Mechel OAO
Form 20-F
July 02, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 20-F

o Registration Statement pursuant to Section 12(b) or (g) of the Securities Exchange Act of 1934

or

x Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2006

or

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

or

o Shell company report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 333-119497

MECHEL OAO

(Exact name of Registrant as specified in its charter)

Russian Federation

(Jurisdiction of incorporation or organization)

Krasnoarmeyskaya Street 1, Moscow 125993, Russian Federation

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
AMERICAN DEPOSITARY SHARES, EACH ADS REPRESENTING THREE COMMON SHARES	**NEW YORK STOCK EXCHANGE**
COMMON SHARES, PAR VALUE 10 RUSSIAN RUBLES PER SHARE	**NEW YORK STOCK EXCHANGE(1)**

Securities registered or to be registered pursuant to Section 12(g) of the Act:

NONE

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

NONE

(Title of Class)

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report.

35,462,954 ADSs

12,886,303 GDS

416,270,745 common shares

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

o Yes x No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

o Yes x No

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

o Yes x No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer x Accelerated Filer o Non-accelerated filer o

Indicate by check mark which financial statement item the Registrant has elected to follow:

o Item 17 x Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

o Yes x No

(1) Listed, not for trading or quotation purposes, but only in connection with the registration of ADSs pursuant to the requirements of the Securities and Exchange Commission.

TABLE OF CONTENTS

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS		3
Item 1.	Identity of Directors, Senior Management and Advisors	4
Item 2.	Offer Statistics and Expected Timetable	4
Item 3.	Key Information	4
Item 4.	Information on the Company	38
Item 5.	Operating and Financial Review and Prospects	84
Item 6.	Directors, Senior Management and Employees	122
Item 7.	Major Shareholders and Related Party Transactions	128
Item 8.	Financial Information	129
Item 9.	The Offer and Listing	130
Item 10.	Additional Information	131
Item 11.	Quantitative and Qualitative Disclosures and Market Risk	150
Item 12.	Description of Securities Other than Equity Securities	155
Item 13.	Defaults, Dividend Arrearages and Delinquencies	156
Item 14.	Material Modifications to the Rights of Security Holders and Use of Proceeds	156
Item 15.	Controls and Procedures	156
Item 16A.	Audit Committee Financial Expert	164
Item 16B.	Code of Ethics	165
Item 16C.	Principal Accountant Fees and Services	165
Item 16D.	Exemptions from the Listing Standards for Audit Committees	166
Item 16E.	Purchases of Equity Securities by the Issuer and Affiliated Purchasers	166
Item 17.	Financial Statements	167
Item 18.	Financial Statements	167
Item 19.	Exhibits	167
SIGNATURES		168

Unless the context otherwise requires, references to Mechel, Company, us and our refer to Mechel OAO and its subsidiaries.

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

For purposes of calculating certain market share data, we have included businesses that are currently part of our group that may not have been part of our group during the period for which such market share data is presented.

In this document, references to U.S. dollars, $ or cents are to the currency of the United States, references to rubles are to the currency of the Russian Federation and references to euro or are to the currency of the member states of the European Union, or EU, participating in the European Monetary Union.

The term tonne as used herein means a metric tonne. A metric tonne is equal to 1,000 kilograms or 2,204.62 pounds.

Certain amounts that appear in this document have been subject to rounding adjustments; accordingly, figures shown as totals in certain tables or in the text may not be an arithmetic aggregation of the figures that precede them.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Matters discussed in this document may constitute forward-looking statements, as defined in the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. We wish to caution you that these statements are only predictions and that actual events or results may differ materially. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts. The words believe, expect, anticipate, intend, estimate, forecast, project, will, may, should and similar expressions identify forward-looking statements. Forward-looking sta appear in a number of places including, without limitation, Item 3. Key Information Risk Factors, Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects, and include statements regarding:

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

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

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

PART I

Item 1. Identity of Directors, Senior Management and Advisors

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

Selected Financial Data

The financial data set forth below as of December 31, 2006, 2005, 2004, 2003 and 2002, and for the years then ended, have been derived from our consolidated financial statements. Our reporting currency is the U.S. dollar and we prepare our consolidated financial statements in accordance with U.S. GAAP.(1)

Our results of operations for the periods presented are significantly affected by acquisitions. Results of operations of these acquired businesses are included in our consolidated financial statements for the periods after their respective dates of acquisition. The financial data below should be read in conjunction with, and are qualified in their entirety by reference to, our consolidated financial statements and related notes included under Item 18. Financial Statements and Item 5. Operating and Financial Review and Prospects.

	Year ended December 31,				
	2006	2005	2004	2003	2002
	(in thousands of U.S. dollars, except per share data)				
Consolidated income statement data:					
Revenue, net	4,397,811	3,804,995	3,635,955	2,028,051	1,314,149
Cost of goods sold	(2,868,564)	(2,469,134)	(2,225,088)	(1,422,987)	(947,527)
Gross profit	1,529,247	1,335,861	1,410,867	605,064	366,622
Selling, distribution and operating expenses	(803,549)	(820,133)	(660,060)	(407,383)	(277,478)
Operating income	725,698	515,728	750,807	197,681	89,144
Other income and expense, net	139,135	10,131	794,288	(21,555)	(18,083)
Income before tax, minority interest, discounted operations, extraordinary gain and changes in accounting principle	864,833	525,859	1,545,095	176,126	71,061
Income tax expense	(230,599)	(136,643)	(175,776)	(47,759)	(2,653)
Minority interest in loss (income) of subsidiaries	(31,528)	(6,879)	(11,673)	18,979	10,433
Income from continuing operations	602,706	382,337	1,357,646	147,346	78,841
Income (loss) from discontinued operations, net of tax	543	(1,157)	(15,211)	(5,790)	(1,835)
Extraordinary gain, net of tax			271	5,740	1,388
Changes in accounting principle, net of tax				(3,788)	10,859
Net income	603,249	381,180	1,342,706	143,508	89,253
Currency translation adjustment	148,920	(53,822))	49,116	46,921	
Adjustment of available-for-sale securities	11,203	2,181	(2,350)		
Additional minimum pension liability	(4,669)				
Comprehensive income	758,703	329,539	1,389,472	190,429	89,253
Earnings per share from continuing operations	1.48	0.95	3.63	0.39	0.24
Loss per share effect of discontinued operations	0.00	0.00	(0.04)	(0.01)	(0.01)
Earnings per share effect of extraordinary gain	0.00	0.00	0.00	0.02	0.01
Earnings per share effect of changes in accounting principle	0.00	0.00	0.00	(0.01)	0.03
Net income per share	1.48	0.95	3.59	0.39	0.27
Cash dividends per share	0.46	0.48	0.01	0.07	0.04
Weighted average number shares outstanding	408,979,356	403,118,680	373,971,312	366,178,815	333,243,450
Steel segment income statement data:					
Revenue, net(2)	3,085,333	2,766,846	2,832,189	1,656,358	1,050,554
Cost of goods sold(2)	(2,235,476)	(2,146,621)	(2,065,480)	(1,230,314)	(801,481)
Gross profit	849,857	620,225	766,709	426,044	249,073
Selling, distribution and operating expenses	(446,121)	(505,749)	(399,955)	(291,814)	(194,341)
Operating income	403,737	114,475	366,754	134,230	54,732
Mining segment income statement data:					
Revenue, net(2)	1,712,711	1,431,375	1,201,409	599,756	372,216
Cost of goods sold(2)	(1,033,321)	(715,738)	(557,252)	(420,736)	(254,667)
Gross profit	679,390	715,637	644,158	179,020	117,549
Selling, distribution and operating expenses	(357,428)	(314,383)	(260,103)	(115,570)	(83,137)
Operating income	321,962	401,252	384,055	63,450	34,412
Consolidated balance sheet data (at period end):					
Total assets	4,449,058	3,600,083	3,678,269	1,834,509	1,387,378
Shareholders equity	2,864,963	2,210,474	2,057,629	448,826	278,051
Long-term debt, net of current portion	322,604	45,615	216,113	122,311	36,496
Consolidated cash flows data:					
Net cash provided by operating activities	554,923	620,875	296,137	119,858	81,069
Net cash provided by (used in) investing activities	(552,538)	(994,707)	455,716	(210,317)	(86,633)
Net cash provided by (used in) financing activities	(162,782)	(308,870)	252,269	103,079	3,422
Non-U.S. GAAP measures(3):					
Consolidated EBITDA(4)	1,068,258	726,252	1,707,711	341,472	207,452
Steel segment EBITDA(4)	660,119	260,542	1,249,643	245,820	133,448
Mining segment EBITDA	408,139	465,710	458,068	95,652	74,004

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

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

(3) EBITDA represents net income before interest expense, income taxes and depreciation, depletion and amortization. We present EBITDA because we consider it an important supplemental measure of our operating performance and believe it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. We also present EBITDA by segment because our overall performance is best explained with reference to results of each segment.

EBITDA has limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for analysis of our operating results as reported under U.S. GAAP. Some of these limitations are as follows:

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

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

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

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

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

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

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

	Year ended December 31,				
	2006	**2005**	**2004**	**2003**	**2002**
Consolidated EBITDA reconciliation:					
Net income	603,249	381,180	1,342,706	143,508	89,253
Add:					
Depreciation, depletion and amortization	196,227	167,600	137,820	101,689	78,773
Interest expense	38,183	40,829	51,409	48,516	36,773
Income taxes	230,599	136,643	175,776	47,759	2,653
Consolidated EBITDA	1,068,258	726,252	1,707,711	341,472	207,452
Steel segment EBITDA reconciliation:					
Net income	406,448	67,444	1,014,356	114,011	57,977
Add:					
Depreciation, depletion and amortization	102,112	95,789	81,052	67,272	49,728
Interest expense	25,722	35,889	36,058	38,351	30,416
Income taxes	125,837	61,420	118,177	26,186	(4,673)
Consolidated EBITDA	660,119	260,542	1,249,643	245,820	133,448
Mining segment EBITDA reconciliation:					
Net income	196,801	313,736	328,350	29,497	31,274
Add:					
Depreciation, depletion and amortization	94,115	71,811	56,768	34,417	29,045
Interest expense	12,461	4,940	15,351	10,165	6,357
Income taxes	104,762	75,223	57,599	21,573	7,328
Consolidated EBITDA	408,139	465,710	458,068	95,652	74,004

(4) The 2004 amount includes a gain of $800.0 million from the sale of our stake in Magnitogorsk Iron and Steel Works, or MMK.

6

Exchange Rates

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

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

	Rubles per U.S. dollar			
Year ended December 31,	**High**	**Low**	**Average(1)**	**Period End**
2006	28.78	26.18	27.19	27.33
2005	29.00	27.46	28.29	28.78
2004	29.45	27.75	28.82	27.75
2003	31.88	29.25	30.61	29.45
2002	31.86	30.14	31.39	31.78

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

	Rubles per U.S. dollar	
	High	**Low**
May 2007	25.92	25.73
April 2007	26.01	25.69
March 2007	26.24	25.97
February 2007	26.55	26.16
January 2007	26.58	26.45
December 2006	26,78	26,18

The exchange rate between the ruble and the U.S. dollar on July 2, 2007 was 25.82 rubles per one U.S. dollar.

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

Risk Factors

An investment in our shares and ADSs involves a high degree of risk. You should carefully consider the following information about these risks, together with the information contained in this document, before you decide to buy our shares and ADSs. If any of the following risks actually occurs, our business, financial condition, results of operations or prospects could be materially adversely affected. In that case, the value of our shares and ADSs could also decline and you could lose all or part of your investment.

We have described the risks and uncertainties that our management believes are material, but these risks and uncertainties may not be the only ones we face. Additional risks and uncertainties, including those we currently are not aware of or deem immaterial, may also result in decreased operating revenues, increased operating expenses or other events that could result in a decline in the value of our shares and ADSs.

Risks Relating to Our Business and Industry

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

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

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

We derived approximately 55% and 46% of our total revenues from sales to customers in Russia in 2006 and 2005, respectively. The Russian economy has experienced significantly fluctuating growth rates over the past 10 years. From 1994 to 1998, the Russian economy contracted in real terms at an average rate of 4.9% per year; after the Russian crisis in 1998, the economy recovered and grew in real terms at an average rate of 6.8% per year from 1999 to 2006. Russian production of steel also suffered a substantial decline from over 77 million tonnes in 1991 to 44 million tonnes in 1998, but then recovered to 71 million tonnes in 2006. Further, our products in Russia are mainly used in the construction, engineering and automotive industries, which are particularly vulnerable to general economic downturns. In addition to Russia, Asia and the Middle East are also large destinations for our products, and these areas, like Russia, face greater risks of volatility. Accordingly, any significant decrease in demand for steel products or decline in the price of these products in Russia or other emerging market economies could result in significantly reduced revenues, thereby materially adversely affecting our results of operations and financial condition.

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

We face competition from domestic and foreign steel manufacturers, many of which have greater resources. A number of our Russian competitors are undertaking modernization and expansion plans, which may make them more efficient or allow them to develop new products.

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

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

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

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

The total cost of our capital improvements over the next five years is expected to be approximately $2.7 billion. Most of our current borrowings are from Russian and international banks and financial institutions as well as ruble-denominated bonds. In the future, we may rely to a greater extent than currently on foreign capital markets and other foreign financing sources for our capital needs. It is possible that these foreign sources of financing, as well as domestic sources, may not be available in the future in the amounts we require or at an acceptable cost. See Risks Relating to the Russian Federation Emerging markets such as Russia are subject to greater risks than more developed markets, and financial turmoil in any emerging market could disrupt our business, as well as cause the price of our securities to suffer and Risks Relating to the Russian Federation The Russian banking system remains underdeveloped, and another banking crisis could place severe liquidity constraints on our business.

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

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

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

- additional demands placed on our senior management, who are also responsible for managing our existing operations;
- increased overall operating complexity of our business, requiring greater personnel and other resources;
- significant, initial cash expenditures to integrate new acquisitions;
- incurrence of debt to finance acquisitions and higher debt service costs related thereto; and
- strains on our labor force as production may be shifted to new companies or locations to optimize our overall production.

Moreover, the integration of new businesses may be difficult for a variety of reasons, including statutory limitations, differing culture, management styles and systems and infrastructure and poor records or internal controls. For example, the regional government in Bashkiria has special perpetual rights, or a golden share, in our subsidiary Beloretsk Metallurgical Plant, giving it the right to veto certain shareholder decisions and appoint a voting representative on the board of directors of this subsidiary. The shareholder decisions regarding Beloretsk Metallurgical Plant that may be vetoed by the regional government are as follows:

- approval of amendments and supplements to the company s charter or approval of a new version of the charter;
- reorganization of the company;
- liquidation of the company, appointment of a liquidation committee and approval of interim and final liquidation balances;
- changes the amount of the charter capital of the company; and
- approval of major and interested party transactions.

In addition, integrating new acquisitions may require significant initial cash investments. Furthermore, even if we are successful in integrating our existing and new businesses, expected synergies and cost savings may not materialize, resulting in lower than expected profit margins. We cannot assure you that we will be successful in realizing any of the anticipated benefits of the companies that we are now in the process of integrating or that we may acquire in the future. If we do not realize these benefits, our financial condition, results of operations and prospects could be materially adversely affected.

We also may acquire or establish businesses in countries that may represent new operating environments for us and which may be located a great distance from our headquarters in Russia. We may thus have less control over the activities of these companies and may face more uncertainties with respect to the operational and financial needs of these businesses, which may hinder our integration efforts.

We have had material weaknesses in our internal control over financial reporting in the past and cannot assure you that additional material weaknesses will not be identified in the future. Our failure to implement and maintain effective internal control over financial reporting could result in material misstatements in our financial statements which could require us to restate financial statements, cause investors to lose confidence in our reported financial information and have a negative effect on our stock price.

Management has identified nine material weaknesses in our internal control over financial reporting as defined in the Public Company Accounting Oversight Board s Auditing Standard No. 2 that affected our financial statements for the year ended December 31, 2006. The material weaknesses in our internal control over financial reporting for the year ended December 31, 2006 are described in Item 15 Controls and Procedures.

Notwithstanding the steps we have taken and continue to take that are designed to remedy each material weakness identified above, we may not be successful in remediating these material weaknesses in the near or long term and we cannot assure you that additional significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified in the future. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could result in additional significant deficiencies or material weaknesses, cause us to fail to meet our periodic reporting obligations or result in material misstatements in our financial statements. Any such failure could also adversely affect the results of periodic management evaluations and annual auditor attestation reports regarding the effectiveness of our internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act of 2002 and the rules promulgated under

Section 404. The existence of a material weakness could result in errors in our financial statements that could result in a restatement of financial statements, cause us to fail to meet our reporting obligations and cause investors to lose confidence in our reported financial information, leading to a decline in our stock price.

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

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

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

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

The Land Code of the Russian Federation, as amended, which was enacted October 25, 2001, requires privatized Russian companies to either purchase or lease the land on which they operate. This requirement was scheduled to take effect on January 1, 2004, but implementation has been delayed by the Russian legislature until January 1, 2008. Currently, there is no procedure for calculating a repurchase price set by law. A draft law scheduled for consideration by the Russian State Duma in the Spring of 2007 establishes the repurchase price of the land plots in the amount of 2.5% of the cadastral value of such land plots. Companies wishing to purchase the land on which they operate prior to the law s enactment may do so at a price calculated by multiplying the state cadastral value, land tax rate and repurchase rate set by the laws of the relevant sub-federal political units. Based on the latter calculation, we estimate the cost for us to purchase the land on which we operate would range from $49.7 million to $194.8 million. This estimate excludes certain land plots on which Beloretsk Metalurgical Plant, Southern Urals Nickel Plant, Southern Kuzbass Coal Company operate, which were not included in the state cadastral valuation.

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

In 2006, our Russian operations purchased approximately 3 billion kWh of electricity, representing 65% of their needs, from local subsidiaries of RAO UES, the government-controlled national holding company for the Russian power sector. Domestic electricity prices are regulated by the Russian

government. The government is currently in the early stages of implementing a restructuring plan for the power sector aimed at introducing competition, liberalizing the wholesale electricity market and moving from regulated pricing to a market-based system by 2008. This reform process could also cause disruptions to the supply of electricity to us. In addition, while subject to doubt as to whether it will be implemented as currently written, according to the Russian Energy Strategy approved by the Russian government in 2003, electricity tariffs for industrial users are expected to reach 3.2-3.6 cents per kWh by 2007 and 4.0-4.5 cents per kWh by 2020. In 2006, our average cost of electricity was 3.3 cents per kWh. Assuming a price of 3.6 cents per kWh in 2006, our Russian operations would have incurred approximately $9 million in additional costs. Further price increases for electricity may also occur in the future as the industry is restructured and controlled to a greater extent by the private sector. If we are required to pay higher prices for electricity in the future, our costs will rise and our business and prospects could be materially adversely affected.

Our Russian operations also purchase significant amounts of natural gas, primarily for the production of electricity at our own co-generation facilities, from Gazprom. Gazprom is a government-controlled company and the dominant producer and monopoly transporter of natural gas within Russia. Domestic natural gas prices are regulated by the government. These prices have been rising over the last few years. The average price for industrial consumers was approximately $45 per thousand cubic meters ($1.28 per thousand cubic feet) in 2006, and increased by 16% compared with 2005. Further, domestic natural gas prices are significantly below Western European levels, which helps to provide us with a cost advantage over our competitors. According to the Russian Ministry of Economic Development and Trade forecasts, natural gas prices are expected to reach $108 per thousand cubic meters ($3.06 per thousand cubic feet) by 2010. If we are required to pay a higher price for natural gas, our costs will rise and our business and prospects could be materially adversely affected.

If we are unable to obtain adequate capital, we may have to limit our operations substantially, which could have a material adverse effect on our business, financial condition and results of operations.

We will need to make significant capital expenditures in our business. We spent $397.8 million during 2006 and expect to spend approximately $500.0 million in 2007 for the fulfillment of our capital spending plans. Our ability to fund planned capital expenditures will depend on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. To meet our requirements, we may need to attract equity or debt financing, especially in international capital markets or from international lenders. It is possible that these foreign sources of financing may not be available or may be available only at an unacceptable cost.

Among other things, increased levels of indebtedness, and particularly increases in the level of secured indebtedness, could potentially: (1) limit our ability to obtain additional financing; (2) limit our flexibility in planning for, or reacting to, changes in the markets in which we compete; (3) place us at a competitive disadvantage relative to our competitors with superior financial resources; (4) lead to a partial or complete loss of control over our key subsidiaries or properties; (5) render us more vulnerable to general adverse economic and industry conditions, (6) require us to dedicate all or a substantial part of our cash flow to service our debt; and (7) limit or eliminate our ability to pay dividends. Our ability to make payments on our indebtedness depends upon our ability to maintain our operating performance at a certain level, which is subject to general economic and market conditions and to financial, business and other factors, many of which we cannot control.

In addition, Russian companies are limited in their ability to issue shares in the form of ADSs or other depositary receipts due to Russian securities regulations. We have received permission from the Federal Service for the Financial Markets for up to 40% of our shares to be circulated abroad through depositary receipt programs, which was the maximum volume allowed at that time. Current Russian securities

regulations provide that no more than 35% of a Russian company s shares may be circulated abroad through depositary receipt programs. Our ADS program currently accounts for approximately 35% of our shares. Russian securities regulations are unclear as to whether the FSFM s approval of an amount greater than 35% prior to the establishment of this limit in the securities regulations will be permitted to stand, or whether the 35% limit established in the regulation trumps prior FSFM permissions for higher amounts. Until this is clarified, we have instructed our depositary not to allow for the conversion of more than 35% of our shares into ADS. We therefore are limited in our ability to raise additional equity financing through depositary receipts. Furthermore, in the event that securities regulations are enacted in the future that further reduce the 35% limit, our depositary may be forced to cancel and convert some of our ADS into a corresponding number of shares. The Russian government or its agencies may also impose other restrictions on international financings by Russian issuers.

Any of the foregoing factors may limit the amount of capital available to meet our operating requirements. If we cannot obtain adequate funds to satisfy our capital requirements, we may need to limit our operations significantly, which could have a material adverse effect on our business, financial condition and results of operations.

From time to time, we may merge certain subsidiaries for operational reasons. Under Russian law, such mergers would be considered a reorganization and the merged subsidiaries would be required to notify their creditors of this reorganization. Russian law also provides that, for a period of 30 days after notice, these creditors would have a right to accelerate the merged subsidiaries indebtedness and demand reimbursement for applicable losses. In the event that we decide to undertake any such merger and all or part of certain of our subsidiaries indebtedness is accelerated, we and such subsidiaries may not have the ability to raise the funds necessary for repayment and our business and financial condition could be materially adversely affected.

The reorganization of the Russian railways transportation sector exposes us to uncertainties regarding transportation costs of raw materials and steel products.

Railway transportation is our principal means of transporting raw materials and steel products to our facilities and to customers in Russia and abroad. The Russian railways are owned by OAO Russian Railroads, an open joint stock company wholly-owned by the Russian government. Russian Railroads is responsible for the management of all Russian railroads.

The Russian government, through several government ministries, Russian Railroads, and in cooperation with large consignors, sets domestic rail tariffs and the terms of transportation. Factors which have lead and may continue to lead to an increase in domestic rail tariffs include inflation, the poor state of repair of Russia s rolling stock and the cross-subsidization of unprofitable passenger and cheap raw material transportation sectors by increasing tariffs for the transport of more expensive cargo, including metallurgical products. Failure of Russian Railroads to upgrade its rolling stock within the next few years could also result in a shortage of available working rolling stock and a disruption in transportation of our materials and products. If these or other factors result in continued increases in railway transport costs, our results of operations, notwithstanding our efforts to minimize costs and increase the rolling stock, could be materially adversely affected.

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

We face numerous protective tariffs, duties and quotas which reduce our competitiveness in, and limit our access to, particular markets. Several key steel importing countries currently have import restrictions in place on steel products or intend to introduce them in the future. The EU has a quota system in place with respect to Russian steel imports, which affected our exports to ten countries in Central and Eastern Europe and the Baltic States that joined the EU in 2004 as well as to Romania and Bulgaria, which joined

the EU in 2007. Our sales into the EU constituted approximately 9% of our steel segment revenues in 2006. The export of our steel into the EU is an important part of our growth strategy. If EU quotas are not increased in line with our sales growth objectives, our ability to expand our sales in the EU and pursue our growth strategy could be limited.

The United States has a quota system in place with respect to imports of hot-rolled coil and thick steel plate. In September 2003, China imposed anti-dumping duties on cold-rolled steel imports from Russia, which were suspended from January 14, 2004 for an indefinite period of time. In July 2006, Ukraine imposed an antidumping duty on steel rope imports from Russia at a rate of 32.63% for four months, and we expect Ukraine to extend this duty for an additional five-year period. In 2006, approximately 81% of our steel segment revenues were derived from sales of steel products that were subject to import restrictions. See Item 4. Information on the Company Steel Business Trade Restrictions.

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

Russia has in place import tariffs with respect to certain imported steel products. These tariffs generally amount to 5% of value, but also step up to 15% of value for certain higher value-added steel products. Russia has in place a 21% countervailing duty on Ukrainian steel bars, which has been extended through August 2007. We believe we benefit from this duty because it prevents subsidized Ukrainian exports to Russia from reducing the prices we can obtain for these products in our domestic markets. While we have petitioned for the extension of this duty, we believe there is a low probability that the extension will be granted.

From March 20, 2007, an antidumping duty has been imposed on corrosion-resistant steel originating in the EU at a rate of 840 euro per ton. The duty, which we believe will benefit us, will be in force for three years.

Almost all of our sales of steel products in Russia were protected by these import tariffs in 2006. These tariffs and duties may be reduced or eliminated in the future, which could materially adversely affect our revenues and results of operations.

According to press reports, Russia may complete its negotiations and join the WTO in 2007. Russia s future accession to the WTO could negatively affect our business and prospects. In particular, Russia s entry into the WTO may require gradual lowering or removing of import tariffs and duties on steel products, causing increased competition in the domestic steel market from foreign producers and exporters. See also Increasing tariffs and restructuring in the energy sector could materially adversely affect our business.

