determined in good faith by the competent management body of the Guarantor or the relevant competent management body of the Material Subsidiary) and an amount equal to such proceeds (less any costs incurred in relation to such Asset Sale) (the “**Disposal Proceeds**”) is either (a) applied to repay permanently any Consolidated Indebtedness (other than subordinated Indebtedness), (b) invested in assets of a nature or type that is used or usable in the ordinary course of business of the Issuer, the Guarantor or any of its Subsidiaries, being the Core or Related Business, (c) retained as cash deposited with a bank or invested in Cash Equivalents or (d) applied to finance the acquisition, merger, reorganisation or other combination of business of the Group with the business of a Person whose business is similar to the Core or Related Business in each case

within 360 days of the date when such proceeds are received; provided that if the Disposal Proceeds are applied pursuant to paragraph (c), the Guarantor or such Material Subsidiary, as the case may be, shall apply or invest the Disposal Proceeds on or prior to the date falling 540 days after the date when such proceeds are received either to (i) repay permanently any Consolidated Indebtedness (other than subordinated Indebtedness), (ii) invest in assets of a nature or type that is used or usable in the ordinary course of business of the Issuer, the Guarantor or any of its Subsidiaries, being the Core or Related Business or (iii) applied to finance the acquisition, merger, reorganisation or other combination of business of the Group with the business of a Person whose business is similar to the Core or Related Business.

3.4 Mergers and Similar Transactions

- (a) Subject to Condition 3.4(b) below, neither the Issuer nor the Guarantor shall, without the prior consent of the Trustee, in the case of the Guarantor, enter into any reorganisation (by way of a merger, accession, division, separation, transformation or other bases or procedures for reorganisation contemplated or as may be contemplated from time to time by Russian legislation) and, in the case of the Issuer, merge with or into or enter into a transaction whose effect would be similar to that of a merger or, in the case of the Guarantor or the Issuer, sell, convey, transfer, lease or otherwise dispose of all or substantially all of its property and assets (for the avoidance of doubt, not including Capital Stock of the Guarantor) (each a “**merger**”) to any Person or permit any Person to merge with or into the Issuer.
- (b) Condition 3.4(a) shall not apply to any mergers between the Guarantor and any of its Subsidiaries or Affiliates provided that:
- (i) the Guarantor shall be the continuing Person, or the Person (if other than the Guarantor) into which the Guarantor is merged or that acquired or leased such property and assets of the Guarantor (the “**Surviving Entity**”) shall be a company organised and validly existing under the laws of the Russian Federation or a member of the European Union (as the European Union is constituted on the date hereof) and shall expressly assume, by amendment hereto, executed and delivered by such continuing Person to the Trustee, in form and substance satisfactory to the Trustee, the due and punctual payment of the principal of and interest under the Notes and Coupons, as the case may be, and the due and punctual performance and observance of all the covenants, conditions and other obligations of the Guarantor in respect of the Trust Deed and the Notes;
 - (ii) immediately before and after giving effect to such transaction or series of transactions on a pro forma basis (and treating any Indebtedness which becomes, or is anticipated to become, an obligation of the Surviving Entity or any Subsidiary thereof as a result of such transaction or series of transactions as having been incurred by the Surviving Entity or such Subsidiary at the time of such transaction or series of transactions), no Potential Event of Default or Event of Default shall have occurred and be continuing;
 - (iii) the Issuer delivers to the Trustee an opinion of counsel or tax adviser in form and substance reasonably acceptable to the Trustee, to the effect that neither the Guarantor nor the Noteholders will recognise income, gain or loss for tax purposes as a result of the merger or sale of assets and the Guarantor and the Noteholders would, after the merger or sale of assets, be subject to taxes on the same amount and in the same manner and at the same times as would have been the case if such merger or sale of assets had not occurred; and
 - (iv) the Person (if other than the Guarantor) into which the Guarantor is merged or that acquired or leased such property and assets of the Guarantor undertakes, in its ordinary course of business prior to the merger, acquisition or lease, as the case may be, a Core or Related Business.

3.5 Maintenance of Authorisations

- (a) The Issuer and the Guarantor shall, and the Guarantor shall procure that each of its Material Subsidiaries shall, take all necessary action to obtain and do or cause to be done all things necessary, in the opinion of the Issuer, the Guarantor or the relevant Material Subsidiary, to ensure the continuance of its corporate existence, its business and intellectual property relating to its business; and

- (b) the Issuer and the Guarantor shall obtain or make, and procure the continuance or maintenance of, all registrations, recordings, filings, consents, licences, approvals and authorisations, which may at any time be required to be obtained or made in Russia, the Grand Duchy of Luxembourg or any other relevant jurisdiction for the purposes of the execution, delivery or performance of the Notes and the Trust Deed and for the validity and enforceability thereof,

provided that, in any case if the Issuer, the Guarantor or as the case may be, the relevant Subsidiary can remedy any failure to comply with (a) and (b) above within 90 days of such failure or of the occurrence of such event, then this covenant shall be deemed not to have been breached.

3.6 Maintenance of Property

The Issuer and the Guarantor shall, and the Guarantor shall cause each of its Material Subsidiaries to, cause all property used in the conduct of its or their business to be maintained and kept in good condition, repair and working order and supplied with all necessary equipment and shall cause to be made all necessary repairs, renewals, replacements and improvements thereof, all as, in the judgment of the Guarantor or any such Material Subsidiary, may be reasonably necessary so that the business carried on in connection therewith may be properly conducted at all times; provided that if the Guarantor or any such Material Subsidiary can remedy any failure to comply with the above within 90 days or any failure relates to property with a value not exceeding U.S.\$10,000,000 (or its foreign currency equivalent), this covenant shall be deemed not to have been breached.

3.7 Payment of Taxes

The Issuer and the Guarantor shall, and the Guarantor shall cause each of its Material Subsidiaries to, pay or discharge, or cause to be paid and discharged, before the same shall become overdue all Taxes, assessments and governmental levies, except that if the Issuer, the Guarantor or any such Material Subsidiary can remedy any failure to comply with the above within 90 days, this covenant shall be deemed not to have been breached and further provided that no such payment or discharge of any such Taxes, assessments or government levies shall be required (a) whose amount, applicability or validity is being contested in good faith by appropriate proceedings and for which adequate reserves in accordance with International Financial Reporting Standards as consistently applied or other appropriate provision has been made or (b) whose amount, together with all such other unpaid or undischarged Taxes, assessments or government levies, does not in the aggregate exceed U.S.\$10,000,000 (or its foreign currency equivalent).

3.8 Insurance

The Issuer and the Guarantor shall, and the Guarantor shall cause each of its Material Subsidiaries to, obtain and maintain insurance with an insurer or insurers of sufficient standing (in the reasonable judgement of the Guarantor or such Material Subsidiary) against such losses and risks and in such amounts as are prudent and customary in the businesses in which they are engaged in the jurisdiction where they operate, respectively; provided that if the Issuer, the Guarantor or any such Material Subsidiary can remedy any failure to comply with the above within 90 days or if such potential losses or risks (which may be assessed by reference to the actual risks and losses borne by the Guarantor or Material Subsidiary over the preceding 3 years) do not exceed U.S.\$10,000,000 (or its foreign currency equivalent), this covenant shall be deemed not to have been breached.

3.9 Financial Information

The Guarantor undertakes that it shall deliver to the Trustee:

- (a) its audited annual financial statements, prepared in accordance with International Financial Reporting Standards, or such other international financial reporting standards as may be adopted from time to time by the Guarantor, consistently applied with the corresponding financial statements for the preceding period, within 180 days of the end of the financial year to which such statements relate; and
- (b) its semi-annual (or other interim) unaudited financial statements, prepared in accordance with International Financial Reporting Standards, or such other international financial reporting standards as may be adopted from time to time by the Guarantor, consistently applied with the corresponding financial statements for the preceding period, within 120 days of the end of the period to which such statements relate,

and, in the case of delivery of the audited annual financial statements, together with a certificate signed by two members of the board of directors of the Guarantor (one of which shall be the member of the Board of Directors responsible for financial matters) stating that the Guarantor and the Issuer, to the best of the signing directors' knowledge, has kept, observed, performed and fulfilled its obligations under, and complied with, these Conditions and the Trust Deed and is not in default in the performance or observance of any of the terms, provisions and conditions hereof or the Trust Deed (or, if an Event of Default or Potential Event of Default shall have occurred, describing all such Events of Default or Potential Events of Default of which he may have knowledge).

4. INTEREST

4.1 *Interest Payment Date*

The Notes bear interest from 21 October 2003 (the "**Issue Date**") at the rate of 8% per annum, payable semi-annually in arrear in equal instalments on 21 April and 21 October in each year (each, an "**Interest Payment Date**"), subject as provided in Condition 6. Each period beginning on (and including) the Issue Date or, as the case may be, an Interest Payment Date and ending on (but excluding) the next (or first) Interest Payment Date is herein called an "**Interest Period**".

4.2 *Cessation of Interest*

Each Note will cease to bear interest from the due date for redemption unless, upon due presentation, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at such rate (as well after as before judgment) until whichever is the earlier of (a) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (b) the day which is seven days after the Principal Paying Agent or the Trustee has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).

4.3 *Calculation of Interest*

Interest required to be calculated for any period of less than a year will be calculated on the basis of a year of 360 days consisting of 12 months of 30 days each and, in the case of an incomplete month, the actual number of days elapsed on the basis of a month of 30 days.

5. PAYMENTS

5.1 *Payment of principal and interest*

Subject as provided in Condition 5.3, payments of principal and interest on or in respect of Notes represented by the Permanent Global Note will be made against presentation of the Permanent Global Note to, or to the order of, the Principal Paying Agent or, at the option of the holder of the Permanent Global Note, at the Specified Office of any other Paying Agent, by transfer to a United States dollar account maintained by the payee with a bank in New York.

A record of each payment made on the Permanent Global Note distinguishing between any payment of principal and interest will be made on the Permanent Global Note by the Paying Agent to which the Permanent Global Note is presented for the purpose of making such payment and such record shall be *prima facie* evidence that the payment in question has been made.

Payments of principal in respect of definitive Notes will (subject as provided below) be made by transfer to a United States dollar account maintained by the payee with a bank in New York only against presentation and surrender of definitive Notes, and payments of interest in respect of definitive Notes will (subject as provided below) be made as aforesaid only against presentation and surrender of Coupons, in each case at the specified office of any Paying Agent.

Definitive Notes should be presented for payment with all unmatured Coupons appertaining thereto, failing which the amount of any missing unmatured Coupon (or, in the case of payment not being made in full, the same proportion of the amount of such missing unmatured Coupon as the sum so paid bears to the sum due) will be deducted from the sum due for payment. Each amount of principal so deducted will be paid in the manner mentioned above against surrender of the relative missing Coupon at any time before the expiry of 10 years after the Relevant Date (as defined in Condition 18) in respect of such principal (whether or not such Coupon would otherwise have become void under Condition 8), but in no event thereafter.

If the due date for redemption of any definitive Note is not an Interest Payment Date, interest (if any) accrued in respect of such Note from and including the preceding Interest Payment Date or, as the case may be, the Issue Date shall be payable only against surrender of the relevant definitive Note.

5.2 *Payments to holder of the Permanent Global Note*

The holder of the Permanent Global Note (or, as provided in the Trust Deed, the Trustee) is the only person entitled to receive payments of principal and interest on the Notes represented by the Permanent Global Note and the Issuer and the Guarantor will each be discharged by payment to, or to the order of, the holder of the Permanent Global Note (or the Trustee, as the case may be) in respect of each amount so paid. No person other than the holder of the Permanent Global Note (or, as provided in the Trust Deed, the Trustee) shall have any claim against the Issuer or the Guarantor in respect of any payments due on the Permanent Global Note.

5.3 *Payments subject to laws and regulations*

All payments in respect of the Notes are subject in all cases to any applicable or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 7. No commissions or expenses shall be charged to the Noteholders in respect of such payments.

5.4 *Payment on a Business Day*

The holder of the Permanent Global Note or definitive Note, as the case may be, shall be entitled to present the Permanent Global Note or definitive Note, as the case may be, for payment only on a Presentation Date and shall not be entitled to any further interest or other payment if a Presentation Date is after the due date.

“**Presentation Date**” means a day which (subject to Condition 8):

- (a) is or falls after the due date;
- (b) is a Business Day in the place of the Specified Office of the Paying Agent at which the Note is presented for payment; and
- (c) in the case of payment by credit or transfer to a United States dollar account in the City of New York (as referred to above) is a Business Day in the City of New York and London.

In this Condition 5, “**Business Day**” means, in relation to any place, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in that place.

5.5 *Partial Payment*

If a Paying Agent makes a partial payment in respect of any Note or Coupon presented to it for payment, such Paying Agent will endorse thereon a statement indicating the amount and date of such payment.

5.6 *Paying Agents*

In acting under the Agency Agreement and in connection with the Notes, the Paying Agents act solely as agents of the Issuer and the Guarantor and (to the extent provided therein) the Trustee and do not assume any obligations towards or relationship of agency or trust for or with any of the Noteholders. The initial Paying Agents and their initial Specified Offices are listed below. The Issuer and the Guarantor reserve the right (with prior approval of the Trustee) at any time to vary or terminate the appointment of any Paying Agent and to appoint a successor Principal Paying Agent and additional or successor Paying Agents; provided that the Issuer shall at all times maintain a Principal Paying Agent and at least two Paying Agents (one of which may be the Principal Paying Agent) having Specified Offices in separate European cities approved by the Trustee, one of which, so long as the Notes are listed on the Luxembourg Stock Exchange, shall be Luxembourg. In addition, the Issuer undertakes that it will ensure that it maintains a paying agent in a European Union member state that will not be obliged to withhold or deduct tax pursuant to any European Union Directive referred to in Condition 7.1(c) or any law implementing or complying with or introduced in order to conform to, such Directive. Notice of any change in any of the Paying Agents or in their Specified Offices shall promptly be given to the Noteholders in accordance with Condition 12.

6. REDEMPTION AND PURCHASE

6.1 *Redemption on Maturity Date*

Unless previously redeemed, or purchased and cancelled as provided below, the Notes will be redeemed at their principal amount on 21 October 2008.

6.2 *Redemption for taxation reasons*

If (a) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction, or any change in the application or generally accepted official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after 14 October 2003, on the next Interest Payment Date either (i) the Issuer would be, or will become required to pay increased amounts as provided or referred to in Condition 7 or (ii) the Guarantor would be unable for reasons outside its control to procure payment by the Issuer and in making payment itself would be, or will become required to pay such additional amounts, and (b) the requirement cannot be avoided by the Issuer or, as the case may be, the Guarantor taking reasonable measures available to it, the Issuer may at its option, having given not less than 30 nor more than 60 days' notice to the Noteholders in accordance with Condition 12 (which notice shall be irrevocable), redeem all the Notes, but not some only, at any time at their principal amount together with interest accrued to but excluding the date of redemption, provided that no notice of redemption shall be given earlier than 90 days before the earliest date on which the Issuer or, as the case may be, the Guarantor would be required to pay the additional amounts were a payment in respect of the Notes then due. Prior to the publication of any notice of redemption pursuant to this paragraph, the Issuer shall deliver to the Trustee a certificate signed by two members of the board of directors of the Issuer or, as the case may be, the Guarantor stating that the requirement referred to in (a) above applies or will apply on the next Interest Payment Date and cannot be avoided by the Issuer or, as the case may be, the Guarantor taking reasonable measures available to it and the Trustee shall be entitled to accept the certificate as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event it shall be conclusive and binding on the Noteholders and the Couponholders.

6.3 *Purchases*

The Issuer, the Guarantor or any of its Subsidiaries may at any time purchase Notes (provided that all unmatured Coupons appertaining to the Notes are attached thereto or surrendered therewith) in the open market or otherwise and at any price.

6.4 *Cancellation of Notes*

The Issuer, the Guarantor and any of its Subsidiaries may resell all Notes so purchased. All Notes redeemed by the Issuer, a Guarantor or any of its Subsidiaries shall be cancelled together with all relevant unmatured Coupons attached to the Notes or surrendered with the Notes and may not be reissued or resold.

7. TAXATION

7.1 *Taxation*

All payments of principal and interest in respect of the Notes by or on behalf of the Issuer or the Guarantor shall be made free and clear of, and without withholding or deduction for, any taxes, duties, assessments or governmental charges of whatsoever nature (“**Taxes**”) imposed, levied, collected, withheld or assessed by or on behalf of any of the Relevant Jurisdictions, unless such withholding or deduction of the Taxes is required by law. In that event, the Issuer or (as the case may be) the Guarantor shall pay such increased amounts as will result in the receipt by the Noteholders and Couponholders of such amounts as would have been received by them if no such withholding or deduction had been required, except that no such additional amounts shall be payable in respect of any Note or Coupon:

- (a) to, or to a third party on behalf of, a holder who is liable to such taxes, duties, assessments or governmental charges in respect of such Note or Coupon by reason of such holder having some connection with a Relevant Jurisdiction other than the mere holding of such Note or Coupon or by the receipt of principal, or interest in respect of any Note or Coupon; or

- (b) presented for payment more than 30 days after the Relevant Date except to the extent that the relevant holder would have been entitled to such additional amounts if it had presented such Note or Coupon on the last day of such period of 30 days; or
- (c) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to any European Union Directive on the taxation of savings income implementing the conclusions of the ECOFIN Council meetings of 26-27 November 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (d) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note or Coupon to another Paying Agent in a member state of the European Union.

7.2 References to Principal or Interest

Any reference in these Conditions to principal or interest shall be deemed to include any additional or increased amounts in respect of principal or interest (as the case may be) which may be payable under this Condition 7 or any undertaking given in addition to or in substitution of this Condition 7 pursuant to the Trust Deed.

8. PRESCRIPTION

Claims for principal shall become void unless the relevant Notes or Coupons are presented for payment within ten years of the appropriate Relevant Date. Claims for interest shall become void unless the relevant Notes or Coupons are presented for payment within five years of the appropriate Relevant Date.

9. EVENTS OF DEFAULT

If any of the following events (“Events of Default”) occurs and is continuing, the Trustee at its discretion may, and if so requested by holders of at least one quarter in principal amount of the Notes then outstanding or if so directed, by an Extraordinary Resolution (as defined in the Trust Deed) shall (subject in each case to it being indemnified to its satisfaction), give notice to the Issuer that the Notes are, and they shall immediately become, due and payable at their principal amount together with accrued interest:

- (a) default by the Issuer or the Guarantor in the payment of principal of (or premium, if any, on) the Notes, in the currency and in the manner provided herein, when the same becomes due and payable at maturity, upon acceleration, redemption or otherwise if such default continues for a period of 3 Business Days;
- (b) default by the Issuer or the Guarantor in the payment of interest on the Notes, in the currency and in the manner provided herein when the same becomes due and payable if such default continues for a period of 5 Business Days;
- (c) default by the Issuer or the Guarantor in the performance or breach of any other provisions of the Notes or the Trust Deed and, other than with respect to the provisions of Conditions 3.3, 3.5, 3.6, 3.7, 3.8 and 3.9, that failure continues for a period of 15 days (except where in any such case that failure is not capable of remedy);
- (d) any Indebtedness of either the Issuer, the Guarantor or any of its Subsidiaries is not paid when due (taking into account any originally applicable grace period), or any Indebtedness of either the Issuer, the Guarantor or any of its Subsidiaries is either declared to be or otherwise becomes due and payable prior to its Stated Maturity by reason of the occurrence of a default (howsoever described) in relation thereto; provided, however, that the total amount of such Indebtedness which is not paid when due or becomes due and payable prior to its Stated Maturity is equal to or greater than U.S.\$20 million (or its equivalent in another currency) disregarding any guarantee of the Issuer, the Guarantor or its Subsidiaries given in respect of such Indebtedness owed by the Issuer, the Guarantor or its Subsidiaries, as the case may be;
- (e) any final, non-appealable and non-reviewable judgment or order for the payment of money in excess of U.S.\$25,000,000 (or its foreign currency equivalent) in the aggregate for all such final and non-appealable judgments or orders against all such Persons shall be rendered against the Issuer, the Guarantor or any of its Material Subsidiaries and shall not be paid or discharged, and there shall be any period of 30 consecutive calendar days following entry of the final, non-appealable and non-reviewable judgment or order that causes the aggregate amount for all such final, non-appealable

and non-reviewable judgments or orders outstanding and not paid or discharged against all such Persons to exceed U.S.\$25,000,000 (or its foreign currency equivalent);

- (f) the validity of the Trust Deed or the Notes is contested by the Issuer or the Guarantor or the Issuer or the Guarantor shall deny any of its obligations under the Trust Deed or the Notes; or it is, or will become, unlawful for the Issuer or the Guarantor to perform or comply with any of its obligations under or in respect of the Trust Deed or the Notes or any of such obligations shall become unenforceable or cease to be legal, valid and binding;
- (g) a decree, judgment, or order by any Agency or court, in each case of competent jurisdiction shall have been entered (i) adjudging the Issuer, the Guarantor or any of its Material Subsidiaries as bankrupt or insolvent, or (ii) instituting supervision (*nablyudeniye*), financial rehabilitation (*finansovoye ozdorovlenie*) or external management (*vneshneye upravleniye*) or bankruptcy management (*konkursnoye proizvodstvo*) (as the above terms are defined in the Federal Law of the Russian Federation No. 127-FZ “On Insolvency (Bankruptcy)” of 26 October 2002 (as amended or replaced from time to time) (the “**Bankruptcy Law**”)) on the Guarantor or any of its Material Subsidiaries or any analogous proceedings under the laws of the Grand Duchy of Luxembourg or other applicable jurisdiction, and such decree or order shall have continued undischarged and unstayed for a period of 60 days, with respect to the Guarantor or any of its Material Subsidiaries organised under the laws of Russia, or 15 days, with respect to the Issuer or any Material Subsidiaries of the Guarantor organised under the laws of a jurisdiction other than Russia; or a decree or order of a court of competent jurisdiction over the appointment of a receiver, liquidator, trustee, or assignee in bankruptcy or insolvency of the Issuer, the Guarantor or any of its Material Subsidiaries, or any substantial part of the assets or property of any such Person, or for the winding up or liquidation of the affairs of any such Person, shall have been entered, and such decree, judgment or order shall have remained in force undischarged and unstayed for a period of 60 days, with respect to the Guarantor or any of its Material Subsidiaries organised under the laws of Russia, or 15 days, with respect to the Issuer or any Material Subsidiaries of the Guarantor organised under the laws of a jurisdiction other than Russia except for the purpose of, and followed by, a reconstruction, amalgamation, reorganisation, merger or consolidation on terms approved prior to such reconstruction, amalgamation, reorganisation, merger or consolidation by the Trustee or by an Extraordinary Resolution or on terms in accordance with Condition 3.4;
- (h) the Issuer, the Guarantor or any of its Material Subsidiaries shall institute proceedings to be adjudicated a voluntary bankrupt, or shall consent to the filing of a bankruptcy proceeding against it, or shall file a petition or answer or consent seeking reorganisation under any bankruptcy or similar law or similar statute, or shall consent to the filing of any such petition, or shall consent to the appointment of a custodian, receiver, liquidator, trustee or assignee in bankruptcy or insolvency of it or any substantial part of its assets or property, or shall make a general assignment for the benefit of creditors, or shall admit its inability to pay its debts generally as they become due, or shall, within the meaning of the Bankruptcy Law, or any analogous legislation under the laws of the Grand Duchy of Luxembourg, become insolvent, fail generally to pay its debts as they become due, or takes any corporate action in furtherance of or to facilitate, conditionally or otherwise, any of the foregoing;
- (i) any distress or execution affects any asset or assets of the Issuer, the Guarantor or any of its Material Subsidiaries having an aggregate value of in excess of US\$10,000,000 (or its foreign currency equivalent) and is not discharged, stayed or fully bonded within 60 days of taking such affect; and
- (j) any event occurs that, under the laws of any relevant jurisdiction, has an analogous effect to any of the events referred to in any of the foregoing paragraphs provided that no such event shall constitute an Event of Default until, where applicable, the expiry of the periods referred to in Conditions 9(a), (b), (c), (e), (g) and (i).

