Kuzbasskaya Toplivnaya Company

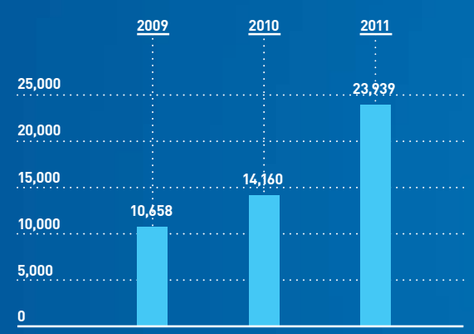
ANNUAL REVIEW

2011

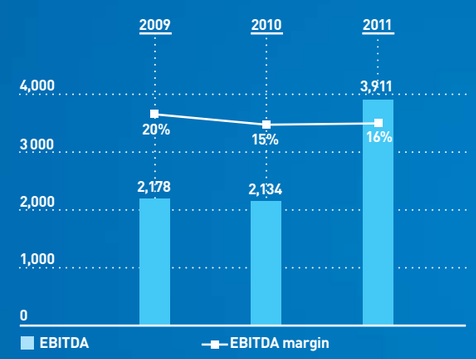
DELIVERING PROMISES

THE COMPANY
AT A GLANCE

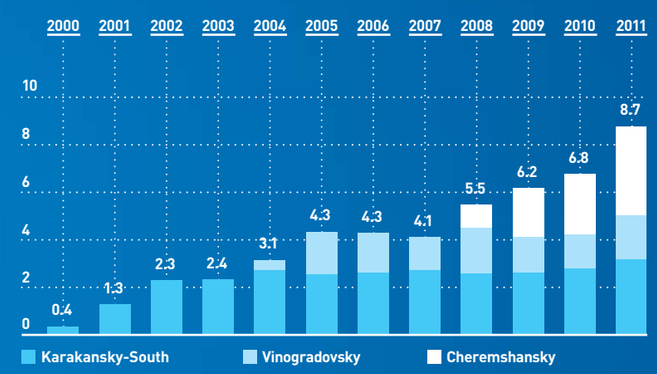
Revenue, mln RUB



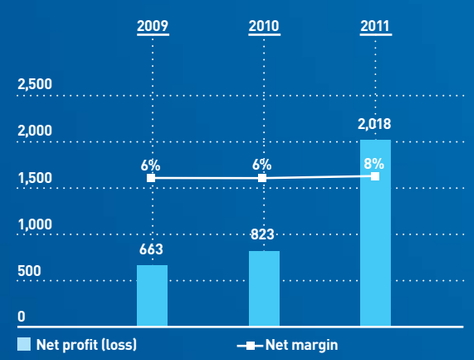
EBITDA, mln RUB



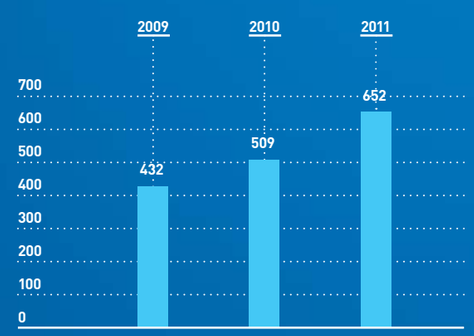
Coal production by mine, mln tonnes



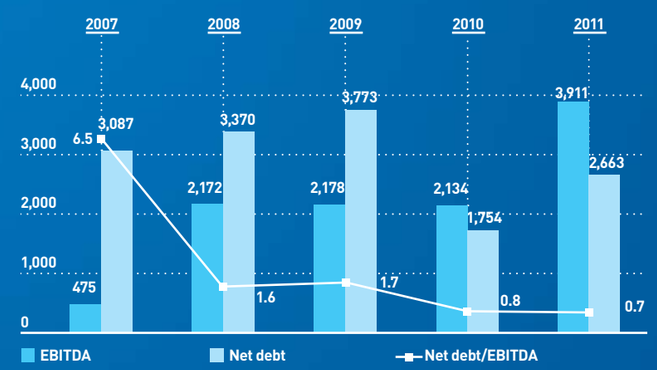
Net profit (loss), mln RUB



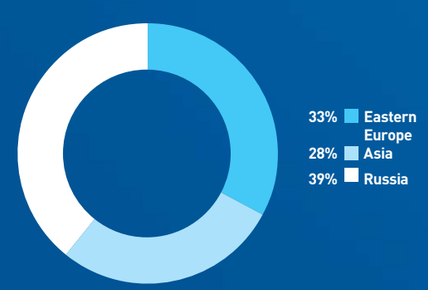
Production costs, RUB/t



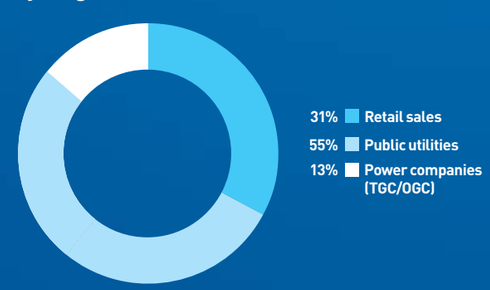
Indebtedness, mln RUB



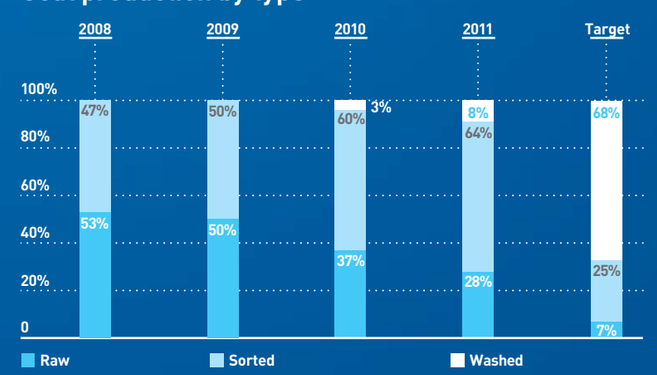
Geography of sales in 2011



Structure of domestic sales in 2011, by segment



Coal production by type



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KTK's performance in 2011 shows that the company has fulfilled the planned target and also well advanced in achieving of long-term goals.

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In the course of the year the Company consistently met its obligations to investors, partners and counterparties.

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SHAREHOLDER EQUITY

KTK's current share price does not reflect the Company's fundamental value, indicating the possibility of future growth. Analysts at leading investment companies largely share this view.

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OPERATING RESULTS FOR 2011

KTK was Russia's seventh largest producer of thermal coal in 2011. The Company plans to increase production of washed coal by building additional washing facilities.

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DISTRIBUTION SYSTEM

The rapid growth of the distribution network is being driven by the demand in Western Siberian regions for a stable supplier of quality coal who can provide a full range of sales and delivery services to consumers.

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KEY FIGURES 2011
are in the valve cover

DELIVERING PROMISES
read more at pages 2–13

1 EXPANSION OF THE FLEET OF MODERN MINING AND TRANSPORT EQUIPMENT

PURCHASED EQUIPMENT FOR

772.5

MILLION RUBLES

READ MORE ON **PAGE 55**

2 EXPANSION OF GONDOLA CARS FLEET, GETTING THE LOAN FOR FURTHER PURCHASES OF CARS

READ MORE ON **PAGES 47, 59**

In early 2012 the **500** **cars** were purchased in the property

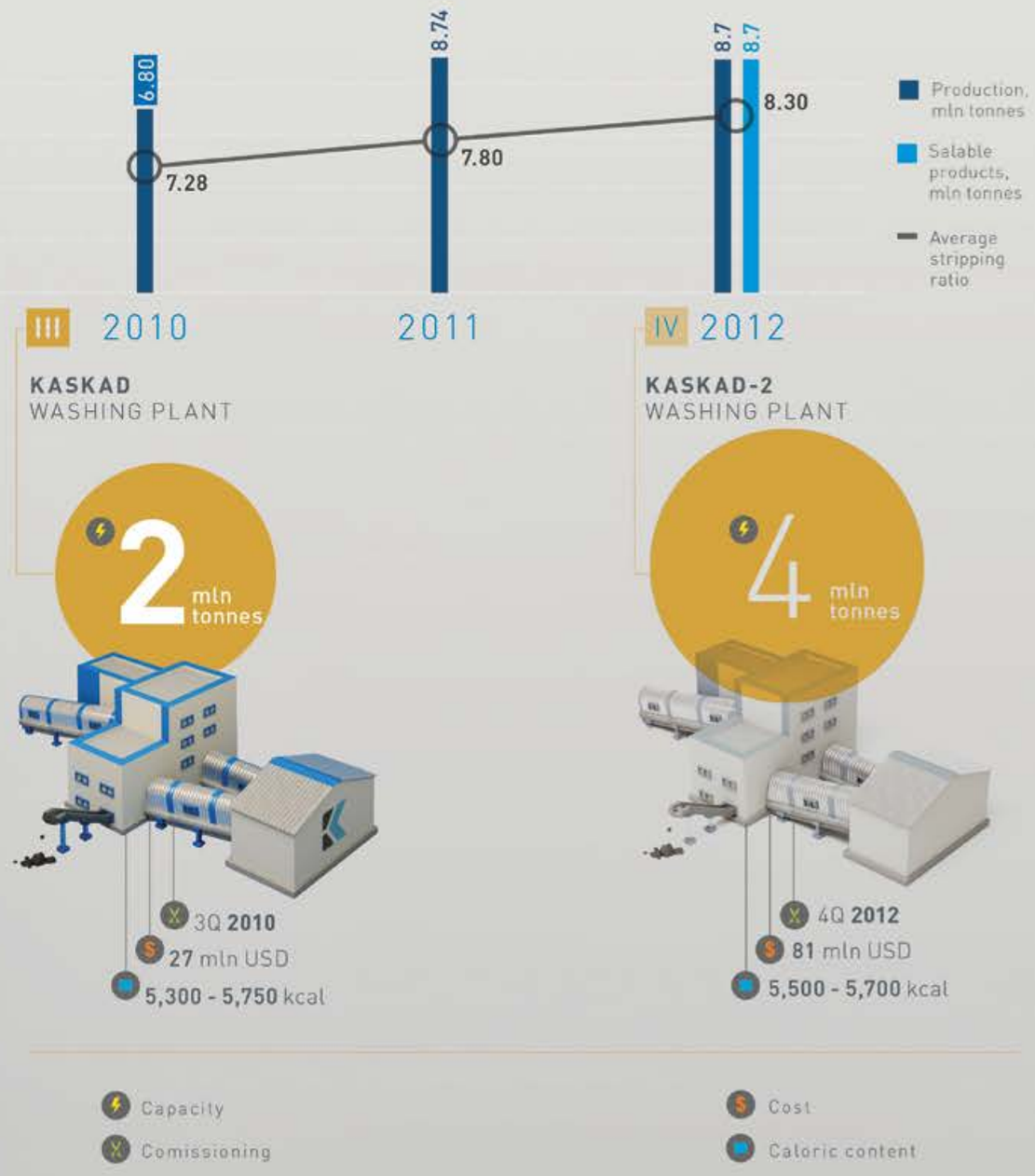
TOTAL

3,128

CARS IN FLEET

3 COAL WASHING GROWTH

READ MORE ON PAGES 46, 50, 54



4 EXPAND THE RESOURCE BASE

IN DECEMBER 2011, THE COMPANY WON THE AUCTION FOR THE RIGHTS TO EXPLORE AND MINE THE **BRYANSKY** SECTION OF THE KARAKANSKOYE HARD THERMAL COAL FIELD WITH RESOURCES OF **250** MILLION TONNES.