Inflation could increase our costs and decrease operating margins.

The Russian economy has been characterized by high rates of inflation. In 2006, the inflation rate was 9.7%, according to Rosstat. The prices for many of our products are denominated in U.S. dollars. As we tend to experience inflation-driven increases in certain of our ruble-denominated costs, including salaries, rents and energy costs, which are sensitive to rises in the general price level in Russia, our costs in U.S. dollar terms will rise. In this situation, due to competitive pressures, we may not be able to raise the prices we charge for our products sufficiently to preserve operating margins. Accordingly, high rates of inflation in Russia could increase our costs and decrease operating margins.

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

Our reporting currency is the U.S. dollar. Our products are typically priced in rubles for domestic sales and in U.S. dollars (and, to a lesser extent, euros) for export sales, whereas the majority of our direct costs are incurred in rubles and, to a lesser extent, in other local currencies where our operations are based. Appreciation in real terms of the ruble against the U.S. dollar results in an increase in our costs relative to our revenues, adversely affecting our results of operations. In 2006, the ruble appreciated in real terms against the U.S. dollar by 10.7% over 2005 according to the Rosstat, and further real appreciation of the ruble against the U.S. dollar may materially adversely affect our results of operations.

Limitations on the conversion of rubles to foreign currencies in Russia could increase our costs when making payments in foreign currencies to suppliers and creditors and could cause us to default on our obligations to them.

Many of our major capital expenditures are denominated and payable in various foreign currencies, including the U.S. dollar and euro. Russian legislation currently permits the conversion of ruble revenues into foreign currency without limitations. However, Russian currency legislation allows for the imposition of certain restrictions on the conversion of rubles into foreign currencies in the event of an economic or currency crisis. Should such restrictions be imposed, there may be delay or other difficulty in converting rubles into a foreign currency to make a payment or delay in or restriction on the transfer of foreign currency. This, in turn, could limit our ability to meet our payment and debt obligations, which could result in the loss of suppliers, acceleration of debt obligations and cross-defaults and, consequently, have a material adverse effect on our business, financial condition and results of operations.

Estimates of our reserves are subject to uncertainties.

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

We are subject to mining risks.

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

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

Hazards associated with our underground mining operations include:

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

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

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

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

Generally, there is a greater awareness in Russia of damage caused to the environment by industry than existed during the Soviet era. At the same time, environmental legislation in the jurisdictions where we operate is generally weaker and less stringently enforced than in the EU or the United States. However, more stringent standards may be introduced in the future or enforcement increased in Russia and elsewhere where we conduct our operations. Based on the current regulatory environment in these jurisdictions, as of December 31, 2006, we have not created any reserves for environmental liabilities and compliance costs, other than an accrual in the amount of $92.4 million for asset retirement obligations (ARO), consistent with U.S. GAAP requirements. In addition, upon our acquisitions of Mechel Targoviste and Mechel Campia Turzii, as part of the purchase agreements, we committed to the Romanian government to invest $7.3 million and $4.6 million, respectively, into environmental protection and reclamation, which investments we completed as of December 31, 2006. Any change in this regulatory environment could result in actual costs and liabilities for which we have not provided.

Also, in the course, or as a result, of an environmental investigation, courts can issue orders and decisions administratively halting for a 90-day period part or all of the production at a facility that has violated environmental standards. In the event that production at one of our facilities is partially or wholly prevented due to this type of sanction, our business could suffer and our operating results would be negatively affected.

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

The Kyoto Protocol may negatively affect us.

The Kyoto Protocol to the United Nations Framework Convention on Climate Change, which was ratified by Russia on November 4, 2004, and took effect on February 16, 2005, requires the signatory countries to make substantial reductions in greenhouse gas emissions. Future Russian legislation enacted to implement the Kyoto Protocol may result in raised environmental standards for industries including the mining and steel industries, which may in turn result in increased environmental costs. Russian industrial technologies may not be able to comply with these raised environmental standards and such non-compliance may become an additional basis for restricting Russian steel exports to the European market. The amount of EU anti-dumping duty on Russian exports may be increased as a result of adjustments to the relatively low environmental component of production costs of Russian companies used in the calculation of the EU dumping margin. Additionally, Russian companies may not be able to participate in certain mechanisms provided for in the Kyoto Protocol, including trading in carbon emissions, due to a lack of a relevant legislative and regulatory framework in Russia. This may benefit our competitors from countries that have timely implemented such a framework.

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

Our business depends on the continuing validity of certain licenses and the issuance of certain new licenses and our compliance with the terms thereof, including subsoil licenses for our mining operations. Regulatory authorities exercise considerable discretion in the timing of license issuance, renewal and monitoring licensees compliance with license terms. Requirements imposed by these authorities may be costly and time-consuming and may result in delays in the commencement or continuation of exploration or production operations. Further, private individuals and the public at large possess rights to comment on and otherwise engage in the licensing process, including through intervention in courts and political pressure. Accordingly, the licenses we need may not be issued or renewed, or if issued or renewed, may not be issued or renewed in a timely fashion, or may involve requirements which restrict our ability to conduct our operations or to do so profitably.

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

We have a limited history of renewing our subsoil licenses. In 2003, we extended the subsoil license for the Tatianinsk deposit, which was set to expire in 2002, until 2012. In 2006, we extended the license for the Olzherasky deposit, which was set to expire in 2007, to 2022. Of our fifteen coal subsoil licenses, six expire on dates falling in or between 2012 through 2014 and nine expire on dates falling in or between 2021 through 2025; our four iron ore subsoil licenses expire on dates falling in or between 2009 through 2015; and our two nickel subsoil licenses expire on dates falling in 2012 and 2013. See Item 4. Information on the Company Mining Business Mineral Reserves.

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

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

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

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

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

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

Moreover, during the tumultuous period of the transformation of the Russian planned economy into a free market economy in the 1990s, documentation relating to subsoil licenses was not properly maintained and, in many cases, was lost or destroyed. Initially, during the period between the dissolution of the Soviet Union and the privatizations of the mid-1990s, as state subsidies ceased, many mining operations were forced to shut down or scale back production. In addition, during this time, complete governmental planning and oversight ceased, leaving the local management ill-equipped to operate these businesses, which faced severe liquidity problems. The employees, who were often unpaid for months, had little incentive to look after the businesses. In these circumstances, the maintenance of documentation relating

to subsoil licenses, as well as compliance with the administrative requirements of the legislation of this period, was not a priority for management. The situation did not significantly improve as these mines were privatized in the mid-1990s, primarily since most Russian businesses during these times continued to face severe liquidity problems and the management focused on the operation of these mines. Thus, in many cases, although it may be clearly evident that a particular enterprise has mined a licensed subsoil area for decades, the historical documentation relating to their subsoil licenses may not be complete.

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

Our Romanian operations face certain risks.

Romania is not self-sufficient in energy resources. Domestic energy prices, which are significantly higher than the prices we pay in Russia, have been increasing and may continue to increase in the future, which might hurt the profitability of our operations in Romania. For example, in 2006, the price of natural gas increased by approximately 43% in Romania and is expected to continue to increase through 2007. Shortages in energy supplies, including administrative limitations during peak usage, may limit our production capacity and efficiency and hinder our output. If we are unable to obtain these resources on economic terms, the operations of our Romanian subsidiaries could be materially adversely affected.

In addition, Romania s admission into the EU on January 1, 2007 will result in increased environmental liabilities, labor costs and other expenditures for our Romanian operations. Entrance into the EU requires the restructuring of Romania s major metallurgical entities, including our Romanian subsidiaries Mechel Targoviste and Mechel Campia Turzii. As part of this process, individual viability plans must be agreed upon with EU consultants and incorporated into each company s business plans. Evidence of implementation of these plans and achievement of the targets stated therein must be provided to investors under their privatization contracts. The viability plans of Mechel Targoviste and Mechel Campia Turzii include additional investments into technology and increased environmental controls. After the restructuring is complete, key business performance indicators must be in line with EU requirements. In addition to the costs of complying with these requirements, Romania s admission to the EU may also result in trade duties and quotas on the export of steel finished and semi-finished products into Romania.

Our controlling shareholder has the ability to take actions that may conflict with those of the holders of our securities.

Our Chief Executive Officer, Mr. Igor Zyuzin, directly and indirectly, owns approximately 68.3% of our common shares. Except in certain cases as provided by Joint Stock Companies Law, resolutions at a shareholders meeting are adopted by a simple majority in a meeting at which shareholders holding more than half of the voting shares are present or represented. Accordingly, Mr. Zyuzin has the power to control the outcome of most matters to be decided by vote at a shareholders meeting and can control the appointment of the majority of directors and the removal of all of the elected directors. Thus, this controlling shareholder can take actions that may conflict with the interests of other shareholders and holders of our ADSs.

Our competitive position and future prospects depend on our senior managers and other key personnel.

Our ability to maintain our competitive position and to implement our business strategy is dependent to a large degree on the services of our senior management team and other key personnel, particularly Mr. Zyuzin, our Chief Executive Officer, who is our controlling shareholder. Mr. Zyuzin has provided strategic direction and leadership to us. Over the course of 2006, Mr. Vladimir Iorich, who formerly held a 42.2% ownership stake in Mechel and served as Chief Executive Officer from 2004 to 2006, disposed of his

stake in Mechel and stepped down as our Chief Executive Officer. On June 29, 2007, Mr. Iorich stepped down as a director of Mechel.

Moreover, competition in Russia, and in the other countries where we operate, for personnel with relevant expertise is intense due to the small number of qualified individuals and, as a result, we attempt to structure our compensation packages in a manner consistent with the evolving standards of the Russian labor market. We are not insured against the detrimental effects to our business resulting from the loss or dismissal of our key personnel. The loss or decline in the services of members of our senior management team or an inability to attract, retain and motivate qualified key personnel could have a material adverse effect on our business, financial condition and results of operations.

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

Almost all of our business consists of privatized companies, and our business strategy will likely involve the acquisition of additional privatized companies. The statute of limitations for challenging privatization transactions was recently reduced from ten years to three years. However, to the extent that privatization legislation is vague, inconsistent or in conflict with other legislation, including conflicts between federal and local privatization legislation, many privatizations are vulnerable to challenge, including selective challenges. For instance, a series of presidential decrees issued in 1991 and 1992 that granted to the Moscow City government the right to adopt its own privatization procedures were subsequently held to be invalid by the Constitutional Court of the Russian Federation, which ruled, in part, that the presidential decrees addressed issues that were the subject of federal law. While this court ruling, in theory, did not require any implementing actions, the presidential decrees were not officially annulled by another presidential decree until 2000. In the event that any title to, or our ownership stakes in, the privatized companies acquired by us, including Chelyabinsk Metallurgical Plant, Southern Urals Nickel Plant, Southern Kuzbass Coal Company and its subsidiaries, Beloretsk Metallurgical Plant, Urals Stampings Plant, Korshunov Mining Plant, Port Posiet, Port Kambarka, Yakutugol or Izhstal, are subject to challenge as having been improperly privatized and we are unable to defeat this claim, we risk losing our ownership interest in such company or its assets, which could materially affect our business and results of operations.

In addition, under Russian law, transactions in shares may be invalidated on many grounds, including a sale of shares by a person without the right to dispose of such shares, breach of interested party and/or major transaction rules and failure to register the share transfer in the securities register. As a result, defects in earlier transactions in shares of our subsidiaries (where such shares were acquired from third parties) may cause our title to such shares to be subject to challenge.

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

Our business has grown substantially through the acquisition and founding of companies, many of which required the prior approval or subsequent notification of the Russian Federal Antimonopoly Service or its predecessor agencies. In part, relevant legislation restricts the acquisition or founding of companies by groups of companies or individuals acting in concert without this approval or notification. This legislation is vague in certain parts and subject to varying interpretations. If the Federal Antimonopoly Service were to conclude that an acquisition or the creation of a new company was done in contravention of applicable legislation and that competition has been reduced as a result, it could seek redress, including suing for the transactions that led to the violation of competition laws to be declared invalid, obliging the acquirer to perform activities to restore competition, and seeking the dissolution of the company operating

in contravention of antimonopoly legislation. Any of these actions could adversely affect our business strategy and our results of operations.

Three of our subsidiaries were included by the Federal Antimonopoly Service into the register of companies controlling more than 35% on a specific market, including:

- Beloretsk Metallurgical Plant controls more than 65% of the market for wire nails in the Republic of Bashkortostan;

- Chelyabinsk Metallurgical Plant controls more than 35% but less than 65% of the market for forgings made of stainless steel ingots in the Russian Federation market; and

- Southern Urals Nickel Plant controls more than 65% of the market for nickel in sulfate and hydroxide in the Russian Federation.

Inclusion of our subsidiaries in the register of companies controlling more than 35% of a specific market, as well as the classification of us or our subsidiaries as monopolists or persons holding a dominant position, does not by itself restrict our current activities or the activities of these subsidiaries. However, in the event we are deemed to abuse our dominant position, the Federal Antimonopoly Service may impose certain restrictions that could restrict and negatively affect the operations of these subsidiaries and materially adversely affect our business and results of operations.

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

We own less than 100% of the equity interests in some of our subsidiaries. In addition, certain of our wholly-owned subsidiaries have had other shareholders in the past. We and our subsidiaries in the past have carried out, and continue to carry out, transactions with us and others which may be considered to be interested party transactions under Russian law, requiring approval by disinterested directors, disinterested independent directors or disinterested shareholders depending on the nature of the transaction and parties involved. See Item 10. Additional Information Charter and Certain Requirements of Russian Legislation Interested Party Transactions. The provisions of Russian law defining which transactions must be approved as interested party transactions are subject to different interpretations, and these transactions may not always have been properly approved. We cannot assure you that our and our subsidiaries applications of these concepts will not be subject to challenge by former and current shareholders. Any such challenges, if successful, could result in the invalidation of transactions, which could have a material adverse effect on our business, financial condition, results of operations or prospects.

In addition, Russian law requires a three-quarters majority vote of the holders of voting stock present at a shareholders meeting to approve certain transactions and other matters, including, for example, charter amendments, major transactions involving assets in excess of 50% of the assets of the company, repurchase by the company of shares and certain share issuances. In some cases, minority shareholders may not approve interested party transactions requiring their approval or other matters requiring approval of minority shareholders or supermajority approval. In the event that these minority shareholders were to challenge successfully past interested party transactions, or do not approve interested party transactions or other matters in the future, we could be limited in our operational flexibility and our business, financial condition, results of operations or prospects could be materially adversely affected.

In the event certain minority shareholder lawsuits are resolved against us, our financial condition and results of operations could be materially adversely affected.

Russian law does not protect us and does not allow us to include in our charter protections against greenmail and other similar actions by minority shareholders. For example, minority shareholders holding as little as a single share in a company have standing under Russian law to bring claims against such company. These deficiencies in Russian corporate law are often abused by minority shareholders, who can bring claims in local courts seeking injunctions and other relief for which, as a practical matter, we may not receive notice. Any such actions by minority shareholders could have a material adverse effect on our business, results of operations and financial condition.

For example, in 2006, several claims were brought against us in Russian courts by a group of minority shareholders. In three of them, minority shareholders are seeking payment by us of damages to our subsidiary Southern Kuzbass Coal Company in the amount of $264.4 million, allegedly caused to the subsidiaries of Southern Kuzbass Coal Company as a result of losses of such subsidiaries in 2005 through first half of 2006. In another case, a minority shareholder of Mechel is seeking Mechel s transfer of 626,913 shares of Southern Kuzbass Coal Company amounting to $18 million, which it claims it did not receive as a result of conversion of shares due to a merger of Southern Kuzbass Coal Company and one of its subsidiaries, Olzherassky Pit. The aforementioned cases are pending in court. We expect additional similar claims to be filed against us by the same minority shareholders. In the event that the foregoing lawsuits are resolved against us, our financial condition and results of operations could be materially adversely affected.

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

As of December 31, 2006, approximately 69% of our employees were represented by trade unions. Although we have not experienced any business interruption at any of our businesses as a result of labor disputes from the dates of their respective acquisition by us and we consider our employee relations to be good, large union representation subjects our businesses to interruptions through strikes, lockouts or delays in renegotiations of collective bargaining agreements. Our existing arrangements with trade unions also may not be renewed on terms favorable to us. In such events, our business and results of operations could be materially adversely affected.

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

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

If transactions of members of the group and their predecessors-in-interest were to be challenged on the basis of non-compliance with applicable legal requirements, the remedies in the event of any successful challenge could include the invalidation of such transactions or the imposition of other liabilities on such group members.

Members of the group, or their predecessors-in-interest at different times, took a variety of actions relating to share issuances, share disposals and acquisitions, mandatory buy-out offers, valuation of property, interested party transactions, major transactions, meetings of the group members governing bodies, other corporate matters and anti-monopoly issues that, if successfully challenged on the basis of non-compliance with applicable legal requirements by competent state authorities, counterparties in such transactions or shareholders of the relevant group members or their predecessors-in-interest, could result in the invalidation of such transactions and our corporate decisions, restrictions on voting control or the imposition of other liabilities. Because applicable provisions of Russian law are subject to many different interpretations, we may not be able to defend successfully any challenge brought against such transactions, and the invalidation of any such transactions or imposition of any such liability may, individually or in the aggregate, have a material adverse effect on our business, financial condition and results of operations.

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

Russian transfer pricing rules effective since 1999 give Russian tax authorities the right to control prices for transactions between related entities and certain other types of transactions between unrelated parties, such as foreign trade transactions or transactions with significant price fluctuations if the transaction price deviates by more than 20% from the market price. Special transfer pricing rules apply to operations with securities and derivative instruments. The Russian transfer pricing rules are vaguely drafted, and are subject of interpretation by Russian tax authorities and courts. Due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge our prices and make adjustments which could affect our tax position. In particular, we have received assessments from the tax authorities for transfer prices-related taxes, interest and penalties owing totaling $12.5 million. If such assessments are upheld, our financial condition and results of operations could be materially adversely affected. In addition, we could face significant losses associated with the assessed amount of underpaid prior tax and related interest and penalties. See also Legal Risks and Uncertainties Characteristics of and changes in the Russian tax system could materially adversely affect our business, financial condition, results of operations and prospects and the value of the shares and ADSs.

In addition, a number of draft amendments to the transfer pricing law have recently been introduced which, if implemented, would considerably toughen the existing law. The proposed changes, among other things, may shift the burden of proving market prices from the tax authorities to the taxpayer, cancel the existing permitted deviation threshold and introduce specific documentation requirements for proving market prices.

Risks Relating to Our Shares and ADSs and the Trading Market

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

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

Russian law may treat the depositary as the beneficial owner of the shares underlying the ADSs. This is different from the way other jurisdictions treat ADSs. In the United States, although shares may be held in the depositary s name or to its order, making it a legal owner of the shares, the ADS holders are the

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

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

ADS holders will have no direct voting rights with respect to the shares represented by the ADSs. They will be able to exercise voting rights with respect to the shares represented by ADSs only in accordance with the provisions of the deposit agreement relating to the ADSs and relevant requirements of Russian law. Therefore, there are practical limitations upon the ability of ADS holders to exercise their voting rights due to the additional procedural steps involved in communicating with them. For example, the Joint Stock Companies Law and our charter require us to notify shareholders no less than 30 days prior to the date of any meeting and at least 50 days prior to the date of an extraordinary meeting to elect our Board of Directors upon publication of the notice in the Russian newspaper Rossiiskaya Gazeta . Our ordinary shareholders will receive notice directly from us and will be able to exercise their voting rights by either attending the meeting in person or voting by power of attorney.

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

In addition, although securities regulations expressly permit the depositary to split the votes with respect to the shares underlying the ADSs in accordance with instructions from ADS holders, there is little court or regulatory guidance on the application of such regulations, and the depositary may choose to refrain from voting at all unless it receives instructions from all ADS holders to vote the shares in the same manner. You may thus have significant difficulty in exercising voting rights with respect to the shares underlying the ADSs. There can be no assurance that holders and beneficial owners of ADSs will (1) receive notice of shareholder meetings to enable the timely return of voting instructions to the depositary, (2) receive notice to enable the timely cancellation of ADSs in respect of shareholder actions or (3) be given the benefit of dissenting or minority shareholders rights in respect of an event or action in which the holder or beneficial owner has voted against, abstained from voting or not given voting instructions.

The price of our shares and ADSs may be highly volatile.

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

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

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

Dividends that we may pay in the future on the shares represented by the ADSs are calculated in Russian rubles and may be declared and paid to the depositary in rubles. Such dividends will be converted into U.S. dollars by the depositary and distributed to holders of ADSs, net of the depositary s fees and expenses. The ability to convert rubles into U.S. dollars is subject to the availability of U.S. dollars in Russia s currency markets. Although there is an existing, albeit limited, market within Russia for the conversion of rubles into U.S. dollars, including the interbank currency exchange and over-the-counter and currency futures markets, the further development of this market is uncertain. At present, there is a limited market for the conversion of rubles into foreign currencies outside of Russia and only a limited emerging market in which to hedge ruble and ruble-denominated investments.

ADS holders may not be able to benefit from the United States-Russia income tax treaty.

Under Russian law, dividends paid to a non-resident holder of the shares generally will be subject to Russian withholding tax at a rate of 15% for legal entities and organizations and at a rate of 30% for individuals.

Russian tax rules applicable to the holders of the ADSs are characterized by significant uncertainties and, until recently, by an absence of interpretive guidance. In 2005 and 2006, the Ministry of Finance of the Russian Federation expressed its opinion in private rulings that holders of global depositary receipts should be treated as the beneficial owners of the dividends paid on underlying shares for the purposes of double tax treaty provisions applicable to taxation of dividend income from the underlying shares, provided that the tax treaty residence of the holders of the global depositary receipts is duly confirmed. However, the Russian tax authorities have not provided official, generally applicable guidance addressing how an ADS holder should demonstrate its beneficial ownership in underlying shares. In the absence of any specific provisions in Russian tax legislation with respect to the concept of beneficial ownership and taxation of income of beneficial owners, it is unclear how the Russian tax authorities will ultimately treat the ADS holders in this regard.

Until the Russian tax authorities clarify whether it is permitted under Russian law to withhold Russian withholding tax in respect of dividends a company pays to the Depositary at a lower rate than the domestic rate applicable to such payments (currently 15%), we intend to withhold Russian withholding tax at the domestic rate applicable to such dividends, regardless of whether the Depositary (the legal owner of the shares) or an ADS holder would be entitled to reduced rates of Russian withholding tax under the relevant

income tax treaty if it were the beneficial owner of the dividends for purposes of that treaty. Although non-resident ADS holders may apply for a refund of a portion of the amount so withheld by us under the relevant income tax treaty, no assurance can be made that the Russian tax authorities will grant any refunds. See Item 10. Additional Information Taxation Russian Income and Withholding Tax Considerations for additional information.

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

Under Russian tax legislation, gains realized by non-resident legal entities or organizations from the disposition of Russian shares and securities, as well as financial instruments derived from such shares, such as the ADSs, may be subject to Russian profits tax or withholding income tax if immovable property located in Russia constitutes more than 50% of our assets. However, no procedural mechanism currently exists to withhold and remit this tax with respect to sales made to persons other than Russian companies and foreign companies with a registered permanent establishment in Russia. Gains arising from the disposition at foreign stock exchanges of the foregoing types of securities listed on these exchanges are not subject to taxation in Russia.

Gains arising from the disposition of the foregoing types of securities and derivatives outside of Russia by U.S. holders who are individuals not resident in Russia for tax purposes will not be considered Russian source income and will not be taxable in Russia. Gains arising from disposition of the foregoing types of securities and derivatives in Russia by U.S. holders who are individuals not resident in Russia for tax purposes may be subject to tax either at the source in Russia or based on an annual tax return, which they may be required to submit with the Russian tax authorities.

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

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

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

Risks Relating to the Russian Federation

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

Investors in emerging markets such as the Russian Federation should be aware that these markets are subject to greater risk than more developed markets, including in some cases significant legal, economic and political risks. Investors should also note that emerging economies such as the economy of the Russian Federation are subject to rapid change and that the information set out herein may become outdated relatively quickly. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, their investment is appropriate. Generally, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved and investors are urged to consult with their own legal and financial advisors before making an investment in the shares and ADSs.

Economic Risks

Economic instability in Russia could adversely affect our business and the value of the shares and ADSs.

Since the dissolution of the Soviet Union in the early 1990s, the Russian economy has experienced at various times:

- significant declines in gross domestic product;
- hyperinflation;
- an unstable currency;
- high government debt relative to gross domestic product;
- a weak banking system providing limited liquidity to domestic enterprises;
- high levels of loss-making enterprises that continued to operate due to the lack of effective bankruptcy proceedings;
- significant use of barter transactions and illiquid promissory notes to settle commercial transactions;
- widespread tax evasion;
- growth of a black and gray market economy;
- pervasive capital flight;
- high levels of corruption and the penetration of organized crime into the economy;
- significant increases in unemployment and underemployment; and
- the impoverishment of a large portion of the population.

Although Russia has benefited recently from the increase in global commodity prices, providing an increase in disposable income and an increase in consumer spending, the Russian economy has been subject to abrupt downturns in the past. In particular, on August 17, 1998, in the face of a rapidly deteriorating economic situation, the Russian government defaulted on its ruble-denominated securities, the Central Bank of Russia stopped its support of the ruble and a temporary moratorium was imposed on certain foreign currency payments. These actions resulted in an immediate and severe devaluation of the ruble and a sharp increase in the rate of inflation; a substantial decline in the prices of Russian debt and equity securities; and an inability of Russian issuers to raise funds in the international capital markets. These problems were aggravated by a

major banking crisis in the Russian banking sector after the events of

August 17, 1998, as evidenced by the termination of the banking licenses of a number of major Russian banks. This further impaired the ability of the banking sector to act as a consistent source of liquidity to Russian companies and resulted in the losses of bank deposits in some cases.