In this Condition 9, “**Business Days**” means a day (other than a Saturday or Sunday) on which commercial banks are open for business (including dealings in foreign exchange and foreign currency deposits) in New York, London and Moscow.

10. REPLACEMENT OF NOTES AND COUPONS

If any Note or Coupon is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the Specified Office of the Luxembourg Paying Agent, subject to all applicable laws and stock exchange requirements,

upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer may reasonably require. Mutilated or defaced Notes or Coupons must be surrendered before replacements will be issued.

11. MEETINGS OF NOTEHOLDERS; MODIFICATION AND WAIVER; SUBSTITUTION

11.1 Meetings of Noteholders

The Trust Deed contains provisions for convening meetings of Noteholders to consider matters relating to the Notes, including the modification of any provision of these Conditions or the Trust Deed. Any such modification may be made if sanctioned by an Extraordinary Resolution. Such a meeting may be convened by the Trustee, the Issuer or the Guarantor, or by the Trustee upon the request in writing of Noteholders holding not less than 10 per cent. of the aggregate principal amount of the outstanding Notes. The quorum at any meeting convened to vote on an Extraordinary Resolution will be one or more persons holding or representing a clear majority of the aggregate principal amount of the outstanding Notes or, at any adjourned meeting, one or more persons holding or representing one more than one quarter of the aggregate principal amount of the outstanding Notes; provided that certain proposals (including any proposal to change any date fixed for payment of principal or interest in respect of the Notes, to reduce the amount of principal or interest payable on any date in respect of the Notes, to alter the method of calculating the amount of any payment in respect of the Notes or the date for any such payment, to change the currency of payments under the Notes or to change the quorum requirements relating to meetings or the majority required to pass an Extraordinary Resolution) may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders at which one or more persons holding or representing at least 75 per cent. of the aggregate principal amount of the outstanding Notes form a quorum (or at any adjourned meeting, at least 51 per cent.). Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present or not and on all Couponholders.

11.2 Modification of the Notes and the Trust Deed

The Trustee may agree, without the consent of the Noteholders or Couponholders, to (a) any modification of any of the provisions of the Trust Deed that is of a formal, minor or technical nature or is made to correct a manifest error, (b) any other modification (except as mentioned in the Trust Deed), and any waiver or authorisation of any breach or proposed breach, of any of the provisions of the Trust Deed and (c) determine that any Event of Default or Potential Event of Default will not be treated as such, provided that such modification, waiver or determination is in the opinion of the Trustee not materially prejudicial to the interests of the Noteholders and, if the Trustee so requires, such modification shall be notified to the Noteholders as soon as practicable.

11.3 Substitution

The Trust Deed contains provisions permitting the Trustee to agree, subject to such amendment of the Trust Deed and such other conditions as the Trustee may require, but without the consent of the Noteholders, to the substitution of any other company in place of the Issuer, the Guarantor or of any previous substituted company, as principal debtor under the Trust Deed and the Notes and the Coupons.

11.4 Entitlement of the Trustee

In connection with the exercise of its functions (including but not limited to those referred to in this Condition 11) the Trustee shall have regard to the interests of the Noteholders as a class and shall not have regard to the consequences of such exercise for individual Noteholders or Couponholders and the Trustee shall not be entitled to require, nor shall any Noteholder or Couponholder be entitled to claim, from the Issuer or the Guarantor any indemnification or payment in respect of any tax consequence of any such exercise upon individual Noteholders or Couponholders.

12. NOTICES

Without prejudice to the requirements of the Luxembourg Stock Exchange, notices to the Noteholders and Couponholders shall be valid if published in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*) or, if such publication is not practicable, in a leading English language daily newspaper having general circulation in Europe and by delivery of the

relevant notice to Euroclear and Clearstream, Luxembourg. Any such notice shall be deemed to have been given on the date of delivery of such notice to Euroclear and Clearstream, Luxembourg.

13. ENFORCEMENT

The Trustee may, at its discretion and without further notice, institute such proceedings in the manner contemplated in Condition 17 against the Issuer and/or the Guarantor, as the case may be, as it may think fit to enforce the terms of the Trust Deed and the Notes; but it need not take any such proceedings unless (a) it shall have been so directed by an Extraordinary Resolution or so requested in writing by Noteholders holding at least one quarter in principal amount of the Notes outstanding, and (b) it shall have been indemnified to its satisfaction. No Noteholder may proceed directly against the Issuer and/or the Guarantor, as the case may be, unless the Trustee, having become bound so to proceed, fails to do so within a reasonable time and such failure is continuing.

14. INDEMNIFICATION OF THE TRUSTEE

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility. The Trustee is entitled to enter into business transactions with the Issuer and any entity related to the Issuer without accounting for any profit.

15. FURTHER ISSUES

The Issuer may from time to time without the consent of the Noteholders create and issue further notes having the same terms and conditions as the Notes (so that, for the avoidance of doubt, references in the conditions of such notes to “**Issue Date**” shall be to the first issue date of the Notes) and so that the same shall be consolidated and form a single series with the Notes, and references in these Conditions to “**Notes**” shall be construed accordingly.

16. CURRENCY INDEMNITY

Any amount received or recovered in a currency other than the currency in which payment under the relevant Note or Coupon is due (whether as a result of, or of the enforcement of, a judgment or order of a court of any jurisdiction, in the winding-up or dissolution of the Issuer or the Guarantor or otherwise) by any Noteholder or Couponholder in respect of any sum expressed to be due to it from the Issuer or the Guarantor shall only constitute a discharge to the Issuer or the Guarantor, as the case may be, to the extent of the amount in the currency of payment under the relevant Note or Coupon that the recipient is able to purchase with the amount so received or recovered in that other currency on the date of that receipt or recovery (or, if it is not practicable to make that purchase on that date, on the first date on which it is practicable to do so). If the amount received or recovered is less than the amount expressed to be due to the recipient under any Note or Coupon, the Issuer, failing whom the Guarantor, shall indemnify the recipient against the cost of making such purchase. These indemnities constitute a separate and independent obligation from the Issuer’s and the Guarantor’s other obligations, shall give rise to a separate and independent cause of action, shall apply irrespective of any indulgence granted by any Noteholder or Couponholder and shall continue in full force and effect despite any other judgment, order, claim or proof for a liquidated amount in respect of any sum due under any Note or any other judgment or order.

17. GOVERNING LAW, JURISDICTION AND ARBITRATION

17.1 Governing Law

The Notes are governed by, and shall be construed in accordance with, English law. The provisions of Articles 86 to 94-8 of the Luxembourg law on commercial companies of 10 August 1915, as amended, are excluded.

17.2 Arbitration

- (a) Subject to Condition 13 and notwithstanding Condition 17.2(b), each of the Issuer and Guarantor has agreed in the Trust Deed that the Trustee or any Noteholder may elect by written notice to the Issuer and/or the Guarantor, as the case may be, that, with respect to the Trustee or such Noteholder (as the case may be), any claim, dispute or difference of whatever nature arising under, out of or in connection with the Notes (including a claim, dispute or difference regarding the existence, termination or validity of the Notes or the Trust Deed (a “**Dispute**”)) shall be resolved by litigation and not by arbitration (a “**Litigation Election**”), provided that a Litigation Election may

not be made by a Noteholder who has (i) given or received notice of arbitration pursuant to the Rules of the London Court of International Arbitration (the “**Rules**”) with respect to such Dispute and (ii) appointed an arbitrator under the Rules or failed to do so within the time prescribed by the Rules.

- (b) Subject to Condition 17.2(a) and 17.3, any Dispute between the Issuer and/or, as the case may be, the Guarantor and the Trustee and any Noteholder(s) shall be finally settled by arbitration in accordance with the Rules as at present in force and as modified by this Condition, which Rules shall be deemed incorporated in this Condition. For the purposes of any arbitral proceedings commenced pursuant to this Condition:
 - (i) the number of arbitrators shall be three;
 - (ii) the seat of arbitration shall be London, England;
 - (iii) the language of arbitration shall be English;
 - (iv) without prejudice, and subject to Condition 17.2(a), the arbitral tribunal under appropriate circumstances shall have the power to order, upon the application of any of the Issuer, the Guarantor, any Noteholder(s) (whether or not such applicant is an existing party to the arbitral proceedings), the joinder of any of the Issuer, or Guarantor, any Noteholder(s) to the arbitral proceedings; and
 - (v) Sections 45 and 69 of the Arbitration Act 1996 shall not apply.
- (c) In the event that a Litigation Election is made in the manner contemplated in Condition 17.2(a), the arbitration agreement contained in Condition 17.2(b) shall be inoperative in relation to the person making the election and, for the avoidance of doubt, the matters in respect of which the Litigation Election is made cannot thereafter be referred to arbitration by such person.

17.3 Jurisdiction

In the event that a Litigation Election has been made in the manner contemplated in Condition 17.2(a) with respect to any Dispute, each of the Issuer and the Guarantor, for the benefit of the Trustee and/or any Noteholder(s) that make(s) a Litigation Election with respect to any Dispute, irrevocably submits to the jurisdiction of the courts of England. The irrevocable submissions to the jurisdiction of the courts of England are made for the benefit of each of the Trustee and/or the Noteholder(s) and shall not affect the right of any of them to take proceedings (“**Proceedings**”) in relation to a Dispute in any other court of competent jurisdiction nor shall the taking of such Proceedings in one or more jurisdiction preclude the taking of Proceedings in any other jurisdiction (whether concurrently or not).

17.4 Appropriate Forum

Each of the Issuer and the Guarantor hereby irrevocably waive any objection which any of them might now or hereafter have to the courts of England being nominated as the forum to hear and determine any Proceedings and to settle any Disputes, and agree not to claim that any such court is not a convenient or appropriate forum.

17.5 Service of Process

Each of the Issuer and the Guarantor agrees that the documents which start any Proceedings and any other documents required to be served in relation to those Proceedings may be served on it by being delivered to Hackwood Secretaries Limited at One Silk Street, London EC2Y 8HQ or, if different, its registered office for the time being or at any address of the Issuer or the Guarantor in Great Britain at which process may be served on it in accordance with Part XXIII of the Companies Act 1985. If such person is not or ceases to be effectively appointed to accept service of process on behalf of the Issuer and the Guarantor, the Issuer and the Guarantor (acting together) shall, on the written demand of the Trustee, appoint a further person in England to accept service of process on its behalf and failing such appointment within 15 days, the Trustee shall be entitled to appoint such a person by written notice addressed to the Issuer and the Guarantor. Nothing in this paragraph shall affect the right of the Trustee or any of the Noteholders to serve process in any other manner permitted by law.

18. DEFINITIONS

In these Conditions the following terms have the meaning given to them in this Condition 18.

“**Affiliate**” of any specified Person means any other Person, directly or indirectly controlling, controlled by, or under direct or indirect common control with, such specified Person. For purposes of this definition, “control” (including, with correlative meanings, the terms “controlling,” “controlled by” and “under common control with”), as applied to any Person, means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of such Person, whether through the ownership of voting securities, by contract or otherwise; provided that beneficial ownership of 20 per cent. or more of the Capital Stock with voting power of a Person shall be deemed to be control.

“**Agency**” means any agency, authority, central bank, department, committee, government, legislature, minister, ministry, official or public or statutory person (whether autonomous or not).

“**Approved Jurisdiction**” means the United States of America, Russia and any member nation of the European Union as presently constituted.

“**Asset Sale**” means any lease, sale, sale and lease-back, transfer or other disposition either in one transaction or in a series of related transactions, by the Issuer, the Guarantor or any of its Subsidiaries to a Person that is not part of the Group, of any Production Assets the value of which exceeds 10 per cent. of the total Production Assets of the Group in any 12-month period (determined in each case by reference to the most recent publicly available annual or interim financial statements of the Guarantor prepared in accordance with International Financial Reporting Standards, or such other international financial reporting standards as may be adopted from time to time by the Guarantor); provided that “Asset Sale” shall not include sales or other dispositions of inventory or stock in trade in the ordinary course of business or assignments of or other arrangements over the rights or revenues arising from contracts for the sale of steel products at Fair Market Value.

“**Board of Directors**” means, as to any Person, the board of directors of such Person or any duly authorised committee thereof.

“**Business Days**” means a day (other than a Saturday or a Sunday) on which commercial banks are open for business (including dealings in foreign exchange and foreign currency deposits) in New York and London.

“**Capital Stock**” means, with respect to any Person, any and all shares, interests, participations or other equivalents (however designated, whether voting or non-voting) of such Person’s equity, including any preferred stock of such Person, whether now outstanding or issued after the date hereof, including without limitation, all series and classes of such Capital Stock.

“**Cash Equivalents**” means:

- (1) any evidence of Indebtedness with a maturity of one year or less issued or directly and fully guaranteed or insured by an Approved Jurisdiction or any Agency or instrumentality thereof; provided that the full faith and credit of an Approved Jurisdiction (or similar concept under the laws of the relevant Approved Jurisdiction) is pledged in support thereof;
- (2) commercial paper with a maturity of one year or less issued by a corporation organised under the laws of an Approved Jurisdiction and rated at all times at least the same rating as that of the unsecured, unsubordinated debt obligations of the Guarantor by Standard & Poor’s Ratings Services, a division of McGraw-Hill Companies, Inc. or by Moody’s Investors Service Limited to the extent that the aggregate amount of Cash Equivalents (as defined in this paragraph (2)) invested by application of Disposal Proceeds do not exceed at any time \$50,000,000; and/or
- (3) commercial paper with a maturity of one year or less, issued by a corporation organised under the laws of an Approved Jurisdiction, and at all times listed or traded on the Moscow Inter-Currency Exchange to the extent that the aggregate amount of Cash Equivalents (as defined in this paragraph (3)) invested by application of Disposal Proceeds do not exceed at any time \$50,000,000.

“**Consolidated EBITDA**” means, in relation to any period, the annualised consolidated operating profit of the Guarantor for that period (which, for the avoidance of doubt is calculated before taxation and Total Interest Debt Costs) but adjusted to the extent necessary to exclude:

- (a) any share of the profit or loss of any associated company, associated undertaking or joint venture and any income from any other fixed asset investments;

- (b) any amounts written off the value of investments; and
- (c) extraordinary and exceptional items, including realised and unrealised exchange gains and losses which do not relate to ordinary trading activities,

but adding back amounts charged in the period in respect of the depreciation or amortisation of tangible and intangible fixed assets, all as interpreted and calculated in accordance with the consolidated financial statements of the Guarantor prepared in accordance with International Financial Reporting Standards. For the avoidance of doubt, where Consolidated EBITDA is to be calculated with reference to interim accounts, the figures used shall be calculated by reference to the 12 month period ending on the date to which the most recent interim financial statements were prepared.

“**Consolidated Indebtedness**” means at any date of determination (and without duplication) all Indebtedness as calculated in accordance with the consolidated financial statements of the Guarantor prepared in accordance with International Financial Reporting Standards, or such other international financial reporting standards as may be adopted from time to time by the Guarantor.

“**Core or Related Business**” means the business of (a) producing steel and ferrous metal products, (b) investing in property, plant or equipment for the production of steel and ferrous metal products, (c) mining and processing of raw materials and manufacturing equipment for the production of steel and ferrous metal products, (d) conducting business connected with the consumption of steel and ferrous metal products, (e) industrial construction for the production of steel and ferrous metal products, (f) automobile and railway transportation of steel and ferrous metal products in connection with the Group’s production of steel and ferrous metal products, or (g) evaluating, participating in or pursuing any other activity or opportunity that is related to those identified in paragraphs (a) to (f) above.

“**Fair Market Value**” means the price that would be paid in an arm’s-length transaction between an informed and willing seller under no compulsion to sell and an informed and willing buyer under no compulsion to buy, as determined in good faith by the competent management body of the Guarantor or the relevant competent management body of the Material Subsidiary (including a majority of the disinterested directors, if applicable) whose determination shall be conclusive if evidenced by a resolution of such relevant competent management body.

“**Group**” means the Issuer, the Guarantor and its Subsidiaries.

“**Indebtedness**” means, with respect to any Person at any date of determination (without duplication):

- (1) all indebtedness of such Person for borrowed money;
- (2) all obligations of such Person evidenced by bonds, debentures, notes or other similar instruments;
- (3) all obligations of such Person in respect of letters of credit or other similar instruments (including reimbursement obligations with respect thereto);
- (4) all obligations of such Person to pay the deferred and unpaid purchase price of property, assets or services, which purchase price is due more than 90 days after the earlier of the date of placing such property in service or taking delivery and title thereof or the completion of such services;
- (5) all capitalised lease obligations of such Person;
- (6) all Indebtedness of other Persons secured by a Lien granted by such Person on any asset (the value of which, for these purposes, shall be determined by reference to the balance sheet in respect of the latest half year period of the Person providing the Lien) of such Person, whether or not such Indebtedness is assumed by such Person;
- (7) all Indebtedness of other Persons guaranteed by such Person to the extent such Indebtedness is guaranteed by such Person; and
- (8) to the extent not otherwise included in this definition, net obligations under any currency or interest rate hedging agreements,

other than, in each case, any fees or commissions owing to banks or agent banks with respect to such Indebtedness.

For the purpose of determining compliance with any dollar-denominated restriction on Indebtedness denominated in a foreign currency, the dollar-equivalent principal amount of such Indebtedness pursuant thereto shall be calculated based on the relevant currency exchange rate (being, with respect to the

Russian rouble/dollar currency exchange rate, the official rate of the Central Bank of Russia) in effect on the date of determination thereof.

The amount of Indebtedness of any Person at any date shall be the outstanding balance at such date of all unconditional obligations as described above and, with respect to contingent obligations as described above, the maximum liability upon the occurrence of the contingency giving rise to the obligation.

“**Lien**” means any mortgage, pledge, security interest, encumbrance, lien or charge of any kind (including, without limitation, any conditional sale or other title retention agreement or lease in the nature thereof, any sale with recourse against the seller or any Affiliate of the seller, or any agreement to give any security interest) securing any obligation of any Person.

“**Material Subsidiary**” means at any relevant time a Subsidiary of the Guarantor:

- (1) whose total assets represent not less than 2 per cent. of the total consolidated assets of the Guarantor or whose gross revenues represent not less than 3 per cent. of the gross consolidated revenues of the Guarantor (determined by reference to the most recent publicly available annual or interim financial statements of the Guarantor prepared in accordance with International Financial Reporting Standards, or such other international financial reporting standards as may be adopted from time to time by the Guarantor and the latest audited accounts of the Subsidiary); or
- (2) to which is transferred all or substantially all the assets and undertaking of a Subsidiary which immediately prior to such transfer is a Material Subsidiary,

save that the Issuer shall at all times be deemed to be a Material Subsidiary.

