

## 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.

Year ended December 31,	Rubles per U.S. dollar			
	High	Low	Average <sup>(1)</sup>	Period End
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
2001	30.30	28.16	29.22	30.14
2000	28.87	26.90	28.13	28.16

(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 2005	28.09	27.78
April 2005	27.94	27.71
March 2005	27.83	27.46
February 2005	28.19	27.75
January 2005	28.16	27.75
December 2004	28.15	27.75

The exchange rate between the ruble and the U.S. dollar on June 27, 2005 was 28.68 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 securities involves a high degree of risk. You should carefully consider the risks described below and the other information contained in this document before making a decision to invest in our securities. Any of the following risks could adversely affect our business, financial condition and results of operations, in which case the trading price of our securities could decline and you could lose all or part of your investment.*

### Risks Relating to Our Business and Industry

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

The steel industry is cyclical in nature because the industries in which steel customers operate are cyclical and sensitive to changes in general economic conditions. The demand for steel products thus generally correlates to macroeconomic fluctuations in the economies in which steel producers sell products, as well as in the global economy. The prices of steel products are influenced by many factors, including demand, worldwide production capacity, capacity-utilization rates, raw-material costs,

exchange rates, trade barriers and improvements in steel-making processes. Steel prices have experienced, and in the future may experience, significant fluctuations as a result of these and other factors, many of which are beyond our control.

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

We derived approximately 39% and 49% of our total revenues from sales to customers in Russia in 2004 and 2003, respectively. The Russian economy has experienced significantly fluctuating growth rates over the past 10 years. From 1994 to 1998, the Russian economy contracted in real terms at an average rate of 4.9% per year; after the Russian crisis in 1998, the economy recovered and grew in real terms at an average rate of 6.3% per year from 1999 to 2004. 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 64.3 million tonnes in 2004. 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 \$1.25 billion. Most of our current borrowing is from Russian institutions. In the future, we expect to rely to a greater extent than currently on foreign capital markets and other foreign financing sources for our capital needs. It is possible that these foreign sources of financing, as well as domestic sources, may not be available in the future in the amounts we require or at an acceptable cost. See "—Risks

Relating to the Economic Environment in Russia—Emerging markets such as Russia are subject to greater risks than more developed markets, and financial turmoil in any emerging market could disrupt our business, as well as cause the price of our securities to suffer" and "—Risks Relating to the Economic Environment in Russia—The Russian banking system remains underdeveloped, and another banking crisis could place severe liquidity constraints on our business."

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

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

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

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

***Our independent registered public accounting firm reported material weaknesses in our internal control over financial reporting and we may not be able to remedy these material weaknesses or prevent future weaknesses. If we fail to do so, there is a more than remote likelihood that a material misstatement of the annual or interim statements will not be prevented or detected.***

In connection with the audit of our consolidated financial statements for the year ended December 31, 2004, management and our independent registered public accounting firm identified material weaknesses in our internal control over financial reporting as defined in the standards established by the Public Company Accounting Oversight Board's Auditing Standard No. 2 that affected our financial statements for the year ended December 31, 2004. The material weaknesses in our internal control over financial reporting are summarized below:

- we do not have an adequate system of internal control over the preparation of our U.S. GAAP consolidated financial statements to ensure that material errors do not occur in their preparation;
- we do not have an adequate financial reporting system for certain disclosure information to be submitted by our subsidiaries in the preparation of our U.S. GAAP consolidated financial statements;
- we do not have a unified, comprehensive accounting and financial reporting system for U.S. GAAP reporting purposes; and
- we do not have adequate accounting resources and expertise in respect of the preparation of our U.S. GAAP consolidated financial statements.

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 may not be able to prevent other material weaknesses in the future. Any failure to maintain or implement required new or improved internal control over financial reporting, or any difficulties we encounter in their implementation, could result in significant deficiencies or additional 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 that will be required when the SEC's rules under Section 404 of the Sarbanes-Oxley Act of 2002 become applicable to us beginning with our annual report for the year ending December 31, 2006, to be filed in 2007. 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 the price of our securities. See "Item 15. Controls and Procedures" for additional information.