1 2 3 4

COMPANY'S RESOURCE BASE CONSIST OF

599.4

mln tonnes of coal

1 **VINOGRADOVSKY** OPEN-PIT MINE

142.6

mln tonnes of coal

2 **CHEREMSHANSKY** OPEN-PIT MINE

165.3

mln tonnes of coal

3 **KARAKANSKY-SOUTH** OPEN-PIT MINE

41.5

mln tonnes of coal

4 **BRYANSKY** SECTION

+250

mln tonnes of coal

5 **KASKAD** WASHING PLANT

6 **KASKAD-2** WASHING PLANT

7 ADMINISTRATIVE COMPLEX

Settlement

Station

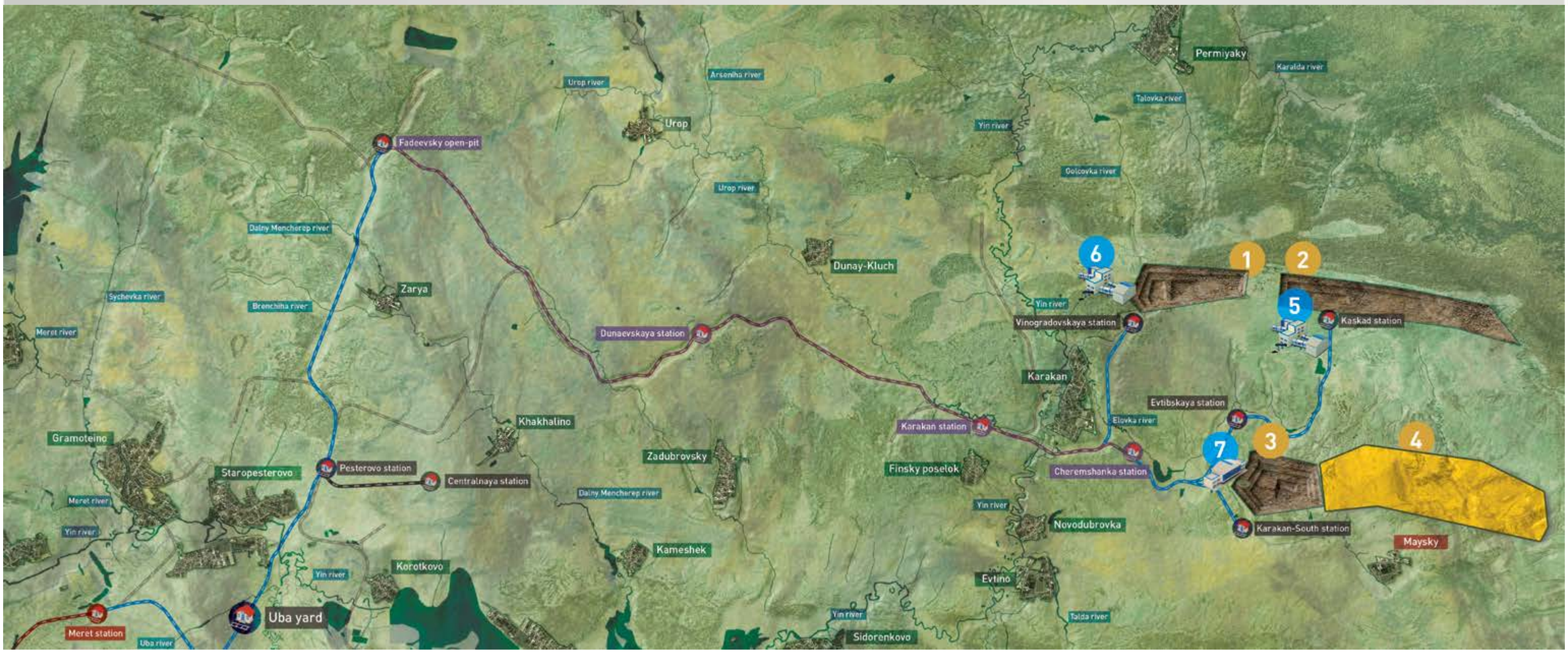
River

Railways

Railway infrastructure of KTK

Railway infrastructure of Kuzbassrazrezugol

Railway infrastructure of RZD



5 SALES GEOGRAPHICAL **EXPANSION**

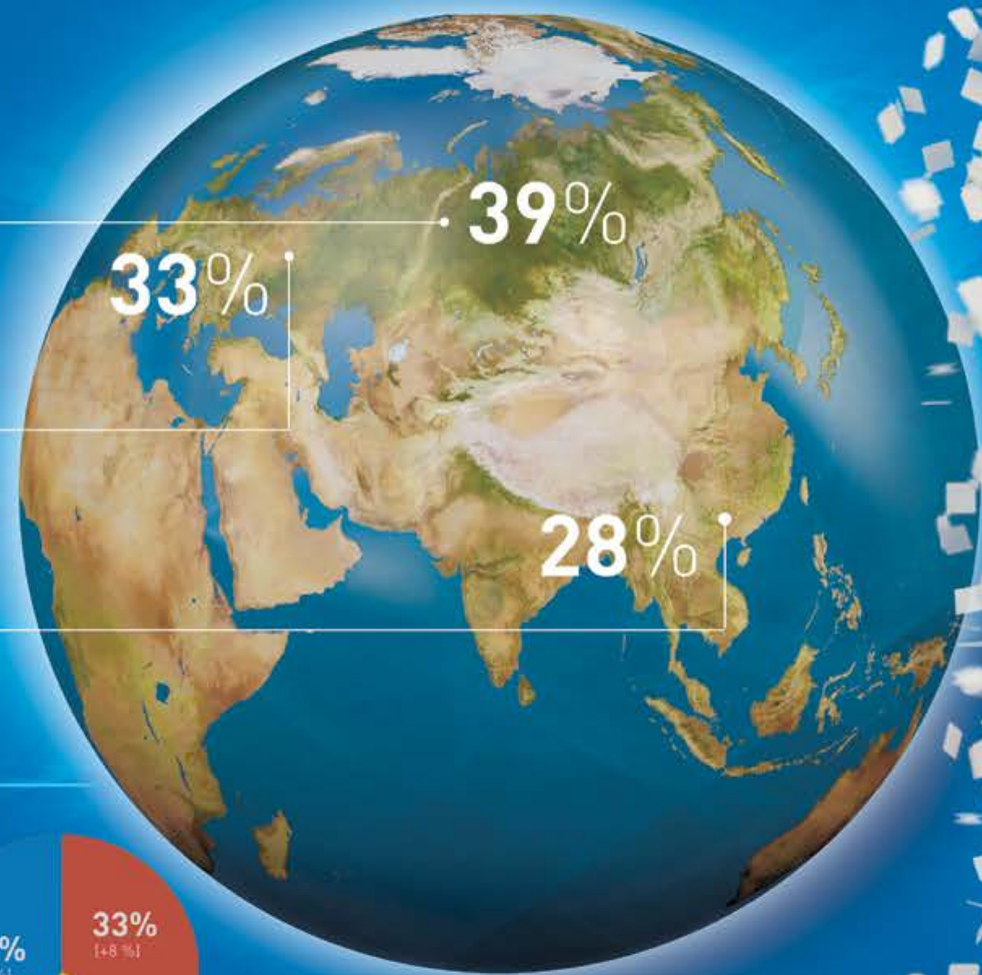
READ MORE ON PAGE 62

KTK'S SALES GEOGRAPHY,
by regions, in 2011

RUSSIA **4.21** mln tonnes

EASTERN EUROPEAN COUNTRIES **3.53** mln tonnes

ASIA AND OCEANIA **2.92** mln tonnes



by years

RUSSIA

The Siberian Federal District
3.85 mln tonnes

Volga Federal District
0.15 mln tonnes

North-Western Federal District
0.11 mln tonnes

Urals Federal District
0.10 mln tonnes

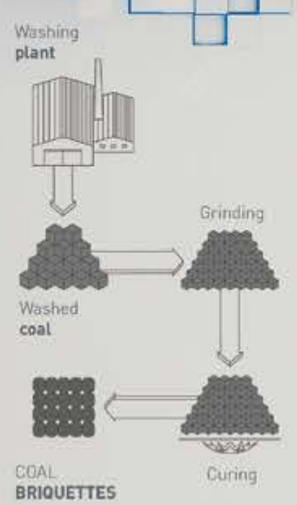
Central Federal District
0.01 mln tonnes

6 PRE-FEASIBILITY STUDIES

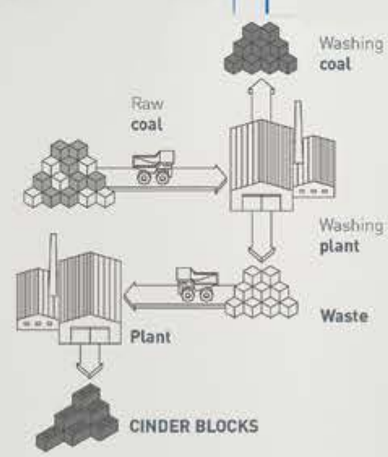
ARE CARRIED OUT IN **3** MAIN AREAS

1 COAL BRIQUETTES

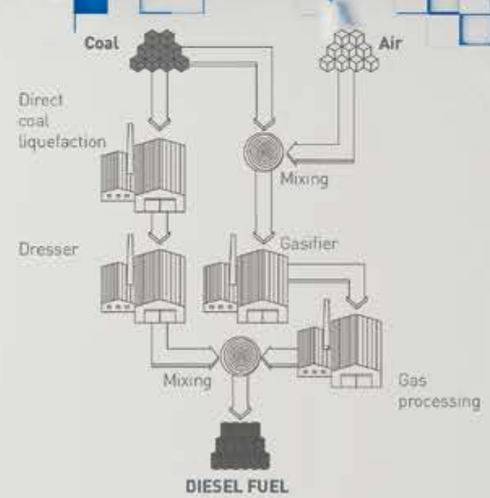
READ MORE ON **PAGE 80**



2 BUILDING MATERIALS FROM THE WASTE



3 DIESEL FUEL



1 THE COMPANY TODAY

69% REVENUE GROWTH IN 2011

145% NET PROFIT GROWTH IN 2011

122% EPS GROWTH IN 2011

95% EBITDA GROWTH IN 2011

Kuzbasskaya Toplivnaya Company OJSC (KTK or the Company) is one of the largest independent thermal coal producers in Russia, the Company is not part of any major energy group.

The Company strip mines coal in the Kuznetsk Basin in Western Siberia, one of the largest deposits of coal in the world.

RESOURCES

The Company currently mines coal at three open-pit mines: Karakansky-South, Vinogradovsky and Cheremshansky, which comprise an integrated operation with design capacity of 11 million tonnes per year. In the next few years, the Company plans to begin developing a fourth open-pit mine that will include the Bryansky license block acquired in December 2011.

The Company had JORC resources of 402 million tonnes of coal as of January 1, 2011, including 185 million tonnes of probable and proved reserves. The reserves of the new Bryansky block are estimated at 250 million tonnes category C2. Its development will increase the Company's coal mining capacity to 14 million-15 million tonnes per year from the current 11 million tonnes.

The Company also has well-developed production and transport infrastructure, including a railroad network, washing plant with annual capacity of 2 million tonnes, coal storage yards with sorting facilities, repair centers, power company Kaskad-Energo and other assets. The Company plans to launch a second washing plant with capacity of 4 million tonnes with pilot production in the fourth quarter of 2012.

INDICATORS FOR 2011

KTK was Russia's seventh largest producer of thermal coal in 2011. The Company increased coal production by 28.5% year-on-year to 8.7 million tonnes in 2011, including 0.74 million tonnes of high quality washed coal. The Company plans to increase production of washed coal by building additional washing facilities next to its coal mining operations.

Kuzbasskaya Toplivnaya Company's export sales surged 76% in 2011, propelling the Company into the ranks of the top-five exporters of thermal coal from Russia for the first time. The Company is becoming an increasingly visible player on both the domestic market and the global arena. The Company's sales are split among three regions: Russia, Asia and Eastern Europe.

The Company's financial results for 2011 demonstrated strong growth. Revenues grew 69%, net profit soared 145% and earnings per share increased by 122%. Earnings before interest, tax and depreciation (EBITDA) expressed dollar terms grew 90% to $133 million. The Company is pursuing a conservative debt policy, which is reflected in its low net debt to EBITDA ratio of 0.68.

INVESTMENT

KTK is investing heavily in production, spending 2.25 billion rubles in 2011. Key areas of investment are construction of washing facilities, expansion of the fleet of mining and transport equipment and railroad infrastructure.

The Company has also made research and development a priority. Pre-feasibility studies are now being carried out in three areas: development of fuel briquettes with high heat value, production of construction materials from coal production waste and production of synthetic diesel fuel with coal gasification technology.

KTK remains the only publicly traded independent thermal coal producer in Russia.

The Company's market capitalization was about 15 billion rubles on December 30, 2011, according to Moscow Exchange MICEX-RTS. The free float was 34.4% at the year end.