“**Permitted Liens**” means:

- (1) Liens granted by a Subsidiary in favour of the Issuer or the Guarantor or a Subsidiary of the Guarantor or by the Guarantor in favour of a Subsidiary of the Guarantor or the Issuer with respect to the property or assets, or any income or profits therefrom, of the Issuer or the Guarantor or such Subsidiary, as the case may be;
- (2) any Lien existing on the date hereof;
- (3) statutory and common law Liens of landlords and carriers, warehousemen, mechanics, suppliers, material men, repairmen or other similar Liens arising in the ordinary course of business;
- (4) any Lien on any property, income or assets of any Person existing at the time such Person is acquired, merged or consolidated with or into the Issuer, the Guarantor or any of its Subsidiaries and not created in contemplation of such event; provided that no such Lien shall extend to any other property, income or assets of such Person or to any other property or assets of the Subsidiaries of such Person or the Issuer, the Guarantor or any of its Subsidiaries;
- (5) any Lien existing on any property, income or assets prior to the acquisition thereof by the Issuer, the Guarantor or any of its Subsidiaries and not created in contemplation of such acquisition; provided that no such Lien shall extend to any other property, income or assets or any property, income or assets of the Issuer, the Guarantor or any of its Subsidiaries;
- (6) any extension, renewal or replacement of any Lien described in clauses (1) to (5) above, provided that (i) such extension, renewal or replacement shall be no more restrictive in any material respect than the original Lien, (ii) the amount of Indebtedness secured by such Lien is not increased and (iii) if the property or assets securing the Indebtedness subject to such Lien are changed in connection with such refinancing, extension or replacement, the Fair Market Value of such property, income or assets is not increased;
- (7) any Lien on the property, income or assets of the Issuer, the Guarantor or any of its Subsidiaries securing Indebtedness of the Issuer, the Guarantor or such Subsidiaries incurred in an aggregate principal amount outstanding at any one time not to exceed 10 per cent. of the total assets of the Group (determined by reference to the most recent publicly available annual or interim financial statements of the Guarantor prepared in accordance with International Financial Reporting Standards, or such other international financial reporting standards as may be adopted from time to time by the Guarantor). For the avoidance of doubt this paragraph (7) does not include any Lien created in accordance with paragraphs (1) to (6) or (8) to (14) hereof;
- (8) any Lien arising solely by operation of law which is discharged within 45 days of arising;

- (9) any Lien on any property or assets of the Guarantor or any Subsidiary of the Guarantor securing Indebtedness incurred for the purpose of financing all or part of the acquisition, maintenance, repair or construction of such property or assets provided that (i) such Lien is created solely for the purpose of securing Indebtedness incurred by the Guarantor or a Subsidiary of the Guarantor in compliance with Condition 3.2, (ii) no such Lien shall extend to any other property or assets of the Guarantor or any of its Subsidiaries, (iii) the aggregate principal amount of all Indebtedness secured by Liens under this paragraph (9) on such property or assets does not exceed the purchase price of such property or assets (including customs duties, transport, insurance, construction and installation costs and other incidental costs and expenses of purchase and any VAT or similar taxes thereon) and (iv) such Lien attaches to such property or assets concurrently with the maintenance or repair thereof or within 90 days after the acquisition or commencement of construction thereof, as the case may be;
- (10) any Lien granted in favour of a Person providing Project Financing if the Lien is solely on the property, income, assets or revenues of the project for which the financing was incurred provided that (i) the person or persons providing such financing limits its recourse solely to the property, income, assets or revenues subject to such Lien, (ii) such Lien is created solely for the purpose of securing Indebtedness incurred by the Guarantor or a Subsidiary of the Guarantor in compliance with Condition 3.2, and (iii) no such Lien shall extend to any other property, income, assets or revenues of the Guarantor or any of its Subsidiaries;
- (11) any Lien upon any steel or ferrous metal export contract (including contract for sale, transportation or exchange, utilisation and pooling declaration and agreements) entered into from time to time between the Guarantor or any of its Subsidiaries and a purchaser in the ordinary course of the Guarantor's or such Subsidiary's business that is customary in the steel industry;
- (12) any Lien in respect of obligations arising under hedging agreements so long as the related indebtedness is permitted to be incurred under these Conditions and any such hedging agreement is not speculative;
- (13) a right of set-off, right to combine accounts or any analogous right which any bank or other financial institution may have relating to any credit balance of any member of the Group; and
- (14) any Lien for ad valorem, income or property taxes or assessments and similar charges which either are not delinquent or are being contested in good faith by appropriate proceedings for which the Guarantor has set aside in its accounts reserves to the extent required by IAS;

“**Person**” means any individual, corporation, partnership, joint venture, trust, unincorporated organisation or government or any Agency or political subdivision thereof.

“**Potential Event of Default**” means any event that is, or after notice or passage of time or both would be, an Event of Default.

“**Production Assets**” means property, plant and equipment of the Group determined in accordance with International Financial Reporting Standards or such other international financial reporting standards as the Guarantor may adopt from time to time with respect to its financial statements.

“**Project Financing**” means any financing of all or part of the costs of the acquisition, construction, development or operation of any asset or project if the person or persons providing such financing limits its recourse solely to the asset or project financed and the revenues derived from such asset or project.

“**Relevant Date**” means whichever is the later of (a) the date on which the payment in question first becomes due and (b) if the full amount payable has not been received by the Principal Paying Agent on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Noteholders and Couponholders.

“**Relevant Jurisdiction**” means (in the case of payments by the Issuer) the Grand Duchy of Luxembourg or any political subdivision or any authority thereof or having power to tax therein or (in the case of payments by the Guarantor) Russia or any political subdivision or any authority thereof or having power to tax therein or in any case any other jurisdiction or any political subdivision or any authority thereof or having power to tax therein to which the Issuer or the Guarantor, as the case may be, becomes subject in respect of payments made by it of principal or interest on the Notes.

“**Russia**” shall mean the Russian Federation and any province or political subdivision or Agency thereof or therein, and “**Russian**” shall be construed accordingly.

“**Stated Maturity**” means (1) with respect to any Indebtedness, the date specified in such Indebtedness as the fixed date on which the final instalment of principal of such Indebtedness is due and payable; and (2) with respect to any scheduled instalment of principal of or interest on any Indebtedness, the date specified in such Indebtedness as the fixed date on which such instalment is due and payable.

“**Subsidiary**” of any Person means any corporation, association, partnership or other business entity of which more than 50 per cent. of the total voting rights of its Capital Stock is at the time owned or controlled directly by such Person, such Person and one or more Subsidiaries of such Person or one or more Subsidiaries of such Person. For the avoidance of doubt, any reference herein to a Subsidiary of the Guarantor shall include, without limitation, the Issuer.

“**Total Interest Debt Costs**” means in relation to any period, all interest, commissions, periodic fees and other financing charges accrued by the Guarantor in respect of Indebtedness during that period (including the interest element payable under any finance lease) adjusted as follows:

- (a) if not already taken into account, deducting the net amount receivable or adding the net amount payable by the Guarantor under any interest rate protection agreement of any kind; and/or
- (b) deducting any interest received in respect of cash balances during the period,

all as interpreted and calculated in accordance with the consolidated financial statements of the Guarantor prepared in accordance with International Financial Reporting Standards.

TAXATION

Prospective purchasers of the Notes are advised to consult their own tax advisers as to the consequences under the tax laws of the country of which they are resident of a purchase of Notes, including, but not limited to, the consequences of the receipt of interest and the sale or redemption of Notes. The following is a general description of certain tax laws relating to the Notes, as in effect on the date hereof, and does not purport to be a comprehensive discussion of the tax treatment of the Notes.

Russian Federation

The following is a summary of certain Russian tax considerations relevant to the purchase, ownership and disposition of Notes by non-resident holders. The summary is based on the laws of Russia in effect on the date of this Offering Circular. The summary does not seek to address the applicability of, and procedures in relation to, taxes levied by regions, municipalities or other non-federal level authorities of Russia, nor does the summary seek to address the availability of double tax treaty relief in respect of the Notes, or practical difficulties involved in obtaining such double tax treaty relief. Prospective investors should consult their own tax advisers regarding the tax consequences of investing in the Notes in their own particular circumstances. No representation with respect to the Russian tax consequences to any particular holder is made hereby.

Many aspects of Russian tax law are subject to significant uncertainty. Further, the substantive provisions of Russian tax law applicable to financial instruments may be subject to more rapid and unpredictable change and inconsistency than in jurisdictions with more developed capital markets. In this regard, the interpretation and application of such provisions will in practice rest substantially with local tax inspectorates.

In practice, interpretation by different tax inspectorates may be inconsistent or contradictory and may constitute the imposition of conditions, requirements or restrictions not stated by the law. Similarly, in the absence of binding precedents, court rulings on tax or related matters by different courts relating to the same or similar circumstances may also be inconsistent or contradictory.

For the purposes of this summary, a “non-resident holder” means an individual actually present in Russia for an aggregate period of less than 183 days in a given calendar year (not counting days of arrival into Russia but counting days of departure from Russia) or a legal entity or organisation in each case not organised under Russian law which holds and disposes of the Notes other than through its permanent tax establishment in Russia.

Taxation of the Notes

A non-resident holder will not be subject to any Russian taxes in respect of payments of interest, principal and premium on the Notes received from the Issuer.

A non-resident holder also generally should not be subject to any Russian taxes in respect of gain or other income realised on a redemption, sale or other disposal of the Notes outside Russia, provided that the proceeds of such disposal are not received from a source within Russia.

In the event that proceeds from a disposal of Notes are received from a source within Russia, a non-resident holder that is a legal entity or organisation should not be subject to any Russian taxation in respect of such proceeds, provided that no portion thereof is attributable to accrued interest. Any portion of such sales proceeds attributable to accrued interest may be subject to Russian withholding tax on income at the rate of 20 per cent. subject to any available double tax treaty relief, even if the disposal itself results in a capital loss. Non-resident holders that are legal entities or organisations should consult their own tax advisers with respect to this possibility and the relevant procedures.

If proceeds from a disposal of the Notes are received from a source within Russia, a non-resident holder who is an individual will generally be subject to tax at a rate of 30 per cent., subject to any available double tax treaty relief, in respect of gross proceeds from such disposal less any available cost deduction (which includes the purchase price of the Notes). In this regard, if the Notes are disposed of in Russia, for Russian personal income tax purposes, the proceeds of such disposition are likely to be regarded as received from a Russian source. In certain circumstances, if the disposal proceeds are payable by a Russian legal entity, individual entrepreneur or a Russian permanent establishment of a foreign organisation, the payer may be required to withhold this tax. In such a situation, there is a risk that the taxable base may be affected by changes in the exchange rates between the currency of acquisition of the

Notes, the currency of sale of the Notes and roubles. Non-resident holders who are individuals should consult their own tax advisers with respect to these possibilities.

Where proceeds from the disposition of Notes are received from a Russian source, in order for the non-resident holder, whether an individual, legal entity or organisation, to enjoy the benefits of an applicable double tax treaty, documentary evidence is required to confirm the applicability of the double tax treaty for which benefits are claimed.

Resident holders

A Noteholder who is an individual or legal entity resident in Russia for tax purposes is subject to all applicable Russian taxes including any documentation requirements that may be required by law or practice. Resident Noteholders should consult their own tax advisers with respect to their tax position regarding the Notes.

Taxation of payments under the Guarantee

Payments on account of interest under the Guarantee are likely to be characterised as Russian source income. Accordingly, such payments should be subject to a withholding tax rate of 20 per cent. in the event that a payment under the Guarantee is made to a non-resident holder that is a legal entity or organisation and 30 per cent. in the event that a payment under the Guarantee is made to an individual, subject to reduction or elimination further to the provisions of any applicable double tax treaty. No assurance can be offered that such withholding tax would not be imposed upon the full payment under the Guarantee, including with respect to the principal amount of the Notes.

In order for the non-resident holder, whether an individual, legal entity or organisation, to enjoy the benefits of an applicable double tax treaty, documentary evidence is required to confirm the applicability of the double tax treaty for which benefits are claimed.

Payments under the Guarantee should not be subject to Russian value added tax.

Refund of Tax Withheld

Where double tax treaty relief is available for a Noteholder which is not an individual, but where Russian withholding tax on income was withheld by the source of payment, a refund of tax withheld is possible within three years from the end of the tax period in which the tax was withheld. In order to obtain a refund of tax, documentation confirming the right of the non-resident recipient of income to double tax treaty relief is required.

For an individual Noteholder, where double tax treaty relief is available, the documentation for the refund of tax may be filed within one year after the end of the year to which the tax benefit relates.

The tax authorities may, in practice, require a wide variety of documentation confirming the right to benefits under a double tax treaty. Such documentation, in practice, may not be explicitly required in the law.

Refund of the tax withheld may be a time-consuming process and can involve considerable practical difficulties.

Luxembourg

The Issuer intends to treat the Notes as debt for all Luxembourg tax purposes and will report payments made on the Notes in a manner consistent with such characterisation. The following is a general discussion of certain Luxembourg income tax consequences of the acquisition, ownership and disposition of such Notes by original purchasers who are not residents of Luxembourg. For this purpose, a tax resident of Luxembourg is a person whose residence, customary place of abode, seat or place of management is located in Luxembourg. The summary is based on laws currently in force and as applied in practice on the date of this Offering Circular, all of which are subject to change, possibly with retroactive effect. The information provided below does not purport to be a complete, exhaustive or final summary of the tax law and practice currently applicable in Luxembourg, and prospective investors should consult their own tax advisers regarding the tax consequences of investing in the Notes in their own particular circumstances.

A Noteholder will not become resident, or deemed to be resident, in Luxembourg only by virtue of holding the Notes.

Noteholders who are not Luxembourg residents and who do not hold the Notes through a Luxembourg permanent establishment are not liable to Luxembourg income tax on payments of principal or interest; accrued but unpaid interest; payments received upon redemption, repurchase or exchange of the Notes; or capital gains on the sale or other disposition of any Notes.

A holder of a Note who is an individual or legal entity resident in Luxembourg for tax purposes is subject to all applicable Luxembourg taxes. It is expected that as from 1 January 2004 or more probably 2005, a 10 per cent. Luxembourg withholding tax may be introduced for interest payments made to Luxembourg residents.

Luxembourg net wealth tax will not be levied on Notes or other assets held by a Noteholder, unless such a Noteholder is resident in Luxembourg for the purpose of the relevant legal provisions or unless the Notes are attributable to an enterprise or part thereof which is carried on through a permanent establishment or a permanent representative of the Noteholder in Luxembourg.

There is no Luxembourg value added tax (“VAT”) payable in respect of payments in consideration for the issuance of the Notes or in respect of the payment of interest or principal under the Notes or the transfer of the Notes. Luxembourg VAT may, however, be payable in respect of fees charged for certain services rendered to the Issuer if, for Luxembourg VAT purposes, such services are rendered or are deemed to be rendered in Luxembourg and an exemption from Luxembourg VAT does not apply with respect to such services.

There is no Luxembourg registration tax, capital tax, stamp duty or any other similar tax or duty (other than nominal court fees and contributions for registration with the Chamber of Commerce) payable in Luxembourg in respect of or in connection with the execution, delivery and enforcement by legal proceedings (including any foreign judgment in the courts of Luxembourg) of the Notes or the performance of the Issuer’s obligations under the Notes. In certain circumstances, for instance where a Note cannot be considered as a collective instrument and in a case where the documents related to the issue of the Notes are presented to a Luxembourg court or to an *autorité constituée*, registration may be required, in which case the documents will be subject to registration duties depending on the nature of the documents and, in particular, a loan will be subject to an *ad valorem* registration duty of 0.24 per cent., calculated on the amounts mentioned therein.

No gift, estate or inheritance tax will be levied on the transfer of the Notes upon death of a Noteholder unless the *de cuius* is considered to be a Luxembourg resident for inheritance tax purposes.

EU Directive on the Taxation of Savings Income

The Council of the European Union has adopted proposals for a new directive regarding the taxation of savings income. Subject to a number of important conditions being met, it is proposed that any economic operator (paying agent) situated within a Member State (or, subject to specific bilateral agreements with the EU, within associated or dependant territories and some third countries, such as Switzerland) will be required from 1 January 2005 to provide to the tax authorities of its country of origin (which will forward this information to the tax authorities of another Member State) details of payments of interest (or other similar income) paid by the economic operator within its jurisdiction to or for the benefit of an individual, as well as, in some cases, to specific forms of organisations such as partnerships (not being a legal person and not being themselves subject to tax) and trusts (so called “residual entities”), resident of that other Member State, subject to the right of certain Member States, including Luxembourg, to opt instead for a withholding system for a transitional period in relation to such payments. Certain dependent or associated territories and certain third countries may also apply withholding instead of exchange of information during the transitional period. Any withholding tax levied pursuant to the Directive may be in addition to any domestic withholding tax levied by those Member States.

Luxembourg has opted to adopt a withholding system (15 per cent. raising over time to 35 per cent.) for a period of, in principle and subject to certain conditions, seven years for payments made to individual beneficial owners of debt claims (which may include, for example, individuals who hold interests through forms of organisations such as partnerships and trusts, among others) who are resident in a Member State of the European Union that is different from the Member State of the issuer of the debt or the Member State of any paying agent (which could, for these purposes, include a person making payment in respect of the debt on behalf of the issuer or on behalf of the holder). Thus, payments made on or after 1 January 2005 by a Luxembourg issuer of debt or through a Luxembourg paying agent in respect of instruments issued after 1 March 2001 could be subject to withholding tax under the directive (especially if the beneficial owners of the bonds are EU resident individuals).

SUBSCRIPTION AND SALE

Subscription Agreement

ABN AMRO Bank N.V. and UBS Limited as joint-lead managers, Rosbank Switzerland S.A. as senior co-lead manager, Alpha Bank A.E. and Raiffeisen Zentralbank Österreich Aktiengesellschaft as co-lead managers and Parex Bank, TRUST Investment Bank and Unicredit Banca Mobiliare S.p.A as co-managers (together the “Managers”) have, pursuant to a Subscription Agreement dated 14 October 2003 (the “Subscription Agreement”), jointly and severally agreed with the Issuer and the Company, subject to the satisfaction of certain conditions set forth therein, to subscribe the Notes at the issue price of 98.992 per cent. of the principal amount of the Notes. The Issuer, failing which the Company, has also agreed to pay a combined management and underwriting and selling commission of 0.70 per cent. of such principal amount to the Managers.

The Issuer, failing which the Company, has also agreed to pay certain costs incurred in connection with the issue of the Notes and to reimburse the Managers for certain of their expenses in connection with the issue of the Notes. The Managers are entitled to terminate the Subscription Agreement in certain circumstances prior to the time of payment to the Issuer in respect of the Notes. The Issuer and the Company have agreed jointly and severally to indemnify the Managers against certain liabilities in connection with the issue of the Notes. Mr Rashnikov, the General Director of the Company, is also a member of the Board of Directors of Joint Stock Commercial Bank Rosbank, the parent of Rosbank Switzerland S.A.

Selling Restrictions

United States of America

The Notes and the Guarantee have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

The Notes are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986 and regulations thereunder.

The Notes are being offered and sold outside of the United States to non-U.S. persons in reliance on Regulation S.

Each Manager has agreed that, except as permitted by the Subscription Agreement, it will not offer, sell or deliver the Notes, (i) as part of their distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering and the Issue Date within the United States or to, or for the account or benefit of, U.S. persons, and it will have sent to each dealer to which it sells Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after the commencement of the offering, an offer or sale of Notes within the United States by a dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

United Kingdom

Each Manager has represented, warranted and agreed that:

- (i) it has not offered or sold and, prior to the expiry of a period of six months from the Issue Date, will not offer or sell any Notes to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995;
- (ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the “FSMA”)) received by it in connection with the issue or sale of the Notes in circumstances in which section 21(1) of the FSMA does not apply to the Issuer or the Company; and

- (iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

Russia

Each Manager has represented, warranted and agreed that it has not offered, transferred or sold the Notes as part of their initial distribution to or for the benefit of any persons (including legal entities) resident, organised, established or having their usual residence or place of business in the Russian Federation or to any person located within the territory of the Russian Federation, except in compliance with Russian law.

Luxembourg

Each Manager has represented, warranted and agreed that the Notes have not been and will not be authorised for public offering in Luxembourg and may not be offered or sold in Luxembourg in circumstances that would constitute a public offer unless the requirements of Luxembourg law concerning public offers have been complied with.

Republic of Italy

The offering of the Notes has not been cleared by CONSOB (the Italian Securities Exchange Commission) pursuant to Italian securities legislation and, accordingly, each Manager has represented and agreed that no Notes may be offered, sold or delivered, nor may copies of the Offering Circular or of any other document relating to the Notes be distributed in the Republic of Italy, except:

- (i) to professional investors (*operatori qualificati*), as defined in Legislative Decree No. 58 of 24 February 1998 (the “Financial Services Act”) and Article 31, second paragraph, of CONSOB Regulation No. 11522 of 1 July 1998, as amended;
- (ii) in circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of the Financial Services Act and Article 33, first paragraph, of CONSOB Regulation No. 11971 of 14 May 1999, as amended; or
- (iii) to an Italian resident who submits an unsolicited offer to purchase the Notes.

The Notes will not be offered, sold or delivered, either in the primary market or in the secondary market, to individuals residing in Italy.

Any offer, sale or delivery of the Notes or distribution of copies of the Offering Circular or any other document relating to the Notes in the Republic of Italy under (i) or (ii) above must be:

- (a) made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act and Legislative Decree No. 385 of 1 September 1993 (the “Banking Act”), as amended; and
- (b) in compliance with Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy pursuant to which the issue or the offer of securities in the Republic of Italy may need to be preceded and followed by an appropriate notice to be filed with the Bank of Italy depending, *inter alia*, on the aggregate value of the securities issued or offered in the Republic of Italy and their characteristics and, even when an exemption from the prior notification applies, may need to be followed by a subsequent communication reporting to the Bank of Italy the results of the issue and of the placement; and
- (c) in compliance with any other applicable notification requirement or limitation which may be imposed by CONSOB or the Bank of Italy.

The Netherlands

Each Manager has represented and agreed that it has not made and will not make, any offers (or solicitations of such offers) in respect of the Notes to any individual or legal entity in The Netherlands, other than to individuals or legal entities, who or which trade or invest in securities in the conduct of a business or profession (which includes banks, firms, insurance companies, pension funds, investment institutions, central governments, large international and supranational organisations, finance companies and treasury departments of large enterprises).

General

Each Manager has acknowledged that no action has been or will be taken in any jurisdiction by the Issuer or the Company that would permit a public offering of the Notes, or possession or distribution of any offering material in relation thereto, in any country or jurisdiction where action for that purpose is required. Accordingly, each Manager has (a) represented and warranted to the Issuer and the Company that, to the best of its knowledge and belief, no action has been or will be taken in any jurisdiction by such Manager that would permit a public offering of the Notes and (b) undertaken to the Issuer and the Company that it will to the best of its knowledge and belief comply with all applicable laws and regulations in each country or jurisdiction in which it purchases, offers, sells or delivers Notes or has in its possession or distributes such offering material including the Preliminary Offering Circular (as defined in the Subscription Agreement) and the Offering Circular, in all cases at its own expense.