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

Our subsidiaries maintain their books and records in local currencies and prepare accounting reports in accordance with local accounting principles and practices. In particular, each of our Russian subsidiaries maintains its books in rubles and prepares separate unconsolidated financial statements in accordance with Russian accounting standards. For every reporting period, we translate, adjust and combine these standalone Russian statutory financial statements to prepare consolidated U.S. GAAP financial statements. This is a difficult task requiring U.S. GAAP-experienced accounting personnel at each of our subsidiaries and at our Moscow corporate offices. While we have hired accounting

personnel who are CPAs and ACCA-qualified in the past year, Russia has available only a small number of accounting personnel with U.S. GAAP expertise. Moreover, there is an increasing demand for such personnel as more Russian companies are beginning to prepare financial statements on the basis of U.S. GAAP or other international standards. Such competition, combined with the remote locations of our subsidiaries which such personnel may not find suitable in comparison to other opportunities, makes it difficult for us to hire and retain such personnel, and our key accounting staff may leave our company. Under these circumstances, we may have difficulty in remedying the material weaknesses identified by our independent registered public accounting firm and in the timely and accurate reporting of our financial information in accordance with U.S. GAAP.

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

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

The Land Code of the Russian Federation of October 25, 2001, as amended, or the Land Code, requires privatized Russian companies to purchase or lease the land on which they operate. The purchase price and lease terms are to be determined in accordance with legislation enacted by governmental authorities, however, the current government land owners have broad discretion in making these determinations. This requirement was scheduled to take effect on January 1, 2004, but implementation has been delayed by the Russian legislature to January 1, 2006. At present, we estimate that the cost of purchasing the land on which we operate would be approximately \$155 million. Thus, if not eliminated or limited prior to implementation, the requirement that we purchase or lease the land we occupy will require significant expenditures by us and may have a material adverse effect on our financial condition.

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

In 2004, our Russian operations purchased approximately 3.9 billion kWh of electricity, representing 69% of their needs, from local subsidiaries of RAO UES, the government-controlled national holding company for the Russian power sector. Domestic electricity prices are regulated by the Russian government. The government is currently in the early stages of implementing a restructuring plan for the power sector aimed at introducing competition, liberalizing the wholesale electricity market and moving from regulated pricing to a market-based system by 2008. This reform process could also cause disruptions to the supply of electricity to us. In addition, while subject to doubt as to whether it will be implemented as currently written, according to the Russian Energy Strategy approved by the Russian government in 2003, electricity tariffs for industrial users are expected to reach 3.2-3.6 cents per kWh by 2006. In 2004, our average cost of electricity was 3.0 cents per kWh. Assuming a price of 3.6 cents per kWh in 2004, our Russian operations would have incurred approximately \$23 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 \$28 per thousand cubic meters (\$0.79 per thousand cubic feet) in 2004, and increased by 27% to approximately \$36 per

thousand cubic meters (\$1.01 per thousand cubic feet) as of January 1, 2005. Further, domestic natural gas prices are significantly below Western European levels, which helps to provide us with a cost advantage over our competitors. Recently, in connection with Russia's potential accession to the World Trade Organization, or WTO, Russia and the EU agreed that Russia would raise domestic gas prices to \$37-42 per thousand cubic meters (\$1.05-1.19 per thousand cubic feet) by 2006 and to \$49-57 per thousand cubic meters (\$1.39-\$1.61 per thousand cubic feet) by 2010. Assuming a price of \$42 per thousand cubic meters in 2004, our Russian operations would have incurred approximately \$30 million in additional costs. If we are required to pay a higher price for natural gas, our costs will rise and our business and prospects could be materially adversely affected.