Recently, the Russian economy has experienced positive trends, such as the increase in the gross domestic product, a relatively stable ruble, strong domestic demand, rising real wages and a reduced rate of inflation; however, these trends may not continue or may be abruptly reversed.

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

Russia s banking and other financial systems are less developed or regulated in comparison with developed countries, and Russian legislation relating to banks and bank accounts is subject to varying interpretations and inconsistent application. The August 1998 financial crisis resulted in the bankruptcy and liquidation of many Russian banks and almost entirely eliminated the developing market for commercial bank loans at that time. Since that time, the Russian banking sector has steadily developed, as demonstrated by the growing presence of prominent international banks in Russia and emergence of a small number of creditworthy Russian banks. However, many Russian banks currently do not meet international banking standards, and the transparency of the Russian banking sector in some respects still lags far behind internationally accepted norms. Aided by inadequate supervision by the regulators, certain banks do not follow existing Central Bank of Russia regulations with respect to lending criteria, credit quality, loan loss reserves or diversification of exposure. This has resulted in cancellation of a number of bank licenses in the last few years. Furthermore, in Russia, bank deposits made by corporate entities generally are not insured.

Recently, there has been a rapid increase in lending by Russian banks, which many believe has been accompanied by a deterioration in the credit quality of the borrowers. In addition, a robust domestic corporate debt market is leading to Russian banks increasingly holding large amounts of Russian corporate ruble bonds in their portfolios, which is further deteriorating the risk profile of Russian bank assets. In addition, since Russian banks generally have a lower capital adequacy, the banking sector could be more susceptible to market downturns or economic slowdowns, including due to Russian corporate defaults that may occur during any such market downturn or economic slowdown. If a banking crisis were to occur, Russian companies would be subject to severe liquidity constraints due to the limited supply of domestic savings and the withdrawal of foreign funding sources that would occur during such a crisis.

There is currently a limited number of sufficiently creditworthy Russian banks. We hold the bulk of our excess ruble and foreign currency cash in Russian banks, including subsidiaries of foreign banks. There are few, if any, safe ruble-denominated instruments in which we may invest our excess ruble cash. Another banking crisis or the bankruptcy or insolvency of the banks from which we receive or with which we hold our funds could result in the loss of our deposits or affect our ability to complete banking transactions in Russia, which could have a material adverse effect on our business, financial condition and results of operations.

The infrastructure in Russia is inadequate, which could disrupt normal business activity.

The infrastructure in Russia largely dates back to Soviet times and has not been adequately funded and maintained over the past decade. Particularly affected are the rail and road networks, power generation and transmission systems, communication systems and building stock. In May 2005, a fire and explosion in one of the Moscow power substations built in 1963 caused a major power outage in a large section of Moscow and some surrounding regions. The blackout disrupted the ground electric transport, including the metro system, led to road traffic accidents and massive traffic congestion, disrupted electricity and water supply in office and residential buildings and affected mobile communications. The trading on exchanges and the operation of many banks, stores and markets were also halted.

The deterioration of the infrastructure in Russia harms the national economy, disrupts the transportation of goods and supplies, adds costs to doing business and can interrupt business operations. The Russian government is actively considering plans to reorganize the nation s rail, electricity and communications systems. Any such reorganization may result in increased charges and tariffs while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems. These factors could have a material adverse effect on our business and results of operations.

Fluctuations in the global economy could materially adversely affect the Russian economy and the value of the shares and ADSs.

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in Russia and Russian businesses could face severe liquidity constraints, further materially adversely affecting the Russian economy. Additionally, because Russia produces and exports large amounts of oil, the Russian economy is especially vulnerable to the price of oil on the world market and a decline in the price of oil could slow or disrupt the Russian economy or undermine the value of the ruble against foreign currencies. Military conflicts and international terrorist activity also significantly impact oil and gas prices, and pose additional risks to the Russian economy. Russia is also a major producer and exporter of metal products and its economy is vulnerable to fluctuations in world commodity prices and the imposition of tariffs and/or anti-dumping measures by the United States, the European Union or by other principal export markets.

Political and Social Risks

Political and governmental instability could materially adversely affect our business, financial condition, results of operations and prospects and the value of the shares and ADSs.

Since 1991, Russia has sought to transform itself from a one-party state with a centrally-planned economy to a democracy with a market economy. As a result of the sweeping nature of the reforms, and the failure of some of them, the Russian political system remains vulnerable to popular dissatisfaction, including dissatisfaction with the results of privatizations in the 1990s, as well as to demands for autonomy from particular regional and ethnic groups.

Current and future changes in the government, major policy shifts or lack of consensus between various branches of the government and powerful economic groups could disrupt or reverse economic and regulatory reforms. In addition, the Russian presidential elections scheduled for 2008 could bring more volatility to the market. Any disruption or reversal of reform policies could lead to political or governmental instability or the occurrence of conflicts among powerful economic groups, which could have a material adverse effect on our business, financial condition, results of operations and prospects and the value of the shares and ADSs.

Conflict between central and regional authorities and other conflicts could create an uncertain operating environment, hindering our long-term planning ability.

The Russian Federation is a federation of 86 sub-federal political units, consisting of republics, territories, regions, cities of federal importance and autonomous regions and districts. The delineation of authority and jurisdiction among the members of the Russian Federation and the federal government is, in many instances, unclear and remains contested. Lack of consensus between the federal government and local or regional authorities often results in the enactment of conflicting legislation at various levels and may lead to further political instability. In particular, conflicting laws have been enacted in the areas of privatization, land legislation and licensing. Some of these laws and governmental and administrative decisions implementing them, as well as certain transactions consummated pursuant to them, have in the past been challenged in the courts, and such challenges may occur in the future. This lack of consensus hinders our long-term planning efforts and creates uncertainties in our operating environment, both of which may prevent us from effectively and efficiently implementing our business strategy.

Additionally, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions and, in certain cases, military conflict, such as the continuing conflict in Chechnya. Violence and attacks relating to this conflict have spread to other parts of Russia, and several terrorist attacks have been carried out by Chechen terrorists in other parts of Russia, including in Moscow. The further intensification of violence, including terrorist attacks and suicide bombings, or its spread to other parts of Russia, could have significant political consequences, including the imposition of a state of emergency in some or all of Russia. Moreover, any terrorist attacks and the resulting heightened security measures are likely to cause disruptions to domestic commerce and exports from Russia. These factors could materially adversely affect our business and the value of the shares and ADSs.

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

The political and economic changes in Russia in recent years have resulted in significant dislocations of authority. The local and international press have reported that significant organized criminal activity has arisen, particularly in large metropolitan centers. Property crime in large cities has increased substantially. In addition, the local press and international press have reported high levels of corruption, including the bribing of officials for the purpose of initiating investigations by government agencies. Press reports have also described instances in which government officials engaged in selective investigations and prosecutions to further the commercial interests of certain government officials or certain companies or individuals. Additionally, some members of the Russian media regularly publish disparaging articles in return for payment. The depredations of organized or other crime, demands of corrupt officials or claims that we have been involved in official corruption could result in negative publicity, could disrupt our ability to conduct our business effectively and could thus materially adversely affect our business, financial condition and results of operations and the value of the shares and ADSs.

Social instability could increase support for renewed centralized authority, nationalism or violence and thus materially adversely affect our business, financial condition, results of operations and prospects.

The failure of the government and many private enterprises to pay full salaries on a regular basis and the failure of salaries and benefits generally to keep pace with the rapidly increasing cost of living have led in the past, and could lead in the future, to labor and social unrest. Labor and social unrest may have political, social and economic consequences, such as increased support for a renewal of centralized authority, increased nationalism, including restrictions on foreign involvement in the economy of Russia, and increased violence. An occurrence of any of the foregoing events could restrict our operations and lead to the loss of operating revenues, materially adversely affecting our business, financial condition, results of operations and prospects.

Legal Risks and Uncertainties

Weaknesses relating to the legal system and legislation create an uncertain environment for investment and business activity.

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

- inconsistencies between and among the Constitution, federal law, presidential decrees and governmental, ministerial and local orders, decisions, resolutions and other acts;
- conflicting local, regional and federal rules and regulations;
- the lack of judicial and administrative guidance on interpreting legislation;
- substantial gaps in the regulatory structure due to the delay or absence of implementing legislation;
- the relative inexperience of judges and courts in interpreting legislation;
- the lack of an independent judiciary and corruption within the judiciary;
- a high degree of discretion on the part of governmental authorities, which could result in arbitrary actions such as suspension or termination of our licenses; and
- poorly developed bankruptcy procedures that are subject to abuse.

The recent nature of much of Russian legislation, the lack of consensus about the scope, content and pace of economic and political reform and the rapid evolution of the Russian legal system in ways that may not always coincide with market developments place the enforceability and underlying constitutionality of laws in doubt and results in ambiguities, inconsistencies and anomalies. In addition, Russian legislation often contemplates implementing regulations which have not yet been promulgated, leaving substantial gaps in the regulatory infrastructure. All of these weaknesses could affect our ability to enforce our rights under our licenses and under our contracts, or to defend ourselves against claims by others. We cannot assure you that regulators, judicial authorities or third parties will not challenge our compliance with applicable laws, decrees and regulations.

Failure to comply with existing laws and regulations or the findings of government inspections, or increased governmental regulation of our operations, could result in substantial additional compliance costs or various sanctions or court judgments which could materially adversely affect our business, financial condition, results of operations and prospects.

Our operations and properties are subject to regulation by various government entities and agencies in connection with obtaining and renewing various licenses, permits, approvals and authorizations, as well as with ongoing compliance with existing laws, regulations and standards. Regulatory authorities exercise considerable discretion in matters of enforcement and interpretation of applicable laws, regulations and standards, the issuance and renewal of licenses, permits, approvals and authorizations and in monitoring licensees compliance with the terms thereof. Russian authorities have the right to, and frequently do, conduct periodic inspections of our operations and properties throughout the year. Any such future inspections may conclude that we or our subsidiaries have violated laws, decrees or regulations, and we may be unable to refute such conclusions or remedy the violations.

Our failure to comply with existing laws and regulations or the findings of government inspections or to obtain all approvals, authorizations and permits required for our operations, may result in the imposition of fines or penalties or more severe sanctions including the suspension, amendment or

termination of our licenses, permits, approvals and authorizations or in requirements that we cease certain of our business activities, or in criminal and administrative penalties applicable to our officers. Moreover, an agreement made or transaction executed in violation of a law may be invalidated and unwound by a court decision. Any such decisions, requirements or sanctions, or any increase in governmental regulation of our operations, could increase our costs and materially adversely affect our business, financial condition, results of operations and prospects.

One or more of our subsidiaries could be forced into liquidation on the basis of formal non-compliance with certain requirements of Russian law, which could materially adversely affect our business, financial condition, results of operations and prospects.

Certain provisions of Russian law may allow a court to order liquidation of a Russian legal entity on the basis of its formal non-compliance with certain requirements during formation, reorganization or during its operation. There have been cases in the past in which formal deficiencies in the establishment process of a Russian legal entity or non-compliance with provisions of Russian law have been used by Russian courts as a basis for liquidation of a legal entity. For example, in Russian corporate law, negative net assets calculated on the basis of Russian accounting standards as at the end of the second or any subsequent year of a company s operation, can serve as a basis for a court to order the liquidation of the company, upon a claim by governmental authorities. Many Russian companies have negative net assets due to very low historical asset values reflected on their Russian accounting standards balance sheets; however, their solvency, *i.e.*, their ability to pay debts as they come due, is not otherwise adversely affected by such negative net assets. Currently, we have three subsidiaries with negative net assets, Port Kambarka, Vyartsilya Metal Products Plant and Mechel Recycling.

Weaknesses in the Russian legal system create an uncertain legal environment, which makes the decisions of a Russian court or a governmental authority difficult, if not impossible, to predict. If involuntary liquidation were to occur, then we may be forced to reorganize the operations we currently conduct through the affected subsidiaries. Any such liquidation could lead to additional costs, which could materially adversely affect our business, financial condition, results of operations and prospects.

The judiciary s lack of independence, overall inexperience, occasional abuse of discretion, the difficulty of enforcing court decisions and governmental discretion in enforcing claims could prevent us or you from obtaining effective redress in a court proceeding.

The independence of the judicial system and its immunity from economic, political and nationalistic influences in Russia remain largely untested. The court system in Russia is understaffed and underfunded. Judges and courts are generally inexperienced in the area of business and corporate law. Judicial precedents generally have no binding effect on subsequent decisions. Not all Russian legislation and court decisions are readily available to the public or organized in a manner that facilitates understanding. The Russian judicial system can be slow or unjustifiably swift. Enforcement of court orders can, in practice, be very difficult in Russia. Additionally, court claims are often used in furtherance of political and commercial aims or infighting. We may be subject to such claims and may not be able to receive a fair hearing. Additionally, court orders are not always enforced or followed by law enforcement agencies, and the government may attempt to invalidate court decisions by backdating or retroactively applying relevant legislative changes. Judicial decisions in Russia can be unpredictable and may not provide effective redress.

These uncertainties also extend to property rights. During Russia s transformation from a centrally planned economy to a market economy, legislation has been enacted to protect private property against expropriation and nationalization. However, it is possible that due to the lack of experience in enforcing these provisions and due to political factors, these protections would not be enforced in the event of an attempted expropriation or nationalization. Expropriation or nationalization of any of our entities, their

assets or portions thereof, potentially without adequate compensation, would have a material adverse effect on our business, financial condition, results of operations and prospects.

Selective or arbitrary government action could have a material adverse effect on our business, financial condition, results of operations and prospects and the value of the shares and ADSs.

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

In addition, in recent years, the Russian tax authorities aggressively have brought tax evasion claims on the basis of certain Russian companies use of tax-optimization schemes, and press reports have speculated that these enforcement actions have been selective and politically motivated. Selective or arbitrary government action, if directed at us, could have a material adverse effect on our business, financial condition, results of operations and prospects, and the value of the shares and ADSs.

Lack of developed corporate and securities laws and regulations in Russia could limit our ability to attract future investment.

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

- the Federal Service for the Financial Markets, or the FSFM;
- the Ministry of Finance;
- the Russian Federal Anti-Monopoly Service;
- the Central Bank of Russia; and
- various professional self-regulatory organizations.

The regulations of these various authorities are not always coordinated and may be contradictory. In addition, Russian corporate and securities rules and regulations can change rapidly, which may materially adversely affect our ability to conduct securities-related transactions. While some important areas are subject to virtually no oversight, the regulatory requirements imposed on Russian issuers in other areas result in delays in conducting securities offerings and in accessing the capital markets. It is often unclear whether or how regulations, decisions and letters issued by the various regulatory authorities apply to our group. The FSFM has recently introduced a number of regulations relating to offerings of shares in and

outside of Russia, including combined offerings involving closed subscription for new shares and the sale of existing shares, which remain largely untested and subject to varying interpretations. Any challenges of such regulations or transactions consummated pursuant to them could have an adverse effect on our ability to effect equity offerings in the future. As a result, we may be subject to fines and/or other enforcement measures despite our best efforts at compliance, which could have a material adverse effect on our business, financial condition and results of operations.

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

In general, minority shareholder protection under Russian law derives from supermajority shareholder approval requirements for certain corporate action, as well as from the ability of a shareholder to demand that the company purchase the shares held by that shareholder if that shareholder voted against or did not participate in voting on certain types of actions. Companies are also required by Russian law to obtain the approval of disinterested shareholders for certain transactions with interested parties. See Item 10. Additional Information Charter and Certain Requirements of Russian Legislation Description of Capital Stock Rights Attaching to Common Shares for a more detailed description of some of these protections. While these protections are similar to the types of protections available to minority shareholders in U.S. corporations, in practice, corporate governance standards for many Russian companies and enforcement of protections have proven to be poor, and minority shareholders in Russian companies have suffered losses due to abusive share dilutions, asset transfers and transfer pricing practices. Shareholder meetings of some companies have been irregularly conducted, and shareholder resolutions have not always been respected by management. Shareholders of some companies also suffered as a result of fraudulent bankruptcies initiated by hostile creditors.

The supermajority shareholder approval requirement is met by a vote of 75% of all voting shares that are present at a shareholders meeting. Thus, controlling shareholders owning slightly less than 75% of outstanding shares of a company may have a 75% or more voting power if certain minority shareholders are not present at the meeting. In situations where controlling shareholders effectively have 75% or more of voting power at a shareholders meeting, they are in a position to approve amendments to the charter of the company or significant transactions including asset transfers, which could be prejudicial to the interests of minority shareholders. It is possible that our controlling shareholder and our management in the future may not run us and our subsidiaries for the benefit of minority shareholders, and this could materially and adversely affect the value of the ADSs. See Risks Relating to Our Business and Industry Our controlling shareholder has the ability to take actions that may conflict with those of the holders of our securities.

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

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

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

The Civil Code and the Joint Stock Companies Law generally provide that shareholders in a Russian joint stock company are not liable for the obligations of the joint stock company and bear only the risk of loss of their investment. This may not be the case, however, when one person is capable of determining decisions made by another person or entity. The person or entity capable of determining such decisions is deemed an effective parent. The person whose decisions are capable of being so determined is deemed an effective subsidiary. Under the Joint Stock Companies Law, an effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if:

- this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between the companies; and
- the effective parent gives obligatory directions to the effective subsidiary.

In addition, an effective parent is secondarily liable for an effective subsidiary s debts if an effective subsidiary becomes insolvent or bankrupt resulting from the action or inaction of an effective parent. This is the case no matter how the effective parent s ability to determine decisions of the effective subsidiary arises. For example, this liability could arise through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary s losses from the effective parent which caused the effective subsidiary to take action or fail to take action knowing that such action or failure to take action would result in losses. Accordingly, we could be liable in some cases for the debts of our subsidiaries. This liability could have a material adverse effect on our business, results of operations and financial condition.

Shareholder rights provisions under Russian law could result in significant additional obligations on us.

Russian law provides that shareholders that vote against or abstain from voting on certain matters have the right to request that the company redeem their shares at market value in accordance with Russian law. The decisions that trigger this right include:

- decisions with respect to a reorganization;
- the approval by shareholders of a major transaction, which, in general terms, is a transaction involving property worth more than 50% of the gross book value of our assets calculated according to Russian accounting standards, regardless of whether the transaction is actually consummated, except for transactions undertaken in the ordinary course of business; and
- the amendment of our charter in a manner that limits shareholder rights.

Our (or, as the case may be, our subsidiaries) obligation to purchase shares in these circumstances, which is limited to 10% of our or each of our subsidiary s net assets, as applicable, calculated in accordance with Russian accounting standards at the time the matter at issue is voted upon, could have a material adverse effect on our business, financial condition, results of operations and prospects.

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

Ownership of Russian joint stock company shares (or, if the shares are held through a nominee or custodian, then the holding of such nominee or custodian) is determined by entries in a share register and is evidenced by extracts from that register. Currently, there is no central registration system in Russia. Share registers are maintained by the companies themselves or, if a company has more than 50 shareholders or so elects, by licensed registrars located throughout Russia. Regulations have been

issued regarding the licensing conditions for such registrars, as well as the procedures to be followed by both companies maintaining their own registers and licensed registrars when performing the functions of registrar. In practice, however, these regulations have not been strictly enforced, and registrars generally have relatively low levels of capitalization and inadequate insurance coverage. Moreover, registrars are not necessarily subject to effective governmental supervision. Due to the lack of a central and rigorously regulated share registration system in Russia, transactions in respect of a company s shares could be improperly or inaccurately recorded, and share registration could be lost through fraud, negligence, official and unofficial governmental actions or oversight by registrars incapable of compensating shareholders for their misconduct. This creates risks of loss not normally associated with investments in other securities markets. Further, the depositary, under the terms of the agreement governing the deposit of ADSs, will not be liable for the unavailability of shares or for the failure to make any distribution of cash or property with respect thereto due to the unavailability of the shares. See Item 10. Additional Information Charter and Certain Requirements of Russian Legislation Description of Capital Stock Registration and Transfer of Shares.

Characteristics of and changes in the Russian tax system could materially adversely affect our business, financial condition, results of operations and prospects and the value of the shares and ADSs.

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

- profits tax;
- value-added tax, or VAT;
- unified social tax;
- extraction tax; and
- property and land taxes.

Laws related to these taxes have been in force for a short period relative to tax laws in more developed market economies and few precedents with regard to the interpretation of these laws have been established. Global tax reforms commenced in 1999 with the introduction of Part One of the Tax Code of the Russian Federation, or the Tax Code, which sets general taxation guidelines. Since then, Russia has been in the process of replacing legislation regulating the application of major taxes such as corporate profits tax, VAT and property tax with new chapters of the Tax Code.

In practice, the Russian tax authorities generally interpret the tax laws in ways that rarely favor taxpayers, who often have to resort to court proceedings to defend their position against the tax authorities. Recent events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretations of the legislation and assessments. Differing interpretations of tax regulations exist both among and within government ministries and organizations at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Tax declarations, together with related documentation such as customs declarations, are subject to review and investigation by a number of authorities, each of which may impose severe fines, penalties and interest charges. Generally, in an audit, taxpayers are subject to inspection with respect to the three calendar years which immediately preceded the year in which the audit is carried out. Previous audits do not completely exclude subsequent claims relating to the audited period because Russian tax law authorizes upper-level tax inspectorates to reaudit taxpayers which were audited by subordinate tax inspectorates. In addition, on July 14, 2005, the Russian Constitutional Court issued a decision that allows the statute of limitations for tax liabilities to be extended beyond the three-year term set forth in the tax laws if a court determines that a taxpayer has obstructed or hindered a tax audit. Because none of the relevant terms is defined, tax authorities may have broad discretion to argue that a taxpayer has obstructed or hindered an audit and ultimately seek back

taxes and penalties beyond the three-year term. In some instances, new tax regulations have been given retroactive effect.

Moreover, financial results of Russian companies cannot be consolidated for tax purposes. Therefore, each of our Russian subsidiaries pays its own Russian taxes and may not offset its profit or loss against the loss or profit of any of our other subsidiaries. In addition, intercompany dividends are subject to a withholding tax of 9%, if being distributed by Russian companies to Russian companies and/or individual Russian residents, and 15%, if being distributed by foreign companies to Russian companies and natural persons (tax residents of the Russian Federation) or by Russian companies to foreign companies. Dividends from foreign companies to Russian companies are subject to a tax of 15%. Taxes paid in foreign countries by Russian companies may be offset against payment of these taxes in the Russian Federation up to the maximum amount of the Russian tax liability. In order to apply the offset, the company is required to confirm the payment of taxes in the foreign country. The confirmations must be authorized by the tax authority of the foreign country if taxes were paid by the company itself, and the confirmation must be authorized a the tax agent if taxes were withheld by the tax agent under foreign tax law or international tax agreement.

The foregoing conditions create tax risks in Russia that are more significant than typically found in countries with more developed tax systems, imposing additional burdens and costs on our operations, including management resources. In addition to our substantial tax burden, these risks and uncertainties complicate our tax planning and related business decisions, potentially exposing us to significant fines and penalties and enforcement measures despite our best efforts at compliance. See also Risks Relating to the Russian Federation Legal Risks and Uncertainties Selective or arbitrary government action could have a material adverse effect on our business, financial condition, results of operations and prospects and the value of the shares and ADSs.

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

In the past, Russian currency regulations imposed various restrictions on operations involving foreign currencies in an attempt to support the ruble. Effective from January 1, 2007, most of these restrictions have been removed. However, in case of a crisis, the government and the Central Bank of the Russian Federation may impose requirements on cash inflows and outflows into and out of Russia or on the use of foreign currency in Russia in the future. For example, Russian companies currently must repatriate proceeds from export sales. Moreover, the foreign currency market in Russia is still developing and we may experience difficulty in converting rubles into other currencies. Any delay or difficulty in converting rubles into a foreign currency to make a payment or any practical difficulty in the transfer of foreign currency could limit our ability to meet our payment and debt obligations, which could result in the acceleration of debt obligations and cross defaults, or prevent us from carrying on necessary business transactions.

Furthermore, there are only a limited number of available ruble denominated instruments in which we may invest our excess cash. Any balances maintained in rubles will give rise to losses if the ruble devalues against major foreign currencies. Moreover, these restrictions could prevent or delay any acquisition opportunities outside of Russia that we might wish to pursue.

Russian thin capitalization rules could affect our ability to deduct interest on certain borrowings.

Russian thin capitalization rules limit the amount of interest that can be deducted by a Russian company on debts payable to non-resident shareholders. Until January 1, 2006, these rules applied only to loans issued to a Russian company by a foreign shareholder owning directly or indirectly more than 20% of the share capital of the Russian company. However, thin capitalization rules that came into effect on January 1, 2006 extend the rules application to loans issued to a Russian company by another Russian company that is affiliated with the foreign shareholder as well as to loans secured by such foreign

shareholder or its affiliated Russian company. Under these rules, a positive difference between the accrued interest and maximum interest calculated in accordance with the thin capitalization rules is considered to be dividends and, thus, is not included in the taxable expenses.

Other Risks

We face similar risks in other countries of the former Soviet Union and former Soviet-bloc countries in Eastern and Central Europe.

We currently have two steel mills in Romania and a hardware plant in Lithuania. We may acquire additional operations in the countries of the former Soviet Union and former Soviet-bloc countries in Eastern and Central Europe. Additionally, we owned a pipe mill in Croatia until August 2004, when we transferred its ownership back to the government of Croatia. As with Russia, these countries are emerging markets subject to greater political, economic, social and legal risks than more developed markets. In many respects, the risks inherent in transacting business in these countries are similar to those in Russia, especially those risks set out above in Risks Relating to the Economic Environment in Russia, Risks Relating to the Social Environment in Russia and Risks Relating to Russian Legislation and the Russian Legal System.

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

We have not independently verified information we have sourced from third parties.

We have sourced certain information contained in this document from third parties, including private companies and Russian government agencies, and we have relied on the accuracy of this information without independent verification. 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. In addition, the veracity of some official data released by the Russian government may be questionable. In 1998, the Director of the Russian State Committee on Statistics and a number of his subordinates were arrested and subsequently sentenced by a court in 2004 in connection with their misuse of economic data.