GENERAL INFORMATION

- (1) The issue of the Notes was authorised and approved by a resolution of the Board of Directors of the Issuer passed on 26 September 2003. The giving of the Guarantee was authorised and approved by a resolution of the Management Board of the Company passed on 26 September 2003. The Issuer and the Company have obtained all consents, approvals and authorisations required under the prevailing laws of Luxembourg and the Russian Federation for the issue of, and performance of their respective obligations under, the Notes, the Trust Deed, the Paying Agency Agreement and the Subscription Agreement.
- (2) Application has been made to list the Notes on the Luxembourg Stock Exchange. The legal notice relating to the application for listing and the Articles of Incorporation of the Issuer and the Charter of the Company will be lodged prior to the listing with the *Registre de Commerce et des Sociétés à Luxembourg* where the same may be inspected and copies thereof obtained.
- (3) For so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of the Luxembourg Stock Exchange so require all notices to holders of Notes will be published in a daily newspaper with general circulation in Luxembourg, which is expected to be the *Luxemburger Wort* and, for so long as the Notes are listed on the Luxembourg Stock Exchange, the Luxembourg Paying Agent will serve as intermediary between the Issuer and the Company and the holders of the Notes.
- (4) The Notes evidenced from time to time by the Global Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The Common Code for the Notes is 017750305 and the ISIN for the Notes is XS0177503058.
- (5) Except as disclosed in this Offering Circular, there has been no significant change in the financial or trading position and no material adverse change in the financial position or prospects, of the Issuer since 31 December 2002, the date of the last audited accounts of the Issuer, or of the Company or the MMK Group since 31 December 2002, the date of the most recent consolidated audited accounts of the Company.
- (6) Neither the Issuer, the Company nor any member company of the MMK Group is, or has been, involved in any litigation or arbitration proceedings which may have, or have had during the 12 months preceding the date of this document, a significant effect on the financial position of the Issuer, the Company or the MMK Group, nor is the Issuer or the Company aware that any such proceedings are pending or threatened.
- (7) Copies of the latest consolidated audited annual financial statements and semi-annual financial statements of MMK and its subsidiaries prepared in accordance with IFRS, the latest audited annual financial statements of the Issuer and this Offering Circular may be obtained, and copies of the Trust Deed will be available for inspection, at the specified office of each of the Paying Agents during normal business hours (including the Paying Agent in Luxembourg), so long as any of the Notes is outstanding.
- (8) KPMG has audited, and rendered unqualified audit reports on, the IFRS consolidated financial statements of MMK and its subsidiaries for each of the three years ended 31 December 2002. KPMG has given and has not withdrawn its written consent to the issue of this document with the inclusion in it of its audit report in respect of the consolidated financial statements of the MMK Group as of 31 December 2002 and for the year then ended and its review report in respect of the consolidated financial statements of the MMK Group as of 30 June 2003 and for the six months then ended and references to its name in the form and context in which the same appear. KPMG have reviewed the half-year consolidated financial statements of MMK and its subsidiaries for the six month period ended 30 June 2003 and 2002. KPMG Audit Réviseurs d'Entreprises has audited, and rendered an unqualified audit report on, the statutory financial statements of the Issuer for the year ended 31 December 2002, which are incorporated by reference herein.
- (9) Copies of the following documents (which are in the English language except where otherwise stated) may be obtained free of charge at the offices of the Luxembourg Paying Agent during usual business hours on any weekday (Saturdays, Sundays and public holidays excepted) for so long as the Notes are listed on the Luxembourg Stock Exchange:
 - (a) the Articles of Incorporation of the Issuer and the Charter of the Company, and in the case of the Company, an English translation thereof;

- (b) the most recently available annual audited IFRS consolidated financial statements and semi-annual financial statements of MMK and its subsidiaries and the most recently available annual audited financial statements of the Issuer;
 - (c) the Subscription Agreement;
 - (d) the Trust Deed (which includes the forms of the Global Notes and the definitive Notes);
 - (e) the Paying Agency Agreement; and
 - (f) this Offering Circular.
- (10) So long as the Notes are listed on the Luxembourg Stock Exchange, the Company will maintain a Luxembourg Paying Agent.

GLOSSARY OF STEELMAKING TERMS

Annealing – The heat treatment process by which steel products are reheated to a suitable temperature in order to remove stresses resulting from previous processing and to soften them and/or improve their machinability and cold forming properties.

Billet – A semi-finished steel product with a square cross section up to 155mm x 155mm. This product is either rolled or continuously cast and is further processed by rolling to produce finished products like wire rod, merchant bars and other sections. The range of semi-finished products above 155mm x 155mm are called blooms.

Blast furnace – A furnace used in integrated steelmaking in which coke and iron ore react together under a hot air flow to form liquid hot metal, also called pig iron.

Blooms – See “Billet”.

Coated Steel – Steel sheet coated through a heat process or through electrolysis with a layer of substance to protect the base metal (substrate) against corrosion. The most commonly used material is zinc which can be applied either using the heat process (hot-dip galvanising) or using electrolysis (electro-galvanising). An organic coating (paint, plastic) can also be deposited on the layer of zinc. The zinc-coated steel is often referred to as “galvanised steel”.

Coils – Steel that has been wound.

Coke – A fuel obtained by pyrolysis of coal in coke ovens and used as a reducing agent or iron ore in the blast furnace.

Cold-rolled sheet – Sheet steel that has been run through a cold-reduction mill.

Cold-rolling mill – Equipment that reduces the thickness or gauge of flat steel products by rolling the metal between alloy steel cylinders at room temperature. Several roll passes are generally necessary to reduce the steel gradually to the desired thickness.

Continuous casting – The process pursuant to which molten steel is transformed into semi-finished products such as billets, blooms and slabs. The molten steel is poured at a steady rate from a ladle to a bottomless mould. As the molten steel enters the water-cooled mould, a shell quickly forms at the mould wall. When the steel bar exits the mould, this solidified shell must be thick enough to maintain the liquid core as the product totally solidifies. The continuously cast steel is then cut into required lengths.

Electric arc furnace – A furnace for scrap-based steelmaking. Once the furnace is charged and covered, graphite electrodes are lowered through holes in the roof. The electric arc travelling between the electrodes and the metallic charge creates intense heat which melts the scrap. Alloying elements can be added during the process.

Ferrous alloy – A metal product commonly used as a raw material feed in steelmaking, usually containing iron and other metals to aid various stages of the steelmaking process such as deoxidation, desulphurisation and adding strength.

Ferrous – Metals that consist primarily of iron.

Flat products – A type that is produced by rolls with smooth surfaces and ranges of dimension, varying in thickness. The two major flat steel product categories are thin flat products (between 1mm and 10mm in thickness) and plates (between 10mm and 200mm in thickness and used for large welded pipes, ship building, construction, major works and boilers).

Galvanised steel – Steel coated with a thin layer of zinc to provide corrosion resistance.

Hot-rolled steel – A coil of steel rolled on a hot-strip mill.

Hot-rolling – When solidified steel, preheated to a high temperature, is continuously rolled between rotating cylinders.

Ingot – An intermediate product made by pouring molten steel into moulds of given dimensions. In further processing steps in different hot-rolling mills, the ingots are transformed first to simple shape semi-finished products like billets, blooms or slabs before being transformed by hot-rolling in a finishing mill. Ingot casting is now largely replaced by continuous casting.

Integrated steel making – The process of making steel out of coke and iron ore, which are processed in a blast furnace to make liquid metal called pig iron. The pig iron is then converted to molten steel in basic oxygen converters and subsequently transformed into various semi-finished products.

Ladle furnace – A furnace used for refining hot metal between the converter or electric arc furnaces and casting.

Long products – Long products are used in all industrial sectors, particularly in the construction and engineering industries.

Open-hearth furnace – A broad, shallow hearth to refine pig iron and scrap into steel. Heat is supplied from a large flame over the surface and the refining takes 7-9 hours.

Pellets – Iron ore or limestone particles that are rolled into little balls in a balling drum and hardened by heat.

Pickling – The process in which the surface of the steel is cleaned with acid to remove scale, rust and dirt - such process being preparation for further processing, such as cold-rolling, galvanising or polishing.

Refining – A stage in the process of making crude steel, during which most residual impurities are removed from the crude steel and additions of other metals may be made before it is cast (see also “Ladle furnace”).

Reversing mill – The stand of rolls used to reduce steel sheets or plates by passing the steel back and forth between the rolls; the gap between the rolls is reduced after each pass.

Scrap – Iron containing material that generally is remelted and recast into new steel. Integrated mills use scrap for up to 25 per cent. of their basic oxygen furnace charge.

Semi-finished products – Steel products such as billet, blooms and slabs. These products can be made by direct continuous casting of hot steel or by pouring the liquid steel into ingots, which are then hot-rolled into semi-finished products.

Sinter – Baked particles that stick together in roughly one-inch chunks. Normally prepared from iron ore dust collected from blast furnaces.

Slab – A semi-finished steel product obtained by rolling ingots on a rolling mill or processed through a continuous caster and cut into various lengths. The slab has a rectangular cross section and is used as a starting material in the production process of flat products, i.e., hot-rolled coils.

Slag – A by-product, containing inert materials of the burden, produced during the melting process of blast furnace and steelmaking operations.

Slitting – Cutting a sheet of steel into narrower strips.

Strip – Flat steel coil products, with widths of less than 600mm for hot-rolled products and less than 500mm for cold-rolled products.

OVERVIEW OF THE STEEL INDUSTRY

The following information includes extracts from information and data publicly released by officials and has been extracted from public and other sources. The Issuer and the Company accept responsibility for extracting and reproducing accurately such information but accept no further responsibility in respect of such information and data.

Overview of Global Steel Industry

General

The worldwide steel industry is comprised of hundreds of steelmaking facilities divided into two major categories, integrated steelworks (including the Company) and non-integrated steelworks (sometimes called “mini-mills”), characterised by the method used for producing molten steel.

In integrated steel production, coal is converted to coke in a coke oven, then combined in a blast furnace with iron ore and limestone to produce pig iron, which is subsequently combined with scrap in an oxygen converter of Siemens-Martin furnace to produce raw or liquid steel. The Siemens-Martin technology is outdated and less efficient, and has been replaced by oxygen converter furnaces in most of the world. Once produced, liquid steel is metallurgically refined and then either poured as ingots for later re-heating and processing or transported to a continuous caster for casting into a billet, bloom or slab, which is then further shaped or rolled into its final form. These processes may, in turn, be followed by various finishing processes or various coating processes.

In recent years, integrated steel production has declined as a proportion of total steel production (with a corresponding increase in mini-mill steel production) due to high costs of building, operating and maintaining integrated steel operations, including environmental compliance and remediation costs related to coke production and the costs and lost production time associated with periodic blast furnace relinings.

Crude Steel Production by Process (2002)

Country	Integrated Process		Mini-mill	Other	Total
	Oxygen	Siemens-Martin			
European Union (15)	58.9%	–	41.1%	–	100.00%
Other Europe	57.0%	–	43.0%	–	100.00%
Former USSR	57.6%	30.3%	12.1%	–	100.00%
NAFTA	48.3%	–	51.7%	–	100.00%
Central and South America	64.5%	–	35.5%	–	100.00%
Africa	43.5%	–	56.5%	–	100.00%
Middle East.....	17.9%	–	82.1%	–	100.00%
Asia.....	66.0%	1.0%	27.8%	5.1%	100.00%
World	60.0%	3.8%	33.9%	2.2%	100.00%

Source: International Iron & Steel Institute

Global Market for Steel

During the first half of the twentieth century, the worldwide steel industry was dominated by the integrated steel works in the United States. During the second half of the century, however, steelworks in Europe and Japan were completely rebuilt with modern technology, and modern steelmaking plants were also constructed in countries with emerging industrial economies such as Brazil, China and South Korea. By the early 1970s, the growth of global steelmaking capacity began to exceed the growth of global demand for steel products. This imbalance worsened during the 1970s and 1980s, as a result of a global recession and the rapid growth of small non-integrated plants. Consequently, during the 1980s, many integrated steel companies were unable to compete effectively and experienced a sustained period of unprofitability. Several of the largest integrated steel companies in the United States were forced to restructure. During the 1990s, the global steel production has annually been exceeding consumption by approximately 50-100 million tonnes. According to the International Iron and Steel Institute, the global steel production capacity in 2001 amounted to approximately 1,068 million tonnes with actual production of approximately 847 million tonnes and demand for only approximately 721 million tonnes. In 2002, steel production rose by 6.4 per cent. amounting to 887 million tonnes. The overproduction gap in 2002 amounted to 20 per cent. of the steel market (approximately 220 million tonnes). As a result, steel prices

are near their lowest levels for the past 20 years. By the end of 1990s, significant growth in the degree of competition within the worldwide steel industry had prompted several nations to protect more rigorously their respective steel industries from imports. The most significant trend in 2002 became the closure of the biggest national steel consuming markets. The process was initiated by the US by establishing quotas and significant steel import custom fees. Shortly thereafter the European Union, China and other countries, including Russia announced the closure of their markets for imported steel products. In order to narrow the overproduction gap, the OECD has proposed measures aiming at reduction of production capacity. In December 2001, most of the world's steel makers agreed to cut as much as 97.5 million tonnes of steel capacity by 2010. According to the agreement, cumulative steel capacities should be reduced by 70.5-74.5 million tonnes by 2005.

Overcapacity in the sector and the decline in world steel prices have created significant pressures on producers to maximise their efficiency. As a result, the sector has seen a series of mergers or strategic alliances among the major producers (e.g., Arcelor, JFE, ThyssenKrupp Stahl and the LNM Group).

Recent Developments and Outlook

Notwithstanding high prices for almost all steel products in 2002 and the continuing growth in the first quarter of 2003, experts are divided in their forecasts of the steel market trends. Frequent dramatic price fluctuations, overproduction, sharp competition and imposition of trade and import restrictions may adversely affect the stability of the world steel market.

The main trend in the world steel industry in 2002 remained the increase of production. Negotiations between major steel producers, focused on eliminating inefficient excess capacity, continue and have not shown any results yet. Imposition of tariffs and import restrictions worldwide may lead to a "domino effect", whereby one by one all domestic markets will be closed for imports leading to an overstocking of such markets and a subsequent fall of steel prices.

Overview of Russian Steel Industry

The Soviet Union was producing approximately 160 million tonnes of crude steel a year at the end of the 1980s. Following the collapse of the Soviet Union, the steel industry suffered a substantial decline in production, to about 75 million tonnes of crude steel for all the newly independent states combined in 1997. At that point, Russia was producing approximately 38 million tonnes of rolled products annually.

However, steel production started to recover following the devaluation of the Rouble in 1998 and the significant cost benefits that steel exporters faced in 1999 and 2000. While the major mills were export-oriented and their sales receipts were mostly dollar-based, their operating costs fell substantially in dollar terms following the devaluation. In addition, the strength in steel prices in 2000 led to increased capacity utilisation rates even at technologically inferior mills. In the second half of 2001 and the beginning of 2002, steel prices decreased but starting from the second half of 2002 the steel market demonstrated robust recovery in terms of both prices and volumes. In the first half of 2003, the production of steel grew by approximately 6 per cent. as compared to the first half of 2002.

Privatisation of the Russian Steel Industry

Privatisation of the Russian steel industry began in 1993 and was primarily "insider" focused. Factories were sold to their employees with subsequent re-sale to the management. The privatisation programme provided for the supervision of Roskommatalrugya (successor to the USSR Ministry of Metals) over the privatisation process. As the privatisation programme envisaged no special regime for privatisation of the steel sector, the number of state owned companies started rapidly to decline. By mid-1994, the share of the state in the total iron and steel production amounted only to 15 to 25 per cent. By the end of 1995, control over most of the largest Russian steel producers such as Severstal, MMK, Mechel and NLMK was transferred to private management and ownership. Without having enacted a serious privatisation programme for the steel industry, the state failed to attract the required investment, technology and know-how into the sector. Therefore, in 1995 the Government decided to change the method of privatisation and thereby attract strategic investors into the sector. Pursuant to an Edict of President Yeltsin, a holding company, OJSC Rossiyskaya Metallurgiya, was established. 10 per cent. stakes in steel producing companies remaining in the state ownership and 100 per cent. stakes in five leading scientific-research institutes in steel production were transferred into the holding's ownership. The Government intended to sell 49 per cent. of shares in OJSC Rossiyskaya Metallurgiya thus retaining control over the companies and attracting investments at the same time. Unfortunately, investors did not show any interest in the project and OJSC Rossiyskaya Metallurgiya was liquidated in 1997. Stakes in several

companies were sold in cash auctions, primarily to “insiders”. Stakes in the remaining companies were re-transferred into the ownership of the Ministry of Property Relations.

Steel Production

In 2002, Russia ranked as the world’s fourth largest producer of steel, producing 59.8 million tonnes of steel, or approximately 7 per cent. of global production. The metals and mining sector is one of the most important sectors of the Russian economy. In 2001, it accounted for 17 per cent. of the country’s industrial output and was the third largest taxpayer (behind the oil and gas sectors). Russian enterprises produce a wide range of metal products for the domestic economy, in particular for the oil and gas, defence and construction industries. The sector has developed considerably since 1991 and is over 90 per cent. privatised, although foreign investment in the sector has been limited and virtually all of the main steel producers are private companies controlled by Russian entrepreneurs.

Regulation of Russian Steel Industry

Russia has not enacted any specific legislation governing the operation of the steel industry and the business of steel manufacturing companies. The production, sale and distribution of steel in the Russian Federation is regulated by general civil legislation and special legislation relating to quality standards, industrial safety rules and environmental and other rules.

On 5 September 2002, the Russian Government approved the “Plan of Measures for Development of the Russian Steel Industry until 2010” (the “Plan”). The Plan proposes measures supporting voluntary certifications of steel products and promotion of innovation in the industry, reduction of import duties on high-tech machinery, financing of research and development in the steel industry, investing in new technologies, professional development and social protection of the industry’s personnel.

The implementation of the Plan is expected to facilitate the modernisation of the Russian steel industry, increase its export potential, improve the quality of steel and steel products and allow the sector to develop in a positive manner over the relevant period.

At the federal level, *the Ministry for Industries, Science and Technologies of the Russian Federation* is the principal agency supervising the operation of the steel sector. The Ministry is responsible for the development of governmental policy in the industry (for example attracting investment, foreign trade, taxation, support of scientific research and employment), but, however, lacks direct regulatory authority.

The Federal Mining and Industrial Supervision Committee (Gosgortekhnadzor) is the federal regulator which sets mandatory safety rules for the steel industry and oversees compliance therewith. Such rules cover, *inter alia*, safety procedures in relation to the installation, deployment and operation of technical devices and machinery used in the steel industry and the procedure for maintaining technological processes.

The Federal Law “On Technical Regulation” No. 184-FZ dated 27 December 2002 (the “Technical Regulation Law”) introduced new rules relating to development, enactment, application and enforcement of obligatory technical requirements and the development of voluntary standards relating to manufacturing processes, operations, storage, transportation, selling and utilisation.

The Technical Regulation Law supersedes the Law of the Russian Federation “On Certification of Goods and Services” No. 5151-1 dated 10 June 1993 and will be followed by the revision of existing legislation and technical rules falling within the scope of its regulation. In particular, Gosgortekhnadzor will be responsible for developing and enacting new technical rules relating to the industrial safety of steel and ironmaking facilities as well as coking and chemical facilities, safety rules relating to iron ore extraction. It is expected that these new rules will be enacted in 2004-2005.

The State Committee on Standardisation and Metrology (Gosstandard) sets and oversees compliance with obligatory general and industrial standards.

The Ministry for Natural Resources of the Russian Federation is the federal licensing authority for the use of natural resources (see “Licensing – Subsoil Licensing”).

The Ministry for External Economic Relations of the Russian Federation regulates Russian exports and imports of steel products and coordinates intergovernmental negotiations relating to export and import regulations.

Aside from the above federal executive bodies, which are directly involved in regulating and supervising the steel sector in Russia, there are a number of other federal regulators and their structural subdivisions

which have authority over general issues relevant to the Russian steel industry such as defence, internal affairs, security, border services, justice, tax enforcement, rail transport and others.

Licensing

General

The Federal Law “On Licensing of Certain Types of Activities” No. FZ-128-FZ dated 8 August 2001 (as amended), which came into force in January 2002 (the “Licensing Law”) established a list of activities which can only be performed on the basis of licences issued by the relevant Russian authorities. The Licensing Law removed certain licensing requirements which had previously existed and amended the previous list of licenced activities. The list of activities relating to the steel industry now includes, *inter alia*, the collection, processing and sale of scrap iron and base metals, activities connected with hazardous waste, the operation of explosive and chemically hazardous production facilities and the construction of buildings and other structures connected with steel production.

Under the Licensing Law, the minimum period for which a licence is issued is five years. A licence can be suspended if the licensee repeatedly commits material breaches of the terms and conditions of such licence. If a licensee does not mitigate any such breach of the licence granted to it within the period established by the licensing authority, that authority may apply to court for the cancellation of that licence. The court may also cancel the licence in certain other cases (for example, if a breach of the terms and conditions of a licence by the licensee has damaged the rights, legal interests or health of individuals, etc.). Finally, the licensing authority may cancel a licence without a court order if the licensee does not pay a licensing commission within three months of the granting of the licence. In addition, the Federal Law “On Subsoil Resources” No. 2395-1 dated 21 February 1992 (as amended) (the “Subsoil Resources Law”) establishes certain licensing requirements connected with the use of subsoil resources.

Subsoil Licensing

In 1992, the Subsoil Resources Law introduced a licensing system governing the study, exploration and production of natural resources from the subsoil in Russia. Until 1995, licences for fields where exploration and production were already in process were granted without a tender offer. Licences for new fields and subsoil plots, however, were awarded through auctions or tenders conducted by the governing body of the relevant regional government and the Ministry of Natural Resources. The most important criterion for granting the licence at these auctions was the lump sum amount the bidder was prepared to pay for the right to use the subsoil, but technical, environmental, safety and national security factors were also taken into consideration.

In certain instances, such as upon the enactment of production sharing agreements between the development company, investors and regional and the federal government, the Subsoil Resources Law allows for licences to be issued without a tender procedure.

Licensing agreements for subsoil use identify the terms and conditions for the use of the subsoil, the rights and obligations of the licensee and the manager of the subsoil plot and the level of payments. There are usually three parties to any licensing agreement: the regional authority of the region where the field is located, the Ministry of Natural Resources of the Russian Federation and the licensee.

There are four types of licences applicable to the study, exploration and production of natural resources (i) licences for geological exploration of the subsoil plot; (ii) licences for exploration and assessment of natural resources; (iii) licences for production of natural resources; and (iv) combined licences for exploration, assessment and production of natural resources. Under the Subsoil Resources Law, licences are granted for the term stipulated in the licence: up to five years for exploration; and either for the period for which the field is operational¹ or for a short term of up to one year for production. The Subsoil Resources Law allows the subsoil user to request an extension of the existing licence in order to complete either the exploration of the field or the procedures necessary to vacate the land once the exploitation of the subsoil is complete, provided such user complies with the terms and conditions of the licence. Indefinite term licences are provided for the construction and operation of waste burial facilities, and underground storage facilities.

¹ Previously exploration and assessment and production licences were restricted to a maximum term of 20 years and 25 years, respectively, but this restriction was abolished as of 13 January 2000 by Federal Law “On Amendment of the Law of the Russian Federation on Subsoil Resources” No. 20-FZ dated 2 January 2000.