***The 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, as well as to ports for onward transportation overseas. In accordance with legislation enacted in 2003, the Russian Railways Ministry was privatized and its assets are now 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 the Federal Tariff Service, continues to set rail tariffs and pursue its policy of maintaining international transportation tariffs and possibly increasing domestic tariffs. Factors which may lead to an increase in domestic tariffs include the insufficient financial transparency of Russian Railroads, the poor state of repair of Russia's rolling stock and the cross-subsidization of unprofitable passenger transportation sectors. 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 increased railway transport costs, our results of operations 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 on May 1, 2004. Our sales into the EU constituted approximately 16.9% of our steel segment revenues in 2004, and we used 92.9% of our EU steel import quota allocation during 2004. 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. It previously had a quota system in place with respect to imports of pig-iron, slabs, zinc-plated steel products, hot-rolled bars, cold-processed bars, wire-rod and some other products from Russia which expired on July 12, 2004. We may attempt to expand our steel product exports to the U.S. market. We expect, however, that depending on market conditions, the United States may impose new anti-dumping duties or other types of trade restrictions which might force us to decrease our exports to the United States below current levels. In December 2003, the United States also withdrew safeguard measures in the form of tariffs on most steel exports to the United States after the WTO's Appellate Body had determined them to be inconsistent with the requirements of the WTO. In January 2004, China imposed new anti-dumping duties on cold-rolled steel imports from Russia that are retroactive to September 2003 and will last for five years. These duties, however, have been temporarily suspended. In 2004, approximately 77.4% of our steel segment revenues were derived from sales of steel products that were subject to import restrictions. We also expect that an anti-dumping investigation with respect

to Russian exports of steel ropes and cables will be initiated in the United States. There are also risks of anti-dumping investigations against Russian steel exports in other markets. 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 20% of value for certain higher value-added steel products. In addition, Russia has in place a 21% countervailing duty on Ukrainian steel bars, which expires in August 2005. Our Russian sales of steel products that are protected by these tariffs and duties accounted for approximately 100% of our steel segment revenues in 2004. We believe we benefit from these tariffs and duties because they prevent subsidized Ukrainian exports to Russia from reducing the prices we can obtain for these products in our domestic markets. These tariffs and duties may be reduced or eliminated in the future, which could materially adversely affect our revenues and results of operations.

In May 2004, Russia and the EU agreed on terms for Russia's entry into the WTO and, according to press reports, Russia may complete its negotiations with other countries to be able to join the WTO by the end of 2005. Russia's future accession to the WTO could negatively affect our business and prospects. In particular, Russia's entry into the WTO may require lowering or removing of tariffs and duties on steel products, causing increased competition in the domestic steel market from foreign producers and exporters. See also "—Increasing tariffs and restructuring in the energy sector could materially adversely affect our business."

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

Our reporting currency is the U.S. dollar. Our products are typically priced in rubles for domestic sales and in U.S. dollars (and, to a lesser extent, euros) for export sales, whereas the majority of our direct costs are incurred in rubles and, to a lesser extent, in other local currencies where our operations are based. Appreciation in real terms of the ruble against the U.S. dollar results in an increase in our costs relative to our revenues, adversely affecting our results of operations. In 2004, the ruble appreciated in real terms against the U.S. dollar by 15.1% according to the Russian Central Bank, and further real appreciation of the ruble against the U.S. dollar may materially adversely affect our results of operations.

***Estimates of our reserves are subject to uncertainties.***

The estimates concerning our reserves contained in this 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;
- production disruptions due to weather; and
- hazards associated with the disposal of mineralized waste water, such as groundwater and waterway contamination.

Hazards associated with our underground mining operations include:

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

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

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

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

Generally, there is a greater awareness in Russia of damage caused to the environment by industry than existed during the Soviet era. For example, a news article in 2004 cited us as Russia's tenth worst polluter. Environmental legislation in the jurisdictions where we operate, however, is generally weaker, and less stringently enforced, than in the EU or the United States. More stringent standards may be introduced or enforcement increased in Russia and elsewhere where we conduct our operations. Based on the current regulatory environment in these jurisdictions, as of December 31, 2004, we have not created any reserves for environmental liabilities and compliance costs, other than an accrual in the amount of \$75.0 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. Any change in this regulatory environment could result in actual costs and liabilities for which we have not provided.