Item 4. Information on the Company

Overview

We are a low-cost integrated mining and steel group with revenues of $4.4 billion in 2006. Our mining business is focused on mining products used in the production of steel, primarily coking coal, iron ore and nickel. We also produce a significant amount of steam coal. We have substantial coal, iron ore and nickel mining interests in Russia, with the flexibility to supply our own steel production or sell to third parties depending on price differentials between purchases from local suppliers and sales to foreign and domestic customers. We are capable of internally sourcing 80% of the coking coal, 40% of the iron ore and 67% of the nickel requirements of our steel segment. We were the third largest producer of coking coal in Russia in 2006, with a 13.8% market share, and Russia s second largest exporter of coking coal and coal concentrate. We also control 20% of the coking coal washing capacity in Russia.

Our steel business comprises the production and sale of semi-finished steel products, carbon and specialty long products, carbon and stainless flat products and value-added downstream metal products including hardware, stampings and forgings. It also produces significant amounts of coke, both for internal use and for sales to third parties. We are the largest and most comprehensive producer of specialty steels and alloys in Russia, producing 39% of total Russian specialty steel output in 2006. We are also the third largest producer in Russia of long products.

Mechel OAO is an open joint stock company incorporated under the laws of the Russian Federation. We are a holding company and conduct our business through a number of subsidiaries. We are registered with the Ministry of Taxes and Duties of the Russian Federation under the main state registration number 103770301896. Our principal executive offices are located at Krasnoarmeyskaya Street, 1, Moscow 125993, Russian Federation. Our telephone number is +7 495 221 8888. Our Internet addresses are www.mechel.com and www.mechel.ru. Information posted on our website is not a part of this document. We have appointed CT Corporation Systems, 111 Eight Avenue, New York, New York 10011 as our authorized agent upon which process may be served for any suit or proceeding arising out of or relating to our shares, ADSs or deposit agreement.

Our History and Development

We trace our beginnings to a small coal trading operation in Mezhdurechensk in the southwestern part of Siberia in the early 1990s. See Item 5. Operating and Financial Review and Prospects The Reorganization. Since that time, through strategic acquisitions in Russia and abroad, Mechel has developed into a large, integrated mining and steel group, comprising coal, iron ore, nickel and limestone mining, coke production, and steel production, with operations in Russia, Romania and Lithuania. With each of our acquisitions, we implement improved operational and management practices, and we are generally able to realize significant increases in production efficiency and volume with only modest, targeted capital expenditures. We also devote the management, technological and logistical resources necessary to integrate new acquisitions into all aspects of our business, including the supply of raw materials and steel, production methodologies and sales and distribution.

By 2000, we had acquired many of our coal interests, consisting of seven mining operations and related processing plants, all located within close proximity to each other in Mezhdurechensk in the southwestern part of Siberia. These operations, now consolidated under Southern Kuzbass Coal Company and OAO Tomusinsky Pit, produced 17.0 million tonnes of coal in 2006.

Set forth below are our primary mining and steel acquisitions after 2000:

In 2001, we acquired:

- Chelyabinsk Metallurgical Plant, an integrated blast furnace and BOF/EAF steel mill which produced 4.9 million tonnes of raw steel, 4.0 million tonnes of rolled products and 2.3 million tonnes of coke in 2006 and which is located in Chelyabinsk, in the southern Urals near the border with Kazakhstan; and

- Southern Urals Nickel Plant, consisting of two open-pit nickel mines and a nickel processing facility which produced 14,436 tonnes of nickel products in 2006 and which is located in Orsk, in the southern Urals.

In 2002, we acquired:

- Vyartsilya Metal Products Plant, a hardware plant which produced 62,571 tonnes of hardware in 2006 and which is located in Sortavala, Karelia, in northwest Russia close to the border with Finland;

- Beloretsk Metallurgical Plant, a hardware plant which produced a total of 571,563 tonnes of rolled steel products in 2006, including 202,340 tonnes of wire rod and 363,223 tonnes of hardware and which is located in Beloretsk, in the southern Urals;

- Pugachev limestone quarry, consisting of a quarry and processing facility which produced 2.0 million tonnes of limestone in 2006 and which is located close to Beloretsk, in the southern Urals; and

- Mechel Targoviste, a steel mill which produced 465,825 tonnes of raw steel and 385,632 tonnes of rolled products in 2006 and which is located in Targoviste, Romania.

In 2003, we acquired:

- Mechel Zeljezara, a Croatian steel mill that produced pipes, which we subsequently shut down in August 2004 due to its high input costs and a persistent weakness in pipe prices;

- Urals Stampings Plant, a forging and stamping mill which produced 82,978 tonnes of specialty steel stampings in 2006 and which is located in Chebarkul, in the southern Urals;

- Mechel Campia Turzii, a steel mill which produced 17,940 tonnes of raw steel in 2006 prior to closing down its raw steel production in February 2006 for modernization. Mechel Campia Turzii produced 141,708 tonnes of rolled products and 86,016 tonnes of hardware in 2006 and is located in Campia Turzii, Romania;

- Korshunov Mining Plant, consisting of three iron ore mines and an iron ore concentrator plant which produced 4,975 million tonnes of iron ore concentrate in 2006 and which is based in Zheleznogorsk-Ilimskiy, in eastern Siberia;

- Mechel Nemunas, a hardware plant which produced 63,835 tonnes of products in 2006 and which is located in Kaunas, Lithuania; and

- Mechel Coal Resources, a coal washing plant in Kazakhstan, which we subsequently sold in August 2005 together with our Gorbachev Mine in Kazakhstan in accordance with our strategy to focus on our Russian operations. Final settlement of the sale transaction occurred in November 2006.

In 2004, we acquired:

- Port Posiet, a port located in Russia s Far East on the Sea of Japan and which has approximately two million tonnes of cargo and 140,000 tonnes of warehousing capacity and processed 1,427 tonnes of cargo, mostly coal, in 2006;

- Gorbachev Mine, an underground coal mine located in Kazakhstan, which we subsequently sold in August 2005 together with Mechel Coal Resources;

- Izhstal, a Russian specialty steel producer located in Izhevsk, Udmurtia, west of the Urals, which produced approximately 586,655 tonnes of raw steel, 366,235 tonnes of rolled products, 42,363 tonnes of hardware and 17,428 tonnes of stampings and forgings in 2006; and

- a subsoil license for the Sibirginsky mine area of the Sibirginsky and Tomsky coal deposits, near our Sibirginsk Open Pit Mine.

In 2005, we acquired:

- a blocking minority stake of 25% plus one share in Yakutugol, located in eastern Siberia, which produced 5.4 million tonnes of coking coal and 5.0 million tonnes of steam coal in 2006 from open and underground mines;

- Port Kambarka, a river port located in Kama in the Republic of Udmurtia, which processed 543 tonnes of cargo, mostly sand and crushed stone, in 2006;

- two subsoil licenses for the Raspadsky open-pit mine area of the Raspadsky coal deposit and Berezovsky-2 area of the Berezovsky and Olzherassky coal deposits;

- two subsoil licenses for the Erunakov-1 and Erunakov-3 coal mines near Kemerovo; and

- three subsoil licenses for the Sorokinsky, Razvedochny and Olzherassk coal fields in Kemerovo.

In 2006, we acquired:

- Mechel Recycling, a Chelyabinsk-based metal scrap processing company in line with our policy of enhancing the steel segment s self-sufficiency in raw materials.

- Moscow Coke Gas Plant, a coking coal producer based in the Moscow Region which produced 1.0 million tonnes of coke in 2006.

In 2007, we acquired:

- Southern Kuzbass Power Plant, a power plant located in Kemerovo Region that was separated from Kuzbassenergo in July 2006. As of January 1, 2007, its installed electric power capacity was 554 MWt, and the heat power capacity was 560 Gcal/h. On March 29, 2007, we acquired 93.4% of the voting stock of Southern Kuzbass Power Plant.

Business Strategy

Our goal is to expand our mining business, both through organic growth as well as acquisitions; to improve our steel segment margins through plant modernization, cost cutting and product portfolio optimization; to maintain our strong position as a producer of carbon and specialty long steel products in Russia; and to capitalize on the synergies deriving from our status as an integrated mining and steel group. We also intend to leverage our core businesses, where appropriate, with acquisitions of value-added downstream businesses.

The key elements of our strategy include the following:

Expand our Mining Business. We intend to build on our substantial mining experience by:

- Developing our existing coal and iron ore reserves, particularly in order to sell more high-quality coking coal and iron ore concentrate to third parties. We plan to increase our coal production from 17 million tonnes in 2006 to 25 million tonnes in 2010, and maintain our iron ore concentrate production at the level of 5.0 million tonnes during 2006-2011.

- Continuing to make selective acquisitions of coal and other mining enterprises, including new subsoil licenses, particularly in Russia, as strategic opportunities present themselves.

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

Improve our Steel Segment Margins through Plant Modernization, Cost Cutting and Product Portfolio Optimization and Further Enhance our Position as a Low-Cost Producer. We intend to further increase our efficiency and reduce our manufacturing costs by:

- Selectively investing in technology and capital improvements, including expanding use of continuous casters in our steel-making, optimizing our product portfolio and cuttings costs.

- Preserving cost advantages in our labor, raw materials and energy inputs.

- Achieving additional savings by fully integrating recent acquisitions into our operations.

Maintain our Position as a Leading Producer of Carbon Long Products in Russia. We have already built a solid presence in this sector, including the second largest market share for fittings. We are also a market leader in rod production and have a strong presence in the structural steel production market. We intend to maintain these positions, including through the addition of new production capacity achieved by targeted, cost-effective capital expenditures. We plan to increase our rolled products output from 4.3 million tonnes as of the end of 2006 to 4.5 million tonnes as of the end of 2009, primarily at our Chelyabinsk Metallurgical Plant. Additionally, we seek to benefit from the following factors in Russia:

- If the economy continues to expand, the demand for long products, particularly in the construction industry, should increase, providing us with additional sales opportunities.

- Substantial infrastructure repairs and industrial upgrade needs should also drive demand for our products.

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

- Our low-cost production provides us with a competitive base for expanding our market share in Europe, Asia and the CIS countries.

- The Russian market for specialty long products has considerable room for growth if demand from domestic engineering and manufacturing sectors recovers from historic post-Soviet lows in the past few years.

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

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

- Is a logical extension of our specialty and low-carbon long product lines, representing a higher margin, next value-added step for products that we already manufacture.

- Is in a market less cyclical than the upstream market, reducing our exposure to market downturns.

- Moves us closer to our final customers, enabling us to better understand customer needs, influence buyer behavior and respond quickly to change.

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

Maintain Strong Export Sales. We intend to maintain our strong relationships with our significant export customers. Although we are focused on maintaining our market position within Russia, export sales,

which constituted 38% of our total sales in 2006, allow us to diversify our sales and reduce our reliance on the Russian market in the event that it were to experience a downturn.

Implementation of these strategies is subject to a number of risks. See Item 3. Key Information Risk Factors for a description of these risks.

Competitive Strengths

Our main competitive strengths are the following:

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

- *Low-Cost Raw Materials.* We are capable of internally sourcing 80% of the coking coal, 40% of the iron ore and 67% of the nickel requirements of our steel segment. Our mines, processing facilities and steel production facilities have long and established operating histories, and we continue to find additional cost savings through internally sourcing these raw materials. Having the ability to internally source also gives us a better bargaining position with our outside suppliers and allows us to control our raw material costs.

- *Inexpensive Energy.* We internally satisfy about 31% of our electricity needs from our own co-generation facilities, and purchase most of the remainder at low, regulated prices. We also purchase natural gas from Gazprom at low, regulated prices for our electrical and other production needs. See Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry Increasing tariffs and restructuring in the energy sector could materially adversely affect our business.

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

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

Ability to Internally Source Significant Amounts of Raw Materials. We are capable of internally sourcing 80% of the coking coal, 40% of the iron ore and 67% of the nickel requirements of our steel segment. We are also currently expanding our iron ore processing capability so that we will be able to internally process more of our iron ore concentrate into sinter. While other steel producers have certain captive raw-materials suppliers, we are the only steel manufacturer in the world with its own nickel production facilities. We believe that our captive supply of coking coal, iron ore and nickel provides us significant advantages over other steel producers, such as higher stability of operations, better control of quality of end products, reduced production costs, improved flexibility and planning latitude in the production of our steel and value-added steel products and the ability to respond quickly to market demands and cycles. Moreover, in recent years, the supply of iron ore and coal, the two primary raw materials inputs into the steel-making process, has been increasingly concentrated among fewer companies, resulting in weaker bargaining positions for steel makers. Our integration strategy has allowed us to minimize the adverse effect of such concentration and maintain a consistent supply of raw materials. In addition, our ability to source raw materials internally and within Russia means that we are not exposed to any shortages in worldwide shipping capacity.

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

Ability to Increase Current Production Cost Effectively. We believe that we have a significant competitive advantage over our competitors in our ability to increase our production capacity relatively cost effectively because our substantial existing infrastructure can accommodate new facilities and production lines through brownfield development. Moreover, due to our integration, experience and location in Russia, which has some of the largest reserves of coal and iron in the world, we are better positioned than our European competitors to secure raw materials for any increases in steel production. For example, we plan to increase Chelyabinsk Metallurgical Plant s rolled steel production capacity from 4.1 million tonnes as of the end of 2006 to 4.3 million tonnes in 2009.

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

Established Export Market Presence. We export a substantial portion of our products through our sales and distribution network in seven countries and agents in 12 additional countries. These export sales, which constituted 38% and 45% of our total sales in 2006 and 2005, respectively, allow us to diversify our sales, provide us with additional growth opportunities and reduce our reliance on the Russian market in the event that it were to experience a downturn.

Well-Situated for Construction Market. The location of our primary steel manufacturing facility, Chelyabinsk Metallurgical Plant, in the southern Urals makes it better situated, compared to our primary competitor in this market, to serve the Russian construction market. Our share of the Russian reinforcing bars market in 2006 was approximately 20%.

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

Track Record of Successful Acquisitions. Building upon our success in turning around the coal operations of Southern Kuzbass Coal Company in the late 1990s and following our acquisition and revitalization of Chelyabinsk Metallurgical Plant, a steel manufacturer that was one of our primary customers of coking coal, in the last few years we have acquired other metal finishing and hardware manufacturing operations that we can supply with our steel. With each of our acquisitions, we implement improved operational and management practices, and we are generally able to realize significant increases in production efficiency and volume with only modest, targeted capital expenditures. We also devote the management, technological and logistical resources necessary to integrate new acquisitions into all aspects of our business, including the supply of raw materials and steel, production methodologies and sales and distribution. We have a good track record of using existing workforces and maintaining excellent relations with the local communities where we operate.

Increasing Control over Logistics. Our increasing internal logistics capabilities, currently centered on our railway freight and forwarding company, and enhanced by our acquisitions of Port Posiet, located on the Sea of Japan, and Port Kambarka, a river port, help us to optimize our transportation expenses.

Strong and Focused Management Team. Our current management team has significant experience in all aspects of our businesses and has successfully transformed us from a small coal trading operation to a large, integrated coal and steel producer. Mr. Zyuzin, our controlling shareholder, is our Chief Executive Officer. Our Chief Operating Officer, Alexey Ivanushkin, has significant experience from his previous

positions at Glencore International and as chief executive officer at Chelyabinsk Metallurgical Plant. Many of our directors and officers began their careers in floor jobs or in mines and moved up into management positions over the course of their careers.

Mining Business

Our main products comprise coking and steam coal concentrate, steam coal, iron ore concentrate and ferronickel. Among the key advantages of our mining business is the high quality of our coking coal, the low level of volatile matters in our steam coal and our modern coal washing facilities, primarily built during the 1970s and 1980s, including facilities built as recently as 2001-2002.

Sales of mining products

The following table sets forth third-party sales of our mining products (by volume) for the periods indicated.

Product	2006	2005	2004
	(in thousands of tonnes)		
Coking coal concentrate	6,603	5,013	5,247
Steam coal	6,728	5,876	5,539
Iron ore concentrate	2,885	2,876	2,438
Nickel	12	11	9

The following table sets forth revenues by product, as further divided between domestic sales and exports (including as a percentage of total mining segment revenues) for the periods indicated:

Revenues	2006 Amount	% of revenues	2005 Amount	% of revenues	2004 Amount	% of revenues
	(in millions of U.S. dollars, except for percentages)					
Coking coal concentrate	518.3	39 %	463.0	42 %	402.1	46 %
Domestic Sales (%)	74 %		64 %		40 %	
Export (%)	26 %		36 %		60 %	
Steam Coal	311.1	23 %	273.5	25 %	211.7	24 %
Domestic Sales (%)	21 %		12 %		13 %	
Export (%)	79 %		88 %		87 %	
Iron ore concentrate	168.2	13 %	167.1	15 %	113.8	13 %
Domestic Sales (%)	98 %		69 %		52 %	
Export (%)	2 %		31 %		48 %	
Nickel	258.7	19 %	150.5	14 %	108.0	12 %
Domestic Sales (%)	0 %					
Export (%)	100 %		100 %		100 %	
Other(1)	79.8	6 %	40.7	4 %	42.8	3 %
Total	1,336.1	100 %	1,094.8	100 %	878.4	100 %
Domestic Sales (%)	51 %		44 %		33 %	
Export (%)	49 %		56 %		67 %	

(1) Includes revenues from transportation, distribution, construction and other miscellaneous services provided to local customers.

Marketing and distribution

Our mining products are marketed domestically primarily through Mechel Trading House and internationally through Mechel Trading AG s branch in Liechtenstein. The following table sets forth by percentage of sales the regions in which our mining segment products were sold for the periods indicated:

Region(1)	2006	2005	2004
Russia	51.4 %	44.3 %	32.0 %
Other CIS	10.1 %	13.0 %	16.4 %
Europe	31.6 %	31.5 %	31.3 %
Asia	4.3 %	9.3 %	14.3 %
Middle East	2.6 %	1.9 %	6.0 %
Other			
	100.0 %	100.0 %	100.0 %

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

In 2006, the five largest customers of our mining products were Glencore International (nickel, steam coal), MMK (coking coal), ZapSib (iron ore), Evrazresurs (coking coal) and NLMK (coking coal), which together accounted for 59% of our mining segment sales.

Domestic sales

We generally do not involve intermediaries in the domestic distribution of our mining products. Our domestic coking and steam coal and iron ore customers are generally located in large industrial areas and have had long-standing relationships with us. We do not sell our nickel products within Russia.

We ship our coking coal concentrate from our coal washing facilities, located near our coal mines and pits, by railway directly to key customers, including steel producers. Our largest domestic customer for our coking coal concentrate is MMK, accounting for 30% of our total coking coal concentrate sales and 12% of our total mining segment sales in 2006. We generally conclude sales contracts with domestic customers on an annual basis, and set our prices and volumes on a monthly basis by open tender.

Our internal consumption of steam coal is negligible, and we sell substantially all of our steam coal to third parties. Kashirskaya GRES 4, an electric utility, is our largest domestic customer of steam coal, accounting for 6% of our total steam coal sales and 1% of our total mining segment sales in 2006. We ship our steam coal from our warehouses by railway directly to key customers, which are predominantly electric power stations. Sales contracts for steam coal are generally concluded with customers on an annual basis.

Iron ore concentrate is shipped via railway directly from Korshunov Mining Plant to customers. Our largest domestic customer, ZapSib, accounted for 96% of our total iron ore concentrate sales and 12% of our total mining segment sales in 2006. Prices are set monthly.

Since 2002, Mechel Trading House has operated its wholly-owned subsidiary, Mecheltrans, a railway freight and forwarding company. Mecheltrans owns its own rolling stock, consisting of 293 open cars, 259 pellet cars, rents 1,210 open cars and 20 pellet cars, and leases 1,600 open cars. The company transported domestically approximately 36 million tonnes of our cargo in 2006, approximately 80% of which was comprised of coal and iron ore.

Export sales

We export coking coal, steam coal concentrate, low bituminous and anthracite steam coal, iron ore concentrate and ferronickel.

In the year ended December 31, 2006, our largest mining segment customer was Glencore International, accounting for 22% of our total mining segment sales. Glencore International s purchases consisted of nickel (88%) and steam coal (12%). It was also our largest customer in the years ended December 31, 2005 and 2004, accounting for 13.9% and 5.0%, respectively, of the total mining segment sales in those periods.

We are Russia s second largest exporter of coking coal concentrate after Yakutugol. We export our coking coal concentrate primarily to Ukraine, Slovakia and Bulgaria. In 2006, Greenway Trading was our largest foreign customer of coking coal concentrate, accounting for 9% of our total coking coal concentrate sales and 4% of our total mining segment sales. Shipments are made by railway and by ship.

Our exports of steam coal are primarily to Switzerland, Japan, Turkey and Spain, which together accounted for 52% of our total steam coal sales and 12% of our total mining segment sales in 2006. There were two international trading companies among our largest customers, both registered in Switzerland: Mechel Energy, in which we have a 50% stake, and Glencore International. Steam coal is shipped to customers from our warehouses by railway and, in some cases, by ship from Russian and Ukrainian ports.

In February 2004, we acquired Port Posiet, located in Russia s Far East on the Sea of Japan. The port has approximately two million tonnes of cargo handling capacity and 140,000 tonnes of warehousing capacity and processed 1.4 million tonnes of cargo, mostly coal in 2006. We ship primarily our steam coal and coking coal concentrate to Japan from this port.

We also exported iron ore concentrate to China during 2006, accounting for 2% of our total iron ore concentrate sales and 0.3% of our total mining segment sales in 2006. We ship iron ore concentrate to China by rail and by sea.

In 2006, we sold all of our ferronickel that we did not use internally to Glencore International based on the London Metal Exchange, or LME, nickel prices. In 2007, we began selling our ferronickel that we do not use internally to Stratton Metals in addition to Glencore International. The proportion of our sales to Stratton Metals compared to Glencore International is 10:4. In each case, the ferronickel is delivered by railway to the port of St. Petersburg and it is then forwarded by the purchasers to their end users.

Market share and competition

Coal

As a result of mergers and acquisitions undertaken primarily by steel producers, the number of domestic coal producers has decreased from 250 in the mid-1990s to less than 60 in 2006. Over the last few years, domestic coal mining companies have generally enjoyed a relatively stable customer base.

We are the third largest coking coal producer in Russia, with a 13.8% market share, and we have a 5.5% market share with respect to overall Russian coal production. We also control 20.0% of the coking coal washing capacity in Russia. The following table lists the principal Russian coking coal producers in 2006 and their respective shares of total coking coal production, total coal production, location and controlling shareholders.

	Coking coal production (in thousands of tonnes)	Share of total coking coal production	Total coal production (in thousands of tonnes)	Share of total coal production	Location	Controlling shareholder
Yuzhkuzbassugol	10,735.1	15.3 %	16,137.4	5.2 %	Kuzbass	EvrazGroup(1)
Southern Kuzbass Coal Company	9,697.0	13.8 %	17,013.1	5.5 %	Kuzbass	Mechel
Raspadskaya Mine	9,471.7	13.5 %	9,471.7	3.1 %	Kuzbass	EvrazGroup(1)
Kuzbassrazrezugol	4,112.0	5.9 %	41,359.5	13.4 %	Kuzbass	Ural Mining-Metallurgical Company
Prokopievskugol	3,437.8	4.9 %	4,721.3	1.5 %	Kuzbass	NLMK
Kuzbassugol	2,099.4	3.0 %	2,534.8	0.8 %	Kuzbass	Severstal
Mezhdurechye(2)	2,665.8	3.8 %	6,016.6	1.9 %	Kuzbass	Sibuglemet, Bagomes
Yakutugol(3)	5,364.1	7.6 %	9,542.3	3.0 %	Yakutiya	Yakut Government
Other	22,683.0	32.3 %	201,991.2	65.5 %		
Total	70,265.9	100.0 %	308,787.9	100.0 %		

Source: CDU TEK

(1) Accounted for by EvrazGroup on an equity basis.

(2) We own 16.1% of Mezhdurechye.

(3) We own 25% + 1 share in Yakutugol.

In the domestic coal market, we compete primarily on the basis of price, as well as on the basis of the quality of coal, which depends upon the quality of our production assets and the quality of our mineral reserves. Competition in the steam coal market is also affected by the fact that most steam power stations were built near specific steam coal sources and had their equipment customized to utilize the particular type of coal produced at the relevant local source. Outside of Russia, competition in the steam coal market is largely driven by coal quality, including volatile matters and calorie content.

Iron ore

The Russian iron ore market is generally characterized by high demand and limited sources of supply, with product quality as the main factor driving prices. The market is dominated by relatively few producers, with the top three producers representing 49.7% of total production of iron ore concentrate.

The following table lists the main Russian iron ore concentrate producers in 2006 and their respective shares of total production, location and controlling shareholders.

	Iron ore concentrate production (in thousands of tonnes)	Share of total production	Location	Controlling shareholder
Lebedinsky GOK	21,012.4	21.1 %	Belgorod Region	Metalloinvest
Mikhailovsky GOK	17,106.1	17.2 %	Kursk Region	Metalloinvest
Stoylensky GOK	11,305.0	11.4 %	Belgorod Region	NLMK
Karelsky Okatysh	9,964.2	10.0 %	North-West Region	Severstal-Resurs
Kachkanarsky GOK	9,430.7	9.5 %	Urals Region	EvrazGroup
Kovdorsky GOK	5,613.2	5.6 %	North-West Region	EvroChim
Korshunov Mining Plant	4,975.8	5.0 %	Siberia	Mechel
Olenegorsky GOK	4,471.8	4.5 %	North-West Region	Severstal-Resurs
KMAruda	1,850.9	1.9 %	Belgorod Region	Industrial Metallurgical Holding
Sheregeshkoe RU	1,797.2	1.8 %	Siberia	EvrazGroup
Vysokogorsky GOK	1,666.3	1.7 %	Urals Region	EvrazGroup
Irbinskoe RU	1,350.4	1.4 %	Siberia	EvrazGroup
Bogoslovskoe RU	1,331.3	1.3 %	Urals Region	Ural Mining-Metallurgical Company
Other	7,633.6	7.7 %		
Total	99,508.9	100.0 %		

Source: Rudprom

In addition, Sokolovsko-Sarbayskoye Mining Amalgamation, which is located in Kazakhstan with a capacity of 16.7 million tonnes of iron ore concentrate and 8.7 million tonnes of pellets per annum, has been a major supplier to MMK since April 2006.