Licences granted in accordance with the Subsoil Resources Law cannot be sold or transferred to another entity except in limited circumstances, such as to a spin-off company or a subsidiary in which the licensee has a 50 per cent. or greater share. Generally, a licence cannot be held by more than one legal entity. Under a licensing agreement, the licensee makes a number of commitments. For example, the licensee agrees to bring the field on stream by a certain date; to extract an agreed volume of natural resources each year; to keep environmental pollutants within specified limits; and to clean up environmental contamination. When the licence expires, the licensee must return the relevant land, at its own expense, to a condition which is adequate for future use. The licensee can be fined or the licence can be revoked in the event that it remains unused for a period of time, as a result of repeated or significant breaches of the law or the conditions of the licence, upon the occurrence of a direct threat to the lives or health of people working or residing in an area where licensed activities are carried on, or upon the occurrence of force majeure events. Although most of the conditions set out in a licence are based on mandatory rules contained in Russian law, there are a number of provisions in a licensing agreement which are negotiated between the parties.

Environmental Requirements

Russian industry has tended to cause excessive levels of pollution compared to western standards. As a result of the damage inflicted on the environment under the Soviet regime, environmental issues and pollution control have won widespread support.

Two main sets of regulations govern environmental protection. The first set includes the Federal Law "On Environmental Protection" No. 7-FZ of 10 January 2002 (the "Environmental Protection Law") and the Federal Law "On Ecological Expert Review" No. 174-FZ of 23 November 1995 (as amended). These laws require that an environmental impact assessment be made prior to implementation of a project related to the use of natural resources. Companies are also required to obtain operational licences and permits authorising the discharge of pollutants into the air, water and soil under a "pay-to-pollute" regime. If discharge exceeds permissible levels, a company is subject to fines calculated as a multiple of the original "fee" set for discharge of pollutants. There are additional fines for certain other breaches of environmental regulations. The Environmental Protection Law contains an obligation to make compensation payments to the budget for all environmental losses caused by pollution. In the event of a dispute concerning losses caused by breaches of environmental laws and regulations, the prosecutor's office or other authorised governmental bodies may bring suit, though there is no private right of action. Courts may impose clean-up obligations subject to the agreement of the parties in lieu of or in addition to imposing fines.

The second set of regulations on environmental protection comprises a series of laws and regulations that relate to the use of natural resources, including the Subsoil Resources Law. Exploration licences and production licences generally require certain environmental commitments. Although such commitments may be stringent in a particular licence, the penalties for failing to comply and clean-up requirements are generally low.

A new law "On Payments for Negative Ecological Effect" is being reviewed at the State Duma. The law requires an increase in the amount of payments and suggests that most pollution excess payments could be made by way of enterprises implementing environmental improvement programmes. Currently the decision as to whether to keep pollution penalties for investment programmes can be made by local authorities.

While protection of the environment is apparently not an issue of immediate priority to the current Russian Government, it is widely expected that, as the economic situation improves, enforcement of existing legislation and environmental standards and rules will become more stringent, and that more comprehensive legislation will be adopted.

Steel producing countries generally view their steel industries as strategically important and therefore requiring protection from foreign competition. In addition, some emerging economies seek to protect and develop their steel industries by non-market methods, and as the balance between the production levels and product mix and consumption is being achieved, may resort to protectionist measures against imports from third countries.

MMK believes that Russia's accession to the WTO will contribute to lowering protectionist measures against Russian goods.

Trade Barriers and Anti-Dumping Regulations

Exports of steel products from the Russian Federation are primarily regulated by the Federal Law “On State Regulation of Foreign Trade Activity” No. 157-FZ dated 13 October 1995 (as amended) and international treaties of the Russian Federation.

There are several treaties with the U.S. and the EU, which establish minimum prices and/or quotas for certain types of steel products which are exported from the Russian Federation to the US and the EU. These treaties also provide that the export of steel products by Russian exporters is conducted on the basis of licences issued by the Ministry for External Economic Relations of the Russian Federation.

United States

In March 2002, the U.S. Government introduced import duties of 8 to 30 per cent. on 10 varieties of ferrous products, from tin-plate to slabs. In response to these and other measures undertaken by the U.S. Government, MMK discontinued its exports to the U.S. and focused its exports on other jurisdictions.

The Russian Federation and the U.S. reached an agreement in November 2002 whereby the U.S. terminated its anti-dumping investigation against suppliers of cold-rolled steel from Russia and in March 2003 Russia’s export quota of marketable pig iron and square billets was increased by U.S.\$40 million. Furthermore, the current steel prices on the U.S. market are considerably higher than elsewhere in the world. Therefore, slab deliveries to the U.S. are expected to be profitable for MMK and other Russian producers.

European Union

On 29 May 2002, the Russian Federation and the European Union (“EU”) entered into a three-year agreement regarding trade in metals. This agreement established a quota for the export of Russian metals into the EU and supersedes the previous quota system for the export of Russian metals which had been in place since 1996.

The quota for the export of Russian metals into the EU is set out in the table below:

Products	2002	2003
	<i>(in thousand tons)</i>	
Hot-rolled products	250,000	256,250
Hot-rolled products for rolling.....	485,000	497,130
Hot-rolled sheet, thick.....	60,000	61,500
Other flat products.....	80,000	82,000
Alloyed products	90,000	92,250
Beams, U-channels.....	15,000	15,380
Wire	60,000	61,500
Other long products.....	165,000	169,130
Total	1,205,000	1,235,140

On 29 September 2002, the EU introduced new import restrictions in respect of seven varieties of metal product. However, these restrictions did not affect Russian metal exports due to the existing agreement described above and MMK metal exports into the EU were not affected by these new restrictions.

China

On 24 May 2003 China established a quota for metal-roll supplies from Russia for the term of one year. The quota for hot-rolled metal comprises 378,584 tons and for cold-rolled metal comprises 804,261 tons.

In addition, Russia and China have agreed to create a mechanism for resolving trade disputes which will enable them to settle mutual claims without adopting anti-dumping or safeguard measures. A further round of negotiations between Russia and China regarding access for Russian steelmakers to the Chinese market took place in September 2003. The Ministry of Trade of China finally decided on its anti-dumping investigation in respect of Russian exports of cold-rolled products into China. China has announced its decision not to introduce anti-dumping duties on Russian steel exporters in the light of high demand for Russian steel products in China. This will enable MMK to retain its competitive advantages in one of its most important markets.

Ukraine and Kazakhstan

On 28 November 2001, at the request of MMK, Novolipetsk and Severstal, the Russian Government Committee on Protective Measures in Foreign Trade initiated an anti-dumping investigation relating to the import of galvanised rolled steel from Kazakhstan and the Ukraine. The ground for this investigation was an increase from 118,000 tons of galvanised steel imported in 1998 to 173,700 tons imported in 2000, giving the Ukraine and Kazakhstan a market share in the product of approximately 40 per cent. As a result of this investigation, an import duty in respect of Ukrainian exports was introduced for the period from 14 August 2002 until 14 August 2005 at a rate of 21 per cent. Pursuant to a decree issued by the Russian Government, a provisional anti-dumping duty was imposed from 4 August 2002 until 6 December 2002 against the import of galvanised steel from the Ukraine in the amount of 31.8 per cent. and from Kazakhstan in the amount of 36.9 per cent. However, on 8 May 2003, an anti-dumping duty was introduced at 24.3 per cent. for a period of two and a half years.

In addition, as a result of the Ukraine providing specific subsidies to Ukrainian producers of wire rod, debars and round bars, an investigation into the subsidised export of these types of products from the Ukraine was initiated by OAO Mechel on 21 June 2001. As a result of such investigation and the above-mentioned protective measures, the aggregate import of such rolled products into Russia was 2.1 million tons in 2001, which represented an increase of approximately 275,000 tons as compared to 2000. This was substantially lower than the growth in imports existing prior to the introduction of such protective measures (in 2000 imports grew by 51 per cent. (or 615,000 tons)). In 2002, import of rolled products into Russia fell by 33 per cent. as compared to 2001, totalling 1,415,000 tons.

General

In general, the recent trend worldwide has been for the relaxation of import restrictions. In addition, both the EU and the U.S. have ceased to be top priority markets for Russian steel producers. The largest importers of MMK's products are the South-East Asian countries, predominantly China. According to market research, Chinese steel producers cannot meet the needs of the rapidly growing internal market, which, in spite of the adopted import restrictions, will keep Chinese imports in the next few years at the level of approximately 25 million tons per annum.

New restrictive measures in respect of imported metals introduced by certain Latin American countries have also not adversely affected MMK's business, as MMK's exports are customarily directed at markets in South-East Asia for geographical reasons.

MMK believes that following Russia's development to market economy status and its accession to the WTO, it will be easier for Russian steelmakers to defend their interests in the course of anti-dumping and other trade investigations.

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The following is the full text of the audit report issued by KPMG Limited, dated 30 May 2003, on the consolidated financial statements of the Group (as defined below), as of 31 December 2002 and for the year then ended.

Independent Auditor's Report

To the shareholders and Board of Directors of
Open Joint Stock Company Magnitogorsk Iron & Steel Works

We have audited the accompanying consolidated balance sheet of Open Joint Stock Company Magnitogorsk Iron & Steel Works and its subsidiaries (the "Group") as of 31 December 2002 and the related statements of income, changes in equity and cash flows for the year then ended. The consolidated financial statements, as set out on pages 3 to 45, are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2002, and the results of its operations, changes in equity and cash flows for the year then ended in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

KPMG Limited
Moscow, Russian Federation

30 May 2003

Consolidated balance sheet

	Note	As at 31 December 2002	
		2002	2001
<i>In millions of US dollars</i>			
Assets			
Property, plant and equipment	13	2,125	1,853
Intangible assets	14	(2)	22
Investments in associates	15	1	55
Other investments	16	1	2
Other non-current assets	17	3	12
Total non-current assets		2,128	1,944
Inventories	18	231	233
Trade and other receivables	19	266	267
Other investments	16	11	3
Cash and cash equivalents	20	222	77
Total current assets		730	580
Total assets		2,858	2,524
Equity			
Share capital	21	363	26
Treasury shares		(22)	(23)
Additional paid in capital		16	–
Asset revaluation reserve		131	–
Retained earnings		1,319	1,543
Total equity		1,807	1,546
Minority interest		50	7
Liabilities			
Loans and borrowings	22	218	81
Employee benefits	24	22	21
Deferred tax liabilities	25	322	239
Other non-current liabilities		10	26
Total non-current liabilities		572	367
Bank overdrafts		6	–
Loans and borrowings	22	131	195
Trade and other payables	26	292	409
Total current liabilities		429	604
Total liabilities		1001	971
Total equity, minority interest and liabilities		2,858	2,524

The consolidated balance sheet is to be read in conjunction with the notes to and forming part of the consolidated financial statements set on pages F-7 to F-35.

Consolidated income statement

	Note	For the year ended 31 December 2002		
		2002	2001	2000
<i>In millions of US dollars, except earnings per share</i>				
Revenues	6	2,065	1,733	1,713
Cost of sales		(1,516)	(1,333)	(1,160)
Gross profit		549	400	553
Distribution expenses		(92)	(86)	(59)
General and administrative expenses	7	(230)	(165)	(204)
Social costs	8	(35)	(48)	(56)
Impairment and reversal of property, plant and equipment, net	13	150	34	(584)
Revaluation of property plant and equipment	13	(88)	–	–
Other operating expenses, net	9	(9)	(29)	(17)
Profit from operations		245	106	(367)
Impairment of investments in associates	15	–	(11)	–
Net financing costs	11	(43)	(12)	(28)
Profit before tax and minority interest		202	83	(395)
Income tax (expense)/benefit	12	(86)	58	61
Profit before minority interest		116	141	(334)
Minority interest		(1)	3	(4)
Net profit for the year		115	144	(338)

The consolidated income statement is to be read in conjunction with the notes to and forming part of the consolidated financial statements set on pages F-7 to F-35.

Consolidated statement of cash flows

	For the year ended 31 December 2002		
	2002	2001	2000
	<i>In millions of US dollars</i>		
Operating activities			
Profit before tax and minority interest	202	83	(395)
Adjustments for:			
Depreciation and amortisation.....	220	206	176
Impairment and reversal of property, plant and equipment, net	(150)	(34)	584
Revaluation of property, plant and equipment	88	-	-
Impairment of investments in associates	-	11	-
Loss on disposal of property, plant and equipment	15	19	51
Loss/(gain) on other investments.....	2	(1)	(13)
Foreign exchange loss	9	-	-
Interest expense	38	19	21
Operating profit before changes in working capital	424	303	424
Decrease/(increase) in inventories.....	10	(35)	(48)
Decrease/(increase) in trade and other receivables	16	(74)	(41)
(Decrease)/increase in trade and other payables	(150)	145	17
Cash flows from operations before taxes and interest paid	300	339	352
Income taxes paid	(51)	(54)	(105)
Interest paid	(37)	(18)	(26)
Cash flows from operating activities	212	267	221
Investing activities			
Proceeds from disposal of property, plant and equipment	22	3	-
Proceeds from disposal of investments.....	52	-	-
Acquisition of property, plant and equipment	(204)	(287)	(236)
Acquisition of intangible assets	(8)	(14)	(5)
Acquisition of investments in associates	-	(64)	-
Acquisition of subsidiaries less cash acquired	(5)	(2)	-
Net cash flow from other investments	-	4	(6)
Cash flows to investing activities	(143)	(360)	(247)
Financing activities			
Proceeds from borrowings	440	310	156
Repayments of borrowings.....	(375)	(200)	(106)
Cash transactions with minorities	-	-	2
Proceeds from the re-issuance of treasury shares.....	33	-	-
Acquisition of treasury shares	(16)	(8)	(4)
Payments made under finance lease	(10)	(4)	-
Dividends paid	(2)	(2)	(2)
Cash flows from financing activities	70	96	46
Net increase in cash and cash equivalents	139	3	20
Cash and cash equivalents at beginning of year	77	74	54
Cash and cash equivalents at end of year	216	77	74

The consolidated statement of cash flows is to be read in conjunction with the notes to and forming part of the consolidated financial statements set on pages F-7 to F-35.

Consolidated statement of changes in equity

For the year ended 31 December 2002

	Ordinary shares	Prefer- ence shares	Ordin- ary treasury shares	Prefer- ence treasury shares	Addi- tional paid in capital	Asset revalu- ation reserve	Retained earnings	Total
<i>In millions of US dollars</i>								
Balance at 1 January 2000	20	6	(10)	(1)	–	–	1,740	1,755
Acquisition of treasury shares	–	–	(2)	(2)	–	–	–	(4)
Net loss for the year	–	–	–	–	–	–	(338)	(338)
Balance at 31 December 2000	<u>20</u>	<u>6</u>	<u>(12)</u>	<u>(3)</u>	<u>–</u>	<u>–</u>	<u>1,402</u>	<u>1,413</u>
Acquisition of treasury shares	–	–	(3)	(5)	–	–	–	(8)
Dividends.....	–	–	–	–	–	–	(3)	(3)
Net profit for the year	–	–	–	–	–	–	144	144
Balance at 31 December 2001	<u>20</u>	<u>6</u>	<u>(15)</u>	<u>(8)</u>	<u>–</u>	<u>–</u>	<u>1,543</u>	<u>1,546</u>
Shares issued: 1,200 for 1 split	252	85	–	–	–	–	(337)	–
Acquisition of treasury shares	–	–	(10)	(6)	–	–	–	(16)
Property, plant and equipment revaluation, net of tax effect	–	–	–	–	–	792	–	792
Property, plant and equipment impairment decrease, net of tax effect	–	–	–	–	–	(647)	–	(647)
Revaluation reserve arising from step acquisition, net of tax effect	–	–	–	–	–	8	–	8
Minorities share of revaluation gain.....	–	–	–	–	–	(22)	–	(22)
Re-issuance of treasury shares	–	–	6	11	16	–	–	33
Dividends.....	–	–	–	–	–	–	(2)	(2)
Net profit for the year	–	–	–	–	–	–	115	115
Balance at 31 December 2002	<u>272</u>	<u>91</u>	<u>(19)</u>	<u>(3)</u>	<u>16</u>	<u>131</u>	<u>1,319</u>	<u>1,807</u>

The consolidated statement of changes in equity is to be read in conjunction with the notes to and forming part of the consolidated financial statements set on pages F-7 to F-35.

ACCOUNTING POLICIES AND NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. Background

(a) Organisation and operations

The consolidated financial statements of the Open Joint Stock Company Magnitogorsk Iron & Steel Works comprise the parent company Open Joint Stock Company Magnitogorsk Iron & Steel Works (“MMK” or “the Parent Company”) and its 73 subsidiaries (“the Group”). The Parent Company is an open joint stock (public) company as defined in the Civil Code of the Russian Federation. The head office of the Group is located at:

Ulitsa Kirova 93
455002 Magnitogorsk,
Russia

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

(b) Russian business environment

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

2. Basis of preparation

(a) Statement of compliance

The Group maintains its accounting records in accordance with the legislative requirements of the countries in which the individual entities are located (the Russian Federation, Switzerland and Luxembourg). The accompanying consolidated financial statements have been prepared from those accounting records and adjusted as necessary to comply with the requirements of International Financial Reporting Standards (“IFRS”), as promulgated by the International Accounting Standards Board (“IASB”).

(b) Basis of consolidation

(i) Subsidiaries

Subsidiaries are those enterprises controlled by the parent company. Control exists when the parent company has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases. The minority interest represents the minorities’ proportion of the net identifiable assets of the subsidiaries.

(ii) Associates

Associates are those enterprises in which the Group has significant influence, but not control, over the financial and operating policies. The consolidated financial statements include the Group’s share of the total recognised gains and losses of associates accounted for on an equity accounting basis, from the date that significant influence effectively commences until the date that significant influence effectively ceases. When the Group’s share of losses exceeds the carrying amount of the associate, the carrying amount is reduced to nil and the recognition of further losses is discontinued except to the extent that the Group has incurred obligations in respect of the associate.

(iii) *Jointly controlled operations*

Jointly controlled operations are those operations where the Group combines its operations, resources and expertise with other enterprises in order to manufacture, market or distribute goods under a joint contractual agreement, but which do not constitute a legal entity. The consolidated financial statements include those assets controlled by the Group, the liabilities and expenses that it incurs, and its share of the net income that it earns from the sale of goods or services by the jointly controlled operations, from the date that joint control effectively commences until the date that joint control effectively ceases.

(iv) *Transactions eliminated on consolidation*

Intra-group balances and transactions, and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains and losses arising from transactions with associates are eliminated to the extent of the Group's interest in the enterprise. Unrealised gains and losses are eliminated against the investment in the associate. Unrealised losses are eliminated in the same way as unrealised gains except that they are only eliminated to the extent that there is no evidence of impairment.

(c) *Historical cost basis*

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

(d) *Measurement and presentation currency*

The national currency of the Russian Federation is the Russian rouble ("RUR"). The measurement and presentation currency used in the preparation of these financial statements is the United States dollar ("USD"). Management has determined the US dollar to be the measurement currency as they consider that the US dollar reflects the economic substance of the underlying events and circumstances of the Group. In making this assessment, management has considered the following matters:

- A significant portion of the Group's revenues are earned from exports, which are invoiced and collected in US dollars;
- A significant portion of the Group's property, plant and equipment purchases are imported and are invoiced and settled in US dollars;
- A significant portion of the Group's expenses are denominated and settled in US dollars; and
- The Group retains a significant portion of its sales proceeds in US dollars.

All financial information presented in US dollars has been rounded to the nearest million.

The Russian rouble is not a convertible currency outside the Russian Federation and, accordingly, any conversion of Russian rouble amounts to US dollars should not be construed as a representation that Russian rouble amounts have been, could be, or will be in the future, convertible into US dollars at the exchange rate shown, or at any other exchange rate.

(e) *Going concern*

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

(f) *Use of estimates*

Management of the Group has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with IFRS. Actual results could differ from those estimates.

3. Significant accounting policies

The following significant accounting policies have been applied by the Group in the preparation of the financial statements and, except as otherwise stated, are consistent with those applied in the prior year.

(a) Foreign currency

(i) Foreign currency transactions

Transactions in foreign currencies are translated into US dollars at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated into US dollars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated to US dollars at the foreign exchange rate ruling at the date of the transaction.

(ii) Financial statements of foreign operations

The operations of the Group's foreign entities are integral to those of the Group. Accordingly, the assets and liabilities of these entities are translated into US dollars as set out in paragraph (i) above. There are no foreign operations that operate in hyperinflationary economies. Foreign exchange differences are recognised in the income statement.

(b) Property, plant and equipment

(i) Owned assets

Items of property, plant and equipment in use are stated at fair value less accumulated depreciation (see below) and impairment losses (refer accounting policy (h)). This policy was changed on 31 December 2002 (refer note 4). Assets under construction are recorded at cost less impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. Furthermore, borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets are included in the cost.

Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) Leased assets

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

(iii) Subsequent expenditure

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property, plant and equipment. All other expenditure is recognised in the income statement as incurred.

(iv) Revaluations

Revaluations are performed periodically, such that the carrying amount does not differ materially from fair value. Revaluations are carried out by an independent appraiser.

A revaluation increase is recognised in the statement of changes in equity under the heading of revaluation increase, unless it reverses a revaluation decrease previously recognised in the income statement for the same asset. A revaluation decrease is recognised in the income statement unless it reverses a revaluation increase previously recognised in the statement of changes in equity for the same asset.

(v) Depreciation

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

The estimated useful lives are as follows:

- Buildings 28-41 years
- Machinery and equipment 10-30 years
- Transportation equipment 8-21 years
- Fixtures and fittings 3-11 years

(c) Intangible assets

(i) Goodwill

Goodwill arising on acquisition represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired. Goodwill is stated at cost less accumulated amortisation (refer below) and impairment losses (refer accounting policy (h)). In respect of associates, the carrying amount of goodwill is included in the carrying amount of the investment in the associate.

(ii) Negative goodwill

Negative goodwill arising on an acquisition represents the excess of the fair value of the net identifiable assets acquired over the cost of acquisition.

To the extent that negative goodwill relates to an expectation of future losses and expenses that are identified in the plan of acquisition and can be measured reliably, but which have not yet been recognised, it is recognised in the income statement when the future losses and expenses are recognised. Any remaining negative goodwill, but not exceeding the fair values of the non-monetary assets acquired, is recognised in the income statement over the weighted average useful life of those assets that are depreciable/amortisable. Negative goodwill in excess of the fair values of the non-monetary assets acquired is recognised immediately in the income statement.

In respect of associates, the carrying amount of negative goodwill is included in the carrying amount of the investment in the associate. The carrying amount of other negative goodwill is deducted from the carrying amount of intangible assets.

(iii) Patents and trademarks

Patents and trademarks are carried at historical cost less any accumulated amortisation and any accumulated impairment losses (refer accounting policy (h)).

(iv) Research and development

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement as an expense as incurred.

Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised if the product or process is technically and commercially feasible and the Group has sufficient resources to complete development. The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Other development expenditure is recognised in the income statement as an expense as incurred. Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses (refer accounting policy (h)).

(v) Other intangible assets

Other intangible assets, which are acquired by the Group, are stated at cost less accumulated amortisation (refer below) and impairment losses (refer accounting policy (h)). Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

(vi) Subsequent expenditure

Subsequent expenditure on intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

(vii) Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets. Goodwill is amortised from the date of initial recognition and other intangible assets are amortised from the date they are available for use. The estimated useful lives are as follows:

- Goodwill 5-15 years
- Intangibles other than goodwill 3-10 years

(d) Investments

Investments held for trading are classified as current assets and are stated at fair value, with any resultant gain or loss being recognised in the income statement. Where the Group has the positive intent and ability to hold debt securities to maturity, they are stated at amortised cost less impairment losses (refer accounting policy (h)). Other investments held by the Group are classified as being available-for-sale and are stated at fair value, with any resultant gain or loss being recognised in the income statement. The fair value of investments held for trading and investments available-for-sale is their quoted bid price at the balance sheet date.

An investment is recognised by the Group when it becomes a party to the contractual provisions of the investment. An investment is derecognised when the Group loses control over its contractual rights.

(e) Trade and other receivables

Trade and other receivables are stated at their cost less impairment losses (refer accounting policy (h)).

(f) Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The cost of inventories is calculated on the weighted average basis and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition.

(g) Cash and cash equivalents

Cash and cash equivalents comprises cash balances, call deposits and liquid bank promissory notes. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents in the statement of cash flows.

(h) Impairment

The carrying amounts of the Group's assets, other than inventories (refer accounting policy (f)) and deferred tax assets (refer accounting policy (q)), are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amounts are estimated. For intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

An impairment loss in respect of a revalued asset is recognised in the statement of changes in equity to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same asset. Otherwise, all impairment losses are recognised in the income statement.

(i) Calculation of recoverable amount

The recoverable amount of the Group's investments in debt securities and receivables is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset.

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

(ii) Reversals of impairment

An impairment loss in respect of a held-to-maturity security or receivable is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of goodwill is not reversed unless the loss was caused by a specific external event of an exceptional nature that is not expected to recur, and the increase in recoverable amount relates clearly to the reversal of the effect of that specific event.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

A reversal of an impairment loss in respect of a revalued asset is recognised in the income statement to the extent that an impairment loss on the same revalued asset was previously recognised as an expense in the income statement. Otherwise, a reversal of an impairment loss in respect of a revalued asset is recognised in the statement of changes in equity. Reversals of impairment losses in respect of other assets are recognised in the income statement.

(i) Share capital

(i) Preference share capital

Preference share capital that is non-redeemable and for which dividends are payable at the discretion of the directors, is classified as equity.

(ii) Repurchase of share capital

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a change in equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity.

(iii) Dividends

Dividends are recognised as a liability in the period in which they are declared.

(j) Loans and borrowings

Loans and borrowings are recognised initially at cost, net of any transaction costs incurred. Subsequent to initial recognition, loans and borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

When borrowings are repurchased or settled before maturity, any difference between the amount repaid and the carrying amount is recognised immediately in the income statement.

(k) Employee benefits

(i) Short-term employee benefits

The Group reimburses its employees for expenses incurred in case of injuries at work from Group funds and reimbursement from the Social Insurance Fund to which the Group pays a percentage of

each employee's wage as established by the Russian Tax Code. The Group also grants annual vacations to its employees with an average duration of 34 calendar days.

(ii) *Defined contribution plans*

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

(iii) *Defined benefit plans*

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

(l) *Provisions*

A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(m) *Environmental expenditures*

Capital expenditure in respect of ongoing environmental compliance measures is capitalised and recorded in the consolidated balance sheet. Environmental expenditure of a non-capital nature is recognised in the income statement as incurred.

(n) *Trade and other payables*

Trade and other payables are stated at their cost.

(o) *Revenues*

(i) *Goods sold and services rendered*

Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. Revenue from services rendered is recognised in the income statement in proportion to the stage of completion of the transaction at the balance sheet date. The stage of completion is assessed by reference to surveys of work performed. No revenue is recognised if there are significant uncertainties with regard to recovery of the consideration due, associated costs or the possible return of goods.

(ii) *Rental income*

Rental income from property is recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income to be received.

(iii) *Government grants*

Government grants are recognised in the balance sheet initially as deferred income when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group for expenses incurred are recognised as revenue in the income statement on a systematic basis in the same periods in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are recognised in the income statement as revenue on a systematic basis over the useful life of the asset.

(iv) Non-cash transactions

The Group has a significant level of non-cash transactions as is common with many Russian companies. Non-cash transactions consist of mutual settlements arising from the exchange of goods and services, and transactions which are settled by means of promissory notes. Approximately 17% (2001: 13%) of revenues and 18% (2001: 14%) of purchases in 2002 were received and paid for in the form of non-cash transactions. Mutual settlement transactions are centrally managed by the Group. Prices are usually fixed in contracts with the mutual settlement transactions valued and recorded at market prices for the goods involved in the transaction. Non-cash sales and purchases are accounted for on an accruals basis in the same manner as traditional cash transactions.

(p) Expenses

(i) Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease payments made.

(ii) Social costs

Social asset construction costs

Capital expenditure of a social nature that benefits the community as a whole, but which is not expected to bring future economic benefits to the Group, is recognised in the income statement as incurred.

Operational and maintenance expenses

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

(iii) Net financing costs

Net financing costs comprise interest on borrowings, interest income, dividend income and foreign exchange gains and losses.

Interest income is recognised in the income statement as it accrues, taking into account the effective yield on the asset and the liability. Dividend income is recognised in the income statement on the date that the dividend is declared.

Interest that is not directly attributable to the acquisition, construction or production of qualifying assets, as well as the interest expense component of finance lease payments, is recognised in the income statement using the effective interest method.

(q) Income tax

Income tax for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly to equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes, and the initial recognition of assets or liabilities that affect neither accounting nor taxable profit and investments in subsidiaries, where the parent is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the unused tax losses and credits can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(r) Comparative amounts

Comparative amounts were reclassified to separately identify insurance costs and VAT payable in the notes to the consolidated financial statements.

4. Change in accounting policy

With effect from 31 December 2002 the Group prospectively adopted the alternative treatment allowed by IAS 16 Property, Plant and Equipment with respect to the measurement of property plant and equipment in use. The alternative treatment allows property, plant and equipment to be carried at a revalued amount subsequent to initial recognition, being its fair value at the date of revaluation less any subsequent accumulated depreciation and impairment losses. Previously the Group had carried its property, plant and equipment at cost less accumulated depreciation and impairment losses. Management believes that the adoption of the new accounting policy results in a more relevant and reliable presentation of the Group's financial position and performance.

5. Segment information

The Group predominantly produces iron and steel products, which are primarily sold to traders unrelated to the Group for sale on the world steel market. The revenues from the sale of these products constitute more than 95% of total revenues. An analysis of sales by product is included in note 6. Geographically, all significant assets, production and management/administrative facilities are located in Magnitogorsk. An analysis of the regions in which all traders sold the Group's products is included in note 6.

6. Revenues

	2002	2001	2000
	<i>In millions of US dollars</i>		
Rolled steel	1,174	973	926
Assorted rolled products	191	225	208
Tin plated steel	133	199	191
Slabs	112	89	65
Band	94	85	96
Tubes	19	28	43
Other	342	134	184
	<u>2,065</u>	<u>1,733</u>	<u>1,713</u>

Regions in which products are sold by traders

	2002	2001	2000
Russia and the CIS	48%	55%	46%
Asia	21%	20%	22%
Middle East	9%	12%	17%
Europe	19%	11%	11%
Other	3%	2%	4%
	<u>100%</u>	<u>100%</u>	<u>100%</u>

7. General and administrative expenses

	2002	2001	2000
	<i>In millions of US dollars</i>		
Wages, salaries and related taxes	51	44	29
Insurance costs	40	27	17
Services consumed	23	11	28
Depreciation	15	19	17
Amortisation of intangibles	8	8	3
Pension costs, net	3	1	3
Bank charges.....	9	8	8
Taxes other than profit tax	65	45	94
Other administrative expenses	16	2	5
	230	165	204
	230	165	204

Insurance costs

During 2002 the Group insured its property, plant and equipment, constructions in progress and operational current assets. It also insured against certain other risks including risks related to industrial accidents and civil liability. The Group's property, plant and equipment is insured in accordance with its replacement cost as determined by American Appraisal (ARR) Inc. and other licensed appraisers.

Transactions with related parties

OAO SKM

OAO SKM ("SKM") is an insurance company that provides insurance related services to the Group. The Group has the ability to exercise significant influence over the financial and operating policy decisions of SKM through the directors' controlling financial interest in OAO Trust Capital-M, a company in which the Group has no ownership.

The Group insured a significant portion of its risks through SKM, including the property, plant and equipment of the Parent Company. SKM reinsured its property risks with internationally recognised insurance companies, and other risks with OAO National Insurance Group ("NIG"), a Russian legal entity.

In 2002 total insurance expense incurred by the Group with SKM amounted to USD 26 million (2001: USD 20 million, 2000: USD 18 million), of which USD 10 million relates to co-insurance contracts primarily with NIG. Payments made by the Company to SKM totalled USD 39 million (2001: USD 20 million, 2000: USD 18 million). As at the balance sheet date the Group had recorded USD 13 million of insurance prepayments to SKM (2001: Nil). SKM received a commission of approximately 13% for the provision of these insurance services.

8. Social costs

	2002	2001	2000
	<i>In millions of US dollars</i>		
Social asset construction costs	11	31	31
Operational and maintenance expenses	24	17	25
	35	48	56
	35	48	56

9. Other operating expenses, net

	<u>2002</u>	<u>2001</u>	<u>2000</u>
	<i>In millions of US dollars</i>		
Net loss/(gain) on sale of investments	2	(1)	(13)
Bad debts and change in accounts receivable provision, change in other provisions	9	17	6
Loss on disposal of property, plant and equipment	15	19	51
Other operating gain, net	(17)	(6)	(27)
	<u>9</u>	<u>29</u>	<u>17</u>

10. Personnel expenses

	<u>2002</u>	<u>2001</u>	<u>2000</u>
	<i>In millions of US dollars</i>		
Wages, salaries and related taxes included in:			
cost of sales	194	163	131
distribution costs.....	4	4	3
administrative expenses.....	54	44	29
	<u>252</u>	<u>211</u>	<u>163</u>

The average number of employees during the year ended 31 December 2002 was 56,000 (2001: 60,000; 2000: 56,000).

11. Net financing costs

	<u>2002</u>	<u>2001</u>	<u>2000</u>
	<i>In millions of US dollars</i>		
Interest expense	38	19	21
Interest income	(4)	(2)	(3)
Net foreign exchange loss/(gain)	9	(5)	10
	<u>43</u>	<u>12</u>	<u>28</u>

12. Income tax expense/(benefit)

	<u>2002</u>	<u>2001</u>	<u>2000</u>
	<i>In millions of US dollars</i>		
<i>Current tax expense</i>			
Current year expense.....	65	51	101
Overprovided in prior years	(1)	(4)	-
	<u>64</u>	<u>47</u>	<u>101</u>
<i>Deferred tax expense/(benefit)</i>			
Origination and reversal of temporary differences (refer note 25)	22	5	(213)
Change in tax rate	-	(110)	51
	<u>22</u>	<u>(105)</u>	<u>(162)</u>
	<u>86</u>	<u>(58)</u>	<u>(61)</u>

The Parent Company's applicable tax rate is the corporate income tax rate of 24% (2001: 35%, 2000: 30%) and 24% for measuring deferred taxes (2001: 24%, 2000: 35%).

Reconciliation of effective tax rate

	2002		2001		2000
	<i>In millions of US dollars</i>				
Profit before tax and minority interest.....	202		83		(395)
Income tax at applicable tax rate	24% 48	35%	29	30%	(119)
Non-deductible expenses.....	36% 39	96%	80	(13%)	51
Tax incentives not recognised in the income statement	– –	(7%)	(6)	1%	(3)
Tax exemption	– –	(56%)	(47)	10%	(41)
Overprovided in prior years	(1%) (1)	(5%)	(4)	–	–
Impact of change in tax rate	– –	(133%)	(110)	(13%)	51
	59% 86	(70%)	(58)	15%	(61)

13. Property, plant and equipment

	Land and buildings	Machinery and equipment	Transportation equipment	Fixtures and fittings	Assets under construction	Total
Cost						
Balance at 1 January 2002	6,896	4,774	463	60	205	12,398
Additions	9	30	14	6	145	204
Acquisition of subsidiaries	35	29	–	–	–	64
Transfers	77	182	2	1	(262)	–
Disposals	(288)	(76)	(13)	(3)	(1)	(381)
Balance at 31 December 2002 ..	6,729	4,939	466	64	87	12,285
Depreciation						
Balance at 1 January 2002	(6,535)	(3,544)	(418)	(48)	–	(10,545)
Charge for the year	(23)	(181)	(6)	(2)	–	(212)
Disposals	272	58	12	2	–	344
Balance at 31 December 2002 ..	(6,286)	(3,667)	(412)	(48)	–	(10,413)
Revaluation and impairment at 31 December 2002						
Reversal of impairment.....	114	243	5	7	–	369
Revaluation increase	169	829	42	2	–	1,042
Revaluation decrease.....	(50)	(35)	–	(3)	–	(88)
Impairment	(223)	(808)	(30)	(9)	–	(1,070)
Carrying amount						
Balance at 1 January 2002	361	1,230	45	12	205	1,853
Balance at 31 December 2002 ..	453	1,501	71	13	87	2,125
Carrying amount had no revaluation taken place at 31 December 2002						
	453	1,478	59	12	87	2,089

Revaluation

In 2002 management commissioned American Appraisal (AAR) Inc. to independently appraise all classes of property, plant and equipment as at 31 December 2002, with the exception of assets under construction. The fair value of items of property, plant and equipment was determined based on their depreciated replacement cost.

Impairment loss and reversal

Since the revaluation of property, plant and equipment was carried out using a basis other than market value, American Appraisal (AAR) Inc. subsequently determined the recoverable amount of the revalued property, plant and equipment. In addition to highlighting instances where the valuation based on depreciated replacement cost was higher than the asset's recoverable amount, and therefore an impairment loss was required, it also resulted in the partial reversal of the impairment loss recognised in the income statement in 2000.

For impairment purposes the recoverable amount was determined in aggregate for each cash-generating unit. In general each appraised company of the Group was treated as a single cash-generating unit. However, where subsidiaries were fully integral to the Parent Company they were included in the cash-generating unit of the Parent Company. This is consistent with the way in which the recoverable amount was determined when the impairment loss was recognised in 2000.

The recoverable amounts represent their value in use as determined by discounting the future cash flows of each unit generated from the continuing use of property, plant and equipment and from its ultimate disposal. A discount rate of 16% was applied in determining the recoverable amount of the Parent Company's property, plant and equipment. Various discount rates between 19% and 21% were applied in determining the recoverable amounts of property, plant and equipment of the Group's significant subsidiaries, depending on the characteristics of each subsidiary appraised. In 2000 a discount rate of 20% was applied in determining the recoverable amounts of property, plant and equipment of the Parent Company and its subsidiaries.

Recognition of revaluation and impairment

The allocation of the results of the revaluation and impairment testing were applied to property, plant and equipment on an item-by-item basis. As a result, the following amounts were recognised in the income statement and statement of changes in equity:

	2002	
	Income statement	Statement of changes in equity
Reversal of impairment loss recognised in prior years	369	–
Revaluation increase	–	1,042
Impairment loss	(219)	(851)
Revaluation decrease.....	(88)	–
Impact on property, plant and equipment	62	191
Effect of deferred tax	(15)	(46)
Net impact on the income statement/statement of changes in equity....	47	145

Borrowing costs

Borrowing costs incurred during 2002 of USD 10 million were capitalised as part of the cost of qualifying assets (2001: USD 4 million, 2000: USD 1 million).

14. Intangible assets

	Negative Goodwill	Goodwill	Other intangible assets	Total
<i>In millions of US dollars</i>				
Cost				
Balance at 1 January 2002	–	6	25	31
Additions	(9)	–	8	(1)
Disposals	–	–	(3)	(3)
Adjustment arising from business combination (refer note 29).....	(9)	(6)	–	(15)
Balance at 31 December 2002	(18)	–	30	12
Depreciation/Amortisation				
Balance at 1 January 2002	–	–	(9)	(9)
Charge for the year	2	–	(10)	(8)
Disposals	–	–	3	3
Balance at 31 December 2002	2	–	(16)	(14)
Carrying amount				
At 1 January 2002	–	6	16	22
At 31 December 2002	(16)	–	14	(2)

Negative Goodwill

Negative goodwill relating to the acquisition of OAO Magnitogorsky Kalibrovochny Zavod (“MKZ”) and OAO Magnitogorsky Metizno-Metallurgichesky Zavod (“MMMZ”) is being recognised in the income statement over a period of 6 and 7 years, respectively.

15. Investments in associates

The Group has the following significant investments in associates:

	Country of incorporation	Ownership		Voting interest	
		2002	2001	2002	2001
OAO Ugolnaya Kompania					
Kuzbassugol.....	Russia	–	26%	–	26%
ZAO Uralkord	Russia	50%	50%	50%	50%

Disposal of investments in associates

OAO Ugolnaya Kompania Kuzbassugol

In June 2002, the Group sold its 26% investment in OAO Ugolnaya Kompania Kuzbassugol (“Kuzbassugol”) for USD 52 million. The difference between the acquisition price and disposal price of USD 11 million was recognised as an impairment loss in 2001. Consequently, no gain or loss on disposal of the investment was recognised in 2002.

Transactions with associates

Kuzbassugol

A loan provided by the Group to Kuzbassugol of RUR 100 million (USD 3 million) in 2001 was repaid during 2002.

Subsequent events

In April 2003 the Group’s subsidiary, OAO Magnitogorsky Kalibrovochny Zavod, disposed of its equity interest in ZAO Uralkord for USD 5 million. There was no gain or loss on disposal of the equity interest.

16. Other investments

	<u>2002</u>	<u>2001</u>
	<i>In millions of US dollars</i>	
<i>Non-current investments</i>		
Equity securities available-for-sale	1	2
	<u>1</u>	<u>2</u>
<i>Current investments</i>		
Equity securities available-for-sale	9	2
Equity securities held for trading	2	1
	<u>11</u>	<u>3</u>

17. Other non-current assets

	<u>2002</u>	<u>2001</u>
	<i>In millions of US dollars</i>	
Loans to employees	2	1
Restricted cash	1	11
	<u>3</u>	<u>12</u>

Restricted cash

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

Transactions with related parties

OOO Kluch

OOO Kluch ("Kluch") is a construction company that constructs apartment buildings in the city of Magnitogorsk. The Group has the ability to exercise significant influence over the financial and operating policy decisions of Kluch through the positions that certain directors of the Group have on the board of directors of Kluch. As at 31 December 2002, the Group had loaned in aggregate USD 2 million (2001: USD 1 million) to certain employees of the Group in order for them to acquire apartments being constructed by Kluch. As at the balance sheet date the Group had guaranteed USD 5 million (2001: USD 5 million) of loans advanced to Kluch by third parties.

18. Inventories

	<u>2002</u>	<u>2001</u>
	<i>In millions of US dollars</i>	
Raw materials and consumables	155	171
Work in progress	59	48
Finished goods and goods for resale	33	23
	<u>247</u>	<u>242</u>
Provision for obsolescence	(16)	(9)
	<u>231</u>	<u>233</u>

19. Trade and other receivables

	<u>2002</u>	<u>2001</u>
	<i>In millions of US dollars</i>	
Trade accounts receivable.....	96	127
VAT receivable	119	101
Prepayments and advances.....	48	31
Other receivables	19	25
	<u>282</u>	<u>284</u>
Provision for doubtful debts (trade)	(16)	(17)
	<u>266</u>	<u>267</u>

Transactions with related parties

OOO MMK Louch

OOO MMK Louch (“Louch”) is an intermediary trader controlled by the directors of the Group through the directors’ controlling financial interest in OAO Trust Capital-M. During 2002 the Group made sales of USD 16 million to Louch. As at the balance sheet date the Group had received advances from Louch of USD 1 million.

20. Cash and cash equivalents

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

	<u>2002</u>	<u>2001</u>
	<i>In millions of US dollars</i>	
Foreign currency bank accounts	19	20
RUR bank accounts.....	16	15
USD short-term bank deposits	96	14
RUR short-term bank deposits	14	–
USD denominated liquid bank promissory notes.....	69	23
Other RUR denominated cash equivalents.....	8	5
	<u>222</u>	<u>77</u>
Cash and cash equivalents per the balance sheet.....	(6)	–
	<u>216</u>	<u>77</u>

Deposits with related parties

OAO Credit Ural Bank

The Group has cash and cash equivalents of USD 23 million (2001: USD 46 million) on deposit with OAO Credit Ural Bank (“CUB”) in which certain directors of the Group have, in aggregate, a controlling financial interest. In their capacity as owners of CUB, these directors act solely for the benefit of CUB, and not in the interest of the Group.

CUB provided loans (refer note 22), overdrafts, customer and supplier settlements and employee payroll services to the Parent Company and to the majority of its subsidiaries. It is the intention of the Group to enter into such transactions at market prices.

The Group also incurred bank charges from CUB totalling USD 9 million for the year ended 31 December 2002 (2001: USD 9 million, 2000: USD 9.5 million).

21. Equity

Share capital

At the Parent Company’s annual shareholders meeting on 17 May 2002, shareholders approved a decision to increase the value of authorized ordinary and preference shares from RUR 6.6 million (USD 12 million) and RUR 2.2 million (USD 3 million), to RUR 8 billion (USD 252 million) and

RUR 2.6 billion (USD 85 million), respectively, and approved a one thousand two hundred to one split of the Company's ordinary and preference shares. On 22 July 2002 MMK registered the share split and subsequently the shareholders received one thousand two hundred shares for every one share they owned as at 6 August 2002. All references in the consolidated financial statements to ordinary and preference shares and per share amounts have been restated retroactively for the share split, unless otherwise noted.

As at the balance sheet date, the authorised and issued share capital comprised of 7,972,665,600 ordinary shares (2001: 7,972,665,600) and 2,657,556,000 non-redeemable non-cumulative preference shares (2001: 2,657,556,000). All shares have a par value of RUR 1. There were no unpaid shares as at the balance sheet date. All shares rank equally with regard to the Group's residual assets.