MESSAGE FROM **THE GENERAL DIRECTOR**

Igor Prokudin
General Director

Dear shareholders, clients, partners and colleagues!

Summing up the results of 2011, I would first of all like to note the record growth of Kuzbasskaya Toplivnaya Company's operating results.

RECORDS OF 2011

Coal production grew by almost a third compared to 2010, to 8.74 million tonnes, bringing the Company to a new level that enabled it to enter the ranks of the top ten thermal coal producers in Russia.

The Company's exports also reached a record high. We shipped 6.45 million tonnes of high quality coal to our foreign customers, almost 76% more than in 2010.

This made the Company the fifth largest Russian exporter of thermal coal. The Company is confidently moving toward its goal of reaching annual coal production capacity of 11 million tonnes, and is even ahead of schedule.

GROWTH OF RESOURCE BASE

In addition to production growth, the Company's strategic goal is to expand its resource base and in 2011 we made significant progress in achieving this goal. At the end of the year, Kuzbasskaya Toplivnaya Company won an auction for the rights to develop the Bryansky section of the Karakanskoye coal field, adding 250 million tonnes of coal resources in the direct vicinity of the Company's existing infrastructure. Geological exploration is already underway and in the near future we plan to begin developing our fourth open-pit mine based at this site.

CONSTRUCTION OF WASHING PLANTS

Another important development in 2011 was the start of construction on a second washing plant (Kaskad-2), which the Company plans to complete in the fourth quarter of 2012. The plant will have capacity of 4 million tonnes, two times more than the plans presented to participants in KTK's IPO in 2010. The plant will simultaneously use steeply inclined separation and dense medium gravity separation, which is an innovative technology in both Russian and globally.

I would like to point out that the KTK plant is being built in a very short period for a facility of such scale – just 1-1.5 years. We intend to continue to adopt the latest washing technologies, and pursue efforts to improve the quality of our coal and increase the share of high value-added products in our sales. The existing Kaskad plant produced 740,000 tonnes of high quality washed coal in 2011.

MODERNIZATION OF RAILWAY INFRASTRUCTURE

We also carried out plans in 2011 to modernize our own railroad infrastructure, which takes coal from our mines to the national network of Russian Railways (RZD). We completed a major overhaul of our Uba sorting station, building five additional rail tracks with an overhead system, as well as an office and amenities building to house the employees of Meret Freight Forwarding Company and RZD. This enabled us to meet RZD's technical specifications and expand the throughput capacity of the station to 16.7 million tonnes of coal per year.

Ensuring transport independence remains a strategic priority for the Company. The joint venture Kuzbass Transport Company had a fleet of 2,628 coal wagons at the end of 2011 that KTK leased at fixed rates. There are plans to increase the total number of coal wagons to 5,000 in future using borrowed funds.

UPDATE OF THE FLEET OF MINING AND TRANSPORT EQUIPMENT

We continued to update our fleet of mining and transport equipment last year, favoring modern, high-performance machinery. About 40% of the total investment budget for 2011 went toward equipment. As planned, in 2011 we acquired options to purchase mining machinery and equipment valid until 2013, which will minimize the negative impact of price fluctuations and guarantee that equipment is delivered to mines on time.

FINANCIAL RESULTS

The financial results for 2011 reflect the professionalism and efficiency of our management team. The Company's IFRS revenues in ruble terms grew by 69%, net profit jumped 145% and earnings per share increased by 122%. EBITDA totaled $133 million, which was in line with our internal forecasts. The net debt to EBITDA ratio remains low at 0.68. The effective borrowing rate continued to decline last year, which will enable the Company to save on interest payments. Lending institutions' favorable disposition toward KTK is due to objective reasons: the Company's information openness, financial stability and conservative debt policy.

Summarising the results of the year, I would like to note that we met and even surpassed all financial and operating targets set out in the plan for 2011.

I am confident that the Company's fulfillment of all promises made to investors, combined with its financial transparency, high standards of corporate governance and systematic efforts to increase efficiency will lead to the long-term growth of shareholder value. I would like to thank all Kuzbasskaya Toplivnaya Company employees for their teamwork, achievement of goals and support for the management initiatives that ensured the Company's strong growth last year.

MESSAGE FROM THE CHAIRMAN OF THE BOARD

Vadim Danilov
Chairman
of the Board of Directors

Dear ladies and gentlemen!
I can say with confidence that 2011 was another successful year for Kuzbasskaya Toplivnaya Company.

DELIVERING PROMISES

In the course of the year the Company consistently met its obligations to investors, partners and counterparties, and responded quickly to changes in the situation on both the Russian and global coal markets. As a result, the Company made considerable headway toward achieving its strategic goals and objectives and laid a strong foundation for future growth.

The Company's strategy to strengthen its leading position in the industry and increase its investment attractiveness is based on the expansion of the resource base and production capacity, efficient operation of logistics and distribution infrastructure, reduction of transport dependence on railroad operators, growth in the share of high value-added products, tight control over costs, and penetration of new markets both outside Russia and inside the country.

This is the recipe for the Company's success and it is leading to the growth of profitability and efficiency: the Company's net profit more than doubled in 2011 compared to the previous year.

HIGHLIGHTS OF 2011 AND FIRST QUARTER OF 2012

EXPORT SHARE GROWTH

I would also like to mention the expansion of the Company's presence on promising export markets. Due to a warm winter in Europe, the Company moved quickly to redirect exports to countries in Asia, to which it shipped 81% more coal than in 2010. The Company entered the Japanese market for the first time, and received certification from exchanges in South Korea and Taiwan testifying to the reliable quality of Kuzbasskaya Toplivnaya Company's coal. This gives us the green light to increase exports to these countries. An important development on the European market was the opening of a representative office in Warsaw at the beginning of 2012, which in future will make it possible to work on the Polish market without intermediaries.

INCREASE OF INVESTMENT ATTRACTIVENESS

The Company's Board of Directors wants to increase KTK's investment appeal and is increasing information openness with this aim in mind. Meetings with current and potential investors, as well as analysts are held throughout the year. The Company's public status requires it to maintain openness and strengthen investor confidence in its business. Significantly, despite the downturn on the Russian stock market in 2011 (including KTK's shares) not a single major institutional investor pulled out of the Company.

We see strong growth potential for KTK's shares and believe that their current price does not reflect the Company's fundamentals: generated revenue, net profit and profitability. This is demonstrated by the Company's multiples, which are among the lowest in both the Russian and global coal industries. We have not abandoned plans to issue depositary receipts (without an issue of a new shares) on major international exchanges in order to realize the potential target price of our shares. This could happen in the next few years.

CORPORATE GOVERNANCE

The Board of Directors is continuing to devote a great deal of attention to improving corporate governance standards, and we are seeing progress in this key area. The five members of the Board of Directors, including two independent directors, are closely monitoring how the Company's management is achieving set goals. We are striving to continually develop top management and are now working on a three-level system of bonuses for senior executives.

Increasing investment appeal is an important element in Kuzbasskaya Toplivnaya Company's development, so it is the job of the Board of Directors and management to build the foundation for such growth and ensure that shareholders share in the Company's profits.

I am confident that the KTK team will continue to strengthen shareholder confidence in the Company.

FEBRUARY 2011

The Company signed a contract with OJSC Fortum, the Russian division of Finish power company Fortum, to supply coal to Chelyabinsk CHPP-2. Tests showed that KTK coal is the most suitable alternative to brown coal from the Chelyabinsk basin. It makes it possible to generate heat and electricity for Chelyabinsk businesses with the least environmental impact. The partnership with a major energy company strengthens KTK's reputation as a stable and reliable supplier of quality coal.

KTK and the Kemerovo Region administration signed a socioeconomic cooperation agreement for 2011 under which the Company pledged to invest 2.0 billion rubles in production, spend 25 million rubles on creating safe working conditions at its operations, allocate 25.5 million rubles for social payments to its employees and pensioners, and contribute 17.6 million rubles to regional social programs. KTK also pledged to raise average wages by 10% compared to 2010.

MAY 2011

The Board of Directors held a meeting at which it recommended that shareholders at the annual General Meeting approve dividends for 2010 of 3 rubles per common share and set aside 297.8 million rubles for this purpose.

JUNE 2011

The Company held its annual General Meeting to review 2010, at which shareholders approved the recommendation of the Board of Directors to pay dividends for 2010 of 3 rubles per common share, or a total of 297.8 million rubles. Shareholders also confirmed the list of board members: Igor Prokudin, Eduard Alexeenko, Vadim Danilov, David Stewart and Yury Fridman. CJSC Balance Consulting Group was confirmed as domestic auditor to Russian Accounting Standards for 2011.

JULY 2011

Kemerovo Region Deputy Governor for Natural Resources and the Environment Vladimir Kovalev and KTK General Director Igor Prokudin attended the opening of an innovative pumping and filtration station to treat runoff at the Vinogradovsky mine. The station is the only one of its kind in Russia and the world in terms of the set of methods for treatment of industrial and domestic waste water. KTK management plans to use such stations at all of the group's enterprises, making it possible to discharge high quality water and minimize environmental impact. The funds for this are included in the investment program for 2012-2016.

AUGUST 2011

Construction began on the Kaskad-2 washing plant with capacity of 4 million tonnes. The initial plan was for capacity of 2 million tonnes. The plant will simultaneously use steeply-inclined separation and dense medium gravity separation, which is an innovative technology both in Russia and internationally. The plant is scheduled to begin trial production in the fourth quarter of 2012.

SEPTEMBER 2011

KTK completed the overhaul of the Uba coal collection station, where railcars are sorted for subsequent shipment to RZD's Meret station. The project included construction of five tracks with overhead electricity system, an administration building, railcar inspection point building, treatment facilities, and the overhaul of the station's electric interlocking system. This will make it possible to increase coal loading from 500 to 700 cars per day, and increase the station's throughput capacity from 12 million tonnes to 16.7 million tonnes.

NOVEMBER 2011

KTK won prizes in national competitions of annual reports. KTK's report was awarded the prize for Best Debut at the XIV annual competition of annual reports organized by the MICEX and RTS exchanges, which drew a record 141 entries from Russian and foreign companies. In the RCB/FFMS competition, KTK's annual report was recognized as the Best Annual Report in the Fuel and Energy Sector, Best Comprehensive Presentation of a Company, and Best Annual Report from an Issuer in the Siberian Federal District.

A new unheated storage facility was opened at the Karakansky-South mine, and an open coal yard was completed at the Vinogradovsky mine with capacity of 500,000 tonnes per year.

DECEMBER 2011

KTK's market capitalization as of December 30, 2011 was about 15 billion rubles ($470 million at the Central Bank exchange rate), according to the merged Moscow Exchange MICEX-RTS. The average share price in 2011, based on closing prices, was 200.80 rubles. The free float was 34.4% at the end of the year.

OCTOBER 2011

KTK opened a mobile explosives production facility with annual capacity of up to 50,000 tonnes at the Vinogradovsky mine. The facility will make explosives for KTK's mines, enabling the Company to save on outside purchases and ensure a guaranteed supply of explosives for its operations. The new facility provides mobility and improved safety, as well as environmental advantages.

DECEMBER 2011

KTK won an auction for the rights to explore and mine the Bryansky section of the Karakanskoye coal field. The property has hard coal resources of 250 million tonnes and will have a mine life of 30 years. The Company plans to carry out exploration work at Bryansky in order to launch development of a fourth open-pit mine in the future. The Company already has the infrastructure needed to develop the new site, as it is close to the Karakansky-South mine. The development of the new property is expected to increase coal production capacity from 11 million tonnes to 14-15 million tonnes per year.

FEBRUARY 2012

KTK released operating results for 2011. The company increased coal production by 28% to 8.74 million tonnes, exceeding the target for the year by 7.4% and becoming the seventh largest thermal coal producer in Russia. Coal sorting at mobile crushing and screening units increased by 35% to 5.56 million tonnes, and production of washed coal at the Kaskad plant soared 270% to 0.74 million tonnes. Coal sales (which include coal purchased from third parties) grew 25% to 10.66 million tonnes, with exports increasing by 74% to 6.45 million tonnes, making the Company Russia's fifth largest coal exporter.