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

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

***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 June 2002, for a 10-year period. We have not had a need to extend any of our other subsoil licenses. Of our nine coal subsoil licenses, eight expire on dates falling in 2012 through 2014 and one expires at the end of 2005; our four iron ore subsoil licenses expire on dates falling in 2009 through 2015; and our three 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 have to comply with numerous industrial standards, recruit qualified personnel, maintain necessary equipment and a system of quality control, monitor our operations, maintain appropriate filings and, upon request, submit appropriate information to the licensing authorities, which are entitled to control and inspect their activities. In the event that the licensing authorities discover a material violation by our company, we may be required to suspend our operations or incur substantial costs in eliminating or remedying such violation, which could have a material adverse effect on our business or results of operations.

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

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

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

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

Moreover, during the tumultuous period of the transformation of the Russian planned economy into a free market economy in the 1990s, documentation relating to subsoil licenses was not properly

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

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

***Our Romanian operations face certain risks.***

Romania is not self-sufficient in energy resources. Domestic energy prices, which are significantly higher than the prices we pay in Russia, have recently increased and may continue to increase in the future, which might hurt the profitability of our operations in Romania. For example, in 2004, the price of natural gas increased by approximately 32% in Romania and is expected to continue to increase through 2005. Shortages in energy supplies, including administrative limitations during peak usage, may limit our production capacity and efficiency and hinder our output. Our Romanian operations also purchase significant amounts of raw materials, such as scrap, for which prices increased by approximately 60% in 2004 and are expected to continue to increase in 2005. If we are unable to obtain these raw materials on economic terms, the operations of our Romanian subsidiaries could be materially adversely affected.

In addition, preparations in Romania for its possible admission into the EU will result in increased environmental liabilities and expenditures and labor costs for our Romanian operations. See note 23(c) to our consolidated financial statements. These preparations may also result in trade duties and quotas on the export of steel finished and semi-finished products into Romania.

In connection with their acquisition, we also committed to make capital investments of approximately \$21.1 million at Mechel Targoviste and approximately \$22.7 million at Mechel Campia Turzii, as well as to maintain labor force levels for five years from the date of acquisition of these Romanian facilities. See "Item 5. Operating and Financial Review and Prospects—Contractual obligations and commercial commitments." Although we have complied with these undertakings to date, our failure to comply in the future could result in the forfeiture of part of our ownership stake in these companies.

***We are controlled by two shareholders who run our business collectively and whose interests could conflict with those of the holders of our securities.***

The Chairman of our Board of Directors, Mr. Igor Zyuzin, and our Chief Executive Officer, Mr. Vladimir Iorich, own 84.44% of our outstanding common shares. These two shareholders have acted in concert since signing an Ownership, Control and Voting Agreement dated August 1, 1995, which requires them to vote the same way. See "Item 7. Major Shareholders and Related Party Transactions—Major Shareholders—Ownership, Control and Voting Agreement of August 1, 1995" for more information regarding this agreement. This agreement gives them control over us and the ability

to elect a majority of the directors, appoint management, issue additional shares and approve certain actions requiring the approval of a majority of our shareholders. The interests of these shareholders could conflict with those of holders of ADSs and materially adversely affect your investment.

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

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

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

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

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

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

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

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

We own less than 100% of the equity in many of our subsidiaries, with the remaining equity balance being held by minority shareholders. These subsidiaries have in the past carried out, and continue to carry out, numerous transactions with us and our other subsidiaries which may be considered "interested party transactions" under Russian law, requiring approval by disinterested directors, disinterested independent directors or disinterested shareholders. See "Item 10. Additional Information-Charter and Certain Requirements of Russian Legislation-Interested Party Transactions." These transactions may not always have been properly approved, and therefore may be challenged by minority shareholders. In addition, Russian law requires a three-quarters majority vote of the holders of voting stock present at a shareholders meeting to approve certain transactions, 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 share issuances. In some cases, minority shareholders may not approve transactions which are interested party transactions requiring approval. In the event these minority shareholders were to successfully challenge past interested party transactions, or do not approve interested party transactions in the future, we could be limited in our operational flexibility and our results of operations could be materially adversely affected.