Issued and net outstanding shares comprised the following:

	Issued	Treasury shares	Net outstanding
<i>Number of ordinary shares in thousands</i>			
Balance at 1 January 2000	6,644	(2,324)	4,320
Acquisition of treasury shares	–	(18)	(18)
Balance at 31 December 2000	6,644	(2,342)	4,302
Acquisition of treasury shares	–	(171)	(171)
Balance at 31 December 2001	6,644	(2,513)	4,131
Acquisition of treasury shares	–	(278)	(278)
Share issue: 1,200 for 1 split	7,966,022	(3,346,409)	4,619,613
Re-issuance of treasury shares	–	808,415	808,415
Balance at 31 December 2002	7,972,666	(2,540,785)	5,431,881
<i>Number of preference shares in thousands</i>			
Balance at 1 January 2000	2,215	(662)	1,553
Acquisition of treasury shares	–	(63)	(63)
Balance at 31 December 2000	2,215	(725)	1,490
Acquisition of treasury shares	–	(161)	(161)
Balance at 31 December 2001	2,215	(886)	1,329
Acquisition of treasury shares	–	(497)	(497)
Share issue: 1,200 for 1 split	2,655,341	(1,658,217)	997,124
Re-issuance of treasury shares	–	1,268,744	1,268,744
Balance at 31 December 2002	2,657,556	(390,856)	2,266,700

Treasury shares

At the balance sheet date the Group held 2,540,785 thousand (2001: 3,014,954 thousand) of its own ordinary shares and 390,856 thousand (2001: 1,062,998 thousand) of its own preference shares. The Group also controls the voting rights of a further 2,018,835 thousand (2001: 143,043 thousand) of its own ordinary shares and 1,648,648 thousand (2001: 423,973 thousand) of its own preference shares, which subsidiaries of the Group hold in a trustee capacity under trust management agreements. Dividends accrue to the beneficial owners of these shares. Transactions with the shares held under the trust management agreements can only be performed after receiving express written instructions from the Founder of the trust.

During the year the Group re-issued treasury shares in the form of 808,415 thousand ordinary shares and 1,268,744 thousand preference shares for aggregate amounts of USD 25 million and USD 8 million, respectively. As at the balance sheet date a subsidiary of the Group held these shares in a trustee capacity under the trust management arrangement as discussed above .

Subsequent to the balance sheet date, a further 264,744 thousand ordinary and 509,767 thousand preference treasury shares were re-issued for aggregate amounts of USD 8 million and

USD 3 million, respectively. These shares are currently held in a trustee capacity by a subsidiary of the Group under a trust management arrangement with the same terms as discussed above.

Dividends

Holders of non-redeemable non-cumulative preference shares are entitled to receive a fixed dividend of 10% of profit after tax and other deductions calculated in accordance with Russian legislation. The amount of the preference dividend should not be less than the amount of ordinary dividend declared at the annual shareholders' meeting.

According to legislation in the Russian Federation, non-cumulative preference shareholders have the same voting rights as ordinary shareholders in the event of default on full payment of dividends to preference shareholders. This right commences from the shareholders' meeting following the annual meeting at which the decision was made to default on full payment of the preference dividend, and terminates from the moment the preference dividends are paid in full.

In accordance with the terms of the charter governing the preference shares, they may be converted into cumulative preference shares by a decision of those shareholders who hold a right to vote at a general meeting, at which time any unpaid or partially unpaid dividends relating to these shares would accrue and would be paid in the future.

Dividends payable are limited to the maximum retained earnings of the Group as determined in accordance with the legislation of the Russian Federation. At the balance sheet date, reserves available for distribution in accordance with Russian legislation amounted to USD 324 million (2001: USD 242 million, 2000: USD 61 million). The Russian statutory profit after tax for the year was USD 99 million (2001: USD 208 million, 2000: USD 245 million).

At the balance sheet date the following dividends have been recommended by the directors, but have not been approved and are therefore not provided for:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
	<i>In millions of US dollars</i>		
RUR 0.011 per qualifying ordinary share (2001: RUR 0.008)	3	2	2
RUR 0.033 per preference share (2001: RUR 0.008)	3	1	1
	<u>6</u>	<u>3</u>	<u>3</u>

Voting rights of shareholders

The holders of fully paid ordinary shares are entitled to one vote per share at the annual and general shareholder meetings of the Group. Shareholders that own fully paid preference shares shall ordinarily participate in the general meeting of shareholders with the right to vote only on issues of reorganisation or liquidation of the Company, and issues concerning amendments to the Parent Company's charter that would restrict their rights.

Transactions with related parties

Conares Trading AG

A principal shareholder of the Parent Company appointed a representative to the Board of Directors of MMK. The appointed director also has a controlling financial interest in Conares Trading AG ("Conares"), a major export customer of the Group. During 2002 the Group made sales of USD 106 million (2001: USD 118 million, 2000: USD 119 million) to Conares, and as at the balance sheet date Conares owed the Group USD 3 million (2001: USD 5 million).

The Government

The Government of the Russian Federation owned 23.8% of the voting shares of the Group as at 31 December 2002 (2001: 23.8%). The Government plans to sell its financial interest in the Parent Company at a special-purpose auction scheduled for June 2003.

The Government also owns, controls, or has influence over the operations of many other significant companies and enterprises in the Russian Federation and has a significant influence on the National economy. The Group's activities are significantly linked to companies owned or controlled by the Government. The Group has a significant influence in the local community and with local and regional Government authorities.

Management consider such trading relationships to be usual in conducting business in the Russian Federation and believe that these relationships will continue for the foreseeable future.

22. Loans and Borrowings

	Effective interest rate	2002	Effective interest rate	2001
<i>In millions of US dollars</i>				
<i>Non-current liabilities</i>				
Secured loans – RUR, fixed	18%	74	20%	51
– USD, variable	7%	19	7%	15
– EUR, variable	–	–	6%	2
Unsecured loans – USD, fixed	–	–	11%	1
– EUR, fixed	10%	2	–	–
Unsecured bond issues – EUR, fixed	11%	112	–	–
Finance lease liabilities – USD, fixed	17%	3	11%	9
– RUR, fixed	26%	4	24%	3
– USD, variable	10%	4	–	–
		<u>218</u>		<u>81</u>
<i>Current liabilities</i>				
Secured loans – RUR, fixed	22%	2	21%	68
– RUR, variable	20%	8	–	–
– USD, variable	4%	28	6%	28
Unsecured loans – RUR, fixed	19%	7	18%	2
– RUR, variable	21%	2	–	–
– USD, variable	6%	22	7%	7
– USD, fixed	9%	5	5%	48
Unsecured Russian bond issues – RUR, fixed	19%	10	18%	34
Current portion of secured loans – RUR, fixed	17%	20	–	–
Current portion of secured loans – USD, variable	7%	19	7%	3
Current portion of finance lease obligations – USD, fixed	12%	3	11%	3
– RUR, fixed	25%	3	24%	2
– USD, variable	10%	2	–	–
		<u>131</u>		<u>195</u>
Unutilised available borrowing facilities – USD, variable		3		31

Issue of Eurobonds

On 18 February 2002 the Group issued 100,000 notes with a face value of Euro (“EUR”) 1,000 each. The notes constitute unsecured and unsubordinated obligations of MMK Finance S.A. and rank *pari passu* with all other unsecured and unsubordinated present and future obligations of MMK Finance S.A. The notes were issued with a yield of 10.1%, maturing in three years. The Parent Company provided an unconditional, unsecured, and unsubordinated guarantee for the note issue.

A covenant to the note issue, which is specified in the Guarantee agreement, restricts the Parent Company, as Guarantor, from issuing a security interest where the aggregate consolidated secured debt will exceed 10% of the Guarantor’s consolidated total assets, unless the same or similar security interest is provided to the noteholders. Exemptions exist under the covenant depending on the purpose for which the security interest is provided.

The purpose of the note issue was primarily to refinance certain short-term obligations which existed at 31 December 2001, and to finance the Group’s approved capital investment program.

Long-term debt repayment schedule

	Total	Current portion	2004	2005	2006
<i>In millions of US dollars</i>					
Secured bank loans					
– USD, variable	38	19	19	–	–
– RUR, fixed.....	94	20	31	30	13
Unsecured loans – EUR fixed	2	–	–	2	–
Unsecured bond issues –					
EUR, fixed	112	–	–	112	–
Finance lease liabilities					
– USD, fixed	6	3	1	1	1
– RUR, fixed.....	7	3	3	1	–
– USD, variable	6	2	2	1	1
	<u>265</u>	<u>47</u>	<u>56</u>	<u>147</u>	<u>15</u>

Finance lease liabilities

Finance lease liabilities are payable as follows:

	2002			2001		
	Payments	Interest	Principal	Payments	Interest	Principal
<i>In millions of US dollars</i>						
Less than one year.....	11	3	8	7	2	5
Between one and five years	13	2	11	11	3	8
More than five years	–	–	–	5	1	4
	<u>24</u>	<u>5</u>	<u>19</u>	<u>23</u>	<u>6</u>	<u>17</u>

As at the balance sheet date leased assets with a carrying amount of USD 14 million were included in property, plant and equipment (2001: USD 17 million).

Transactions with related parties

CUB

During 2002 the Group obtained additional loans and overdraft financing from CUB totalling USD 249 million (2001: USD 201 million, 2000: USD 57 million) and made repayments to CUB totalling USD 241 million (2001: USD 179 million, 2000: USD 54 million). As at the balance sheet date the Group had loans outstanding to CUB of USD 14 million (2001: USD 3 million), which includes an overdraft USD 2 million (2001: Nil).

CUB also had outstanding loans as at the balance sheet date with related and third parties totalling USD 5 million and 2 million, respectively (2001: USD 5 million to related parties only), that were guaranteed by the Group (refer note 32).

Total interest incurred by the Group on loans and overdraft financing amounted to USD 2 million (2001: USD 2 million).

OOO Leasing-M

OOO Leasing-M (“Leasing-M”) provided leased equipment to the Group under an agreement which in substance is a finance lease. OAO Trust Capital-M retains a financial interest in Leasing-M which enables the Group to influence its financial and operating policy decisions.

The lease agreement is comprised of both Russian rouble and US dollar denominated components which have implicit interest rates of 26% and 10% per annum, respectively. As at the balance sheet date, the Group has outstanding finance lease obligations to Leasing-M of USD 9 million (2001: USD 8 million), and incurred interest of USD 1 million in 2002 (2001: USD 2 million). The Group has net amounts due to Leasing-M of USD 1 million, after the offset of advance payments made by the Group.

Subsequent events

On 17 March 2003 the Group received a USD 100 million medium term syndicated loan at a floating rate of Libor + 4.25% for a period of 3 years. A major customer (trader) of the Group, “MMK Metal Limited” provided a guarantee as security for this loan to the Group.

On 17 April 2003 the Group signed a USD 32 million loan agreement with a floating rate of Libor + 0.45% for a term of 7 years. The loan will be utilised by the Group to purchase equipment. The equipment will be pledged as security for the loan.

On 9 April 2003 the group issued 900,000 notes with a face value of RUR 1000 each. The notes were issued with a yield of 9.75% maturing 740 days after date of issue.

23. Pledges provided by the Group

The Group has pledged property, plant and equipment and inventory of USD 307 million (2001: USD 870 million) and USD 128 million (2001: USD 130 million), respectively. The Group has also pledged export contracts totalling USD 102 million (2001: USD 102 million), and 75% (2001: 75%) of the ordinary shares of a subsidiary, which had net assets of USD 13 million (2001: USD 12 million) at the balance sheet date.

The Group is subject to the following pledges as at 31 December 2002:

	<u>Note</u>	<u>2002</u>	<u>2001</u>
		<i>In millions of US dollars</i>	
<i>Short-term</i>			
Pledges provided for the debt of related parties	26	–	61
Pledges provided for the debt of the Group	22	66	599
Pledges provided for the debt of third parties		–	9
<i>Long-term</i>			
Pledges provided for the debt of the Group	22	484	438
		<u>550</u>	<u>1,107</u>

24. Employee benefits

Defined contribution obligations

Sotsialnaya Zashchita Starosti

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

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

The monthly contribution rate is equal to the employee’s contribution, unless the employee is a male aged between 55 and 60, or a female aged between 50 and 55, in which case the contribution will be 1.5 times the employee’s contribution. The monthly employee contribution by the Group may not exceed RUR 2,000 (USD 63) per employee. In 2002 contributions made by the Group to the fund were USD 3 million (2001: USD 1 million).

Russian Federation State Pension Fund

The Group pays into the Russian Federation State Pension Fund a percentage of each employee’s wage based on a scale as established by the Russian Tax Code. In 2002 total payments made to the state pension fund totalled USD 28 million (2001: 27 million, 2000: 22 million). These amounts are expensed when incurred and are recorded in taxes related to personnel expenses (refer note 10).

Defined benefit obligations

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

The Group makes monthly payments to the fund of RUR 241 (USD 7.58) per retiree (2001: RUR 200, USD 6.64), which are then distributed by the fund to retirees. The fund does not hold any assets set aside for the benefit of retirees under this plan.

	<u>2002</u>	<u>2001</u>
	<i>In millions of US dollars</i>	
Liability for defined benefit obligations	22	21

Movements in the liability recognised in the balance sheet:

	<u>2002</u>	<u>2001</u>
	<i>In millions of US dollars</i>	
Liability at 1 January 2002	21	21
Payments made during the year	(2)	(2)
Expenses recognised in the income statement	3	2
Liability at 31 December 2002.....	<u>22</u>	<u>21</u>

Expenses recognised in the income statement:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
	<i>In millions of US dollars</i>		
Interest costs	4	4	3
Current service costs	-	-	-
Actuarial gain	-	(1)	2
Foreign exchange gain.....	(1)	(1)	(1)
	<u>3</u>	<u>2</u>	<u>4</u>

Current service costs and actuarial gains and losses are recognised in administrative expenses in the income statement (refer note 7).

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

	<u>2002</u>	<u>2001</u>
	<i>In millions of US dollars</i>	
Discount rate at 31 December	18.6%	22.2%
Future retirement benefit increases.....	16.3%	19.8%

25. Deferred tax liabilities

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2002	2001	2002	2001	2002	2001
	<i>In millions of US dollars</i>					
Property, plant and equipment ..	10	3	(329)	(254)	(319)	(251)
Investments	1	–	(5)	(3)	(4)	(3)
Inventories.....	2	34	(5)	(2)	(3)	32
Trade and other accounts receivable	4	5	(3)	(27)	1	(22)
Trade and other accounts payable	7	5	(4)	–	3	5
Loans and borrowings	1	–	(1)	–	–	–
Tax assets/(liabilities).....	25	47	(347)	(286)	(322)	(239)
Set-off of tax	(25)	(47)	25	47	–	–
Net tax liabilities	–	–	(322)	(239)	(322)	(239)

As at 31 December 2002 a deferred tax liability of USD 28 million (2001: USD 3 million) relating to investment in subsidiaries had not been recognised because the Group controls whether the liability will be incurred and it is satisfied that it will not be incurred in the foreseeable future.

Movement in temporary differences during the year

	Balance 01 Jan 02	Recognised in income	Recognised in equity	Acquisition of subsidiary	Balance 31 Dec 02
	<i>In millions of US dollars</i>				
Property, plant and equipment	(251)	(7)	(48)	(13)	(319)
Investments	(3)	(1)	–	–	(4)
Inventories.....	32	(35)	–	–	(3)
Trade and other receivables..	(22)	23	–	–	1
Trade and other payables	5	(2)	–	–	3
	(239)	(22)	(48)	(13)	(322)

26. Trade and other payables

	2002	2001
	<i>In millions of US dollars</i>	
Trade accounts payable.....	127	182
Amounts payable to related parties	6	45
Advances from customers.....	53	32
VAT payable.....	16	19
Other taxes payable	48	36
Provision for litigation.....	8	17
Payables to employees.....	9	9
Other current and accrued liabilities	25	69
	292	409

Provision for litigation

In 2002 the Group released USD 10.8 million of a USD 17.3 million provision previously recognised for litigation initiated by Polska Kasa bank against the Parent Company under a guarantee it had provided to Tokobank that went into bankruptcy in 1999. On 29 May 2002 the International Commercial Court of the Russian Federation reduced the amount of the claim and ruled that the

Parent Company must pay an amount of USD 6.5 million to Polska Kasa bank. The Parent Company is continuing to defend itself through legal proceedings against this decision.

Transactions with related parties

ZAO Vostokprominvest

ZAO Vostokprominvest (“Vostokprominvest”) is an intermediary trader controlled by directors of the Group through their controlling financial interest in OAO Trust Capital-M.

In 2002 the Group purchased coal, iron ore and other raw materials from ZAO Vostokprominvest totalling USD 18 million (2001: USD 89 million, 2000: USD 25 million) at a margin of approximately 9%. Total accounts payable due to Vostokprominvest as at 31 December 2002 were USD 437 thousand (2001: USD 37 million).

In 2001 the Group provided a guarantee and pledged assets with a book value of USD 53 million for loans and a bank credit facility obtained by Vostokprominvest. These guarantee and pledge agreements expired during 2002.

In May 2002 the Group ceased to use this intermediary trader for the supply of raw materials.

ZAO Profit

ZAO Profit is an intermediary trader that supplies scrap to the Group. The Group has the ability to exercise significant influence over the financial and operating policy decisions of ZAO Profit (“Profit”) through immediate family relationships which exist between senior directors of MMK and Profit.

In 2002 the Group purchased scrap metal totalling USD 86.4 million (2001: USD 63 million, 2000: USD 50 million) from Profit, representing approximately 92% of the Group’s scrap metal purchases. Total accounts payable as at 31 December 2002 amounted to USD 4.6 million (2001: USD 7.9 million). In addition, the Group sold USD 6.3 million (2001: USD 6.8 million) of metal products to Profit, of which an amount of USD 232 thousand was outstanding at the balance sheet date.

In 2001 the Group pledged scrap metal with a book value of USD 8 million as security for a loan obtained by Profit. The pledge agreement expired during 2002.

In 2002 the Group guaranteed a USD 16.2 million credit facility obtained by Profit. As at the balance sheet date Profit had drawn down an amount of USD 2 million against this facility.

27. Subsidiary companies

The following is a list of significant subsidiaries:

	Country of incorporation	Effective ownership 2002	Voting Interest 2002	Effective ownership 2001	Voting Interest 2001
MMK Finance SA	Luxembourg	97%	97%	97%	97%
MMK Steel Trade AG	Switzerland	100%	100%	100%	100%
MMK Trading AG.....	Switzerland	100%	100%	–	–
ZAO A Kapital	Russia	100%	100%	100%	100%
OOO Avtotransportnoye Upravleniye	Russia	100%	100%	100%	100%
ZAO Agropromishleny Complex	Russia	100%	100%	100%	100%
OOO Emal	Russia	100%	100%	100%	100%
ZAO Energeticheski complex	Russia	100%	100%	100%	100%
ZAO Elektromont	Russia	100%	100%	100%	100%
ZAO Energetichesky fond	Russia	100%	100%	100%	100%
ZAO Fabrika khlebno-konditerskih izdeliy	Russia	100%	100%	100%	100%
ZAO Glubokaya Pererabotka	Russia	51%	51%	51%	51%
ZAO IK RFC	Russia	100%	100%	100%	100%
OOO Interlux	Russia	51%	51%	51%	51%
ZAO Komplex Glubokoy Pererabotki.....	Russia	51%	51%	96%	96%
ZAO Magma	Russia	100%	100%	100%	100%
OAO Magnitogorsky Kalibrovchny Zavod	Russia	83%	83%	65%	65%
OAO Magnitogorsky Metizno- Metallurgichesky Zavod.....	Russia	73%	91%	30%	37%
OAO MCOZ	Russia	56%	56%	56%	56%
ZAO Meharnoremont	Russia	51%	51%	51%	51%
ZAO Mehanoremontny Komplex	Russia	100%	100%	100%	100%
OOO Mekom	Russia	100%	100%	100%	100%
ZAO Metalloshlak	Russia	100%	100%	100%	100%
ZAO Metalurgspetstroyremont	Russia	100%	100%	100%	100%
ZAO Metiz-Kapital	Russia	62%	62%	–	–
OOO Minimax	Russia	60%	60%	60%	60%
OOO MMK-Trans	Russia	49%	50%	49%	50%
ZAO Ogneupor	Russia	56%	100%	56%	100%
OOO Press-5P	Russia	45%	89%	45%	89%
ZAO Promgrazhdanstroy	Russia	95%	95%	95%	95%
ZAO Radio Magnit	Russia	100%	100%	100%	100%
OOO Region	Russia	100%	100%	100%	100%
ZAO RMK	Russia	100%	100%	100%	100%
ZAO SK Remsroy	Russia	100%	100%	100%	100%
ZAO Staleprokatny Zavod.....	Russia	100%	100%	100%	100%
ZAO Stroitelny Fond	Russia	100%	100%	99%	99%
ZAO Stroitelny Komplex	Russia	100%	100%	100%	100%
OOO TEK MMK	Russia	98%	98%	98%	98%
ZAO Torgovlya and PPP	Russia	79%	73%	79%	73%
OOO Vekselny tsentr MMK	Russia	100%	100%	100%	100%

In April 2002 the Group established a new subsidiary, MMK Trading AG, to be primarily engaged in the trade of steel products manufactured by the Parent Company.

28. Acquisition of subsidiaries

OAO Magnitogorsky Metizno-Metallurgichesky Zavod

In May 2002 the Group acquired a further 43% effective ownership in MMMZ for USD 3.4 million, increasing the Group's total effective ownership to 73%. The net loss attributable to this subsidiary for the 7 months ended 31 December 2002 was USD 1 million.

OAO Magnitogorsky Kalibrovchny Zavod

In April 2002 the Group acquired a further 18% effective ownership in MKZ for USD 104 thousand, increasing the Group's total effective ownership to 83%. The net loss attributable to this subsidiary for the 8 months ended 31 December 2002 was USD 1 million.