FEBRUARY 2012

KTK signed a socioeconomic cooperation agreement for 2012 with the Kemerovo Regional administration. KTK fulfilled its obligations under the 2011 agreement in full. In 2012, the parties agreed to raise average wages for employees by up to 10% compared to 2011 thanks to growth of labor productivity. The Company plans to spend 45 million rubles on social payments to its employees and pensioners (8% more than in 2011), and provide 22.1 million rubles to finance regional initiatives and programs (unchanged from 2011). KTK will deliver 350,000 tonnes of coal at fixed prices in 2012 for the region's public utility needs, and donate 3,500 tonnes of graded coal for poor households in Kemerovo Region.

MARCH 2012

The Company completed the acquisition of 500 railcars through its affiliate LLC Kuzbass Transport Company, increasing its fleet to 3,128 railcars.

The Board of Directors held a meeting at which it recommended that shareholders at the annual General Meeting approve dividends for 2011 of 6 rubles per common share and set aside 595.5 million rubles for this purpose. It also approved a business plan for KTK and its subsidiaries for 2012.

APRIL 2012

KTK released financial results for 2011 to International Financial Reporting Standards. The Company's revenues expressed in rubles grew by 69%, net profit rose by 145% and earnings per share increased by 122%. EBITDA reached $133 million, which was consistent with management forecasts. Cash production costs amounted to 652 rubles per tonne. The net debt/EBITDA ratio remained low at 0.68. All economic and operating targets of the plan for 2011 were met.

KTK held its annual General Meeting, at which shareholders approved the recommendation of the Board of Directors to pay dividends for 2011 of 6 rubles per common share, or 595.5 million rubles, up from 3 rubles per share, or 297.8 million rubles in 2010. CJSC Balance Consulting Group was confirmed as auditor. Shareholders also elected a new Board of Directors. Alex Williams was appointed independent director, replacing David Stewart. No other changes were made to the Board.

2 SHAREHOLDER EQUITY

Charter capital: FREE FLOAT REMAINS AT 34.4%

Kuzbasskaya Toplivnaya Company's charter capital as of December 31, 2011 was 19,851,671 rubles and consisted of 99,258,355 common shares with par value of 0.20 rubles each. KTK does not have preferred shares.

The Company's shares are traded on the merged Moscow Exchange MICEX-RTS in the B quotation list under the ticker KBTK and registration number 10211330F. The International Securities Identification Number (ISIN) is RU000A0JPYD7. The shares are also included in the Micex StartCap index of small cap stocks and RTS-2 index of second-tier stocks.

The share trading history is not very long yet – the Company carried out an initial public offering in April 2010. The free float is about 35%, and most of these shares are controlled by major institutional investors.

Charter capital

19.85

mln rubles

Consisted of

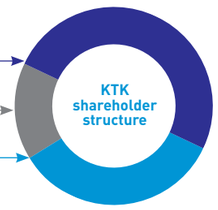
99,258,355

common shares

KTK shareholder structure

as of December 31, 2011

Shareholder	Number of shares	Interest
HAVER HOLDING LIMITED (beneficiary control held by Igor Prokudin)	49,639,103	50.001 %
LAYCRAFT LIMITED (direct control held by Vadim Danilov)	15,494,229	15.6 %
FREE FLOAT	34,125,022	34.4 %
TOTAL	99,258,355	100 %

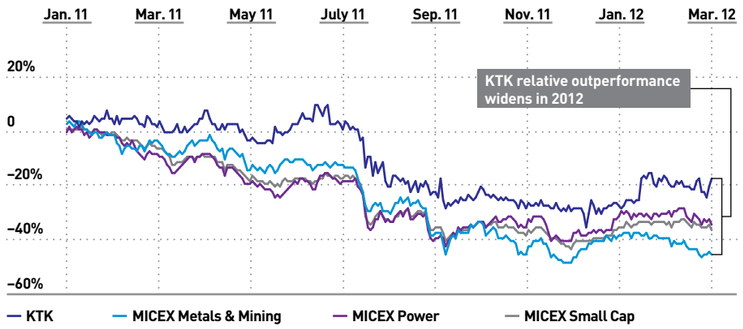


Source: KTK OJSC

Trading history: SHARES OUTPERFORM MARKET

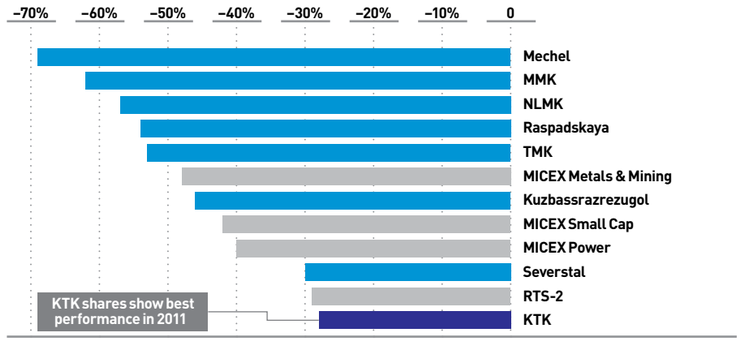
The Company's shares declined in 2011 and are currently trading at about 20% below the IPO price. The Company's market capitalization was about 15 billion rubles as of December 31, 2011, or $470 million at the Central Bank of Russia's exchange rate.

Change in KTK share price compared to MICEX Metals & Mining, MICEX Power and MICEX Smal Cap indexes



Source: Moscow Exchange MICEX-RTS website

Changes in share prices of Metals & Mining companies in 2011



Source: Moscow Exchange MICEX-RTS website

It should be noted that the decline in KTK's share price followed Russian stock market indices and was part of a general downward trend on the market. Global investors' interest in the Russian stock market decreased considerably in the second half of 2011 amid the deteriorating situation in the global economy, particularly the economic problems in Eurozone countries such as Greece, Spain and Portugal. Due to the growing uncertainty, foreign investors preferred to minimize their investments in the equities of emerging markets, including Russia.

A comparison of KTK's share price and the MICEX Metals & Mining and MICEX Power indexes, which reflect changes in the prices of shares in the mining industry and the power sector, shows that the decline of KTK's shares was in line with sector moves and was not related to Company specific factors.

THROUGHOUT 2011, KTK'S SHARES OUTPERFORMED THE MICEX INDUSTRY INDEXES.
At the beginning of 2012, the relative outperformance widened further.

Peer comparison:
KTK SHARES HAVE STRONG GROWTH POTENTIAL

The management believes that KTK's current share price does not reflect the Company's fundamental value, indicating the possibility of future growth. Analysts at leading investment companies largely share this view.

Company	P/E	EV/S	EV/EBITDA
KTK	8.50	0.83	5.07
Growth potential compared to:			
Russian coal companies	4%	377%	38%
Emerging market coal companies	33%	154%	30%
Developed country coal companies	43%	113%	31%

Company	Country	P/E	EV/S	EV/EBITDA
Russia				
Raspadskaya		20.7	4.0	8.9
Kuzbassrazrezugol		7.7	1.6	5.1
Yuzhny Kuzbass		8.8	4.5	n/a
Median		**8.8**	**4.0**	**7.0**
Emerging markets				
Exarro Resourses	S. Africa	9.2	5.9	20.7
China Shenhua Energy	China	11.7	2.5	6.3
China Coal Energy Co	China	11.4	1.4	6.1
Yanzhou Coal Mining	China	7.3	1.9	5.2
Shanxi Xishan Coal	China	15.1	2.7	9.0
Shanxi Lu'an Environm.	China	17.7	2.9	11.4
Pingdingshan Tianan	China	14.2	1.3	8.0
Datong Coal Industry	China	20.2	2.1	7.1
Straits Asia Resources	Singapore	8.9	2.2	5.6
Bumi Resources TBK PT	Indonesia	11.2	1.9	5.3
Median		**11.6**	**2.2**	**6.7**

Table continued on next page.

KTK's financial multiples are among the lowest in the coal industry, not just in Russia but also on a global basis, which shows that the Company is undervalued compared to similar companies. The P/E (price to earnings) ratio is 8.5, while the average for world coal companies is 12. In other words, by this ratio KTK is undervalued by about 40-50%. The Company is undervalued by a third according to the EV/EBITDA (enterprise value to EBITDA) ratio. The discount to global peers according to revenue multiples is more than 100%. There are very few publicly listed Russian coal companies, but comparisons with those that are publicly traded also show that KTK is undervalued by all ratios.

Company	Country	P/E	EV/S	EV/EBITDA
Developed countries				
PEABODY ENERGY CORP	USA	8.1	1.7	6.5
CONSOL ENERGY INC	USA	12.3	1.8	6.4
ARCH COAL INC	USA	13.9	1.5	6.6
NATURAL RESOURCES	USA	12.8	8.4	9.6
MASSEY ENERGY CO	USA	13.0	1.8	6.8
ALLIANCE HOLDINGS GP	USA	11.6	1.6	5.1
ALLIANCE RESOURCE	USA	9.9	1.4	4.4
PENN VIRGINIA RESOURCE	USA	16.3	2.2	11.3
ALPHA NATURAL RESOUR	USA	10.2	0.8	4.3
COAL & ALLIED INDUSTR	Australia	13.0	3.5	8.1
NEW HOPE CORP LTD	Australia	18.6	3.6	10.5
MACARTHUR COAL LTD	Australia	12.4	3.3	7.4
GLOUCESTER COAL LTD	Australia	13.5	5.0	8.9
Walter Energy	USA	10.3	2.3	7.2
Median		**12.6**	**2.0**	**7.0**

Sources: company websites, finance.yahoo.com, Bloomberg

Such a significant undervaluation of KTK's shares by the market indicates that the exchange price does not reflect the Company's fundamentals: generated revenue, net profit, profitability and so on. Analysts are optimistic about the prospects for KTK's development and the growth of its value in the future, praising the Company's high level of transparency and standards of corporate governance, and its openness to the investment community. This means that in the long-term the market should restore the fair valuation of the Company and its share price should grow.

Risk factors:
LOW LIQUIDITY CONSTRAINS GROWTH

While maintaining buy recommendations and forecasting growth for the Company's share price, analysts remark that the main factor constraining the growth of KTK's market capitalization is the low liquidity of its shares.

Average daily trading volume is about $20,000, which puts the Company's shares in the third tier in terms of liquidity. As liquidity grows, private and institutional investors' interest in the Company's shares is expected to increase.

Analysts from leading investment companies comment on KTK's shares

FACTORS PROMOTING PRICE GROWTH

This is one of the few rapidly growing Russian companies that has shown very good growth rates... The owners have shown how a company should be built virtually from nothing... **THE COMPANY HAS THE HIGHEST LEVEL OF INFORMATION OPENNESS IN THE INDUSTRY...** it has no rivals in this regard.

DMITRY SMOLIN, URALSIB CAPITAL

KTK, IN TERMS OF THE COMPANY'S PRODUCTION GROWTH, ONLY EXCEEDS EXPECTATIONS. In terms of innovation, KTK leads the industry, despite its small size. And despite this small size, the company can afford to invest heavily in enrichment...The company is fairly well positioned on the thermal coal market in Russia.

KIRILL CHUIKO, UBS RUSSIA

...There are fairly few coal companies on the stock market, but I would say that compared to all of these companies KTK looks very good in terms of disclosure of its business, in terms of its strategy. I would say that it may be the best in its segment... **THE COMPANY'S STRATEGY IS AIMED AT IMPROVING ITS PRESENCE, INCREASING VOLUMES AND, CORRESPONDINGLY, INCREASING THE SHARE OF VALUE-ADDED PRODUCTS...** The way that the company conducts itself strategically and its attitude toward investors deserves respect.

ILYA MAKAROV, ATON

From the point of view of operating results, KTK is far stronger than its competitors. In terms of the achievements of management, I would say that **THE COMPANY STANDS OUT WITH THE STRONG RESULTS OF GOVERNANCE...**They've grown from nothing and consistently shown good operating results, as promised. The resource base is good...In terms of management...how they conducted the IPO, the quality of corporate disclosure – everything is excellent, five out of five.

IGOR LEBEDINETS, VTB

Compared to competitors, **THE COMPANY LOOKS GOOD IN LIGHT OF ITS OPENNESS FOR INVESTORS, TRANSPARENCY**,... in light of the fact that the company is so far meeting all set goals, even exceeding them... Compared to other players on the market by the above mentioned factors the company looks pretty good... And its role is the role of a young, ambitious player.

ANDREI LOBAZOV, ALFA BANK

FACTORS CONSTRAINING PRICE GROWTH

In our view, KTK's shares are currently not fully appreciated by the market, including because of their low liquidity. We see potential for the company's price to grow at least 20% from the current levels by the end of 2012.