Nickel prices and demands are driven by international markets.

Coal production

Southern Kuzbass Coal Company, through its branches and one subsidiary (Tomusinsk Pit), operate five active coal mines centered around the city of Mezhdurechensk in the southwestern part of Siberia. The mines are located in the Kuznetsky Basin, Russia s largest coal producing region. This basin trends for approximately 300 kilometers in a northwest-southeast direction and averages about 120 kilometers in width. There are four surface mines, Krasnogorsk, Tomusinsk, Olzherassk and Sibirginsk, as well as three underground mines, Lenin, Sibirginsk and New-Olzherassk. Production started at Lenin in 1953, at Krasnogorsk in 1954, at Tomusinsk in 1959, at Sibirginsk in 1973 (open-pit) and 2002 (underground) and at Olzherassk in 1980. We primarily lease or have a right of perpetual use of the land on which our coal mines and processing facilities are located.

The table below sets forth the subsoil licenses used by our coal mines and the expiration dates thereof.

No	Mine / Pit	License Area	License Holder	Expiry Date	Status	Area (sq. km)
1	Krasnogorsk Pit	Tomsk, Sibirginsk	Krasnogorsk Pit(1)	December 2013	In production	22.4
2	Krasnogorsk Pit	Sorokinsky, Tomsk, Sibirginsk	Southern Kuzbass Coal Company	November 2025	In production	2.8
3	Lenin Mine	Olzherassk	Lenin Mine(1)	November 2013	In production	10.0
4	Lenin Mine	Olzherassk	Lenin Mine(1)	December 2014	In production	2.9
5	Olzherassk Pit	Raspadsk, Berezovsk, Olzherassk	Olzherassk Pit(1)	January 2014	In production	10.1
6	Olzherassk Pit	Raspadsk	Southern Kuzbass Coal Company	December 2024	In production	3.5
7	Olzherassk Pit	Berezovsk-2, Berezovsk, Olzherassk	Southern Kuzbass Coal Company	December 2024	In production	8.6
8	Olzherassk Pit	Raspadsk	Olzherassk Pit(1)	December 2021	In production	10.1
9	Olzherassk Pit	Razvedochny, Raspadsk	Southern Kuzbass Coal Company(3)	November 2025	Feasibility study(3)	14.6
10	Sibirginsk Mine	Sibirginsk, Tomsk	Southern Kuzbass Coal Company	December 2024	In production	5.9
11	Sibirginsk Pit	Sibirginsk, Kureinsk, Uregoisk	Southern Kuzbass Coal Company(1)	January 2014	In production	17.7
12	Tomusinsk Pit	Tomsk	Tomusinsk Pit	December 2013	In production	6.7
13	Erunakovsk-1	Erunakovsk-1, Erunakovsk	Southern Kuzbass Coal Company(2)	July 2025	Feasibility study(2)	8.4
14	Erunakovsk-3	Erunakovsk-3, Erunakovsk	Southern Kuzbass Coal Company(2)	July 2025	Feasibility study(2)	7.1
15	Lenin Mine	Olzherassk	Southern Kuzbass Coal Company(2)	November 2025	Feasibility study(2)	19.2

(1) In process of re-registration due to merger of previous license holder into this company.

(2) Not included in our mineral reserves.

(3) Deposits of Olzherassk Pit are partially included in our reserves, as international standards for reserves appraisal only include reserves that can be extracted with economic benefits during the license period. Thus, under the Russian standard, these deposits amounted to 159.9 million tonnes, and under the international standard (which we use), these deposits amounted to 25.5 million tonnes.

Coal is mined using open-pit or underground mining methods. Following a drilling and blasting stage, a combination of shovels and draglines is used for moving coal and waste at our surface mines. Production at the underground mines is predominantly from longwall mining. After mining, depending upon the amount of impurities in the coal, the coal is processed in a wash plant, where it is crushed and impurities are removed. Coking coal concentrate is then transported to steel plants for conversion to coke for use in steel-making. Steam coal is shipped to utilities which use it in furnaces for steam generation to produce electricity.

The coal produced by our mines is predominately low-sulfur (0.3%) bituminous. Heating values for the coking coal range from 6,861 to 8,488 kcal/kg on a moisture- and ash-free basis. Heating values for the steam coal range from 6,627 to 8,286 kcal/kilogram on a moisture- and ash-free basis.

The table below summarizes our coal production by mine and type of coal for the periods indicated.

	2006		2005		2004	
	Tonnes (tonnes in thousands)(1)	% of production	Tonnes	% of production	Tonnes	% of production
Coking Coal						
Sibirginsk (Pit & Mine)	1,759	18.1 %	2,822	32.9 %	3,000	32.2 %
Tomusinsk Pit	2,477	25.6 %	2,607	30.4 %	2,660	28.6 %
Olzherassk Pit	1,613	16.6 %	1,581	18.4 %	1,413	15.2 %
Lenin Mine	1,880	19.4 %	1,573	18.3 %	2,236	24.0 %
Sibirginsk Mine	1,386	14.3 %				
Olzherassk Mine	582	6.0 %				
Total Coking Coal	9,697	100.0 %	8,583	100.0 %	9,309	100.0 %
Steam Coal						
Krasnogorsk Pit	5,587	76.4 %	5,278	74.7 %	4,726	74.6 %
Sibirginsk (Pit & Mine)	1,703	23.3 %	1,649	23.3 %	1,473	23.3 %
Olzherassk Pit	26	0.3 %	135	1.9 %	136	2.1 %
Total Steam Coal	7,316	100.0 %	7,063	100.0 %	6,335	100.0 %
Total Coal	17,013		15,646		15,644	
% Coking Coal		57.0 %		54.9 %		59.5 %
% Steam Coal		43.0 %		45.1 %		40.5 %

(1) Tonnages are reported on a wet basis.

Coal washing plants

We operate four coal washing plants located near our coal mines in Southern Kuzbass. Of the total coal feed enriched by our washing plants in 2006, about 86.6% (14.9 million tonnes) was supplied by our own mining operations, and 13.3% (2.3 million tonnes) from the nearby Raspadsk and Prokopyevsk mines on a tolling basis. In 2006, the capacity of our washing plants in Russia accounted for approximately 15.5% of the total domestic coking coal washing capacity in Russia.

Investments in coal companies

We own 25.0% plus one share of Yakutugol, a coal producer located in eastern Siberia. Yakutugol extracts predominantly coking coal, as well as steam coal, in open and underground mines. Yakutugol s annual output in 2006 was 9.5 million tonnes of coal consisting of 5.4 million tonnes of coking coal and 4.2 million tonnes of steam coal, and it sells most of its output to the Asian Pacific region, primarily Japan, South Korea and Taiwan, mostly under long-term contracts.

Current subsoil licenses of Yakutugol expire in 2013, but based on the provisions of Russian legislation we believe that their extension through the end of the estimated proven and probable reserve depletion period is reasonably assured. We also believe that since the Government of Republic Sakha (Yakutia) owns a majority stake in Yakutugol, the renewal of its subsoil licenses upon their expiration in 2013 is virtually automatic. Consequently, in our consolidated financial statements, we amortize Yakutugol s subsoil licenses using the units-of-production method through the end of the estimated proven and probable reserve depletion period (2031).

We also own 16.1% of Mezhdurechye, a Russian coal producer which accounted for 3.8% of Russian coking coal and 1.9% of Russian total coal output in 2006.

Iron ore and concentrate production

Korshunov Mining Plant operates three iron ore mines, Korshunovsk, Rudnogorsk and Tatianinsk, as well as a concentrating plant located outside of the town of Zheleznogorsk-Ilimsky, 120 kilometers east of the city of Bratsk in eastern Siberia.

The Korshunovsk mine is located near the concentrating plant, and started production in 1965. The Rudnogorsk mine is located about 85 kilometers to the northwest of the concentrating plant, and started production in 1982. The Tatianinsk mine is located about 10 kilometers to the north of the concentrating plant, and started production in 1986. All three mines produce a magnetite ore (Fe_3O_4). We have a right of perpetual use of the land on which Korshunov Mining Plant s facilities and mines are located.

The table below sets forth the subsoil licenses used by our iron ore mines and the expiration dates thereof.

License area	License Holder	Expiry Date	Status	Area (sq. km)
Korshunovsk	Korshunov Mining Plan	June 2009	In production	4.3
Tatyaninsk	Korshunov Mining Plan	June 2012	In production	1.3
Rudnogorsk	Korshunov Mining Plan	June 2014	In production	5.1
Krasnoyarsk	Korshunov Mining Plan	July 2015	Feasibility study(1)	3.0

(1) Not included in our mineral reserves and deposits.

All three mines are conventional open-pit operations. Following a drilling and blasting stage, ore is hauled via a combination of truck and/or rail to the concentrator plant. At the concentrator, the ore is crushed and ground to a fine particle size, then separated into an iron concentrate slurry and a waste stream using wet magnetic separators. The iron ore is upgraded from approximately 29.8% Fe to a concentrate that contains about 62.9% Fe. Tailings are pumped to a tailings dam facility located adjacent to the concentrating plant. The concentrate is sent to disk filters which remove the water to a moist filter cake, and then to a concentrate storage facility. The filter cake is then shipped to customers via rail during warmer months, but in colder periods the filter must be dried further to prevent freezing in the rail cars. Korshunov Mining Plant has its own drying facility.

The table below summarizes our iron ore and iron ore concentrate production for the periods indicated.

	2006		2005		2004	
	Tonnes	Grade (% Fe)	Tonnes	Grade (% Fe)	Tonnes	Grade (% Fe)
	(tonnes in thousands)(1)					
Korshunovsk ore production	6,193	27.6 %	6,522	26.7 %	6,263	26.4 %
Rudnogorsk ore production	5,224	37.1 %	4,104	35.3 %	3,576	35.5 %
Tatianinsk ore production	222	32.2 %	707	30.2 %	364	32.5 %
Total ore production	11,639	32.0 %	11,333	30.0 %	10,203	29.8 %
Iron ore concentrate production	4,976	62.6 %	4,522	62.6 %	3,876	n/a

(1) Tonnages are reported on a wet basis.

Nickel ore and nickel production

Southern Urals Nickel Plant operates two open-pit nickel ore mines, Sakhara and Buruktal, and a nickel production plant in Orsk. The Sakhara mine is located east of the Ural Mountains in the Chelyabinsk Region. It lies 10 to 15 kilometers south of the town of Subutak, which is located on a main-line railroad 20 kilometers east of the city of Magnitogorsk, an industrial center in the Chelyabinsk Region. Stripping of overburden at Sakhara started in 1983, and stripping of the main pit started in 1986. Shipments to Southern Urals Nickel Plant in Orsk (about 375 kilometers south of Sakhara) started in 1994 when Southern Urals Nickel Plant stopped receiving ore from the Kempirsay deposit in Kazakhstan. Production at Sakhara has been continuous since 1994. The Buruktal mine is located east of the south tip of the Ural Mountains, in the Orenburg Region, close to the border with Kazakhstan. It lies near the town of Svetly, which is located 230 kilometers east of Orsk, at the end of a rail line. Mining at Buruktal began in 1968, and has been continuous since then. We generally have a right of perpetual use of the land on which Southern Urals Nickel Plant s facilities and mines are located, although we lease some of the area on which the Buruktal mine is located.

The table below sets forth the subsoil licenses used by our nickel mines and the expiration dates thereof.

License area	License Holder	Expiry Date	Status	Area (sq. km)
Buruktalsk	Southern Urals Nickel Plant	December 2012	In production	5.2
Sakharinsk	Southern Urals Nickel Plant	April 2013	In production	2.2

Both the Sakhara and Buruktal mining operations are typical of Russian open-pit mines of their size. The weathered lateritic ores and overburden can be directly loaded by electric shovel and dragline into haul trucks, without any drilling or blasting. The ore is stockpiled and then loaded into railcars for shipment to Southern Urals Nickel Plant. Overburden waste is hauled to dumping locations inside the mined-out pits whenever possible or placed in dumps adjacent to the pit.

Nickel ore from both mines is transported by rail to our nickel production plant in the city of Orsk, which also lies east of the south tip of the Ural Mountains, close to the border with Kazakhstan. At this plant, nickel ore is processed into sinter, which is smelted (with the addition of coke and limestone) in shaft furnaces and then put through oxygen converters to produce converter matte and tailings. Converter matte is then processed into ferronickel. Ferronickel is shipped via rail from Orsk to our Chelyabinsk Metallurgical Plant and to St. Petersburg or Kaliningrad for export.

The following table summarizes our nickel ore and nickel products production for the periods indicated:

	2006		2005		2004	
	Tonnes	Grade (% Ni)	Tonnes	Grade (% Ni)	Tonnes	Grade (% Ni)
	(tonnes in thousands)(1)					
Sakhara ore production	1,118.3	1.10 %	1,113.7	1.14 %	1,358.4	1.08 %
Buruktal ore production	1,240.3	1.05 %	901.6	1.06 %	1,243.6	1.02 %
Total ore production	2,358.6	1.07 %	2,015.3	1.1 %	2,602.0	1.05 %
Nickel production	14.4	89.75 %	12.6	n/a	12.7	n/a

(1) Tonnages are reported on a wet basis.

Limestone production

The Pugachev limestone quarry is an open-pit mine located approximately 12 kilometers southeast of the city of Beloretsk in the Ural Mountains. The mine is connected to the Beloretsk railway system via a 3-kilometer rail spur. A road system also connects the mine to regional customers of aggregate limestone produced by the mine. The quarry was developed in 1952 to support Beloretsk Metallurgical Plant s steel-making facilities, which are currently closed. The Pugachev limestone quarry is owned by our Beloretsk Metallurgical Plant. The current subsoil license is valid until January 2014.

Pugachev uses conventional mining technology. Ore is drilled and blasted, then loaded with electric shovels into haultrucks. Relatively minor amounts of waste are hauled to external dumps. The ore is hauled to stockpiles located adjacent to the crushing and screening plant. Ore is crushed, screened and segregated by size fraction. Product is separated into three categories for sale: 0-20 millimeters product, 20-40 millimeters product and 40-80 millimeters product.

The quarry produces both high-grade flux limestone for use in steel making and nickel smelting and aggregate limestone for use in road construction. The flux limestone and aggregate limestone are the same grade of limestone, but they are produced in different fraction sizes, which determines their suitability for particular use. In 2006, approximately 71.6% of the limestone produced at Pugachev was used internally, with 51.3% shipped to Chelyabinsk Metallurgical Plant, 16.2% shipped to Southern Urals Nickel Plant, and 2.8% to Izhstal, 1.4% used auxiliary and the remaining 8.0% was sold to third parties. This breakdown does not include normal losses of 2.6% of the total limestone production, which are losses ordinarily sustained during the production process, as well as our stock of 20.4% of the total limestone production, which is limestone produced but neither sold nor consumed. We are capable of internally sourcing 100% of the limestone requirements of our steel operations.

The table below summarizes our limestone production for the periods indicated.

	2006	2005	2004
	(in thousands of tonnes)		
Limestone production	2,013.7	2,054.0	509.0

Following the recent commissioning of our new crushing and screening plant in December 2004, our total production capacity has increased to 2.0 million tonnes of crushed limestone per year.

Mineral reserves

Our mineral reserves are based on exploration drilling and geological data, and are that part of a mineral deposit which could be economically and legally extracted or produced at the time of the reserve determination. Each year we update our reserve calculations based on actual production and other factors, including economic viability and any new exploration data. Our reserves, consisting of proven and probable reserves, meet the standards set by the SEC in its Industry Guide 7 and have been appraised by Marston & Marston, independent mining engineers, as of January 1, 2007.

Russian subsoil licenses are issued for defined boundaries and specific periods, generally about 20 years. Our declared reserves are contained within the current license boundary. Additionally, to meet the legally viable requirement of the SEC, only material that is scheduled to be mined during the license period of existing subsoil licenses based on planned production was included in reserves.

Our subsoil licenses expire on dates falling in 2009 through 2025. These subsoil licenses, however, may be terminated prior to, or not be extended at, the time of their expiration. See Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry Our business could be adversely affected if we fail to obtain or renew necessary licenses and permits or fail to comply with the terms of our licenses and permits; Item 3. Key Information Risk Factors Risks Relating to Our Business and

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

In addition to our mineral reserves, we have mineral deposits. Our mineral deposits are similar to our mineral reserves in all respects, except that the deposit is either (1) contained within the license boundary but is scheduled to be extracted beyond the license period or (2) is adjacent but not contained within the license boundary. In both such cases, we expect to be able to obtain the legal right to extract such deposit in the future, but we have a limited history of license renewals and the Russian legal system provides regulatory authorities with discretion in matters of license renewal. See Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry Our business could be adversely affected if we fail to obtain or renew necessary licenses and permits or fail to comply with the terms of our licenses and permits and Item 3. Key Information Risk Factors Risks Relating to the Russian Federation Legal Risks and Uncertainties Weaknesses relating to the legal system and legislation create an uncertain environment for investment and business activity.

The table below summarizes our reserves as of January 1, 2007.

Summary	Coal Coking	Steam	Iron Ore	Nickel Ore	Limestone
	(quantities in millions of tonnes)				
Reserves	126.3	155.5	61.4	12.9	23.9
Grade(%)	44.8 %(1)	55.2 %(1)	27.4 %	1.0 %	55.2 %
Deposits	56.2	135.4	111.8	63.4	40.5
Grade(%)	29.3 %(1)	70.7 %(1)	27.9 %	1.0 %	55.2 %

(1) Shows percent of the type of coal.

Coal

As of January 1, 2007, we had coal reserves (proven and probable) totaling 281.8 million tonnes, of which approximately 44.8% was coking coal. The table below summarizes coal reserves by mine.

Coal Reserves	Coking Coal	Steam Coal	Heating Value(1)	% Sulfur
	(quantities in millions of tonnes)(2)			
Krasnogorsk		117.5	5,700	0.35 %
Tomusinsk	12.6		8,355	0.22 %
Olzherassk Pit	37.8		8,250	0.30 %
Olzherassk Mine		25.5	7,900	0.30 %
Sibirginsk Pit	19.6	12.6	8,446	0.30 %
Sibirginsk Mine	41.1		8,510	0.30 %
Lenin	15.3		8,451	0.30 %
Total	126.4	155.6		
% of Total	44.8 %	55.2 %		

(1) Heating values (in kcal/kg) are reported on a moisture- and ash-free basis.

(2) Tonnages are reported on a wet in-place basis.

As of January 1, 2007, we had coal deposits totaling 191.6 million tonnes, of which approximately 29.3% was coking coal. The table below summarizes coal deposits by mine.

Coal Deposits	Coking Coal	Steam Coal	Heating Value(1)	% Sulfur
	(quantities in millions of tonnes)(2)			
Krasnogorsk		110.5	5,783	0.35 %
Tomusinsk	8.9		8,355	0.22 %
Olzherask	14.4		8,250	0.30 %
Sibirginsk Pit	12.1	24.9	8,466	0.30 %
Sibirginsk Mine	6.0		8,533	0.30 %
Lenin	14.7		8,450	0.30 %
Total	56.1	135.4		
% of Total	29.3 %	70.7 %		

(1) Heating values (in kcal/kg) are reported on a moisture- and ash-free basis.

(2) Tonnages are reported on a wet in-place basis.

Coal reserves and deposits were estimated using assumed base prices of $30.84 per tonne for coking coal and $22.28 per tonne for steam coal. These prices were for the saleable product so the actual prices in the cash flow were reduced to account for process recoveries, which varied by mine. All present and future operating and capital costs were converted into U.S. dollars using an exchange rate of 26.50 rubles per U.S. dollar.

Iron ore

As of January 1, 2007, we had iron ore reserves (proven and probable) totaling 61.4 million tonnes at an average iron grade of 27.4%. The table below summarizes iron ore reserves by mine.

Iron Ore Reserves(1)	Tonnes(2)	Grade (% Fe)(3)
	(tonnes in millions)	
Korshunovsk	15.0	25.0 %
Rudnogorsk	42.2	30.5 %
Tatianinsk	4.2	26.6 %
Total	61.4	27.4 %

(1) Includes adjustments for dilution and mine recovery, based on historical records.

(2) Tonnages are reported on a wet basis.

(3) Metallurgical recovery is projected to be 70.2%.

As of January 1, 2007, we had iron ore deposits totaling 111.8 million tonnes at an average iron grade of 27.8%. The table below summarizes iron ore deposits by mine.

Iron Ore Deposits(1)	Tonnes(2)	Grade (% Fe)(3)
	(tonnes in millions)	
Korshunovsk	48.2	25.0 %
Rudnogorsk	63.6	30.5 %
Tatianinsk	0.0	0.0 %
Total	111.8	27.8 %

(1) Includes adjustments for dilution and mine recovery, based on historical records.

(2) Tonnages are reported on a wet basis.

(3) Metallurgical recovery is projected to be 70.2%.

Iron ore reserves and deposits were estimated using an assumed iron ore concentrate price of $37.47 per tonne for 2007-2014. All present and future operating and capital costs were converted into U.S. dollars using an exchange rate of 26.50 rubles per U.S. dollar.

Nickel ore

As of January 1, 2007, we had nickel ore reserves (proven and probable) totaling 13.0 million tonnes at an average nickel grade of 1.0%. The table below summarizes nickel ore reserves by mine.

Nickel Ore Reserves(1)	Tonnes(2) (tonnes in millions)	Grade (% Ni)(3)
Sakhara	5.8	1.1 %
Buruktal	7.2	1.0 %
Total	13.0	1.0 %

(1) Includes adjustments for dilution and mine recovery, based on historical records.

(2) Tonnages are reported on a dry basis.

(3) Metallurgical recovery is projected to be 73.8%.

As of January 1, 2007, we had nickel ore deposits totaling 63.4 million tonnes at an average nickel grade of 1.0%. The table below summarizes nickel ore deposits.

Nickel Ore Deposits(1)	Tonnes(2) (tonnes in millions)	Grade (% Ni)(3)
Sakhara	0.0	0.0 %
Buruktal	63.4	1.0 %
Total	63.4	1.0 %

(1) Includes adjustments for dilution and mine recovery, based on historical records.

(2) Tonnages are reported on a dry basis.

(3) Metallurgical recovery is projected to be 73.8%.

Nickel ore reserves and deposits were estimated using an assumed nickel price of $8.05 per pound for the period 2007-2042. All present and future operating and capital costs were converted into U.S. dollars using an exchange rate of 26.50 rubles per U.S. dollar.

Limestone

As of January 1, 2007, we had limestone reserves (proven and probable) totaling 23.9 million tonnes at 55.2% CaO.

Limestone Reserves(1)	Tonnes (tonnes in millions)	Grade (% CaO)
Pugachev	23.9	55.2 %

(1) Includes adjustments for dilution and mine recovery, based on historical records.

As of January 1, 2007, we had limestone deposits totaling 40.5 million tonnes at 55.2% CaO.

Limestone Deposits(1)	Tonnes (tonnes in millions)	Grade (% CaO)
Pugachev	40.5	55.2 %

(1) Includes adjustments for dilution and mine recovery, based on historical records.

Limestone reserves and deposits were estimated using an assumed aggregate limestone price of $5.03 per tonne. All present and future operating and capital costs were converted into U.S. dollars using an exchange rate of 26.50 rubles per U.S. dollar.

Steel Business

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

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

	2006	2005	2004
	(in thousands of tonnes)		
Coke	2,570	2,589	2,942
Coking Products	49	85	120
Pig Iron	3,631	3,349	3,880
Semi-Finished Steel Products, including:	1,785	1,777	1,623
Carbon and Low-Alloyed Semi-Finished Products	1,716	1,755	1,601
Long Steel Products,(1) including:	2,529	2,510	2,902
Stainless Long Products	15	12	18
Alloyed Long Products	79	123	139
Rebar	1,358	1,349	1,229
Wire-Rod	367	349	640
Low-Alloyed Engineering Steel	712	676	877
Flat Steel Products, including:	400	313	331
Stainless Flat Products	39	14	40
Carbon and Low-Alloyed Flat Products	361	299	291
Forgings, including:	75	79	99
Stainless Forgings	3	3	4
Alloyed Forgings	24	14	18
Carbon and Low-Alloyed Forgings	48	62	76
Forged Alloys	1	1	1
Stampings	101	104	78
Hardware,(2) including:	611	558	560
Wire	466	394	395
Ropes	55	55	53

(1) Includes calibrated rolled products of Mechel Targoviste.

(2) Excludes calibrated rolled products of Mechel Targoviste.

With the exception of our foreign subsidiaries, we manufacture almost all of our steel products using internally sourced coke, pig iron, raw steel and semi-finished steel products. When economically justified, we sometimes purchase small quantities of semi-finished steel products from local steel producers. In 2006, we did not purchase any semi-finished steel products from third parties.