Effect of acquisitions

The acquisition of subsidiaries had the following effect on the Group's assets and liabilities on acquisition date:

	Effect of acquisition	Effect of acquisition
	2002	2001
	<i>In millions of US dollars</i>	
Property, plant and equipment	64	7
Inventories	8	4
Trade and other receivables	6	2
Investments	4	1
Interest-bearing loans and borrowings	(6)	(3)
Deferred tax asset/(liabilities)	(13)	2
Trade and other payables	(9)	(13)
Long-term tax payables.....	-	(4)
Minority interest.....	(15)	-
Net identifiable assets and liabilities.....	39	(4)
Goodwill/(negative goodwill) on acquisition	(24)	6
Revaluation reserve arising from step acquisition	(10)	-
Consideration paid, satisfied in cash	5	2
Cash acquired	-	-
Net cash outflow.....	5	2

Changes in value of identifiable assets and liabilities

Subsequent to the acquisition of MKZ in 2001, additional information became available to better determine the amounts assigned to the identifiable assets and liabilities of the subsidiary when the acquisition was initially recognised.

The identifiable assets and liabilities were increased to reflect the results of an independent appraisal of property, plant and equipment performed in 2002, the reinstatement of an equity investment in Uralcord that the Group entered into a binding agreement to sell, and relief obtained from the restructuring of tax liabilities with the Russian tax authorities. The adjustment has been included in the effect of acquisitions in 2002. The majority of the adjustment relates to the change in the value of property, plant and equipment, and a corresponding adjustment has been made to the amount of goodwill initially recognised on acquisition (refer note 14).

The adjustment had no impact on the amount of amortization recognised in 2001 as control of the subsidiary was acquired at the end of 2001.

29. Financial instruments

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

Credit risk

Financial instruments that potentially subject the Group to significant credit risk consist primarily of cash and cash equivalents, accounts receivable and bank deposits. The Group has bank accounts held in Credit Ural Bank, a related party of the Group (refer note 20). The Group also holds deposits in leading Russian banks, and uses promissory notes acquired from Credit Ural Bank as cash equivalents. Credit risk evaluations are performed for all banks in which the Group holds deposits, and all customers requiring credit over a certain amount. The Group does not require collateral in respect of financial assets. The maximum exposure to credit risk is represented by the carrying amount of each financial asset.

Interest rate risk

The Group incurs interest rate risk primarily on loans and borrowings. The interest rate and terms of repayment of loans are disclosed in note 22. The Group borrows on both a fixed and variable interest rate basis. All variable interest rate loans and borrowings are re-priced on a monthly basis.

Foreign currency risk

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

Management considers the Group's major foreign currency risk to be the devaluation of the rouble or the appreciation of the Euro against its measurement currency. Management mitigates against the Russian rouble foreign currency risk by ensuring a Russian rouble denominated net monetary liability position is maintained. This is achieved through ensuring that a significant portion of the Group's sales are exported obtaining US dollar receipts, holding these receipts in liquid US dollar cash equivalents, and incurring a significant portion of the Group's costs in Russian roubles. Management does not use foreign currency forward contracts or any other form of foreign currency derivatives to hedge against its foreign currency risk.

Fair value

The Group's financial instruments include cash and cash equivalents, receivables, payables, short-term and long-term investments, and short and long-term debt. The carrying amounts of cash and cash equivalents, short-term investments, short-term debt, receivables and payables approximate their fair value due to the short-term nature of these instruments. Long-term investments consist primarily of equity securities for which the fair value could not be determined as the securities are not publicly traded. A portion of the Group's long-term debt includes variable rate debt, the carrying amount of which approximates its fair value. As at 31 December 2002, the carrying amount of fixed rate long-term debt (including finance lease liabilities) was USD 195 million (2001: USD 64 million). The fair value of fixed rate long-term debt, based on the estimated market values for debt instruments with similar characteristics, was USD 200 million (2001: USD 65 million).

30. Related party transactions

Related party disclosures are included in notes 7, 15, 17, 19, 20, 21, 22, 23, 24, 26 and 32.

31. Commitments

(i) Capital commitments

The Group is committed to capital expenditure of approximately USD 11 million (2001: USD 77 million).

(ii) Social commitments

The Group makes contributions to mandatory and voluntary social programs (refer note 8). The Group's social assets, as well as local social programs, benefit the community at large and are not normally restricted to the Group's employees. The Group has transferred certain social operations and assets to local authorities, and expects to continue to transfer any remaining responsibility for social programs to the community in the near future.

32. Contingencies

(i) Financial Guarantees

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

	<u>Note</u>	<u>2002</u>	<u>2001</u>
		<i>In millions of US dollars</i>	
Non-current			
Related party supplier – Kluch	17	1	5
Related party supplier – Vostokprominvest	26	–	10
Current			
Related party supplier – Profit.....	26	2	–
Related party supplier – Vostokprominvest	26	–	21
Related party supplier – Kluch	17	4	–
Third party suppliers	–	2	
		<u>9</u>	<u>36</u>

The Group's estimated maximum exposure to credit losses in the event of non-performance by the other parties to these financial guarantees is represented by the contractual amounts disclosed above. Assets of the Group were also pledged against loans advanced to related parties (refer note 23). Management believes that the likelihood of material payments being required under these agreements is remote. As at 31 December 2002 the Group did not have any contractual commitments to extend financial guarantees, credit or other assistance.

(ii) Litigation

Unresolved claims and litigation against the Group as at 31 December 2002 amounted to USD 8 million (2001: USD 4 million). These include a large number of small claims and litigation relating to sales made to domestic customers and purchases of goods and services from suppliers. Based on experience in resolving such matters, management believes that these will be resolved without material loss to the Group and, accordingly, no provision has been made for these unresolved claims and litigations.

(iii) Taxation contingencies

The taxation system in the Russian Federation is relatively new and is characterised by numerous taxes and frequently changing legislation, which is often unclear, contradictory, and subject to interpretation. Often, differing interpretations exist among the numerous taxation authorities and jurisdictions. Taxes are subject to review and investigation by a number of authorities, who are enabled by law to impose severe fines, penalties and interest charges.

These facts may create tax risks in Russia substantially more significant than in other countries. Management believes that it has adequately provided for all tax liabilities based on its interpretation of the tax legislation. However, the relevant authorities may have differing interpretations and the effects could be significant.

(iv) Environmental liabilities

The Group is obligated to undertake certain environmental remediation-activities to ensure site restoration of a large iron ore quarry in the Magnitogorsk region. In accordance with the permission granted by the Magnitogorsk Regional Ecological Committee, the Group utilises production waste to fill the iron ore quarry where this waste does not exceed a prescribed toxicity level. Amounts of waste which exceed this toxicity level are treated by licensed specialists. The future costs associated with the restoration of the iron ore quarry are not expected to be material. 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 material unrecorded liabilities or contingencies, which could have a significant adverse effect on the operating results or financial position of the Group.

Independent Accountant's Review Report

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

We have reviewed the accompanying interim consolidated balance sheet of Open Joint Stock Company Magnitogorsk Iron & Steel Works and its subsidiaries (the "Group") as of 30 June 2003 and the related statements of income, changes in equity and cash flows for the 6 months then ended. These interim consolidated financial statements, as set out on pages F-37 to F-45, are the responsibility of the Group's management. Our responsibility is to issue a report on these financial statements based on our review.

We conducted our review in accordance with the International Standard on Auditing applicable to review engagements as issued by the International Federation of Accountants. This standard requires that we plan and perform the review to obtain moderate assurance about whether the financial statements are free of material misstatement. A review is limited primarily to inquiries of company personnel and analytical procedures applied to financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim consolidated financial statements are not presented fairly, in all material respects, in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board.

KPMG Limited
Moscow, Russian Federation

26 August 2003

Interim consolidated balance sheet

	Note	As of 30 June 2003	
		30 June 2003	31 December 2002
		In millions of US dollars	
		(unaudited)	(audited)
Assets			
Property, plant and equipment	5	2,104	2,125
Intangible assets		(1)	(2)
Investments in associates		2	1
Other investments		1	1
Other non-current assets		5	3
Total non-current assets		2,111	2,128
Inventories		279	231
Trade and other receivables		437	266
Other investments		6	11
Cash and cash equivalents		561	222
Total current assets		1,283	730
Total assets		3,394	2,858
Equity			
Share capital		363	363
Treasury shares	6	(22)	(22)
Additional paid in capital		21	16
Asset revaluation reserve		122	131
Retained earnings		1,630	1,319
Total equity		2,114	1,807
Minority interest		47	50
Liabilities			
Loans and borrowings	8	313	218
Employee benefits		23	22
Deferred tax liabilities		287	322
Other non-current liabilities		13	10
Total non-current liabilities		636	572
Bank overdrafts		49	6
Loans and borrowings	8	182	131
Trade and other payables		366	292
Total current liabilities		597	429
Total liabilities		1,233	1,001
Total equity, minority interest and liabilities		3,394	2,858

A.A. Morozov
First Deputy of General Director

26 August 2003

M.A. Zhemchueva
Chief Accountant

26 August 2003

The interim consolidated balance sheet is to be read in conjunction with the notes to and forming part of the consolidated financial statements set on pages F-41 to F-45.

Interim consolidated income statement

	Note	For the six months ended 30 June	
		2003	2002
		<i>In millions of US dollars</i>	
		(unaudited)	(unaudited)
Revenues		1,478	896
Cost of sales		(914)	(725)
Gross profit		564	171
Distribution expenses		(53)	(41)
General and administrative expenses		(111)	(98)
Social costs		(10)	(21)
Other operating expenses, net		(4)	5
Profit from operations		386	16
Net financing costs	4	(11)	(25)
Profit/(loss) before tax and minority interest		375	(9)
Income tax expense		(66)	–
Profit before minority interest		309	(9)
Minority interest		(2)	(3)
Net profit for the period		307	(12)

The interim consolidated income statement is to be read in conjunction with the notes to and forming part of the consolidated financial statements set on pages F-41 to F-45.

Interim consolidated statement of cash flows

	For the six months ended 30 June	
	2003	2002
	<i>In millions of US dollars</i>	
Operating activities		
Profit/(loss) before tax and minority interest	375	(9)
Adjustments for:		
Depreciation and amortisation.....	109	108
Loss on disposal of property, plant and equipment	25	6
Gain on investments	–	(1)
Foreign exchange	4	–
Interest expense	23	17
Operating profit before changes in working capital	536	121
Decrease/(increase) in inventories.....	(48)	19
Increase in trade and other receivables	(171)	(82)
(Decrease)/increase in trade and other payables	111	(28)
Cash flows from operations before taxes and interest paid	428	30
Income taxes paid	(103)	(11)
Interest paid	(33)	(16)
Cash flows from operating activities	292	3
Investing activities		
Proceeds from disposal of property, plant and equipment	16	9
Proceeds from disposal of investments.....	–	53
Acquisition of property, plant and equipment	(114)	(86)
Acquisition of intangible assets	(5)	(3)
Acquisition of investments in associates	(1)	–
Acquisition of subsidiaries less cash acquired	–	(3)
Net cash flow from other investments	5	–
Cash flows to investing activities	(99)	(30)
Financing activities		
Proceeds from borrowings	257	309
Repayments of borrowings.....	(149)	(202)
Proceeds from the re-issuance of treasury shares.....	11	–
Acquisition of treasury shares	(6)	(7)
Payments made under finance lease	(10)	(3)
Dividends paid	–	(1)
Cash flows from financing activities	103	96
Net increase in cash and cash equivalents	296	69
Cash and cash equivalents at beginning of year	216	77
Cash and cash equivalents at end of period	512	146

Cash and cash equivalents include bank overdrafts of USD 49 million (31 December 2002: USD 6 million).

The interim consolidated statement of cash flows is to be read in conjunction with the notes to and forming part of the consolidated financial statements set on pages F-41 to F-45.

Interim consolidated statement of changes in equity

For the six months ended 30 June 2003

	Ordinary shares	Prefer- ence shares	Ordin- ary treasury shares	Prefer- ence treasury shares	Addi- tional paid in capital	Asset revalu- ation reserve	Retained earnings	Total
<i>In millions of US dollars</i>								
Balance at 1 January 2002	20	6	(15)	(8)	–	–	1,543	1,546
Shares issued: 1,200 for 1 split	252	85	–	–	–	–	(337)	–
Acquisition of treasury shares	–	–	(5)	(2)	–	–	–	(7)
Dividends.....	–	–	–	–	–	–	(2)	(2)
Net loss for the period	–	–	–	–	–	–	(12)	(12)
Balance at 30 June 2002	<u>272</u>	<u>91</u>	<u>(20)</u>	<u>(10)</u>	<u>–</u>	<u>–</u>	<u>1,192</u>	<u>1,525</u>
Acquisition of treasury shares	–	–	(5)	(4)	–	–	–	(9)
Property, plant and equipment revaluation, net of tax effect	–	–	–	–	–	792	–	792
Property, plant and equipment impairment decrease, net of tax effect	–	–	–	–	–	(647)	–	(647)
Revaluation reserve arising from step acquisition, net of tax effect	–	–	–	–	–	8	–	8
Minorities share of revaluation gain.....	–	–	–	–	–	(22)	–	(22)
Re-issuance of treasury shares	–	–	6	11	16	–	–	33
Net profit for the period	–	–	–	–	–	–	127	127
Balance at 31 December 2002	<u>272</u>	<u>91</u>	<u>(19)</u>	<u>(3)</u>	<u>16</u>	<u>131</u>	<u>1,319</u>	<u>1,807</u>
Amortisation of asset revaluation reserve	–	–	–	–	–	(9)	9	–
Acquisition of treasury shares	–	–	(4)	(2)	–	–	–	(6)
Re-issuance of treasury shares	–	–	2	4	5	–	–	11
Dividends.....	–	–	–	–	–	–	(5)	(5)
Net profit for the period	–	–	–	–	–	–	307	307
Balance at 30 June 2003	<u>272</u>	<u>91</u>	<u>(21)</u>	<u>(1)</u>	<u>21</u>	<u>122</u>	<u>1,630</u>	<u>2,114</u>

The interim consolidated statement of changes in equity is to be read in conjunction with the notes to and forming part of the consolidated financial statements set on pages F-41 to F-45.

NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of preparation

The interim consolidated financial statements of the Open Joint Stock Company Magnitogorsk Iron & Steel Works comprise the parent company Open Joint Stock Company Magnitogorsk Iron & Steel Works (“MMK” or “the Parent Company”) and its 70 subsidiaries (“the Group”).

The accompanying interim consolidated financial statements have been prepared on a condensed basis in accordance with International Financial Reporting Standard IAS 34, as promulgated by the International Accounting Standards Board.

The interim consolidated financial statements, which do not include full disclosures of the type normally included in a complete set of financial statements, are to be read in conjunction with the last issued consolidated financial statements as at 31 December 2002.

Accounting policies and methods of computation used in the interim consolidated financial statements are consistent with those applied in the consolidated financial statements for the year ended 31 December 2002.

2. Seasonal Operations

The Group’s operations are not affected significantly by seasonal or cyclical factors during the financial year.

3. Segmental information

The Group predominantly produces iron and steel products, which are primarily sold to traders unrelated to the Group for sale on the world steel market. Geographically, all significant assets, production and management/administration facilities are located in Magnitogorsk. There have been no material changes in the mix of products or the regions in which the traders sold the Group’s products.

4. Net financing costs

	Six months ended 30 June	
	2003	2002
	<i>In millions of US dollars</i>	
Interest expense	23	17
Interest income	(7)	–
Net foreign exchange loss/(gain)	(5)	8
	11	25

5. Property, plant and equipment

	Land and buildings	Machinery and equipment	Transpor- tation equipment	Fixtures and fittings	Assets under construction	Total
	<i>In millions of US dollars</i>					
Carrying value at 1 January 2003	453	1,501	71	13	87	2,125
Additions	2	4	44	–	74	124
Transfers	17	44	5	13	(79)	–
Disposals, net of depreciation	(3)	(20)	(15)	–	(3)	(41)
Depreciation	(18)	(79)	(5)	(2)	–	(104)
Carrying value at 30 June 2003 ..	451	1,450	100	24	79	2,104

6. Treasury shares

Issued and net outstanding shares comprised the following:

	Treasury shares	
	Ordinary	Preference
	<i>Number of shares in thousands</i>	
Balance at 1 January 2003	2,540,785	390,856
Acquisition of treasury shares	141,648	176,849
Re-issuance of treasury shares	(264,901)	(509,791)
Balance at 30 June 2003	<u>2,417,532</u>	<u>57,914</u>

At 30 June 2003 the Group held 2,417,532 thousand (31 December 2002: 2,540,785 thousand) of its own ordinary shares and 57,914 thousand (31 December 2002: 390,856 thousand) of its own preference shares. The Group also controls the voting rights of a further 2,176,932 thousand (31 December 2002: 2,018,835 thousand) of its own ordinary shares and 1,893,233 thousand (31 December 2002: 1,648,648 thousand) of its own preference shares, which subsidiaries of the Group hold in a trustee capacity under trust management agreements. Dividends accrue to the beneficial owners of these shares. Transactions with the shares held under the trust management agreements can only be performed after receipt of express written instructions from the Founder of the trust.

During the period the Group re-issued treasury shares in the form of 264,901 thousand ordinary shares and 509,791 thousand preference shares for aggregate amounts of USD 8 million and USD 3 million, respectively. As at the balance sheet date a subsidiary of the Group held these shares in a trustee capacity under the trust management arrangement as discussed above.

Subsequent to 30 June 2003, a further 406,740 thousand ordinary and 48,241 thousand preference treasury shares were re-issued for aggregate amounts of USD 21 million and USD 397 thousand, respectively. These shares are currently held in a trustee capacity by a subsidiary of the Group under a trust management arrangement with the same terms as discussed above.

7. Dividends

Since the end of the last financial year, the Parent Company declared the following dividends:

	Six months ended 30 June	
	2003	2002
	<i>In millions of US dollars</i>	
RUR 0.011 per qualifying ordinary share (2002: RUR 0.008)	3	2
RUR 0.033 per preference share (2002: RUR 0.008)	3	1
	<u>6</u>	<u>3</u>

8. Loans and borrowings

The following material loans and borrowings were obtained and repaid in full during the six months ended 30 June 2003.

<u>Face value</u>	<u>Effective interest rate</u>	<u>Issue/ maturity</u>	<u>Security/significant covenant restrictions</u>	<u>30 June 2003</u>
				<i>In millions</i>
<i>Loans and borrowings obtained</i>				
USD 100	6.8%	2003-2006	A major customer of the Group, "MMK Metal Limited" provided a guarantee as security for this loan to the Parent Company. A covenant to the loan agreement restricts the Parent Company from incurring indebtedness where the aggregate of the principal amounts exceeds USD 850 million at any given time. In addition, the Parent Company must not pledge bank accounts held with the Russian Federation or provide any other security right over contracts for export which secures indebtedness in aggregate of more than USD 100 million, without the prior written consent of the lender.	98
RUR 900	10.9%	2003-2005	Issued 900,000 rouble denominated notes with a face value of RUR 1,000 each.	29
USD 12.5	3.7%	2003-2006	Pledged revenue of USD 25 million against the credit line. The Parent Company should not perform a reorganisation, dispose, lease or pledge assets of an amount exceeding USD 650 million (calculated in accordance with Russian accounting principles) without the prior written consent of the lender.	13
USD 10	3.9%	2003-2003	Unsecured.	10
USD 7.6	3.9%	2003-2004	Credit facility of USD 18 million. Pledged inventory of USD 9.2 million.	8
USD 6	5.0%	2003-2003	Unsecured.	5
<i>Repayments of loans and borrowings in full</i>				
USD 17.6	4.5%	2002-2003	Pledged inventory of USD 21 million. Loan was repaid in advance in order to conclude a new loan agreement under more favourable terms.	18
USD 10	4.3%	2002-2003	Unsecured. Loan was repaid in advance in order to conclude a new loan agreement under more favourable terms.	10

Unused credit facilities

At the balance sheet date the Group had available unused credit facilities totalling USD 10 million.

Additional loan agreements

At the balance sheet date the Group had signed the following loan agreements. Amounts will be drawn down upon satisfaction of conditions specified in the loan agreements.

Face value	Effective interest rate	Term of Loan	Security/significant covenant restrictions
<i>In millions</i>			
USD 32	4.1% variable	7 years	The loan will be utilized by the Group to purchase equipment that will be pledged as security for the loan. The Parent Company should not sell, transfer, lend or otherwise dispose of assets, rights, revenues which in aggregate exceed 25% of the consolidated net book value of property, plant and equipment calculated in accordance with International Financial Reporting Standards. Capital expenditure should not exceed USD 300 million from each calculation date up to and including the financial year to 31 December 2005, and USD 350 million thereafter. The ratio of EBITDA to interest expense should not be less than 3:1, and the amount of indebtedness of the Group should not exceed USD 700 million.
USD 15.4	5.1% variable	4 years	Unsecured. The loan will be utilized by the Group to purchase equipment.
EUR 6.8	5.1% variable	5 years	Unsecured. The loan will be utilized by the Group to purchase equipment.
EUR 29	3.38% variable	5 years	Unsecured. The loan will be utilized by the Group to purchase equipment. The Parent Company is not permitted to encumber present and future undertakings, assets, rights or revenues to secure any of its future or present indebtedness in excess of USD 380 million in aggregate, other than with the prior written consent of the lender.
USD 7	6% variable	1 year	Credit facility secured by a pledge over inventory in circulation.

9. Related party transactions

There have been no significant changes in the nature of related party relationships during the six months to 30 June 2003. Related party transactions with the Group were as follows:

Related party	Transaction	Six months ended 30 June	
		2003	2002
OAo Credit Ural Bank	Loans and overdrafts obtained	136	89
OAo Credit Ural Bank	Loans and overdrafts repaid	129	84
OAo Credit Ural Bank	Bank charges	5	5
SKM	Insurance payments	16	13
Conares trading	Export sales	78	45
MMK Louch	Domestic sales	18	8
Leasing-M	Lease payments	5	–
ZAO Vostokprominvest	Purchases of raw material	–	18
ZAO Profit	Purchases of scrap	93	18

Balances outstanding with related parties as at the interim reporting date were as follows:

Related party	Balance type	30 June	31 December
		2003	2002
OAo Credit Ural Bank	Cash and cash equivalents	47	23
OAo Credit Ural Bank	Loans and overdraft facilities	21	14
SKM	Insurance prepayment	8	13
Conares trading	Trade receivables	2	3
MMK Louch	Trade receivables	3	1
Leasing-M	Lease payments outstanding	6	1
ZAO Profit	Trade payables	6	5

The Group provided financial guarantees for loans advanced to certain related and third party suppliers of the Group. The estimated maximum exposure to credit losses in the event of non-performance by the related and third parties is USD 5 million and USD 11 million, respectively.

10. Commitments

As of 30 June 2003, the Group is committed to capital expenditure of approximately USD 151 million (31 December 2002: USD 11 million).

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