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

As of December 31, 2004, approximately 88% of our employees were represented by trade unions. Although we have not experienced any business interruption at any of our businesses as a result of labor disputes from the dates of their respective acquisition by us and we consider our employee relations to be good, large union representation subjects our businesses to interruptions through strikes, lockouts or delays in renegotiations of labor contracts. Our existing arrangements with trade unions also may not be renewed on terms favorable to us. In such events, our business and results of operations could be materially adversely affected.

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

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

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

Over the past several years, the ruble has fluctuated dramatically against the U.S. dollar. The Central Bank of Russia has from time to time imposed various currency control regulations in attempts to support the ruble, and may take further actions in the future. For example, Central Bank regulations currently require us to convert into rubles 10% of our export proceeds. Furthermore, the government and the Central Bank may impose additional requirements on cash inflows and outflows into and out of Russia or on use of foreign currency in Russia, which could prevent us from carrying on necessary business transactions, or from successfully implementing our business strategy.

A new framework law on exchange controls took effect on June 18, 2004. This law empowers the government and the Central Bank of Russia to further regulate and restrict currency control matters, including operations involving foreign securities and foreign currency borrowings by Russian companies. The new law also abolishes the need for companies to obtain transaction-specific licenses from the Central Bank, envisaging instead the implementation of generally applicable restrictions on currency operations. See "Item 10. Additional Information—Charter and Certain Requirements of Russian Legislation—Exchange Controls" for further description of Russia's currency control regulations. As the evolving regulatory regime is new and relatively untested, it is unclear whether it will be more or less restrictive than the prior laws and regulations it has replaced.

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

Russian transfer pricing rules entered into force in 1999, giving Russian tax authorities the right to make transfer pricing adjustments and impose additional tax liabilities in respect of all controlled transactions, provided that the transaction price differs from the market price by more than 20%. Controlled transactions include transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions or transactions with significant (by more than 20%) price fluctuations. The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and courts. Due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge our prices and propose adjustments. If such price adjustments are upheld by the Russian courts and implemented, our future financial results could be adversely affected. In addition, we could face significant losses associated with the assessed amount of prior tax underpaid and related interest and penalties, which could have an adverse effect on our financial condition and results of operations. See also "—Risks Relating to Russian Legislation and the Russian Legal System—Weaknesses and changes in the Russian tax system could materially adversely affect our business and the value of our securities."

***Risks Relating to Our ADRs and the Trading Market***

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

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

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 those jurisdictions, an action against the depositary, the legal owner, would not result in the beneficial owners losing their shares. Russian law may not make the same distinction between legal and beneficial ownership, and it may only recognize the rights of the depositary in whose name the shares are held, not the rights of ADS holders, to the underlying shares.

Thus, in proceedings brought against a depositary, whether or not related to shares underlying ADSs, Russian courts may treat those underlying shares as the assets of the depositary, subject to seizure or arrest. We do not know yet whether the shares underlying the ADSs may be seized or arrested in Russian legal proceedings against a depositary. In the past, a lawsuit was filed against a depositary bank other than Deutsche Bank Trust Company Americas seeking the seizure of various Russian companies' shares represented by ADSs issued by that depositary. In the event that this type of suit were to be successful in the future against Deutsche Bank Trust Company Americas, and the shares underlying our ADSs were to be seized or arrested, the ADS holders involved would lose their rights to such underlying shares.

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

You will be able to exercise voting rights with respect to the common shares represented by ADSs only in accordance with the provisions of the deposit agreement relating to the ADSs and relevant requirements of Russian law. However, there are practical limitations upon your ability to exercise your voting rights due to the additional procedural steps involved in communicating with you. For example, the Federal Law on Joint Stock Companies of December 26, 1995, or the Joint Stock Company Law, and our charter require us to notify shareholders at least 30 days in advance of any meeting and at least 50 days in advance of an extraordinary meeting relating to election of directors. Our common shareholders will receive notice directly from us and will be able to exercise their voting rights by either attending the meeting in person or voting by power of attorney.

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

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

***The price of our securities may be highly volatile.***

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

- variations in our operating results and those of other 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.

In addition, there is very limited public free float of our shares on the Russian Trading System, or RTS, the Russian stock exchange where they are currently listed. This, in turn, may affect the liquidity of our shares and ADSs and their trading prices.