Sales of steel products

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

	2006		2005		2004	
Revenues	**Amount**	**% of revenues**	**Amount**	**% of revenues**	**Amount**	**% of revenues**
	(in millions of U.S. dollars, except for percentages)					
Coke	38.7	1 %	49.2	2 %	39.0	1 %
Coking Products	10.3	0 %	17.6	1 %	18.3	1 %
Pig Iron	14.1	0 %	16.7	1 %	37.3	1 %
Semi-Finished Products, including:	397.5	13 %	465.0	17 %	452.9	16 %
Carbon and Low-Alloyed Semi-Finished Products(1)	299.3	10 %	282.1	10 %	306.6	11 %
Long Steel Products, including:	1,436.3	47 %	1,311.1	48 %	1,302.7	47 %
Stainless Long Products	35.2	1 %	44.4	2 %	26.3	1 %
Alloyed Long Products	131.1	4 %	118.3	4 %	89.1	3 %
Rebar	753.0	25 %	616.8	23 %	605.5	22 %
Wire-Rod	202.3	7 %	184.6	7 %	304.9	11 %
Carbon and Low-Alloyed Engineering Steel	314.7	10 %	347.0	13 %	177.0	6 %
Flat Steel Products, including:	304.2	10 %	219.5	8 %	233.3	8 %
Stainless Flat Products	125.2	4 %	45.9	2 %	94.3	3 %
Carbon and Low-Alloyed Flat Products	178.9	6 %	173.6	6 %	139.1	5 %
Forgings, including:	81.2	3 %	93.5	3 %	71.6	3 %
Stainless Forgings	9.8	0 %	11.0	0 %	11.2	0 %
Alloyed Forgings	11.9	0 %	29.8	1 %	19.5	1 %
Carbon and Low-Alloyed Forgings	49.1	2 %	45.8	2 %	28.9	1 %
Forged Alloys	10.3	0 %	6.9	0 %	12.0	0 %
Stampings	151.7	5 %	121.8	4 %	83.1	3 %
Hardware, including:	458.0	15 %	373.8	14 %	326.2	12 %
Wire	303.3	10 %	253.9	9 %	213.0	8 %
Ropes	60.6	2 %	55.7	2 %	52.4	2 %
Other	169.7	6 %	42.3	2 %	193.0	7 %
Total	3,061.7	100 %	2,710.2	100 %	2,757.5	100 %

(1) We deducted the revenues from slab sales in 2004-2006 from sales of carbon and low-alloyed semi-finished products.

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

Region(1)	2006	2005	2004
Russia	57.1 %	48.0 %	41.3 %
Other CIS	5.6 %	5.0 %	2.9 %
Europe	28.5 %	29.9 %	36.3 %
Asia	1.3 %	8.6 %	15.3 %
Middle East	5.5 %	4.7 %	2.3 %
United States	1.7 %	2.1 %	1.2 %
Other	0.3 %	1.7 %	0.6 %

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

In 2006, our steel segment sales outside of Russia were principally to Europe and CIS. Sales in Europe accounted for 28.5% of our total steel segment sales. European sales during 2006 were largely to Romania (9.9%) and Switzerland (6.8%), followed by Germany (2.4%), Poland (1.2%), and France (0.8%). Sales to Switzerland primarily consisted of sales to Glencore International (see below). Sales in Asia accounted for 1.3% of our total steel segment sales, consisting of Indonesia (0.6%), followed by Vietnam (0.3%), and the Philippines (0.2%). Middle East sales in 2006 accounted for 5.5% of our total steel segment sales. The three largest markets were Iran (3.1%), United Arab Emirates (0.6%) and Turkey (0.5%).

In 2006, the five largest customers of our steel segment products were Glencore International (carbon and low alloyed semi finished products, wire rods), Metallokomplekt-M (reinforcing bars and wire rods), MetallService (carbon and low-alloyed flat products, stainless flat products, carbon and low-alloyed engineering steel), Sibpromsnab (carbon and low-alloyed flat products, stainless flat products and reinforcing bars) and Dipos (reinforcing bars, wire rods, carbon and low-alloyed engineering steel), which together accounted for 16% of our steel segment sales.

Sales of our steel products to Glencore International comprised 9.2%, 8.0% and 10.9% of our total steel segment sales in 2006, 2005 and 2004, respectively, which we record as European sales. Glencore International resells these steel products primarily to customers in the Middle East and Asia. In 2006 and 2005, customers in the Middle East accounted for 51.6% and 42.0%, respectively, of these sales, with most of these sales being to Iran, and customers in Asia accounted for 27.0% and 43.0%, respectively, of these sales. See Marketing and Distribution Export Sales below for a further description of our steel product sales to Glencore International.

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

Products	**2006**		**2005**		**2004**	
	(in millions of U.S. dollars, except for percentages)					
Coke	38.7		49.2		39.0	
Domestic (%)	95	%	100	%	100	%
Export (%)	5	%				
Coking Products	10.3		17.6		18.3	
Domestic (%)	99	%	89	%	92	%
Export (%)	1	%	11	%	8	
Pig Iron	14.1		16.7		37.3	
Domestic (%)	100	%	11	%	29	%
Export (%)	0	%	89	%	71	%
Semi-Finished Steel Products	397.5		465.0		452.9	
Domestic (%)	11	%	7	%	8	%
Export (%)	89	%	93	%	92	%
Long Steel Products	1,436.3		1,311.1		1,302.7	
Domestic (%)	76	%	63	%	55	%
Export (%)	24	%	37	%	45	%
Flat Steel Products	304.2		219.5		233.3	
Domestic (%)	79	%	57	%	56	%
Export (%)	21	%	43	%	44	%
Forgings	81.2		93.5		71.6	
Domestic (%)	48	%	48	%	64	%
Export (%)	52	%	52	%	36	%
Stampings	151.7		121.8		83.1	
Domestic (%)	82	%	84	%	89	%
Export (%)	18	%	16	%	11	%
Hardware	458.0		373.8		326.2	
Domestic (%)	76	%	72	%	67	%
Export (%)	24	%	28	%	33	%
Other	169.7		42.3		193.0	
Domestic (%)	70	%	64	%	31	%
Export (%)	30	%	36	%	69	%
Total	3,061.7		2,710.2		2,757.5	
Domestic (%)	68	%	55	%	49	%
Export (%)	32	%	45	%	51	%

The end users of our steel products vary. Our rebars are principally used in the construction industry. The main end users of our wire rods are small wire-drawing operations. Our carbon sheet is used in construction (covers, floor plates), the automotive industry (spare parts) and pipe manufacturing and shipbuilding (non-critical applications). Our high-quality round bars are used in various moving parts manufactured by the automotive industry (spare parts, gear boxes), the machinery industry (hydraulic

devices, drill bits), the shipbuilding industry (forged parts), the basic materials industry (molds, balls for crushing) and other industries. Our forgings and stampings are primarily used in the automotive, aerospace, petrochemical, textile and food and consumer goods sectors.

The following table sets forth by percentage a breakdown of our shipment volumes of all products produced in Russia by industry sector within the Russian market in 2006.

Use by Industry	Metal Works, Hardware Plants	Pipe Factories	Construction	Engineering	Railway Construction, Repair	Power Generation	Other Industries(1)
Semi-Finished Steel Products	95 %	1 %	0 %	3 %	0 %	0 %	1 %
Long Steel Products	4 %	1 %	73 %	17 %	1 %	0 %	4 %
Flat Steel Products	1 %	11 %	67 %	20 %	0 %	0 %	1 %
Forgings	16 %	50 %	0 %	32 %	0 %	0 %	1 %
Stampings	2 %	0 %	4 %	54 %	0 %	0 %	40 %
Hardware	8 %	0 %	19 %	20 %	10 %	2 %	41 %

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

Marketing and Distribution

We use flexible sales strategies that are tailored to our customers and the markets we serve. Mechel Trading House, headquartered in Moscow, coordinates our Russian sales and has four sales branch offices. Mechel Trading AG, based in Zug, Switzerland, coordinates export sales of our steel products through its branch in Schaan, Liechtenstein.

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

Domestic sales

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

In January 2006, we established Mechel Hardware, which will sell products produced at Beloretsk Metallurgical Plant, Vyartsilya Metal Products Plant and Mechel Nemunas to the Russian and international markets.

Our domestic steel production facilities are located in large industrial areas and have long-standing relationships dating from Soviet times with local end-user customers. Mechel Trading House has four branches in Moscow, Chelyabinsk, Chebarkul and Izhevsk; and Mechel-Service has seventeen warehouses in Chelyabinsk, Omsk, Tyumen, Ufa, Kazan, Nizhniy Novgorod, Samara, Saratov, Tolyaty, Ekaterinburg, Perm, Novosibirsk, Rostov, Krasnodar, Sochi, Moscow and St. Petersburg. These branches develop and service our long-standing customer relationships by virtue of their proximity to both production and customers and thereby allow our local sales forces to provide highly specialized and technical sales and service support to our Russian customers.

Mechel Trading House has approximately 300 employees. Mechel-Service has approximately 320 employees. Mechel Hardware has approximately 60 employees.

Export sales

Most of our international steel sales are made to independent distributors, which then sell our products in smaller quantities to end users. Our subsidiary Mechel International Holdings has sales offices in the following seven countries:

Asia		**Europe**	
Philippines	Vietnam	Austria	Belgium
		Liechtenstein	Romania
		Switzerland	

We also work with agents in 12 additional countries. We have an internationally oriented sales force which facilitates communications between our production facilities and the end users of our products, keeping in mind local and international customs in business dealings, including language requirements. Our use of a centralized international sales organization offers comprehensive and coordinated logistical and financial services to our international customers.

Our Romanian sales are carried out by our Romanian subsidiaries Mechel Campia Turzii and Mechel Targoviste.

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

Glencore International is the largest customer of our exported steel segment products. During 2006, 2005, and 2004, we sold $282.6 million, $217.3 million and $299.5 million in steel products to Glencore International, respectively, comprising 9.2%, 8.0% and 10.9% of our total steel segment sales, respectively, during these periods. Starting in November 2004, steel sales to Glencore International were made pursuant to a framework contract providing for the sale of a minimum of 180,000 tonnes of commodity carbon steel products per quarter at market-based prices. This framework contract extends through December 2007. The products purchased by Glencore International consist of wire rod, rebar, billets, hot-rolled sheet and coil, which are then resold by Glencore International abroad, principally to purchasers in Asia and the Middle East.

We also sell steel products to wholesalers on a walk-in basis through large open and covered warehouse areas in the Port of Antwerp, Belgium. At this port, we primarily stock both rolled and forged bars, and intend to expand the product offering to cover other products such as wire rods and nails.

Mechel International Holdings and its subsidiaries, branches and representative offices have approximately 92 employees.

Distribution

Rail transportation is used for nearly all shipments from our production facilities and warehouses to our end customers, wholesale warehouses or sea ports.

Market share and competition

In our core international markets, we primarily compete with Russian and Ukrainian producers, as the leading global steel manufacturers focus more on value-added and higher-priced products. The principal competitive factors include price, distribution, product quality and customer service.

In the Russian market, we compete on the basis of price and quality of steel products, their added value, product range and service, technological innovation and proximity to customers. The Russian steel industry is characterized by relatively high concentration of production, with the six largest integrated steel producers, including us, accounting for 80% of overall domestic steel output in 2006.

Following is a brief description of Russia s other four largest steel producers:

- *EvrazGroup*, which consists of Nizhny Tagil Metallurgical Plant, Zapadno-Sibirsky Metallurgical Plant (ZapSib), and Kuznetsky Metallurgical Plant, is effectively the largest producer in Russia on a consolidated basis, accounting for 22% of Russia s total rolled products output (including production of long products, semi-finished products, forgings and stampings) in 2006. Like us, EvrazGroup focuses on the production of long products including rebars, wire rods and profiled rolled products (such as rails, beams and channels). EvrazGroup also controls iron ore producers Kachkanarsky GOK and Vysokogorsky GOK and coking coal producer Yuzhkuzbassugol, and has an equity investment in Raspaskaya Mine, which produces coking coal.

- *Severstal* had a 17% market share of Russian rolled steel production in 2006. The company specializes in flat products which constitute a significant part of its production. Severstal is the second-leading producer of flat products and controls 24% of Russia s total production output. Domestic sales accounted for 68% of Severstal s output in 2006, with the oil and gas industry and automotive sector as its leading customers. Severstal also controls UAZ, a domestic off-road car-maker, VorkutaUgol and Kuzbassugol, which completely satisfy Severstal s coking coal requirements, and iron ore producers Karelsky Okatysh and Olenegorsky GOK.

- *MMK* accounted for 20% of Russian rolled steel production in 2006. MMK s product mix is comprised mostly of flat products, representing 85% of its commercial steel products output (including production of slabs). Domestically, MMK controls a significant portion of the supplies to the oil and gas and automotive sectors. MMK exported 52% of its output in 2006 and also produces its own iron ore. Its production facilities are located in Magnitogorsk in the southern Urals.

- *NLMK* had a 14% market share of Russian rolled steel production in 2006. The company produces primarily flat products (hot-rolled and cold-rolled), including galvanized products. NLMK exported 66% of its products in 2006. Domestically, NLMK s largest customers are in the construction and oil and gas industries, followed by companies in the automotive sector. NLMK also controls iron ore producer Stoilensky GOK. The company s steel facilities are located in Lipetsk, to the southeast of Moscow.

- Metalloinvest, which consists of OEMK and Ural Steel, had a 9% market share of Russian rolled steel production. OEMK produces only long products, and Ural Steel produces both long and flat products. Metalloinvest exported 37% of its rolled steel production in 2006. The company s production facilities are located in the Central and Ural Regions of Russia. The main shareholder of Metalloinvest also controls Russia s largest iron ore and pellets production facilities, Lebedinskii and Mikhailovskii GOK.

These six companies, including us, can be divided into two groups by product type. MMK, Severstal and NLMK focus mainly on flat products, while we, EvrazGroup and Metalloinvest produce primarily long products. According to Metall-Expert, Mechel is the leading and most comprehensive producer of specialty steel and alloys in Russia, and controlled 39% of total Russian specialty steel output in 2006. We are also the third largest producer in Russia of long products, with significant market shares in both carbon and specialty steel long products, according to Metall-Expert.

In the Russian carbon long market segment, our primary products and our market positions are as follows, according to Metall-Expert:

- *Reinforcement bar* In rebar, we compete in the 6-40 millimeters range. In 2006, the rebar market was dominated by Mechel (20%) and EvrazGroup (25%)(excluding imported rebars from the CIS). At present, the Russian domestic market for rebar is protected from Ukrainian imports by a 21% import tariff, which was extended through August 2007.

- *Wire rod* There were five major producers of wire rod in Russia in 2006: Mechel (30%), EvrazGroup (21%), Severstal (24%), Nizhneserginsky MZ (12%) and MMK (11%). We produce some of the highest quality and widest ranges of wire rod (5-10 millimeters) among Russian producers.

We were one of the leading producers in Russia of specialty steel long products (bearing, tool, high-speed and stainless steel) in 2006, producing 39% of the total Russian output. We had significant market shares in stainless long products (45%), tool steel (39%) and high-speed steel (40%) in 2006. OEMK, an integrated steel mill specializing in long carbon and specialty steel products and our nearest specialty steel competitor, is located in the southwest of Russia and serves customers in the pipe, engineering and ball-bearing industries. Other Russian specialty steel producers, like Electrostal, lag significantly behind us in terms of overall specialty steel production. We were also Russia s largest producer of stainless flat products, with an 84% share of domestic production in 2006. We were the second largest producer of hardware in Russia in 2006 with a 23% market share, following Severstal (35%) and followed by MMK (15%). For products in which we specialize, however, our share was substantially higher. For example, we had a 54% share of the spring wire market and a 47% share of the high-endurance wire market during 2006. The preceding market share data was, in each case, according to the Association of Specialty Steel and Metall-Expert.

Raw materials

The principal raw materials we use in the making of steel are coke (produced from coking coal), iron ore, nickel, ferrous scrap and limestone. We are 80% self-sufficient in our requirements of coking coal, with Southern Kuzbass Coal Company having supplied 2.3 million tonnes of coking coal concentrate to Chelyabinsk Metallurgical Plant in 2006. We process coking coal concentrate into coke at Chelyabinsk Metallurgical Plant. Coke is used in both steel-making operations at Chelyabinsk Metallurgical Plant and our nickel-smelting operations at Southern Urals Nickel Plant. In 2006, we produced and internally used 0.3 million tonnes of coke in our production facilities and produced and sold another 2.2 million tonnes of coke to third parties. Our internal steam coal requirements are not material.

Our steel-making operations use iron ore in the form of pellets, sinter, concentrate and sinter ore. The ultimate form of the iron ore feed into the steel making process, however, consists of pellets and sinter only. In 2006, our steel-making operations used 5.7 million tonnes of iron ore feed, approximately 40% in the form of pellets and 60% in the form of sinter, and we internally sourced 40% of our total iron ore feed requirements during this period. Our Korshunov Mining Plant supplied us with 2.3 million tonnes of iron ore concentrate in 2006, which accounted for 100% of our total iron ore concentrate needs in this period. Iron ore concentrate is converted into sinter at Chelyabinsk Metallurgical Plant. We purchase most of the remaining part of our iron ore feed, mainly in the form of pellets, from Russian domestic suppliers such as Kostomukshinsky GOK, Lebedinsky GOK and Karelsky Okatysh under annual contracts on market terms.

In 2006, we used approximately 5,000 tonnes of nickel in the production of stainless and other specialty steels. We sourced approximately 67% of our nickel requirements in 2006 from our nickel mining and smelting operations at Southern Urals Nickel Plant. We source other nickel grades from Norilsk Nickel, Ufaleinikel and other smaller nickel producers.

Our steel making technology is primarily based on the basic oxygen furnaces, accounting for over half of our raw steel production. Ferrous scrap represents approximately 38% of feedstock, and we are approximately 41% self-sufficient in this raw material, sourcing the balance from various scrap traders. Electric arc furnaces are the primary method of steel-making at Mechel Targoviste.

In March 2006, we acquired Mechel Recycling, a Chelyabinsk-based metal scrap processing company, in line with our policy of ensuring the steel segment s self sufficiency in raw materials.

We internally source all of our limestone requirements from our Pugachev quarry. In 2006, we used approximately 1.1 million tonnes of limestone in the production of steel.

Steel making requires significant amounts of electricity to power electric arc furnaces and rolling mills and to convert coal to coke. In 2006, our operations consumed approximately 3.5 billion kWh of electricity, of which 2.5 billion kWh was used at Chelyabinsk Metallurgical Plant, 0.5 billion kWh was used at other Russian facilities and 0.5 billion kWh was used at our Eastern European plants. Chelyabinsk Metallurgical Plant and Urals Stamping Plant have cogeneration power facilities, which produced 1.7 billion kWh of electricity for internal consumption in 2006, yielding 68% self-sufficiency at these plants and 31% self-sufficiency overall for the group, including mining operations. The balance was purchased from local utilities. Substantially all of our power-generating facilities work on blast furnace and coke gas, which are by-products of our steel-making operations, and natural gas, which we purchase from Gazprom. In 2006, we consumed 5.0 billion cubic meters of blast furnace gas, 0.8 billion cubic meters of coke gas and 2.0 billion cubic meters of natural gas.

Large amounts of water are also required in the production of steel. Water is used to cool the steel, to carry away waste, to help produce and distribute heat and power and to dilute liquids. One of the principal sources of water is rivers, and many of our facilities recirculate a portion of water used for their production needs. For example, Chelyabinsk Metallurgical Plant sources 10% of its water needs from a local river and the rest from recycled water. Each of Vyartsilya Metal Products Plant and Urals Stamping Plant sources 100% of its water needs from a local river. Southern Urals Nickel Plant sources 88% of its water needs through recycling and the rest from a local river. Mechel Targoviste sources 100% of its production water needs through recycling and the rest is sourced from a local river.

Transportation costs are a significant component of our production costs and a factor in our price-competitiveness in the export markets. Rail transportation is our principal means of transporting raw materials from our mines to processing facilities and products to domestic customers and to ports for shipment overseas. For a description of our railway freight and forwarding subsidiary, see Steel Business Marketing and Distribution Distribution above.

For a description of how seasonal factors impact our use and reserve levels of raw materials see Item 5. Operating and Financial Review and Prospects Trend Information Seasonality below.

Steel production facilities

We generally own, lease or have a right of perpetual use of the properties on which our steel production facilities are located. Most of the land on which Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant, Urals Stampings Plant and Izhstal are located is used pursuant to a right of perpetual use. The land on which Vyartsilya Metal Products Plant and Mechel Nemunas are located is leased. The land on which Mechel Targoviste and Mechel Campia Turzii are located is owned.

The main manufacturing processes at Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant, Urals Stampings Plant, Izhstal, Mechel Campia Turzii (with the exception of wire-drawing workshop No. 3, as described below) and Mechel Targoviste are ISO 9001:2000 certified through 2009. Wire-drawing workshop No. 3 of Mechel Campia Turzii is ISO 14001 certified through 2008.

Chelyabinsk Metallurgical Plant

Our raw steel production in Russia takes place at Chelyabinsk Metallurgical Plant. Chelyabinsk Metallurgical Plant is an integrated coke and gas, sintering production, blast furnace and BOF/EAF steel mill. It produces coke for sale, semi-finished steel products, carbon and specialty steel products and forgings. Its customer base is largely comprised of steel producers and tube manufacturers, and customers from the construction, engineering and ball-bearing industries. The plant sources all of its coking coal needs from our Southern Kuzbass Coal Company and most of its iron ore needs from our Korshunov Mining Plant and a majority of its nickel needs from our Southern Urals Nickel Plant, respectively. In 2006, coke production and specialty steel production were separated from Chelyabinsk Metallurgical Plant into separate entities called Mechel Coke and Specialty Steel, respectively. Mechel Coke produces and sells coke, and Specially Steel produces and sells specialty steel. Both Mechel Coke and Specialty Steel are wholly owned subsidiaries of Chelyabinsk Metallurgical Plant.

Chelyabinsk Metallurgical Plant s (including Specialty Steel s) principal steel and hire production lines include a BOF workshop equipped with three converters; three EAF workshops equipped with electric arc ovens, including two large ovens of 100 and 125 tonnes, respectively; small capacity of constant and alternating-current furnaces, vacuum induction and plasmic furnaces; vacuum arc and electroslag remelting furnaces; five comprehensive steel treatment machines; two steel vacuum-degassed machines, an argon-oxygen refining machine; four continuous billet-casters; blooming with continuous rolling mill for 200-320 millimeters and 80-180 millimeters square billets; six long product mills for 8-190 millimeters diameter round bar and 75-156 millimeters square bar, 6.5-10 millimeters wire rod, rebar steel, bands and shaped beams; a hot-rolled flat product workshop with a thick sheet continuous rolling mill for hot-rolled sheets of up to 1,800 millimeters wide and up to 20 millimeters thick; a semi-continuous rolling mill for up to 1,500 millimeters wide and up to 6 millimeters thick hot-rolled coils; a cold-rolled product workshop for 0.3-4 millimeters cold-rolled stainless sheet; a forged piece hammer workshop and a forging and pressing workshop equipped with five presses and forging machines of 1,250-2,000 tonnes, as well as eight coking batteries, seven sintering machines and three blast furnaces. The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for each of Chelyabinsk Metallurgical Plant s principal production areas.

Production Areas	Capacity in 2006	Capacity Utilization Rate in 2006	Planned Increase (2007-2009)
	(in tonnes except for percentages)		
Sintering	5,100,000	74.0 %	700,000
Pig Iron	3,800,000	95.6 %	
Steel-making	5,100,000	95.1 %	
Rolling	4,130,000	97.2 %	195,400
Forging and pressing	73,000	99.2 %	16,440
Coking	3,100,000	74.0 %	

In 2005 we commissioned the first part of a new sinter plant at Chelyabinsk Metallurgical Plant. Currently four sintering machines are operational, and a new sintering plant provides a total capacity of 4.5 million tonnes of sinter per annum.

Izhstal

Izhstal is a Russian specialty steel producer located in the city of Izhevsk, Udmurtia, west of the Urals. Its customer base is largely comprised of companies from the aircraft, defense, automotive, agricultural, power, engineering, oil and gas and construction industries.

Izhstal s principal production lines include five EAF of 30 tonnes each; aggregate ladle stove and ladle vacuum machine with oxygen decarburization; three open hearth furnaces of 130-135 tonnes each; blooming machine for 100-220 millimeters square billets; three medium-sized long products rolling mills for 30-120 millimeters round bars, 30-90 millimeters square bars, bands and hexagonal bars; and one continuous small long products wire mill for 5.5-29 millimeters round, 12-28 millimeters square and 12-27 millimeters hexagonal light sections, reinforced steel and bands. It also has a hardware workshop, equipped with various drawing mills, a pickling line and a forging workshop, equipped with a number of sledge hammers and press-cutters. The following table sets forth the capacity and the capacity utilization rate for each of Izhstal s principal production areas.

Production Areas	Capacity in 2006	Capacity Utilization Rate in 2006	Planned Increase (2007-2009)
	(in tonnes except for percentages)		
Steel-making	700,000	83.8 %	
Rolling	1,000,000	36.6 %	
Hardware	98,000	43.2 %	
Forging and stamping	60,000	29.0 %	

Izhstal experienced low capacity utilization rates due to high production costs and the resulting uncompetitive products. Upon acquisition of Izhstal we took a strategic decision to lower Izhstal production costs in steel-making and rolling activities by supplying Izhstal with our semi-finished products, pig iron and nickel that resulted in increase of Izhstal steel-making and rolling capacity utilization from 71% and 36% in 2004 to 84% and 37% in 2006. Hardware and forging and stamping low capacity utilization rates are explained by low demand for these products on Russian market.

Beloretsk Metallurgical Plant

Beloretsk Metallurgical Plant is a hardware plant that produces wire rod and a broad range of hardware from semi-finished steel products supplied by Chelyabinsk Metallurgical Plant. Its customers are largely from the construction and engineering industries. Beloretsk Metallurgical Plant s principal production lines include a steel-rolling workshop equipped with a wire mill for production of wire rod of 5.5-12 millimeters diameter and a number of hardware workshops equipped with drawing, winding, unwinding, rewinding, polishing and rope machines and thermal treatment ovens. The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for each of Beloretsk Metallurgical Plant s principal production areas.

Production Areas	Capacity in 2006	Capacity Utilization Rate in 2006	Planned Increase (2007-2009)
	(in tonnes except for percentages)		
Rolling	553,000	36.6 %	
Hardware	411,000	89.8 %	43,000

Vyartsilya Metal Products Plant

Vyartsilya Metal Products Plant is a hardware plant that produces low carbon, welding and structural wire, zinc-plated nails, and steel and polymeric-coated nets, from wire rod supplied by Chelyabinsk Metallurgical Plant and Beloretsk Metallurgical Plant. The plant s customers are largely from the construction, automotive and furniture industries. Vyartsilya Metal Products Plant s principal production facilities include drawbenches and nail-making and mesh-weaving machines. The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for Vyartsilya Metal Products Plant s principal production area.