SERGEI FILCHENKOV, IFC METROPOL

I think that the main factor constraining the growth of capitalization is low liquidity. From the fundamental point of view, the company is attractive, but the problem is that liquidity is fairly low and perhaps this hinders growth...and results in a certain discount by multiples. In short, liquidity is one of the main problems.

DENIS GABRIELIK, OTKRITIE

The main problem that the company has to deal with now is the liquidity of its shares, because...in the IPO very many large funds bought its shares and are sitting on them for the long-term...If we're talking about thermal coal, right now this is the only interesting stock in the sector, because the company provides a very good level of information disclosure and is always talking to investors, unlike its competitors.

OLEG PETROPAVLOVSKY, BROKERCREDITSERVICE

The free float is around 35%, but very little is traded on the market...High volatility in the course of the day points to the fact that liquidity is very poor. In principle, the company itself has an interest in acquiring...more speculative investors. In any case, this will require some sort of issue in order to further increase the free float.

ILYA MAKAROV, ATON

The liquidity of its shares remains KTK's main problem on the stock market: the daily turnover of this company's shares on MICEX does not exceed $20,000-$30,000 on average, though the company's free float is 35%.

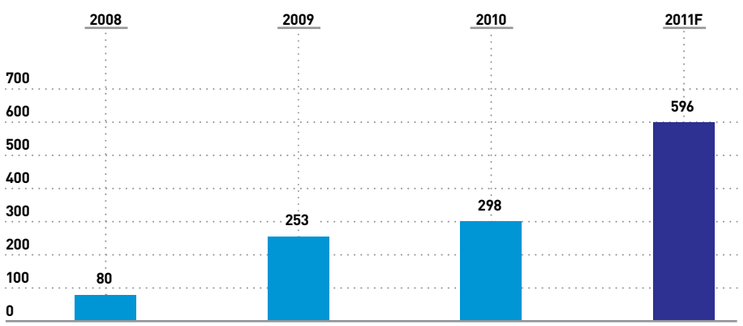
DMITRY SMOLIN, URALSIB CAPITAL

Dividend history:
PAYMENTS TO SHAREHOLDERS GROWING IN LINE WITH PROFITS

The management of the Company has an interest in increasing its investment appeal. With this aim in mind, it is increasing information openness, and holding meetings with current and potential investors. In addition, the strong fundamentals of the business combined with an effective and flexible financial policy aimed at increasing performance enable the Company to return a substantial amount of capital to shareholders in the form of dividends.

The amount of dividends is determined on the basis of KTK's financial results to Russian Accounting Standards and is equivalent to at least 25% of net profit, as stipulated in the Regulation on Dividend Policy (dated November 3, 2009).

KTK dividend history, mln RUB



Source: KTK OJSC

In June 2011, KTK held its annual General Shareholders Meeting, at which shareholders decided to pay out 297.8 million rubles in dividends for 2010, which is equivalent to 3 rubles per share.

In April 2012, the annual General Shareholders Meeting approved the recommendation of the Board of Directors to pay dividends for 2011 of 6 rubles per common share and set aside 595.5 million rubles for this purpose, which is equivalent to 29% of net profit for 2011. Dividends will be paid to shareholders within 60 days of the date the decision to pay the dividends was made, April 16, 2012. The register of shareholders eligible to receive dividends was closed on March 14, 2012.

KTK's management plans to continue to work in the interests of all shareholders and the Company itself. The high standards of corporate governance adopted by KTK ensure that shareholders and investors can be confident that their legal rights and interests will be observed, and make it possible to improve the process of making management decisions aimed at preserving assets, and maximizing the Company's profits and market capitalization.

3 MARKET SITUATION

World coal market:
OPTIMISM IS WARRANTED

Coal is the first fossil fuel used by humans to be extracted on an industrial scale. It is responsible for the industrial revolution, making possible the rise of the first generation of machines that was the precursor of the modern world.

Since then, the role of coal has declined considerably as it has been replaced by other fuels such as oil and gas. The share of coal in the global energy balance is now 30%, down from 50% in the 1950s. However, there is every reason to believe that the demand for coal as a solid fuel resource will only grow in the near future.

COAL HAS A NUMBER OF ADVANTAGES OVER OIL AND NATURAL GAS

COAL RESERVES

First of all, **in terms of global reserves, coal exceeds all other fossil fuels.** The reserves to production ratio is currently 118 years for coal, 59 years for natural gas and 46 years for oil.[1]

RESERVES GEOGRAPHY

Secondly, reserves of oil and gas are concentrated primarily in the Middle East and CIS countries, **whereas coal reserves, while also heavily concentrated, are distributed more evenly** among countries in the Asia-Pacific region, North America, Europe and Asia. This considerably reduces the risk of supply disruptions.

LOW COAL PRICE

Thirdly, there is price. **Coal is a relatively cheap fuel** (even taking into account the cost of mitigating its environmental impact), and its solid waste does not require storage like waste from nuclear energy. In future, the price advantage of coal will only grow as world oil and gas prices increase.

1 Source: BP Statistics 2011.

Coal prices: HEAVY DEPENDENCE ON MARKET SITUATION

Most of the world's trade in coal is done under long-term contracts, and less is traded on the spot market. Spot contracts are traded at current market prices, which vary depending on the region of delivery: Australia, Japan, the United States, etc.

Electronic coal trading platforms have also begun to develop recently, such as NYMEX (New York Mercantile Exchange), ICE (Intercontinental Exchange), EEX (European Energy Exchange), ASX (Australian Stock Exchange) and GlobalCoal. However, still less than 20% of the coal produced in the world is sold on exchanges.

The market price of coal includes several elements and depends on many factors. The primary factor determining the price is the type of coal depending on its application: thermal coal (for power generation) or coking coal (for steel production). The price of coking coal is, as a rule, twice that of thermal coal, which is usually due to its scarcity on the world market. Secondary factors affecting price are the rank and quality of coal, transportation costs, region of sales and so on.

However, regardless of the quality characteristics of coal, the final price is determined by the balance of supply and demand at any given time. The upward long-term trend on the coal market indicates there is strong demand from consumers. Over the past decade, prices for both coking and thermal coal have risen nearly five-fold. The average price of thermal coal for FOB (Australia) rose 22% in 2011 to $129.60/t , up from $35/t in 2001.

Thermal coal prices growth

+313%
for 10 years

+22%
in 2011

+17.3%
future period (2012-2014)

Natural gas prices growth

+340%
for 10 years

+30%
in 2011

+41.6%
future period (2012-2014)

The Russian Economic Development Ministry is forecasting that the price of thermal coal will continue to climb in the next three years amid steadily growing demand. The ministry is forecasting average annual growth of 5-6% for coal prices in 2012-2014, or a total of 17.3% over the three years. Natural gas prices, meanwhile, are expected to rise 150% faster over the three years – by 42%. This means that the price interest in coal as an alternative energy resource will grow. Furthermore, Russia is expected to complete the liberalization of its gas market in the next two years, which will inevitably lead to an increase in the price of gas on the domestic market and give coal a chance to again become the main fuel for thermal power plants, particularly in the Asian part of the country.

Price of thermal coal, FOB Australia, $/t

Price of natural gas in Russia, $/'000 m³

2 FOB (Free on Board), a trade term requiring the seller to deliver the goods to the port and load them on the ship designated by the buyer. The seller bears the cost of transporting the goods on board the ship.
3 Source: GlobalCOAL.

Demand and supply:
BETTING ON EMERGING MARKETS

World coal production in 2010 slightly exceeded consumption. However, the gap is narrowing, as demand for coal in 2010 grew faster that production.

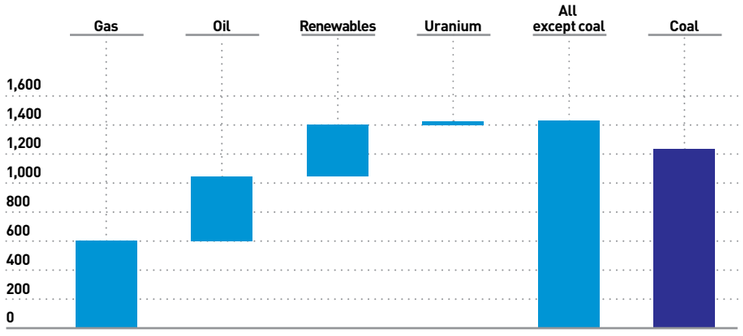
World coal consumption grew by 7.6% in 2010 to 3.55 billion tonnes of oil equivalent (toe), the biggest increase since 2003. The Asia-Pacific region generated 67% of this growth. The global supply of coal, meanwhile, grew more slowly, by 6.3% to 3.7 billion toe (89% of which came from the Asia-Pacific region). Market players believe that global demand for coal exceeded supply in 2011 (in part due to natural disasters in Australia and Indonesia), resulting in a shortage of 9.2 million tonnes.

The share of coal in the global energy balance was 29.6% in 2010, the highest figure since 1970. In the decade from 2000 to 2010 coal accounted for half the growth in global energy demand, the same as all other energy sources combined. Coal's growth in the energy balance has been driven by its relatively low price compared to other fuels, even factoring in environmental costs, as well as the rapid industrial growth in emerging markets. Coal consumption in Asian countries has doubled in the past decade. In China, about 80% of electricity is generated by coal. As urbanization in China and Southeast Asia continues to grow, global demand for thermal coal will only increase.

The International Energy Agency (IEA) forecasts that global demand for primary energy resources will increase by a third by 2035 compared to 2010, to 4.2 billion toe . China and India will account for up to 50% of this growth, and together with other emerging markets in Asia up to 65%, the IEA believes.

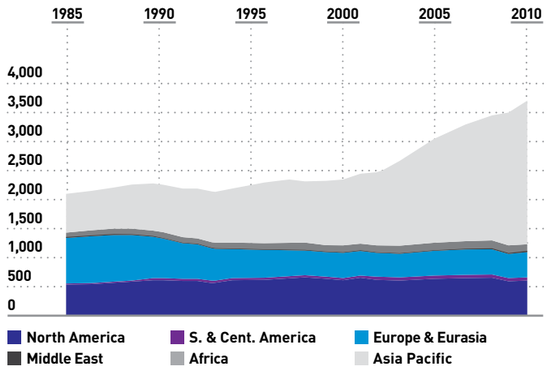
Since the principal factor for emerging markets is the price of energy resources, there is no doubt that a considerable portion of their growing demand will be met by thermal coal, as in the decade from 2000 to 2010. The IEA forecasts that demand for coal will increase by at least 600 million toe by 2035. In addition to Asia, another important region with potential demand for coal is Europe. While Asian countries choose coal in order to save money, the main motivation for Europe is the desire to diversify energy supplies and reduce the dependence on natural gas and oil suppliers (Russia and the Middle East).

Share of total energy demand covered by various sources in 2000-2010, mln toe

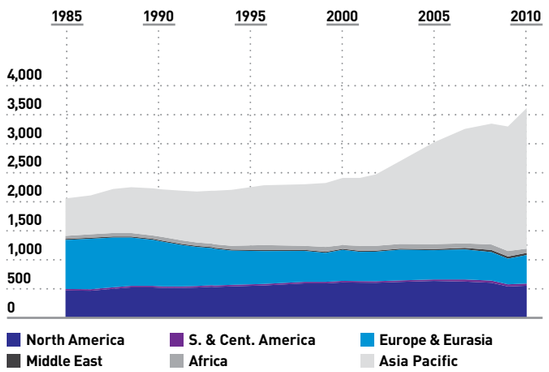


Source: IEA World Energy Outlook 2011

Production by region, mln toe



Consumption by region, mln toe



Source: BP 2011 Statistical Review of World Energy

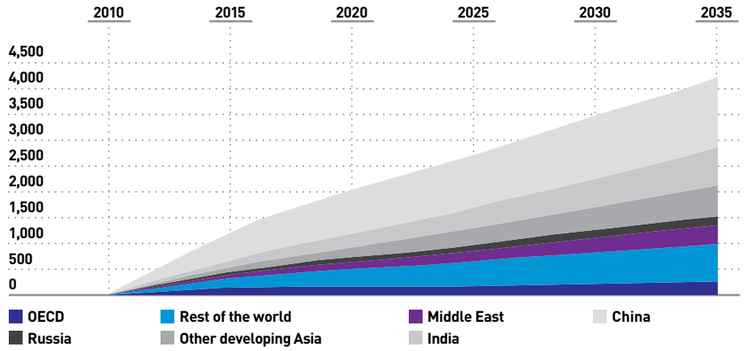
The world's coal companies need to invest about $1.2 trillion by 2035 in order to meet the growing demand for coal.