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

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

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

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

In accordance with Russian legislation, dividends paid to a nonresident holder generally will be subject to Russian withholding at a 15% rate for legal entities, and at the rate of 30% for individuals. This tax may be reduced to 5% to 10% under the United States-Russia income tax treaty for U.S. holders. However, the Russian tax rules applicable to U.S. holders are characterized by significant uncertainties and by the scarcity of available interpretive guidance. In 2005 the Ministry of Finance expressed an opinion that holders of depositary receipts should be treated as the beneficial owners of the underlying shares for the purposes of the double tax treaty provisions applicable to taxation of dividend income from the underlying shares, provided that the tax residencies of depositary receipt holders are duly confirmed. However, 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 depositary receipt arrangements. In particular, it is unclear whether Russian tax authorities will treat U.S. holders as the beneficial owners of the underlying shares for the purposes of the United States-Russia income tax treaty. If the Russian tax authorities were not to treat U.S. holders as the beneficial owners of the underlying shares, then the U.S. holders would not be able to benefit from the provisions of the United States-Russia double tax treaty. See "Item 10. Additional Information—Taxation—Russian Income and Withholding Tax Considerations—United States-Russia Income Tax Treaty Procedures," "Item 10. Additional Information—Taxation—Russian Income and Withholding Tax Considerations—Taxation of Dividends" and "Item 10. Additional Information—Taxation—United States Federal Income Tax Considerations—Taxation of dividends on common shares or ADSs" for a more detailed discussion of this issue and administration procedures.

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

Under Russian tax legislation, gains arising from the disposition of Russian shares and securities, such as our common shares, as well as financial instruments derived from such shares, such as our ADSs, may be subject to Russian income or withholding taxes. However, no procedural mechanism currently exists to withhold any capital gains or for subsequent remittance of such amounts to the Russian tax authorities with respect to sales made between non-residents or sales of ADSs on the New York Stock Exchange. See "Item 10. Additional Information—Taxation—Russian Income and Withholding Tax Considerations—United States-Russia Income Tax Treaty Procedures."



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

Our presence outside the United States may limit your legal recourse against us. Mechel Steel Group is incorporated under the laws of the Russian Federation. All of our directors and executive officers reside outside the United States, principally in Russia. All or a substantial portion of our assets and the assets of our directors and executive officers are located outside the United States. As a result, you may not be able to 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 Political Environment in Russia**

##### ***Political and governmental instability could adversely affect the value of our securities.***

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. Moreover, the composition of the Russian government, the prime minister and the other heads of federal ministries has at times been highly unstable. For example, six different prime ministers headed governments between March 1998 and May 2000. On December 31, 1999, President Yeltsin unexpectedly resigned. Vladimir Putin was subsequently elected president on March 26, 2000 and re-elected for a second term on March 14, 2004. Throughout his first term in office, President Putin has maintained governmental stability and even accelerated the reform process. In February 2004, President Putin dismissed his entire cabinet, including the prime minister. This was followed on March 12, 2004, by President Putin's announcement of a far-reaching restructuring of the Russian government, with the stated aim of making the government more transparent and efficient. The changes included, for example, reducing the number of ministries from 30 to 14 and dividing the government into three levels: ministries, services and agencies. In addition to the restructuring of the Russian federal government, the Russian parliament adopted legislation whereby the executives of sub-federal political units will no longer be directly elected by the population and will instead be nominated by the President of the Russian Federation and confirmed by the legislature of the sub-federal political unit. Further, President Putin has proposed to eliminate individual races in State Duma elections, so that voters would only cast ballots for political parties. These new structures are largely not yet finalized and implemented.

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

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

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

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

#### **Risks Relating to the Economic Environment in Russia**

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

Generally, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved in, and are familiar with, investing in emerging markets. Investors should also note that emerging markets such as Russia are subject to rapid change and that the information set out herein may become outdated relatively quickly. Moreover, financial turmoil in any emerging market country tends to adversely affect prices in stock markets of all emerging market countries as investors move their money to more stable, developed markets. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging

economies could dampen foreign investment in Russia and adversely affect the Russian economy. In addition, during such times, emerging market companies can face severe liquidity constraints as foreign funding sources are withdrawn. Thus, even if the Russian economy remains relatively stable, financial turmoil in any emerging market country could seriously disrupt our business, as well as result in a decrease in the price of our securities.