Production Areas	Capacity in 2006	Capacity Utilization Rate in 2006	Planned Increase (2007-2009)
	(in tonnes except for percentages)		
Hardware	68,000	92.0 %	

Urals Stampings Plant

Urals Stampings Plant is Russia s largest producer of stampings from specialty steels and heat-proof and titanium alloys for the aerospace, oil and gas, heavy engineering, railway transportation, power and other industries. Urals Stampings Plant sources its specialty steel needs from Chelyabinsk Metallurgical Plant. Urals Stampings Plant s principal production facilities include 1.5-25 tonne swages, hydraulic presses and inker machines. The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for Urals Stampings Plant s principal production area.

Production Areas	Capacity in 2006	Capacity Utilization Rate in 2006	Planned Increase (2007-2009)
	(in tonnes except for percentages)		
Stamping	100,000	83.0 %	

Mechel Targoviste

Mechel Targoviste is a major Romanian EAF steel mill that produces specialty and carbon long products, forgings, and hardware. Mechel Targoviste is the largest producer of long products in Romania and the second largest producer of raw steel in Romania, according to Metal Invest Consulting. The plant s customers are largely from the engineering, automotive, tool, ball-bearing, tube, hardware and construction industries.

Mechel Targoviste s principal production lines include an EAF workshop equipped with one modernized electric arc oven of 75 tonne capacity; steel vacuum processing and treatment machines; a continuous billets caster; a blooming machine for 80-400 millimeters square and 90-145 millimeters round billets; and two continuous long products rolling mills for 20-80 millimeters round bars, 24-57 millimeters hexagonal bars, 60-70 millimeters square bars, 6-12 millimeters thick and 60-120 millimeters wide bands, 12-26 millimeters bundle rod and reinforcing steel. The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for each of Mechel Targoviste s principal production areas.

Production Areas	Capacity in 2006	Capacity Utilization Rate in 2006	Planned Increase (2007-2009)
	(in tonnes except for percentages)		
Steel-making	527,000	88.4 %	73,000
Forging and pressing	37,400	12.4 %	
Rolling	780,000	47.5 %	
Hardware	6,700	22.6 %	

Mechel Targoviste experienced low capacity utilization rates due to high production costs and uncompetitive product quality.

Mechel Campia Turzii

Mechel Campia Turzii is a leading Romanian domestic hardware plant that produces long steel products, including carbon and alloyed wire rod, rebar and hardware, including various types of wire, ropes, nets, electric cables and nails, as well as carbon and low-alloyed billets. The plant s customers are largely from the construction and engineering industries.

Mechel Campia Turzii s principal production lines include several hardware workshops equipped with drawing, nail-making and zinc-plating machines. The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for each of Mechel Campia Turzii s principal production areas.

Production Areas	Capacity in 2006	Capacity Utilization Rate in 2006	Planned Increase (2007-2009)
	(in tonnes except for percentages)		
Steel-making	363,000	0.5 %	
Rolling	330,000	42.5 %	
Hardware	100,000	86.0 %	35,500

Mechel Campia Turzii experienced low capacity utilization rates in rolling workshops due to high production costs of production of semi-finished low-alloyed products and resulting uncompetitive products. In February 2006, as part of a restructuring of the production process at the Mechel Campia Turzii, one EAF steel-making workshop and two rolling mills were discontinued.

Mechel Nemunas

Mechel Nemunas is a Lithuanian hardware plant that produces wire, calibrated steel products, nails, rods and nets. Its customers are primarily from the construction, engineering and furniture industries. Mechel Nemunas s principal production facilities include drawing mills, and nail-making, threading, net-weaving, net-wicking and contact-welding machines. The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for Mechel Nemunas s principal production area.

Production Areas	Capacity in 2006	Capacity Utilization Rate in 2006	Planned Increase (2007-2010)
	(in tonnes except for percentages)		
Hardware	90,000	70.9 %	

Trade restrictions

Trade restrictions in the form of tariffs, duties and quotas are widespread in the steel industry. However, we are less exposed than most other Russian steel producers since restrictions on Russian exports have mainly been directed against flat products, whereas most of our exports consist of long products, such as wire rods and rebars. In addition, the abolition by the Russian government of steel export duties in 2002 has also effectively improved the Russian steel export market.

In 2006, approximately 81% of our steel segment revenues were derived from sales of steel products that were subject to import restrictions. We describe below the main applicable trade restrictions in our key markets.

European Union

Our steel sales to the EU constituted approximately 9% of our total steel segment revenues in 2006. The Russian government and the European Community have an export quota system in place whereby Russian exports to the EU are limited to certain stipulated quantities for each product category. The quota by product category is distributed between the Russian producers based on a procedure jointly developed by the Ministry of Economic Development and Trade of the Russian Federation and the Ministry of Industry and Energy of the Russian Federation. The procedure provides that for each product category, a company s export quota allocation is calculated on the basis of shipments by the company of the particular product over the past three years to the EU market (which is given a 70% weighting), and on the company s market share in domestic production of the particular product (which is given a 30% weighting). After the quotas are calculated, the Russian Ministry of Industry and Energy then confirms quota allocations, and the Russian Ministry of Economic Development and Trade issues export licenses for these quotas. In 2006, the quota covered approximately 43.7% of our steel segment products exported to the EU.

In 2006, the total EU quota for Russian steel was 2.3 million tonnes, and we received 268,668 tonnes of the total quota. As quotas are granted by product category, usage of our individual quotas varied. For example, usage of our 2006 quota for long products other than rebar and wire rod was 98%, while usage for our wire rod quota was 83%. The EU-Russia Steel Agreement for 2007 provides for the total Russian quota to be 2.9 million tonnes. Our quota is set at approximately 290,000 tonnes, which includes 19,000 tonnes for flat products and 271,000 tonnes for long products. Our supply of wire rod to Mechel Nemunas, our hardware plant in Lithuania, is also subject to the EU export quota system, and our quota for that plant is 61,500 tonnes for 2007. We also expect to receive an additional quota in 2007 for supplying wire rod to our Romanian subsidiary Mechel Campia Turzii equal to 27,000 tones. See Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry We face numerous protective trade restrictions in the export of our steel products.

In addition, an anti-dumping duty in the amount of 50.7% was applicable for export to the EU of steel ropes and cables manufactured by our Beloretsk Metallurgical Plant until August 2006. This duty is under review at the EU, and we expect that it will be extended for five more years, but at a lower rate.

Finally, an anti-dumping investigation against imports of steel wire ropes originating in Russia was initiated in Ukraine in January 2006. The investigation did not have a material effect on our sales, as we increased our sales in the Russian market.

United States

The United States has a quota system in place with respect to imports of hot rolled flat-rolled carbon quality steel and thick steel plate. The intergovernmental quota agreements provide for quotas and reference prices on Russian exports of these products to the United States. A distribution of quotas between specific Russian producers and the execution of export licenses is carried out in accordance with the same procedure that applies to exports to the EU market. There are no trade restrictions applicable to the export of our Romanian or Lithuanian products to the United States.

Capital Improvements Program

We plan to spend $2.7 billion for our capital expenditures program for the five-year period of 2007 2011. It is targeted at expansion of the mining segment and increasing the efficiency of the steel segment. The split is approximately $1.2 billion in mining and approximately $1.5 billion in steel.

In the mining segment, in line with our target to produce 25 million tonnes of coal in 2010, we will direct approximately $150 million to the development of the Erunakovskaya deposit, which is expected to produce approximately three million tonnes of coking coal annually; and $100 million will be directed to the development of brownfield license areas covering approximately one billion tonnes of predominantly coking coal. Other major mining projects are also aimed at improving quality, and include the construction of Sibirginskaya coal washing plant for approximately $65 million. In the iron ore business, we will invest approximately $90 million in Korshunov Mining Plant.

Steel segment projects are targeted at improving efficiency while maintaining existing output, and will be mainly directed to Chelyabinsk Metallurgical Plant, our core steel-producing facility. We completed construction of an additional continuous caster for approximately $145 million in line with our target to raise the proportion of steel produced through continuous casting from the current 37% to 50% in 2007. Other projects include a new coking battery and reconstruction of rolling facilities.

The following table sets out by segment and facility the major items of our capital expenditures currently in progress or expected to be commenced in 2007-2008.

Project	**Estimated Production Increase and/or Other Improvements**	**Total Planned Expenditures*** (in millions of U.S. dollars)	**Year of Project Start**	**Estimated Year of Commissioning/ completion**
MINING BUSINESS				
Southern Kuzbass Coal Company				
Construction of Erunakovskaya-1 Mine	Increase in coking coal output to 4.0 million tonnes per annum	$ 150.0	2006	2012
Construction of mine in Olzherasskaya-Glubokaya field	Increase in coking coal output to 1.5 million tonnes per annum	$ 75.0	2007	2011
Construction of Sibirginsk Mine	Increase in coal output from 1.7 to 3.2 million tonnes per annum	$ 80.0	2006	2010
Construction of Sibirginsk Washing plant	Increase of coal washing capacity by 4.0 million tonnes of coking coal per annum	$ 65.0	2007	2009
Development of load-haul-dump system	Increase of admission ability to transport the obtained coal by railway	$ 85.0	2007	2009
Maintenance current coal capacity	Modernization and renewal of mountain and transport equipment	$ 265.0	2007	2011
Korshunov Mining Plant				
Development of Concentrate Production Facilities	Maintenance of iron-ore concentrates at the level of 5 million tonnes per annum. Decrease mining and enrichment costs	$ 90.0	2007	2010
Port Posiet				
Reconstruction of Port	Construction of modern port with the aim to increase export. As a result, port will be able to handle water crafts with the capacity of 60 thousand tonnes.	$ 70.0	2007	2009
Southern Urals Nickel Plant				
Conversion to up-to-date technology of production of iron nickel	Increase iron nickel production, decrease production costs and improve ecological indexes.	$ 300.0	2009	2012
STEEL BUSINESS				
Chelyabinsk Metallurgical Plant				
Agglofactory 2	Increase of agglomerate capacity to 6.5 million tonnes per annum	$ 85.0	2009	2012

Construction of blast furnace	Capacity of 1.7 million tonnes per annum. Increase of cast iron production to 4.5 million tonnes per annum. Stopping of out of date equipment.	$	200.0	2008	2010
Reconstruction of basic oxygen shop	Replacement of two converters.Increase of steel production by 270 thousand tonnes per annum	$	90.0	2007	2008/2009
Modernization of mill 250-2	Increase in production capacity by 300 thousand tonnes per annum. Production familiarization of new sort of profiled iron and rod with diameter from 5.5 to 40 millimeter.	$	120.0	2007	2009
Construction of bloom machine with complex of steel processing outside stove in oxygen-converter shop	Increase in continuous casting block production capacity by 1.0 million tonnes per annum	$	145.0	2007	2009
Construction of complex of outside steel processing	Capacity of 0.6 million tonnes per annum	$	90.0	2008	2010
Construction of rolled facilities in the blooming building	Production of new types of rolling for construction usage. Capacity of 1 million tonnes per annum	$	310.0	2008	2010
Modernization of slab machine of continuous steel pouring	Increase in production capacity to 1.2 million tonnes per annum with increase of non-corrosive steel production	$	70.0	2007	2008
Reconstruction of sheet-rolling mill 2300/1700	Increase production capacity to 1.1million tonnes and increase in thick sheet production capacity by 400 thousand tonnes per annum.Production of non-corrosive steel	$	145.0	2007	2008/2009
Reconstruction of cool sheet-rolling mill	Modernization of cool sheet-rolling shop in order to increase non-corrosive rolling production	$	35.0	2008	2009
Izhstal					
Modernization of electro steel melting production	Increase of steel melting capacity to 480 thousand tonnes per annum and steel quality improvements. Close of open-hearth furnace	$	110.0	2007	2009
Reconstruction of mill 250	Increase in capacity to 300 thousand tonnes per annum and increase of quality	$	30.0	2007	2009
Mechel Targoviste					
Modernization of medium-grade and small-grade rolling mill complex	Increase of profiled rolling capacity to 500 thousand tonnes and quality improvement	$	20.0	2006	2007/2008/2009
Reconstruction of vacuum machine	Increase of capacity to200 thousand tonnes per annum, decrease of production expenses	$	5.0	2006	2007
Urals Stamping Plant, Beloretsk Metallurgical Plant, Mechel Campia Turzii, Mechel Nemunas					
Modernization of hardware equipment	Production of new products (wire, rope, nails and forged piece). Quality increase	$	105.0	2007	2007-2011

* We estimate that approximately $31.4 million of the aforementioned planned expenditures for these projects have been made as of December 31, 2006. In 2006, we spent $397.8 million in total for capital expenditures.

Research and Development

We maintain research programs at the corporate level and at certain of our business units to carry out basic research and applied technology development activities, primarily focused on improving casting operations through improvements in working practices and operational methods. At our corporate level, we have the Department of Long-Term Planning and Technological Development, which is responsible for research and development and employed a total of 8 researchers. We also contract with third-party consultants from the metallurgical industry and major Russian research institutions to produce development concepts and conduct feasibility studies.

In addition to these activities performed at our corporate level, each of Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant and Izhstal have specialized research divisions with a total of 201 researchers involved in the improvement of existing technologies and products.

We did not spent a significant amount on research and development activities in 2006, 2005 and 2004.

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. At present, our facilities are not insured, and we have no coverage for business interruption or loss of key management personnel.

Our Russian subsidiaries maintain obligatory insurance, which includes insurance for third-party liability (including ecological) for injuries and losses caused by accidents in dangerous industrial sites, insurance for third-party liability for injuries caused during construction and operation of hydrotechnical installations and auto insurance. Some of our Russian subsidiaries insure automobiles, real estate interest and cargo, but it is not done in all instances and for all significant assets. Mechel Trading Ltd, Zug, Schaan Branch maintains comprehensive insurance, including marine, liability, including products liability, and trade indemnity. Mechel Campia Turzii maintains insurance that covers its employees, property, plant and equipment.

Regulatory Matters

We describe below certain regulatory matters that are applicable to our Russian operations.

Licensing of Operations

We are required to obtain numerous licenses, authorizations and permits from Russian governmental authorities for our operations. The Federal Law on Licensing of Certain Types of Activities of August 8, 2001, as amended, as well as other laws and regulations, set forth the activities subject to licensing and establish procedures for issuing licenses. In particular, some of our companies need to obtain licenses and permits to carry out their activities, including, inter alia:

- the use of subsoil, which is described in more detail in Subsoil Licensing below;
- the use of water resources;
- the discharge of pollutants into the environment;
- the handling of hazardous waste;
- storage and use of explosive, flammable and/or dangerous materials;
- operation of industrial facilities (including mining and surveying activities);
- construction;

- fire control and security;
- medical operations; and
- transportation activities.

These licenses and permissions are usually issued for a period of one to five years and may be extended upon application by the licensee. Licenses for the use of natural resources may be issued for shorter or longer periods. Upon the expiration of a license, it may be extended upon application by the licensee.

Regulatory authorities maintain considerable discretion in the timing of issuing licenses and permits. The requirements imposed by these authorities may be costly, time-consuming and may result in delays in the commencement or continuation of exploration or production operations. Further, private individuals and the public at large possess rights to comment on and otherwise participate in the licensing process, including through challenges in the courts. Accordingly, the licenses we need may not be issued, or if issued, may not be issued in a timely fashion, or may impose requirements which restrict our ability to conduct our operations or to do so profitably.

As part of their obligations under licensing regulations and the terms of our licenses and permits, some of our companies must comply with numerous industrial standards, employ qualified personnel, maintain certain equipment and a system of quality controls, monitor operations, maintain and make appropriate filings and, upon request, submit specified information to the licensing authorities that control and inspect their activities.

Subsoil Licensing

In Russia, mining minerals requires a subsoil license from the state authorities with respect to an identified mineral deposit, as well as the right (through ownership, lease or other right) to use the land where such licensed mineral deposit is located. In addition, as discussed above, operating permits are required with respect to specific mining activities.

The primary law regulating subsoil licensing is the Law on Subsoil Resources of February 21, 1992, as amended, or the Subsoil Law, which sets out the regime for granting licenses for the exploration and production of mineral resources. The Procedure for Subsoil Use Licensing, or the Licensing Regulation, adopted by Resolution of the Supreme Soviet of the Russian Federation on July 15, 1992, as amended, also regulates the exploration and production of mineral resources. According to both the Subsoil Law and the Licensing Regulation, subsurface mineral resources are subject to the joint jurisdiction of the federal and regional authorities.

Among different licenses required for mining minerals in Russia, the two major types of licenses are: (1) an exploration license, which is a non-exclusive license granting the right of geological exploration and assessment within the license area, and (2) a production license, which grants the licensee an exclusive right to produce minerals from the license area. In practice, many of the licenses are issued as combined licenses, which grant the right to explore, assess and produce minerals from the license area. A subsoil license defines the license area in terms of latitude, longitude and depth.

There are two major types of payments with respect to the extraction of minerals: (1) periodic payments for the use of subsoil under the Subsoil Law and (2) the minerals extraction tax under the Tax Code. Failure to make these payments could result in the suspension or termination of the subsoil license. The Subsoil Law-mandated payments are not material to our mining segment s results of operations. The minerals extraction tax is calculated as a percentage of the value of minerals extracted. Currently the tax rates are 4% for coal, 4.8% for iron ore and 8% for nickel. In 2006, we incurred the minerals extraction tax in the amount of $27.0 million, out of which $25.7 million was included in the income statement as other taxes.

The term of the license is set forth in the license. Prior to January 2000, exploration licenses could have a maximum term of five years, production licenses a maximum term of 20 years, and combined exploration, assessment and production licenses a maximum term of 25 years. After amendments of the Subsoil Law in January 2000 and in August 2004, exploration licenses still have a maximum term of five years; in the event that a prior license with respect to a particular field is terminated early (for example, when a license is withdrawn due non-usage of the licensed subsoil), a production license may have a one-year term until a new licensee is determined, but is generally granted to another user for the term of the expected operational life of the field based on a feasibility study; and combined exploration, assessment and production licenses can be issued for the term of the expected operational life of the field based on a feasibility study. These amendments did not affect the terms of licenses issued prior to January 2000, but permit licensees to apply for extensions of such licenses for the term of the expected operational life of the field in accordance with the amended Subsoil Law. The term of a subsoil license runs from the date the license is registered with the Russian Federal Geological Fund.

Issuance of licenses

Subsoil licenses are issued by the Federal Agency for Subsoil Use. Most of the currently existing production licenses owned by companies derive from (1) pre-existing rights granted during the Soviet era and up to the enactment of the Subsoil Law to state-owned enterprises that were subsequently reorganized in the course of post-Soviet privatizations; or (2) tender or auction procedures held in the post-Soviet period. The Russian Civil Code, the Subsoil Law and the Licensing Regulation contain the major requirements relating to tenders and auctions. The Subsoil Law does not forbid production licenses to be issued without a tender or auction procedure only in limited circumstances, such as instances when a mineral deposit is discovered by the holder of an exploration license at its own expense during the exploration phase.

Extension of licenses

The Subsoil Law permits a subsoil licensee to request an extension of a production license in order to complete the production from the subsoil plot covered by the license or the procedures necessary to vacate the land once the use of the subsoil is complete, provided the user complies with the terms and conditions of the license and the relevant regulations.

In order to extend a period of a subsoil license, a company must file an application with the federal authorities to amend the license.

The Order of the Ministry of Natural Resources No. 439-R, dated October 31, 2002, requires that the following issues be considered by the relevant governmental authorities when determining whether to approve an amendment: (1) the grounds for the amendments, with specific information as to how the amendments may impact payments by the licensee to the federal and local budgets; (2) compliance of the licensee with the conditions of the license; and (3) the technical expertise and financial capabilities that would be required to implement the conditions of the amended license.

The factors that may, in practice, affect a company s ability to obtain the approval of license amendments include (1) its compliance with the license terms and conditions; (2) its management s experience and expertise relating to subsoil issues, including experience in amending licenses; and (3) the relationship of its management with federal and/or local governmental authorities, as well as the local governments. For a description of additional factors that may affect Russian companies ability to extend their licenses, see Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry Our business could be adversely affected if we fail to obtain or renew necessary licenses and permits or fail to comply with the terms of our licenses and permits. See also Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry Deficiencies in the legal framework relating to subsoil licensing subject our licenses to the risk of governmental challenges and, if our licenses are

suspended or terminated, we may be unable to realize our reserves, which could materially adversely affect our business and results of operations and Item 3. Key Information Risk Factors Risks Relating to the Russian Federation Legal Risks and Uncertainties Weaknesses relating to the legal system and legislation create an uncertain environment for investment and business activity.

Maintenance and termination of licenses

A license granted under the Subsoil Law is accompanied by a licensing agreement. The law provides that there be two parties to any subsoil licensing agreement: the federal authorities and the licensee. The licensing agreement sets out the terms and conditions for the use of the subsoil.

Under a licensing agreement, the licensee makes certain environmental, safety and production commitments. For example, the licensee makes a production commitment to bring the field into production by a certain date and to extract an agreed-upon volume of natural resources each year. The license agreement may also contain commitments with respect to social and economic development of the region. When the license expires, the licensee must return the land to a condition which is adequate for future use. Although most of the conditions set out in a license are based on mandatory rules contained in Russian law, certain provisions in a licensing agreement are left to the discretion of the licensing authorities and are often negotiated between the parties. However, commitments relating to safety and the environment are generally not negotiated. We expect that we will be able to meet the commitments set forth in our licensing agreements.

The fulfillment of a license s conditions is a major factor in the good standing of the license. If the subsoil licensee fails to fulfill the license s conditions, upon notice, the license may be limited or terminated by the licensing authorities. However, if a subsoil licensee cannot meet certain deadlines or achieve certain volumes of exploration work or production output as set forth in a license, it may apply to amend the relevant license conditions, though such amendments may be denied.

The Subsoil Law and other Russian legislation contain extensive provisions for license termination. A licensee can be fined or the license can be suspended or terminated for the reasons noted above, for repeated breaches of the law, upon the occurrence of a direct threat to the lives or health of people working or residing in the local area, or upon the occurrence of certain emergency situations. A license may also be terminated for violations of material license terms. Although the Subsoil Law does not specify which terms are material, failure to pay subsoil taxes and failure to commence operations in a timely manner have been common grounds for limitation or termination of licenses. Consistent underproduction and failure to meet obligations to finance a project would also likely constitute violations of material license terms. In addition, certain licenses provide that the violation by a subsoil licensee of any of its obligations may constitute grounds for terminating the license.

If the licensee does not agree with a decision of the licensing authorities, including a decision relating to a license termination or the refusal to re-issue an existing license, the licensee may appeal the decision through administrative or judicial proceedings. In certain cases of termination, the licensee has the right to attempt to cure the violation within three months of its receipt of notice of the violation. If the issue has been resolved within such a three-month period, no termination or other action may be taken.

Land Use Rights

Russian legislation prohibits the carrying out of any commercial activity, including mineral extraction, on a land plot without appropriate land use rights. Land use rights are needed and obtained for only the portions of the license area actually being used, including the plot being mined, access areas and areas where other mining-related activity is occurring.

Under the Land Code, companies generally have one of the following rights with regard to land in the Russian Federation: (1) ownership; (2) right of perpetual use; or (3) lease.

A majority of land plots in the Russian Federation are owned by federal, regional or municipal authorities which, through public auctions or tenders or through private negotiations, can sell, lease or grant other use rights to the land to third parties.

Companies may also have a right of perpetual use of land that was obtained prior to the enactment of the Land Code; however, the Federal Law on Introduction of the Land Code of October 25, 2001, with certain exceptions, requires companies using land pursuant to rights of perpetual use either to purchase the land from, or to enter into a lease agreement relating to, the land with the relevant federal, regional or municipal authority owner of the land by January 1, 2008. See Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry The potential implementation by the Russian government of a law requiring Russian companies to purchase or lease the land on which they operate may have a material adverse effect on our financial condition.

Our mining subsidiaries generally have a right of perpetual use of their plots or have entered into long-term lease agreements. A lessee generally has a priority right to enter into a new land lease agreement with a lessor upon the expiration of a land lease. In order to renew a land lease agreement, the lessee must apply to the lessor (usually state or municipal authorities) for a renewal prior to the expiration of the agreement. Any agreement for a period longer than one year must be registered with the relevant state authorities.

Environmental

We are subject to laws, regulations and other legal requirements relating to the protection of the environment, including those governing the discharge of substances into the air and water, the formation, distribution and disposal of hazardous substances and waste, the cleanup of contaminated sites, flora and fauna protection and wildlife protection. Issues of environmental protection in Russia are regulated primarily by the Federal Law on Environmental Protection of January 10, 2002, as amended, or the Environmental Protection Law, as well as by a number of other federal and local legal acts.

Pay-to-pollute

The Environmental Protection Law establishes a pay-to-pollute regime administered by federal and local authorities. The Russian government has established standards relating to the permissible impact on the environment and, in particular, limits for emissions and disposal of substances, waste disposal and resource extraction. A company may obtain approval for exceeding these statutory limits from the federal or regional authorities, depending on the type and scale of environmental impact. As a condition to such approval, a plan for the reduction of the emissions or disposals must be developed by the company and cleared with the appropriate governmental authority. Fees, as set forth in a governmental decree, are assessed on a sliding scale for both the statutory or individually approved limits on emissions and effluents and for pollution in excess of these limits: the lowest fees are imposed for pollution within the statutory limits, intermediate fees are imposed for pollution within the individually approved limits, and the highest fees are imposed for pollution exceeding such limits. Payments of such fees do not relieve a company from its responsibility to take environmental protection measures and undertake restoration and clean-up activities. In 2006, we incurred such fees in the amount of $3.0 million.

Ecological approval

Any activities that may affect the environment are subject to state ecological approval by federal authorities in accordance with the Federal Law on Ecological Expert Examination of November 23, 1995,

as amended. Conducting operations that may cause damage to the environment without state expert ecological approval may result in the negative consequences described in Environmental Liability below.