This is a small amount compared to the anticipated capital outlays required in competing sectors producing other types of energy resources (oil, gas, alternative energy sources), confirming that coal is the least capital intensive. Oil companies will need to invest $10 trillion over the same period, gas companies will need to spend $9.5 trillion and alternative energy companies will need to invest $17 trillion. Given the trend toward cost cutting in most countries of the world, this will shift investors' focus toward the coal market.

Demand for thermal coal could grow even more rapidly than the IEA forecasts due to the fallout from the Fukushima nuclear disaster in Japan in March 2011. The disaster's impact on the global coal market is likely to be felt for years to come. It resulted in the shutdown of 53 of the 54 nuclear reactors in Japan, whose power sector will have to make up for the loss of nuclear power with thermal generation. This means the country could require 4.5 million-6 million tonnes of additional thermal coal per year.

The governments of a number of other countries have also questioned the development of nuclear power. This is particularly true in Europe, where Germany and Switzerland are

Growth of global demand for energy resources, mln toe

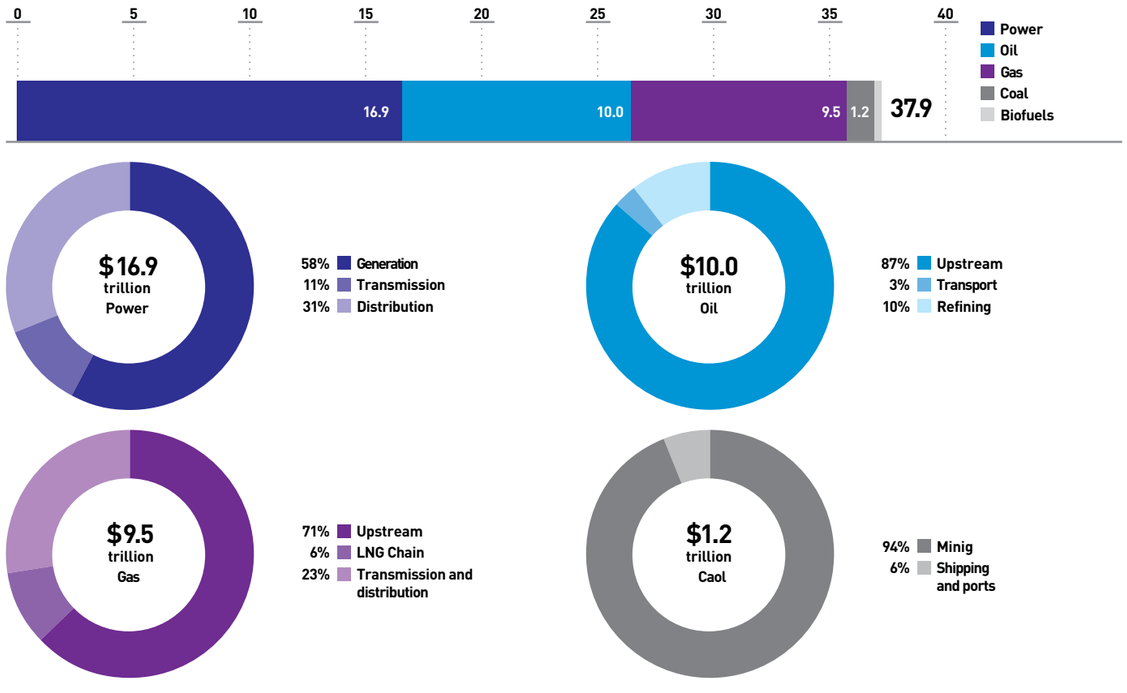


Source: IEA World Energy Outlook 2011

4 Source: BP 2011 Statistical Review of World Energy.
5 Source: IEA World Energy Outlook 2011.

considering abandoning the use of nuclear energy altogether. The U.S. Department of Energy has announced plans to build 100 coal-fired power plants over 15 years; by 2020 coal will become the most popular fuel for power plants in the United States. Demand for thermal coal is also expected to increase in Canada, which will shut down several nuclear reactors once they reach the end of their service life and replace them with thermal power plants. Considerable growth in coal power is also forecast in a number of countries in South America (such as Brazil) and Asia (Vietnam, South Korea and Japan). All this sets the stage for additional growth in global demand for thermal coal.

Total capital investment needed in 2011-2035 by primary energy resource, in $ trillion

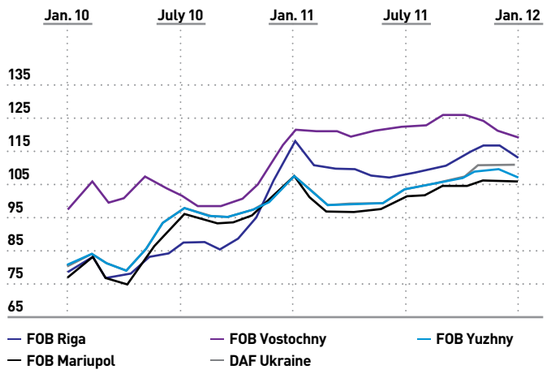


Source: IEA World Energy Outlook 2011

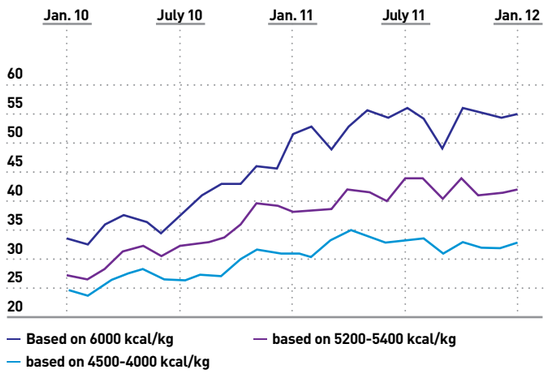
Russian coal market:
A RECORD YEAR FOR THE KUZNETSK BASIN

Coal production in Russia grew 4% to 334.7 billion tonnes[6] in 2011. Nearly 60% of the country's coal has traditionally come from the Kuznetsk Basin (Kuzbass), where Kuzbasskaya Toplivnaya Company operates. There are 58 deep coal mines and 36 open-pit mines operating in the basin.

Export prices for Russian thermal coal, $/t



Domestic prices for Russian thermal coal, $/t

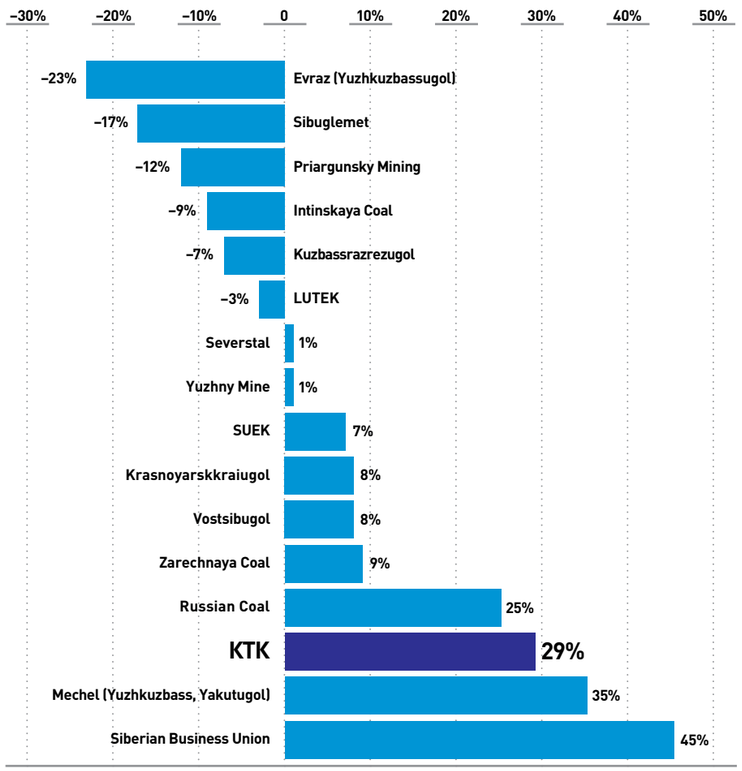


Production of thermal coal grew by 7% in 2011, faster than production of coking coal and the coal market in general. Coal production in Russia overall exceeded the level of pre-crisis 2008, while production in the Kuzbass reached the highest level in the hundred-year history of commercial coal mining in the region, a record 192 million tonnes, 75% of which was thermal coal.

Prices for Russian coal on both the domestic and export markets moved within the scope of the global trend, rising 20-30% depending on region of delivery and coal quality characteristics.

6 Source: Metcoal.

Change in thermal coal production, 2011/2010, %



Source: Metal Expert

Despite the strong market situation, most Russian coal mining companies posted a decline in coal shipments to customers and growth of costs in 2011. This was due to the restructuring of railroad monopoly Russian Railways (RZD), which led to problems with shipping coal out of the Kuzbass at the end of the year. The transfer of RZD's railcar fleet to subsidiaries has led to the emergence of hundreds of new operators on the railroad transport market with their own rolling stock and terms of operation. The chaotic change in the owners of railcar fleets led to an increase in tariffs, shortages of railcars for the most popular destinations and, consequently, a drop in deliveries to customers and an increase in per-unit costs.

Among the coal companies that demonstrated the strongest production growth in 2011 were Siberian Business Union (up 45% year-on-year), Mechel (up 35%), Kuzbasskaya Toplivnaya Company (up 29%) and Russian Coal (up 25%).

Despite the difficulties caused by the disruptions in coal shipments in the second half of the year, **KTK managed to achieve impressive results in 2011 and meet its annual targets for production and sales.**

Despite the difficulties caused by the disruptions in coal shipments in the second half of the year, KTK managed to achieve impressive results in 2011 and meet its annual targets for production and sales, not only thanks to the strong market (the average price of coal sold by the Company rose 28.6% on the domestic market and 21.2% on export markets), but also thanks to successful market positioning and the determined efforts of the Company's management.

- Throughout the year, the Company pursued a strategy to increase the share of high value-added products in total sales. Processed coal products increased to 72.0% of production in 2011 from 63.3% in 2010.
- The company shifted the marketing focus in 2011 to more promising regions. Exports to the Asia-Pacific region surged 80.2% to 2.92 million tonnes, and exports to Eastern Europe rose 65.6% to 3.53 million tonnes.
- Management is maintaining a course toward expanding the resource base and dynamic production growth. In December 2011, the Company won an auction for the rights to explore and mine the Bryansky section of the Karakanskoye thermal coal field with reserves of 250 million tonnes.

As a result, the Company increased production by 28.6% in 2011, and production per employee reached 411.3 tonnes per month, compared to an average of 284.6 tonnes for the Kuzbass coal industry in general (open-pit mining). This highlights the high efficiency of production processes at KTK.

Company's annual production **increased by 28.6% in 2011**

Production per KTK's employee

411.3

tonnes of coal

Average production per employee in industry

284.6

tonnes of coal

Structure of coal consumption in Russia: **EXPORTS GROWING**

An important trend in recent years has been the growth of exports in the structure of Russian coal companies' sales. The proportion of coal exports from Russia has increased 2.5-fold in the past 10 years, largely due to shipments to emerging markets in Asia and Eastern Europe amid rapid economic growth in these countries.

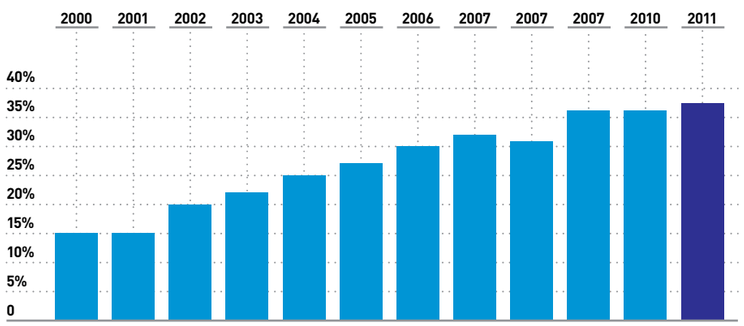
The share of Russian coal exports rose to 37.3% of production in 2011 from 36.2% in 2010.