***Economic instability in Russia could adversely affect our business.***

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

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

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

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

Recent trends in the Russian economy—such as the increase in the gross domestic product, a relatively stable ruble and a reduced rate of inflation—may not continue or may be abruptly reversed. Additionally, because Russia produces and exports large quantities of oil and natural gas, the Russian

economy is especially vulnerable to fluctuations in the price of oil and natural gas on the world market and a decline in the price of oil or natural gas could significantly slow or disrupt the Russian economy. Recent military conflicts and international terrorist activity have created significant uncertainty about the supply of oil and natural gas and delayed the expected recovery of the global economy, and such future events may continue to adversely affect the global economic environment, which could result in a decline in the demand for oil and natural gas. A strengthening of the ruble in real terms relative to the U.S. dollar, changes in monetary policy, inflation or other factors could adversely affect Russia's economy and our business in the future. Any such market downturn or economic slowdown could also severely limit our and our customers' access to capital, also adversely affecting our and our customers' businesses in the future.

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

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

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

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

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

Russia's physical infrastructure largely dates back to Soviet times and has not been adequately funded and maintained over the past decade. Particularly affected are the rail and road networks, power generation and transmission, communication systems and building stock. For example, in May 2005, a fire and explosion in one of the Moscow power substations built in 1963 caused a major multi-hour outage in a large section of Moscow and some surrounding regions. Road conditions throughout Russia are poor, with many roads not meeting minimum quality requirements. The federal government is actively considering plans to reorganize the nation's rail, electricity and telephone systems. Any such reorganization may result in increased charges and tariffs while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems.

The deterioration of Russia's physical infrastructure harms the national economy, disrupts the transportation of goods and supplies, adds costs to doing business in Russia, and can interrupt business operations. These difficulties can impact us directly and further deterioration in the physical infrastructure could have a material adverse effect on our business and the value of our securities.

#### **Risks Relating to the Social Environment in Russia**

***Crime, 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. In addition, the local and international press have reported high levels of official corruption in the locations where we conduct our business, including the bribing of officials for the purpose of initiating investigations by government agencies. Press reports have also described instances in which government officials engaged in selective investigations and prosecutions to further the commercial interests of government officials or certain companies or individuals. Additionally, published reports indicate that a significant number of Russian media regularly publish disparaging articles in return for payment. The depredations of organized or other crime, demands of corrupt officials, claims that we have been involved in official corruption or engaged in improper activities or slanted articles, press speculation and negative publicity could disrupt our ability to conduct our business and could thus materially adversely affect our business, financial condition and results of operations or prospects and the value of our securities.

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

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

## Risks Relating to Russian Legislation and the Russian Legal System

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

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

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

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

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

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

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

In addition, Russian corporate and securities rules and regulations can change rapidly, which may adversely affect our ability to conduct securities-related transactions. While some important areas are subject to virtually no oversight, the regulatory requirements imposed on Russian issuers in other areas result in delays in conducting securities offerings and in accessing the capital markets. It is often

unclear whether or how regulations, decisions and letters issued by the various regulatory authorities apply to our company. As a result, we may be subject to fines or other enforcement measures despite our best efforts at compliance.

Additionally, several fundamental laws have only recently become effective. The enactment of new legislation in the context of a rapid evolution to a market economy and the lack of consensus about the scope, content and pace of economic and political reforms has resulted in ambiguities, inconsistencies and anomalies in the overall Russian legal system. The enforceability and underlying constitutionality of many recently enacted laws are in doubt, and many new laws remain untested. For example, the regulations regarding issuance of permissions for depositary receipt programs and voting by depositaries at the instruction of ADS holders, are relatively new and untested. In addition, Russian legislation often contemplates implementing regulations that have not yet been promulgated, leaving substantial gaps in the regulatory infrastructure. All of these weaknesses could affect our ability to enforce our legal rights, including rights under our contracts, or to defend ourselves against claims by others.