Enforcement authorities

The Federal Service for the Supervision of the Use of Natural Resources, the Federal Service for Environmental, Technological and Nuclear Supervision, the Federal Service for Hydrometrology and Environmental Monitoring, the Federal Agency on Subsoil Use, the Federal Agency on Forestry, the Federal Agency on Water Resources (along with their regional branches) and the Federal Agency on Protection of Consumers Rights are involved in environmental control, implementation and enforcement of relevant laws and regulations. The federal government and Ministry of Natural Resources is responsible for coordinating the activities of the regulatory authorities in this area. Such regulatory authorities, along with other state authorities, individuals and public and non-governmental organizations, also have the right to initiate lawsuits for the compensation of damage caused to the environment. The statute of limitations for such lawsuits is 20 years.

Environmental liability

If the operations of a company violate environmental requirements or cause harm to the environment or any individual or legal entity, a court action may be brought to limit or ban these operations and require the company to remedy the effects of the violation. Any company or employees that fail to comply with environmental regulations may be subject to administrative and/or civil liability, and individuals may be held criminally liable. Courts may also impose clean-up obligations on violators in lieu of or in addition to imposing fines or other penalties to compensate for damages.

Subsoil licenses generally require certain environmental commitments. Although these commitments can be substantial, the penalties for failing to comply and the clean-up requirements are generally low.

Reclamation

We conduct our reclamation activities for land damaged by production in accordance with the Basic Regulation on Land Reclamation, Removal, Preservation, and Rational Use of the Fertile Soil Layer, approved by Order No. 525/67 of December 22, 1995, of the Ministry of Natural Resources. In general, our reclamation activities involve both a technical stage and a biological stage. In the first stage, we backfill the pits, grade and terrace mound slopes, level the surface of the mounds, and add clay rock on top for greater adaptability of young plants. In the biological stage, we plant conifers (pine, larch, cedar) on horizontal and gently sloping surfaces, and shrubs and bushes to reinforce inclines. Russian environmental regulations do not require mines to achieve the approximate original contour (AOC) of the property as is required, for example, in the United States.

Environmental protection programs

We have been developing and implementing environmental protection programs at all of our mining, steel and transportation subsidiaries. Such programs include measures to aid in our adherence to the requirements and limits imposed on air and water pollution, as well as allocation of industrial waste, introduction of environmentally friendly industrial technologies, the construction of purification and filtering facilities, the repair and reconstruction of industrial water supply systems, the installation of metering systems, reforestation and the recycling of water and industrial waste. We are a member of Ecological Movement for Specific Activities, a non-profit organization which develops and facilitates the implementation of environmental programs and individual projects for state and private institutions.

Health and Safety

Due to the nature of our business, much of our activity is conducted at industrial sites by large numbers of workers, and workplace safety issues are of significant importance to the operation of these sites.

The principal law regulating industrial safety is the Federal Law on Industrial Safety of Dangerous Industrial Facilities of July 21, 1997, as amended, or the Safety Law. The Safety Law applies, in particular, to industrial facilities and sites where certain activities are conducted, including sites where lifting machines are used, where alloys of ferrous and non-ferrous metals are produced and where certain types of mining is done.

There are also regulations that address safety rules for coal mines, the production and processing of ore, the blast-furnace industry, steel smelting, alloy production and nickel production. Additional safety rules also apply to certain industries, including metallurgical and coke chemical enterprises, and the foundry industry.

Any construction, reconstruction, liquidation or other activities in relation to regulated industrial sites is subject to a state industrial safety review. Any deviation from project documentation in the process of construction, reconstruction and liquidation of industrial sites is prohibited unless reviewed by a licensed expert and approved by the Federal Service for Environmental, Technological and Nuclear Supervision.

Companies that operate such industrial facilities and sites have a wide range of obligations under the Safety Law and the Labor Code of Russia effective February 1, 2002, as amended, or the Labor Code. In particular, they must limit access to such sites to qualified specialists, maintain industrial safety controls and carry insurance for third-party liability for injuries caused in the course of operating industrial sites. The Safety Law also requires these companies to enter into contracts with professional wrecking companies or create their own wrecking services in certain cases, conduct personnel training programs, create systems to cope with and inform the Federal Service for Environmental, Technological and Nuclear Supervision of accidents and maintain these systems in good working order.

In certain cases, companies operating industrial sites must also prepare declarations of industrial safety which summarize the risks associated with operating a particular industrial site and measures the company has taken and will take to mitigate such risks and use the site in accordance with applicable industrial safety requirements. Such declarations must be adopted by the chief executive officer of the company, who is personally responsible for the completeness and accuracy of the data contained therein. The industrial safety declaration, as well as a state industrial safety review, are required for the issuance of a license permitting the operation of a dangerous industrial facility.

The Federal Service for Environmental, Technological and Nuclear Supervision has broad authority in the field of control and management of industrial safety. In case of an accident, a special commission led by a representative of the Federal Service for Environmental, Technological and Nuclear Supervision conducts a technical investigation of the cause. The company operating the hazardous industrial facility where the accident took place bears all costs of an investigation. The officials of the Federal Service for Environmental, Technological and Nuclear Supervision have the right to access industrial sites and may inspect documents to ensure a company s compliance with safety rules. The Federal Service for Environmental, Technological and Nuclear Supervision may suspend or terminate operations of companies and/or impose administrative liability on officers of such companies.

Any company or individual violating industrial safety rules may incur administrative and/or civil liability, and individuals may also incur criminal liability. A company that violates safety rules in a way that negatively impacts the health of an individual may also be obligated to compensate the individual for lost earnings, as well as health-related damages.

Employment and Labor

Labor matters in Russia are primarily governed by the Labor Code. In addition to this core legislation, relationships between employers and employees are regulated by federal laws, such as the Law on Employment in the Russian Federation of April 19, 1991, as amended, and the Federal Law on compulsory social insurance against industrial accidents and occupational diseases of July 24, 1998, as amended; legal acts of executive authorities; and local government acts related to labor issues.

Employment contracts

As a general rule, employment contracts for an indefinite term are concluded with all employees. Russian labor legislation expressly limits the possibility of entering into term employment contracts. However, an employment contract may be entered into for a fixed term of up to five years in certain cases where labor relations may not be established for an indefinite term due to the nature of the duties or the conditions of the performance of such duties, as well as in other cases expressly identified by federal law. In some cases it is also possible to enter into an employment contract for the employee to perform specified task(s). All terms and conditions of employment contracts are regulated by the Labor Code.

An employer may terminate an employment contract only on the basis of the specific grounds enumerated in the Labor Code, including:

- liquidation of the enterprise or downsizing of staff;
- failure of the employee to comply with the position s requirements due to incompetence, as confirmed by the results of an attestation;
- employee s full incapability to work as confirmed in a medical certification;
- change of control of the employer;
- repeated failure of the employee to fulfill his or her labor duties;
- entering the workplace under the influence of alcohol, narcotics or other intoxicating substances;
- employee s absence without cause for more than four hours in a row within one working day;
- disclosure of state secrets or other confidential information, which an employee has come to know during fulfillment of his professional duties;
- embezzlement, willful damage or destruction of assets, and misappropriation as confirmed by court decision;
- failure to comply with safety requirements in the workplace if such failure to comply caused injuries, casualties or catastrophe; and
- provision by the employee of false documents to gain entry into the employment contract.

An employee dismissed from an enterprise due to downsizing or liquidation is entitled to receive compensation and salary payments for a certain period of time, depending on circumstances.

The Labor Code also provides protections for specified categories of employees. For example, except in cases of liquidation of an enterprise, an employer cannot dismiss minors, expectant mothers, mothers with a child under the age of three, single mothers with a child under the age of fourteen or other persons caring for a child under the age of 14 without a mother.

Any termination by an employer that is inconsistent with the Labor Code requirements may be invalidated by a court, and the employee may be reinstated. Lawsuits resulting in the reinstatement of illegally dismissed employees and the payment of damages for wrongful dismissal are increasingly frequent,

and Russian courts tend to support employees rights in most cases. Where an employee is reinstated by a court, the employer must compensate the employee for unpaid salary for the period between the wrongful termination and reinstatement, as well as for mental distress.

Work time

The Labor Code generally sets the regular working week at 40 hours. Any time worked beyond 40 hours per week, as well as work on public holidays and weekends, must be compensated at a higher rate.

For employees working in hazardous or harmful conditions, the regular working week is decreased by 4 hours in accordance with government regulations. Some of our employees working on steel and mining production entities qualify for this reduced working week.

Annual paid vacation leave under the law is 28 calendar days. Our employees who work in mines and pits or work in harmful conditions may be entitled to additional paid vacation ranging from 7 to 42 working days.

The retirement age in the Russian Federation is 60 years for males and 55 years for females. However, employees who perform underground and open-pit mining works or other work in harmful conditions have a right to retire at an earlier age. The rules defining such earlier retirement ages are set by the Federal Law on Labor Pensions in the Russian Federation dated December 17, 2001, as amended.

Salary

The minimum monthly salary in Russia, as established by federal law, was 800 rubles (approximately $30) in the first four months of 2006 and was increased to 1,100 rubles (approximately $40) from May 1, 2006. It will be further increased to 2,300 rubles (approximately $84) from September 1, 2007. Although the law requires that the minimum wage be at or above a minimum subsistence level, the current minimum wage is generally considered to be less than a minimum subsistence level.

Strikes

The Labor Code defines a strike as the temporary and voluntary refusal of workers to fulfill their work duties with the intention of settling a collective labor dispute. Russian legislation contains several requirements for legal strikes. Participation in a legal strike may not be considered by an employer as grounds for terminating an employment contract, although employers are generally not required to pay wages to striking employees for the duration of the strike. Participation in an illegal strike may be adequate grounds for termination.

Trade Unions

Although recent Russian labor regulations have curtailed the authority of trade unions, they still retain significant influence over employees and, as such, may affect the operations of large industrial companies in Russia. In this regard, our management routinely interacts with trade unions in order to ensure the appropriate treatment of our employees and the stability of our business.

The activities of trade unions are generally governed by the Federal Law on Trade Unions, Their Rights and Guaranties of Their Activity of January 12, 1996, as amended, or the Trade Union Law. Other applicable legal acts include the Labor Code, which provides for more detailed regulations relating to activities of trade unions.

The Trade Union Law defines a trade union as a voluntary union of individuals with common professional and other interests that is incorporated for the purposes of representing and protecting the

rights and interests of its members. National trade union associations, which coordinate activities of trade unions throughout Russia, are also permitted.

As part of their activities, trade unions may:

- negotiate collective contracts and agreements such as those between the trade unions and employers, federal, regional and local governmental authorities and other entities;
- monitor compliance with labor laws, collective contracts and other agreements;
- access work sites and offices, and request information relating to labor issues from the management of companies and state and municipal authorities;
- represent their members and other employees in individual and collective labor disputes with management;
- participate in strikes; and
- monitor redundancy of employees and seek action by municipal authorities to delay or suspend mass layoffs.

Russian laws require that companies cooperate with trade unions and do not interfere with their activities. Trade unions and their officers enjoy certain guarantees as well, such as:

- legal restrictions as to rendering redundant employees elected or appointed to the management of trade unions;
- protection from disciplinary punishment or dismissal on the initiative of the employer without prior consent of the management of the trade union and, in certain circumstances, the consent of the relevant trade union association;
- retention of job positions for those employees who stop working due to their election to the management of trade unions;
- protection from dismissal for employees who previously served in the management of a trade union for two years after the termination of the office term; and
- provision of the necessary equipment, premises and transportation vehicles by the employer for use by the trade union free of charge, if provided for by a collective bargaining contract or other agreement.

If a trade union discovers any violation of work condition requirements, notification is sent to the employer with a request to cure the violation and to suspend work if there is an immediate threat to the lives or health of employees. The trade union may also apply to state authorities and labor inspectors and prosecutors to ensure that an employer does not violate Russian labor laws. Trade unions may also initiate collective labor disputes, which may lead to strikes.

To initiate a collective labor dispute, trade unions present their demands to the employer. The employer is then obliged to consider the demands and notify the trade union of its decision. If the dispute remains unresolved, a reconciliation commission attempts to end the dispute. If this proves unsuccessful, collective labor disputes are generally referred to mediation or labor arbitration.

The Trade Union Law provides that those who violate the rights and guaranties provided to trade unions and their officers may be subject to disciplinary, administrative and criminal liability. Although neither the Code of the Russian Federation on Administrative Misdemeanors, nor the Criminal Code of the Russian Federation, currently has provisions specifically relating to these violations, general provisions and sanctions may be applicable.

Item 5. *Operating and Financial Review and Prospects*

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes and other information in this document. This Item 5 contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in forward-looking statements as a result of various factors, including the risks described in Item 3 and under the caption Cautionary Note Regarding Forward-Looking Statements.

The Reorganization

Mechel OAO was incorporated on March 19, 2003, under the laws of the Russian Federation, in connection with a reorganization to serve as holding company for various mining and steel companies owned by Messrs. Igor Zyuzin and Vladimir Iorich or parties affiliated with them. These individuals acted in concert from 1995 until December 2006 pursuant to an Ownership, Control and Voting Agreement which required them to vote the same way. The reorganization involved the contribution of these companies by these individuals to Mechel in exchange for all the outstanding capital stock of Mechel. Many of the contributed companies had shareholders other than Messrs. Zyuzin and Iorich, and these shareholders were not involved in the reorganization and continue to retain minority interests in certain of our subsidiaries.

During the period from March through December 2006, Mr. Iorich disposed of his entire interest in Mechel OAO, and the Ownership, Control and Voting Agreement terminated on December 21, 2006.

Business Structure

Segments

We have organized our businesses into two segments:

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

- the steel segment, comprising the production and sale of semi-finished steel products; carbon and specialty long products; carbon and stainless flat products; value-added downstream metal products including hardware, forgings and stampings; and coke and coking products.

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

Name	Location	Business	Date Control Acquired	Voting Interest(1) %
***Mining Segment*(2)**				
Southern Kuzbass Coal Company(3)	Russia	Coking coal concentrate, steam coal, steam coal concentrate	January 1999	93.1
Tomusinsk Open Pit Mine	Russia	Coking coal, steam coal	January 1999	74.4
Southern Urals Nickel Plant	Russia	Ferronickel	December 2001	79.9
Korshunov Mining Plant	Russia	Iron ore concentrate	October 2003	85.6
Port Posiet	Russia	Shipping	February 2004	96.9
Port Kambarka	Russia	River shipping	April 2005	90.4
Steel Segment				
Chelyabinsk Metallurgical Plant	Russia	Semi-finished steel products, carbon and specialty long and flat steel products, forgings, coke and coking products	December 2001	95 8
Vyartsilya Metal Products Plant	Russia	Hardware	May 2002	93.5
Beloretsk Metallurgical Plant	Russia	Long steel products, hardware, limestone(4)	June 2002	90.4
Mechel Targoviste	Romania	Carbon and specialty long steel products, forgings, hardware	August 2002	86.6
Urals Stampings Plant	Russia	Stampings	April 2003	93.8
Mechel Campia Turzii	Romania	Long steel products, hardware	June 2003	86.6
Mechel Nemunas	Lithuania	Hardware	October 2003	100.0
Izhstal	Russia	Specialty and carbon steel long products, hardware, stampings and forgings	May 2004	88.1
Mechel Recycling	Russia	Metal scrap processing	March 2006	100.0
Moscow Coke Gas Plant	Russia	Coke and gas works	October 2006	98.9
Southern Kuzbass Power Plant	Russia	Power	March 2007	93.5

(1) The percentages provided in this table are as of June 30, 2007. As of that date, some of our Russian subsidiaries had preferred shares outstanding that have voting rights commensurate with common shares if dividends on those shares have not been paid. We have calculated voting interests by including these preferred shares for subsidiaries where dividends have not been paid.

(2) The mining segment includes our shipping operations, which support both our mining and steel segments.

(3) We merged the following entities into Southern Kuzbass Coal Company: Tomusinsk Processing Mills in October 2004; Sibirginsk Open Pit Mine, Kuzbass Central Processing Plant and Siberian Central Processing Plant from October-December 2005; and Olzherassk Open Pit Mine, Lenin Mine, Usinsk Mine, Tomusinsk Auto Depot and Krasnogorsk Open Pit Mine from October 2006-February 2007.

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

In 2005, we commenced the restructuring of Southern Kuzbass Coal Company, pursuant to which we began merging the company with certain of its subsidiaries, including Tomusinsk Processing Mills in October 2004; Siberian Central Processing Plant, Kuzbass Central Processing Plant and Sibirginsk Open Pit Mine in October-December 2005; Lenin Mine, Krasnogorsky Open Pit Mine and Tomusinsk Auto Depot in October 2006; and Olzherassk Open Pit Mine in February 2007. As a result of the merger of these subsidiaries into Southern Kuzbass Coal Company, our current ownership stake in Southern Kuzbass Coal Company is 93.5%.

We also undertook restructuring activity at the Chelyabinsk Metallurgical Plant in 2006. Specifically, coke production and specialty steel production were separated from Chelyabinsk Metallurgical Plant into separate entities called Mechel Coke and Specialty Steel, respectively. Mechel Coke, formed in June 2006, produces and sells coke, and Specially Steel, formed in April 2006, produces and sells specialty steel. Both Mechel Coke and Specialty Steel are wholly owned subsidiaries of Chelyabinsk Metallurgical Plant.

Intersegment sales

We are an integrated mining and steel group. Our mining segment supplies 80% of our steel segment s coking coal requirements, 40% of our iron requirements, and 67% of our nickel requirements. Our steel segment also supplies wires, ropes and other hardware to our mining segment for use in its day-to-day operations, as well as coke for use in the production of nickel. The prices at which we record these transfers are based on market prices, and these transactions are eliminated as intercompany transactions for purposes of our consolidated financial statements. For the years ended December 31, 2006, 2005, and 2004, mining segment sales to the steel segment amounted to $376.6 million, $336.6 million and $323.0 million, respectively. For the years ended December 31, 2006, 2005 and 2004, steel segment sales to the mining segment amounted to $23.7 million, $56.6 million and $74.7 million, respectively.

Summary of Acquisitions

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

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

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

the secondary market to increase our stake in Chelyabinsk Metallurgical Plant to 95.8%. We have paid a total of $219.3 million for our current stake in Chelyabinsk Metallurgical Plant.

- *Southern Urals Nickel Plant.* Southern Urals Nickel Plant operates two open-pit nickel mines and a nickel processing facility. Southern Urals Nickel Plant was privatized by the Russian government in 1993. We acquired a 46.0% stake in Southern Urals Nickel Plant in September 2001 and increased that stake to a controlling stake in December 2001. We have subsequently purchased shares on the secondary market to increase our stake in Southern Urals Nickel Plant to 79.9%. We have paid a total of $10.0 million for our current stake in Southern Urals Nickel Plant.

- *Vyartsilya Metal Products Plant.* Vyartsilya Metal Products Plant is a hardware plant that produces wire, nails and steel nets. Vyartsilya Metal Products Plant was formed in June 1996 as a spin-off from Vyartsilya Metal Products Plant OAO, which was privatized by the Karelian government in 1994. We acquired an 88.1% stake in Vyartsilya Metal Products Plant from employee-shareholders in May 2002. We have subsequently purchased shares on the secondary market to increase our stake in Vyartsilya Metal Products Plant to 93.5%. We have paid a total of $0.1 million for our current stake in Vyartsilya Metal Products Plant.

- *Beloretsk Metallurgical Plant.* Beloretsk Metallurgical Plant is a hardware plant that produces wire rod and a broad range of hardware. Beloretsk Metallurgical Plant was privatized by the Bashkir government in 1994. We acquired a 33.3% stake in Beloretsk Metallurgical Plant from third parties in 2001, and increased our stake to a controlling interest in June 2002. In November 2003, we acquired another 29.4% stake in Beloretsk Metallurgical Plant from the regional government, and in March 2004, we acquired another 9.7% stake in Beloretsk Metallurgical Plant. During 2005 we acquired an additional stake of 0.1% in Beloretsk Metallurgical Plant, bringing our total stake to 90.4% Beloretsk Metallurgical Plant also owns the Pugachev limestone quarry. The regional government has a golden share in Beloretsk Metallurgical Plant, giving it the right to veto certain shareholder decisions and appoint a voting representative on the board of directors. We have paid a total of $15.2 million for our current stake of 90.4 % in Beloretsk Metallurgical Plant.

- *Mechel Targoviste.* Mechel Targoviste is a Romanian steel mill that produces long products and forgings. We acquired a 79.7% stake in Mechel Targoviste from the Romanian government in August 2002. At the time we acquired Mechel Targoviste, it was in bankruptcy proceedings. The consideration consisted of $3.5 million in cash and a commitment on our part to invest $21.1 million in the modernization of the plant, upgrade of its capacity over five years and environmental protection, as well as a commitment to maintain its workforce level for five years. Under the transaction documents, our stake in Mechel Targoviste was pledged to the Romanian government and was gradually released as we fulfilled our commitments. As a result of our fulfillment of these commitments in 2006, our stake in Mechel Targoviste was fully released from pledge and increased to 86.6%. We paid a total of $22.3 million for our current stake in Mechel Targoviste.

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

- *Mechel Campia Turzii.* Mechel Campia Turzii is a Romanian steel mill that produces rolled products and hardware, including wires, ropes and nails. We acquired a 73.4% stake in Mechel Campia Turzii from the Romanian government in June 2003. The consideration consisted of $2.8 million in cash and a commitment on our part to invest $19.0 million in the modernization of the plant and upgrade of its capacity over five years, a commitment to spend $3.6 million in environmental protection, as well as a commitment to maintain its workforce level for five years. In connection with the acquisition, certain debt of Mechel Campia Turzii was converted into shares,

87

and we subsequently acquired these shares for $1.3 million, increasing our stake to 79.8%. Under the transaction documents, our stake in Mechel Campia Turzii was pledged to the Romanian government until we fulfilled our commitments. As a result of our fulfillment of these commitments in 2007, our stake in Mechel Campia Turzii was fully released from pledge and increased to 86.6%. We paid a total of $37.2 million for our current stake in Mechel Campia Turzii.

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

- *Korshunov Mining Plant.* Korshunov Mining Plant operates three surface iron ore mines and an iron ore concentrating plant. Korshunov Mining Plant was privatized by the local government in 1993. We acquired a 62.5% interest in Korshunov Mining Plant in December 2002 when it was in bankruptcy proceedings. In September 2003, a court approved a debt settlement plan. We recorded our investment in Korshunov Mining Plant at cost until we acquired control in October 2003, and have consolidated its results since that time. We have subsequently purchased shares on the secondary market to increase our stake in Korshunov Mining Plant to 85.6%. We have paid a total of $135.8 million (including loans and advances) for our current stake in Korshunov Mining Plant.

- *Port Posiet.* Port Posiet is located in Russia s Far East on the Sea of Japan. We acquired an 80.0% stake in Port Posiet for $30.0 million in cash in February 2004. In February 2006, we acquired an additional 13.3% stake in Port Posiet at auction for a purchase price of $1.1 million and an additional 3.6% from individuals for a purchase price of $0.2 million increasing our total stake to 96.9%. We have paid a total of $31.2 million for our current stake in Port Posiet.

- *Izhstal.* Izhstal is a Russian specialty steel plant which produces rolled products, hardware, stampings and forgings. We acquired a 62.3% stake in Izhstal for $25.3 million in cash in February through December 2004. In April 2005, we acquired an additional 25.0% stake in Izhstal for approximately $15.7 million in cash. Subsequent acquisitions of additional stakes have resulted in an increase of our share in Izhstal to 87.9%. We have paid a total of $41.0 million for our current stake in Izhstal.

- *Yakutugol.* Yakutugol, located in eastern Siberia, extracts predominantly coking coal, as well as steam coal, in open-pit and underground mines. We acquired a blocking minority stake of 25% plus one share for $411.2 million in January 2005.

- *Port Kambarka.* Port Kambarka is a river port located in Kama in the Republic of Udmurtia, and processed 543 tonnes of cargo, mostly sand and crushed stone, in 2006. We acquired a 90.4% stake in Port Kambarka in April 2005 while Port Kambarka was in bankruptcy proceedings. The bankruptcy proceedings were terminated in May 2005, and we paid $3.4 million in cash for this stake in June 2005.

- *Mechel Recycling.* Mechel Recycling is a Chelyabinsk-based metal scrap processing company. We acquired a 100% stake in Mechel Recycling in March 2006 for $4.8 million.

- *Moscow Coke Gas Plant.* Moscow Coke Gas Plant is a coke and chemical producer located in the Moscow Region. The plant s annual production capacity is approximately 1.5 million tonnes of coke. Its products are sold domestically, mainly to manufacturers located in Russia s Central Region, as well as shipped abroad, in particular to Ukraine and European Union countries. We acquired a 98.9% stake in Moscow Coke Gas Plant and its subsidiaries during the period from July October 2006 in exchange for consideration comprising $179.0 million in cash and 18,645,058 shares of Mechel. The total cost of our investment was $298.9 million.

- *Southern Kuzbass Power Plant.* Southern Kuzbass Power Plant was separated in July 2006 from Kuzbassenergo as the result of Kuzbassenergo s reorganization. The plant is located in the Kemerovo Region. As of January 1, 2007, its installed electric power capacity was 554 MWt, and the heat power capacity was 560 Gcal/h. On March 29, 2007, we acquired at auction 93.4% of the charter capital of Southern Kubzass Power Plant for approximately $265 million.

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

Discontinued Operations

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

We started accounting for Mechel Zeljezara as discontinued operations in September 2004. Mechel Zeljezara is currently in bankruptcy, which is expected to be concluded in 2007. The results of operations of Mechel Zeljezara were included in the consolidated financial statements from the date of acquisition in March 2003. For the years ended December 31, 2006 and 2005 these results were reflected in the consolidated financial statements as discontinued operations.

Results of Operations

The following table sets forth our income statement data for the years ended December 31, 2006, 2005 and 2004.

	Year ended December 31,		
	2006	**2005**	**2004**