The upward trend in export growth applies primarily to producers of coking coal. Exports in the thermal coal segment are more stable and even decreased somewhat in 2011 (to 33.4% from 35.3% in 2010), in part due to the more rapid growth of domestic prices for thermal coal last year.

The main export market for Russian thermal coal is still Europe, but this region's share has been shrinking in recent years as exports to Asian countries have grown. China accounted for about 6% of Russian thermal coal exports in 2011. China's share of exports is expected to double over the next 20 years, according to the Program for the Development of Russia's Coal Industry to 2030. Exports to other Asian markets are also growing, with exports to South Korea up 40% for the year.

The share of Russian coal exports
37.3%

Share of exports in Russian coal production



Source: Rosinformugol, Metal Expert, Metcoal

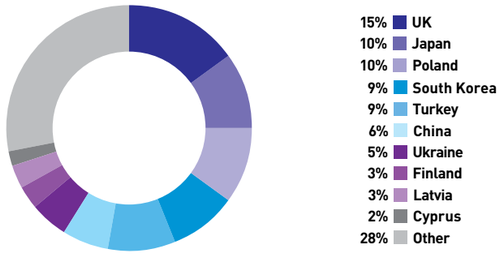
CAGR of exports
13%
per year

Growth in share of exports
2.5-fold

The potential for further growth of Russian coal exports is currently constrained by the throughput capacity of port and railroad infrastructure. The growth of coal exports in the next three years will be affected by a number of infrastructure construction projects, including the construction of a new coal terminal at the Murmansk port by 2014 (three phases with annual capacity of 6 million tonnes each); the second phase of an automated facility at the Ust-Luga coal terminal with capacity of 12.4 million tonnes reaching full capacity in 2012; and the doubling of transfer capacity at the Nakhodka commercial seaport to 5 million tonnes per year.

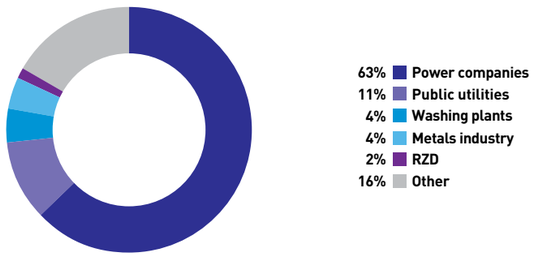
The structure of thermal coal consumption on Russia's domestic market did not see any major changes in 2011 compared to previous years. Power companies, the public utilities sector and washing plants remain the principal customers. The electricity sector accounts for more than 63% of sales on the domestic market. Heat and power plants built near coal deposits in the Soviet era were intended to use coal with low and medium calorific value, which is why domestic demand for high-calorie coal remains very low and most high-calorie coal is exported.

Structure of thermal coal exports from Russia, 2011



Source: Metal Expert

Structure of domestic thermal coal consumption, 2011



Source: Metal Expert

Russian coal industry today: CURRENT CHALLENGES AND HOW TO MEET THEM

Despite the rapid growth of Russia's coal industry in recent years, coal production in the country is still far from its Soviet highs. Production in Soviet-era Russia peaked at 425 million tonnes in 1988, which is 27% more than the country produced in 2011.

Coal production dynamics

mln tonnes	1988	1994	2000	2008	2009	2010	2011
Thermal coal	352	215	197	260	242	258	**265**
Coking coal	73	57	61	69	61	65	**71**
Total production	**425**	**272**	**258**	**329**	**303**	**323**	**336**

THE MAIN CONSTRAINTS ON PRODUCTION GROWTH AND THE DEVELOPMENT OF COMPANIES IN THE INDUSTRY ARE:

1. High logistics costs (transport costs make up 40-50% of the end price of coal), coupled with unpredictable railroad tariffs
2. Low throughput capacity of the railroad network (particularly at border crossings) and ports
3. Uneven playing field in the competition for the domestic energy resources due to the government artificially maintaining low domestic gas prices
4. Lack of incentives to improve the quality and depth of coal processing due to lack of domestic demand for high-calorie coal
5. High capital cost of developing new deposits

The current production capacity of Russian coal companies allows them to increase production and cover the growth in demand both on the domestic and foreign markets. Only 85% of production capacity was utilized in 2010, the Economic Development Ministry estimates.

One of the results of these constraining factors is the low technological level of coal production, including the low level of coal processing (more than 25% of the coal consumed in the country has an ash content of more than 40% and about 20% has a heat value of less than 3,000 kcal). In addition, the high level of depreciation of fixed assets, which is as high as 70-80% at companies specializing in open-pit mining of thermal coal, increases the risk of accidents. Furthermore, Russia's engineering sector is not always capable of meeting required standards of equipment reliability, so mining companies have a wide range of equipment from various firms, which complicates maintenance and reduces efficiency.

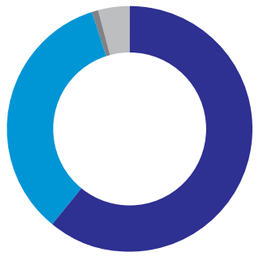
Russian market forecast to 2030: PATH TO THE COAL INDUSTRY'S DEVELOPMENT

It is clear that the constraints mentioned above can be overcome only through the joint efforts of coal companies and the government. The Russian government in January 2012 approved a Long-term Program for the Development of the Russian Coal Industry to 2030.

THE PROGRAM SETS OUT A LIST OF ISSUES THAT NEED TO BE RESOLVED BY RUSSIAN COAL COMPANIES TOGETHER WITH THE GOVERNMENT:

1. Sustainable renewal of the coal industry's mineral resource base
2. Development of modern coal mining and washing facilities that ensure efficient use of the sector's resource potential
3. Development of transport and port infrastructure for shipping coal that supports diversification of markets
4. Increasing the efficiency of coal mining, washing and processing using the latest technologies and equipment

Distribution of financing for Coal Industry Development Program to 2030, bln RUB



- 2,267 Development of energy efficiency & power sector (61 %)
- 1,258 Development of transport infrastructure (34 %)
- 25 Renewal & use of natural resources (1 %)
- 150 Other (4 %)

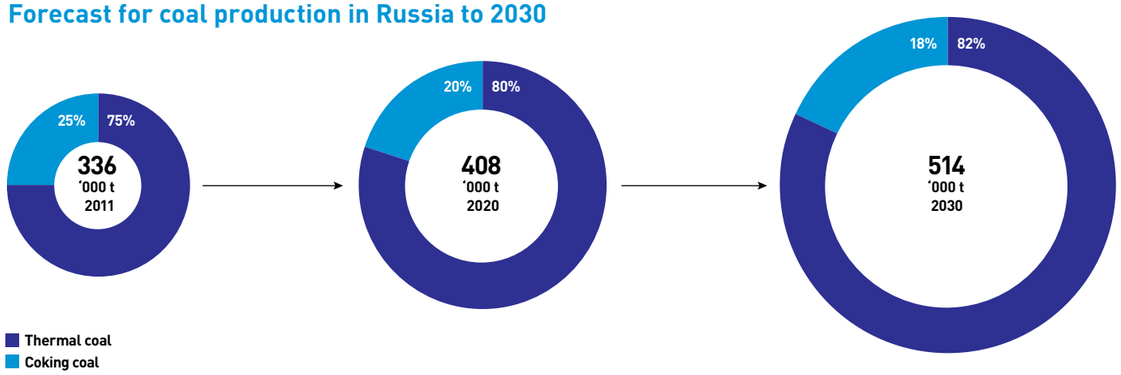
Source: Energy Ministry of Russia website (minenergo.gov.ru)

The program elaborates on the main provisions of Russia's Energy Strategy to 2030 that concern the development of the coal industry. It specifies objectives, timetables and expected results, sets of necessary measures and mechanisms of state energy policy taking into account the further development of the partnership between the government and businesses.

The program estimates that the required investment in the industry will be approximately 3.7 trillion rubles, of which the government intends to finance 251.8 billion rubles. The bulk of the government financing – 196 billion rubles – is earmarked for development of infrastructure (ports and railroads).

The implementation of the measures in the program is expected to reduce transport costs and increase the efficiency of coal shipments. The average shipping distance for coal products is supposed to decrease by a factor of 1.2, including a 1.4 fold reduction on the domestic market. In order to reduce shipping distances, local use of mined coal will be developed in each basin; there are plans to build a number of power and manufacturing plants to support the comprehensive development of coal resources. Construction of modern washing plants will be mandatory.

Forecast for coal production in Russia to 2030



Source: www.rosugol.ru

Russia will aim to increase the overall level of washing to 60% from 40%, and more than 80% of mined coal will undergo some sort of processing (sorting, enrichment, intensive processing, gasification).

Intensive processing of coal, such as production of synthetic gasoline and feedstock for high-tech plastics (phenol, cresol, xylenol and other liquid products), should become a promising area of development for the industry. There are more than 500 various products made in the world from coal. A viable area of coal processing for the Kuzbass in the medium-term is production of porous materials for catalysts and fuel elements, as well as ultra-clean coal (ash content of less than 0.2%), which could become the basis for the production of a range of industrial carbons and special sorbents, including for the medical industry. Russia also needs to learn to manufacture carbon adsorbents, which are used to clean water and air. Meanwhile, working conditions and the safety of mining operations are supposed to improve.

Construction of modern washing plants will be mandatory. **Russia will aim to increase the overall level of washing to 60% from 40%.**

The Ministry of Natural Resource's Program for licensing coal deposits also includes long term forecasts for the development of the coal industry. This program projects that coal production in Russia will total 362 million tonnes (with minimal launch of new capacity) to 400 million tonnes (maximum launch of new capacity) in 2015, with thermal coal making up about 80% of the total. It forecasts production will then grow to 408 million-463 million tonnes by 2020, depending on the launch of capacity, and to 514 million-544 million tonnes by 2030.

Russia's Energy Ministry has also shown an interest in the development of the coal industry. The Ministry is responsible for providing support for coal companies' relations with the Transport Ministry, RZD and the Federal Tariff Service (FTS) on the issue of predictable railroad tariffs.

The Ministry has set up a taskforce to prepare recommendations on how to improve the system for setting railroad shipping rates for coal products, which includes representatives of coal and power companies, the FTS, the Transport Ministry, RZD and the scientific community.

4 STRATEGY IMPLEMENTATION

The management of Kuzbasskaya Toplivnaya Company **closely monitors the implementation of the strategic goals for the development of the business and strives for their maximum execution.**

However, the Company also continually monitors changes in the current market situation and is prepared, if necessary, to quickly adapt its strategy to market conditions. In a highly competitive market such flexibility is a prerequisite for success, as it enables the Company to effectively manage costs and leads to growth of shareholder value.

In 2011 KTK met all of the goals that were set for the year

and made considerable progress toward achieving its long-term objectives.

INCREASE THERMAL COAL PRODUCTION	EXPAND THE RESOURCE BASE	IMPROVE THE QUALITY OF COAL PRODUCTS	APPLY INNOVATIVE TECHNOLOGIES	DEVELOPING OF FUNDAMENTALLY NEW PRODUCTS
READ MORE ON P. 46	READ MORE ON P. 46	READ MORE ON P. 46	READ MORE ON P. 47	READ MORE ON P. 47
DEVELOP COAL TRANSPORT INFRASTRUCTURE	SUPPORT AND DEVELOP MARKETING COMPETENCIES	OPTIMIZE COSTS AND INCREASE EFFICIENCY	EFFECTIVELY MANAGE THE LOAN PORTFOLIO	IMPROVE CORPORATE GOVERNANCE
READ MORE ON P. 47	READ MORE ON P. 48	READ MORE ON P. 48-49	READ MORE ON P. 49	READ MORE ON P. 49

INCREASE THERMAL COAL PRODUCTION,

gradually reaching design capacity of 11 million tonnes

Coal production target for 2011 was exceeded by 7.4%, with 8.7 million tonnes produced instead of the forecast 8.1 million tonnes.

Given a favorable situation on the coal market, design capacity of 11 million tonnes is expected to be achieved in the medium-term. In the long-term, KTK's production could reach 14-15 million tonnes with the development of the Bryansky block acquired in December 2011.