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

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

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

***Selective or arbitrary government action may have an adverse effect on our business, financial condition and results of operations or prospects and the value of our securities.***

We operate in an uncertain regulatory environment. Governmental authorities have a high degree of discretion in Russia and at times act selectively or arbitrarily, without hearing or prior notice, and sometimes in a manner that is 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, 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, often for political purposes. 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 has expressed concerns that "Russian

companies and their investors can be subjected to government pressure through selective implementation of regulations and legislation that is either politically motivated or triggered by competing business groups." In this environment, our competitors may receive preferential treatment from the government, potentially giving them a competitive advantage over us.

In addition, in 2003 and 2004, the Ministry for Taxes and Levies brought tax evasion claims challenging certain Russian companies' use of tax-optimization schemes, and press reports have speculated that these enforcement actions have been selective. Selective or arbitrary government action, if directed at us, could have a material adverse effect on our business, financial condition and results of operations or prospects and the value of our securities.

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

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

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

Moreover, an effective parent is secondarily liable for an effective subsidiary's debts if an effective subsidiary becomes insolvent or bankrupt as a result of the action or inaction of an effective parent. This is the case no matter how the effective parent's capability to determine decisions of the effective subsidiary arises. For example, this liability could arise through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary's losses from the effective parent which caused the effective subsidiary to take action or fail to take action knowing that such action or failure to take action would result in losses. Accordingly, given our status as a holding company, we could be liable in some cases for debts of our consolidated Russian subsidiaries. The total liabilities of our consolidated Russian subsidiaries, as of December 31, 2004, was \$1,021.1 million, excluding intercompany indebtedness.

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

In general, minority shareholder protection under Russian law derives from supermajority shareholder approval requirements for certain corporate action, as well as from the ability of a shareholder to demand that the company purchase the shares held by that shareholder if that shareholder voted against or did not participate in voting on certain types of action. Companies are also required by Russian law to obtain the approval of disinterested shareholders for certain transactions with interested parties. See "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 have proven to be poor, and minority shareholders in Russian companies have suffered losses due to abusive share dilutions, asset transfers and transfer pricing practices. Shareholder meetings have been irregularly conducted, and shareholder



resolutions have not always been respected by management. Shareholders of some companies also suffered as a result of fraudulent bankruptcies initiated by hostile creditors.

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

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

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

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

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

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

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

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

Ownership of Russian joint stock company shares (or, if the shares are held through a nominee or custodian, then the holding of such nominee or custodian) is determined by entries in a share register

and is evidenced by extracts from that register. Currently, there is no central registration system in Russia. Share registers are maintained by the companies themselves or, if a company has more than 50 shareholders or so elects, by licensed registrars located throughout Russia. Regulations have been issued regarding the licensing conditions for such registrars, as well as the procedures to be followed by both companies maintaining their own registers and licensed registrars when performing the functions of registrar. In practice, however, these regulations have not been strictly enforced, and registrars generally have relatively low levels of capitalization and inadequate insurance coverage. Moreover, registrars are not necessarily subject to effective governmental supervision. Due to the lack of a central and rigorously regulated share registration system in Russia, transactions in respect of a company's shares could be improperly or inaccurately recorded, and share registration could be lost through fraud, negligence, official and unofficial governmental actions or oversight by registrars incapable of compensating shareholders for their misconduct. This creates risks of loss not normally associated with investments in other securities markets. Further, the depository, 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."

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

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

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

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

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

In practice, the Russian tax authorities often have their own interpretation of the tax laws that rarely favors taxpayers, who often have to resort to court proceedings to defend their position against the tax authorities. Differing interpretations of tax regulations exist both among and within government ministries and organizations at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Tax declarations, together with related documentation such as customs declarations, are subject to review and investigation by a number of authorities, each of which may impose fines, penalties and interest charges. Generally, taxpayers are subject to inspection for a period of three calendar years of their activities which immediately preceded the year in which the audit is