EXPAND THE RESOURCE BASE

with acquisition of licenses in Kuzbass, the Company's strategic region

In December 2011, the Company won the auction for the rights to explore and mine the Bryansky section of the Karakanskoye hard thermal coal field with resources of 250 million tonnes.

KTK plans to begin exploration work at Bryansky in 2012 in order to start developing its fourth open-pit mine at the site.

The Company already has the infrastructure needed to develop the deposit, which will yield synergies in optimizing capital expenditures. The Company will only need to invest in mining equipment and construction of an washing plant. Development of the site will increase production capacity from 11 million tonnes to 14-15 million tonnes per year.

IMPROVE THE QUALITY OF COAL PRODUCTS

by using the latest washing technology. Enter new markets

In order to maximize recovery of high quality coal from mined ore, KTK uses steeply-inclined separation technology that can yield about 350 kg of export quality coal from every tonne of diluted and high-ash coal.

KTK's first washing plant, Kaskad with capacity of 2 million tonnes per year using steeply-inclined separation technology, launched operations in 2010.

Construction of a second plant, Kaskad-2 with capacity of 4 million tonnes per year using steeply-inclined and dense medium gravity separation technology, began at the Vinogradovsky mine in 2011 and is scheduled for trial production in the fourth quarter of 2012.

The rapid construction of KTK's washing plants (within a period of 1-1.5 years) attests to management's genuine interest in developing the Company's potential and improving product quality.

KTK is working on entering new markets where there is demand for high-calorie content coal, such as Japan and the Baltic states. Sales are growing rapidly in South Korea, where KTK almost completely covers the coal needs of the country's largest cement plant. Kaskad-2 will enable KTK to produce coal that meets the high standards of foreign customers.

APPLY INNOVATIVE TECHNOLOGIES

in production processes, expand the product line with fundamentally new products

KTK conducted pre-feasibility studies in 2011 into the possibility of introducing new technologies in production.

The studies primarily focused on three areas:

> development of a new type of fuel from washed coal, so-called solid natural gas; production of coal briquettes with high heat value (up to 6,700 kcal) using the latest technology, a product that could enable potential customers to reduce fuel consumption by between a third and 50%;

> processing of high-ash coal production waste into light and strong construction materials; production of high-quality bricks that are light due to porous structure but have a high strength rating equivalent at least to M75 bricks. The Company thus intends to manufacture a quality product for which there is guaranteed steady demand with core production waste for which there was previously no application;

> production of synthetic diesel fuel through coal gasification and synthesis; in-house production of diesel would provide a stable and uninterrupted supply of fuel for mining and transport equipment.

KTK will continue working on all three areas in 2012, and increase funding considerably.

All the areas of research are cutting-edge not only in Russia, but also by world standards, and could take KTK to a whole new level of development by increasing productivity, improving efficiency and optimizing costs.

All KTK projects are developed taking into account the strictest and latest environmental standards and therefore meet environmental responsibility criteria.

DEVELOP COAL TRANSPORT INFRASTRUCTURE

The Company's priorities include development of railroad infrastructure to support uninterrupted coal deliveries to customers.

With this goal in mind, KTK and the Sibuglemet group formed Kuzbass Transport Company, through which KTK is investing heavily in acquisition of freight cars. KTK shipped more than half of its exports in its own cars in 2011. There are plans to expand the fleet from the current 3,100 freight cars to 5,000 in the next year, which will enable KTK to ship most of its coal exports in its own cars, the lease rate for which is fixed for 10 years.

The target for railcar purchases in 2011 was not fully met as KTK management believed prices on the market were unjustifiably high. This demonstrates management's flexible approach to strategy implementation amid changing market conditions and its determination to effectively manage costs and grow shareholder value. Management's target payback period for railcars is 10-11 years, while in 2011 prices offered a payback period of 15 years or more. As prices come down, acquisition of railcars will resume. The Company already purchased about 500 railcars at the beginning of 2012.

In 2001 KTKcompleted the modernization of the Uba coal collection station, where railcars are sorted into trains for shipment to customers. The project included construction of five lines with an overhead system, as well as an office and amenities building to house the employees of Meret Freight Forwarding Company and RZhD. This enabled KTK to meet RZhD's technical specifications and expand throughput capacity from 12 million tonnes to 16.7 million tonnes per year. Railcar turnover increased from 500 to 700 per day.

SUPPORT AND DEVELOP MARKETING COMPETENCIES

KTK is putting ever more emphasis on marketing and sales, and plans to develop sales in all aspects: in terms of products, clients and geography.

The product line will be expanded thanks to the premium segment – coal of the highest quality. It is with this goal in mind that KTK began building a second washing plant in 2011 that is scheduled to open in the fourth quarter of 2012. The Company is also investing in the development of technology to manufacture secondary products from coal processing (construction materials, fuel oil, 'solid natural gas').

The client network will be developed by improving quality of service, bolstering KTK's regional presence in Russia and reaching new customers abroad. KTK has the largest distribution network in Western Siberia. Two new points of sale were opened in Altay in 2011, increasing the total number of points of sale to 67. The number of potential customers outside Russia should increase with the offering of new premium products.

Geographically, KTK plans to maintain flexibility in its sales structure depending on changes in the market situation, and increase sales in regions of the world expected to see the strongest growth in demand for energy resources. KTK increased exports by 76% in 2011, including 81% to the Asia-Pacific region and 66% to Eastern Europe. In future, the Company plans to expand into the markets of Western Europe, South Korea, Taiwan and Japan. Russia remains the Company's core market.

The Company's management believes it extremely important to maintain geographic diversification of sales, preferring sustainable business growth to a focus on a single, even if very promising market. The Company's sales are now approximately evenly split between Russia, Eastern Europe and the Asia-Pacific region.

OPTIMIZE COSTS AND INCREASE EFFICIENCY

KTK's costs are low compared to most Russian and international competitors, and the company is continuing to implement a set of measures to reduce per-unit production costs.

The cost of blasting work per unit was slashed by 40% in 2011 compared to 2010 with the hiring of a new contractor. In addition, KTK opened a mobile emulsion explosives production facility with annual capacity of up to 50,000 tonnes at the Vinogradovsky mine in 2011. The facility will cover part of the Company's production needs, enabling it to save on outside purchases.

The Company is steering a course toward reducing transport costs, which account for about 50% of costs. In order to reduce the risk of uncontrolled growth of railroad tariffs for coal shipments, KTK is investing in the acquisition of its own railcar fleet and entering into long-term contracts with outside operators. Such contracts were signed in 2011 with Sibuglemet and RG Trans. In future KTK plans to increase to 100% the share of coal shipped in its own railcars, the leasing price for which will be fixed for 10 years. In that case, growth of tariffs charged by private operators of railcars will not threaten the Company's stability.

The Company is taking a number of steps to reduce the negative impact of higher prices for mining and transport equipment in future. KTK acquired options in 2011 to buy mining equipment and machinery effective in 2011-2013, which will mitigate price volatility and ensure guaranteed delivery of equipment to mines on schedule regardless of price fluctuations.

In addition to striving to optimize total direct costs, the Company is seeking to reduce per-unit costs by increasing efficiency in the following ways:

> Reducing manual labor by acquiring modern high-performance mining equipment. Mine production per employee topped 411 tonnes per month in 2011, while the average for the Kuzbass coal industry (open-pit mining) was about 285 tonnes per employee per month;

> Using the latest coal washing technologies (such as steeply-inclined and dense medium gravity separation) in order to reduce production losses by processing waste into export quality coal;

> Reducing production losses thanks to the downward trend in the stripping ratio.

The stripping ratio increased in 2011, but this is a short-term development due to objective factors. The optimal incline of the pit wall at Cheremshansky had to be recalculated from 40 to 17 degrees due to appearance of cracks in the course of extraction. The increase in stripping of overburden in this case reduced the risk of the mine wall collapsing.

The additional stripping of overburden of 2011-2012 will be treated as stripping of future periods, because mining operations will be conducted at this section of the pit side. Therefore, in the long-term the stripping ratio should see a decline.

There was additional stripping at the Vinogradovsky mine in order to ensure a sufficient supply for additional capacity at the second washing plant to be launched in the fourth quarter of 2012. After analyzing the cost of plant construction, KTK's management decided to double its design capacity from 2 million to 4 million tonnes. This will make it possible to reduce per-unit costs in future, and accommodate the Company's growing resource base.

EFFECTIVELY MANAGE THE LOAN PORTFOLIO

The Company pursues a conservative financial policy and intends to adhere to it in future.

The maximum allowable net debt to EBITDA (earnings before interest, taxes, depreciation and amortization) ratio has been set at 2. As of the end of 2011, this ratio was significantly lower at 0.68.

Interest payments on loans are covered by profit before taxes and interest by a factor of 13, and the average effective borrowing rate dropped from 7.7% to 5.2% in 2011, which enabled the Company to save on debt servicing.

Total debt amounts to 50% of the Company's equity. KTK's equity is high thanks to 43% growth of retained earnings in 2011 and additional paid-in capital of 2,829 million rubles following the 2010 IPO.

Most (93%) of the current loans raised by the Company have fixed interest rates, which significantly reduces the risk of a substantial increase in market rates in future.

The Company has a reputation as a reliable borrower, which helps to maintain effective partnerships with lending institutions.

IMPROVE CORPORATE GOVERNANCE

The Company believes that transparency and improving corporate governance are key to long-term growth, so it will regularly take steps to improve its corporate governance system according to best practice.

In improving corporate governance practices, KTK follows the recommendations of the Corporate Code of Conduct developed by the Federal Securities Commission of Russia.

In line with one of these recommendations, independent directors have been appointed to the Company's Board of Directors since 2010. Yury Fridman and Alex Williams have been the independent directors since April 16, 2012.

The five members of the Board of Directors, including the two independent directors, are closely monitoring how the Company's management is achieving targets. KTK encourages the continual development of top management and is now working on a three-level incentive system for senior executives.

5 OPERATING RESULTS

Production results: BETTING ON COAL WASHING

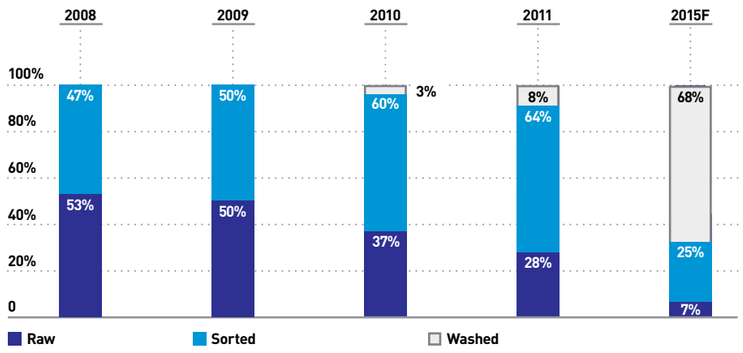
Kuzbasskaya Toplivnaya Company increased coal production by 28.5% to 8.74 million tonnes in 2011, becoming Russia's seventh largest thermal coal producer. The Company has maintained double-digit growth for four consecutive years.

KTK's production volumes

	2008	2009	2010	2011
Coal production, mln tonnes	5.5	6.2	6.8	**8.7**
Year-on-year growth, %	33.7 %	12.4 %	10.6 %	**28.5 %**

Source: KTK OJSC

Coal production by type



Source: KTK OJSC

An important trend is the rapid growth in production of coal with high added-valued. As demand for sized coal among Russian and foreign customers has grown, sorting at KTK's mobile crushing and screening units increased by 35.6% to 5.6 million tonnes in 2011, and production of high quality washed coal from mine waste at the Kaskad plant nearly quadrupled to 740,000 tonnes from 200,000 tonnes in 2010. Production of run-of-mine coal (not sized, sorted, washed, processed, etc.), meanwhile, has been falling for two consecutive years, dropping by 2.4% in 2011 and 19% in 2010.

The Company's strategic plans include increasing the share of washed high-calorie coal to 68% by 2015 from the current 8.5%, while the share of low quality run-of-mine coal should decrease to just 7% in 2015 from the current 27.5%. This should have a positive impact on the Company's profitability, because as the heat value of coal increases its price and sales margins grow significantly. These goals will be achieved by building additional washing facilities next to mining operations.

Production infrastructure: AN INTEGRATED COMPLEX GUARANTEES EFFICIENCY

The Company strip mines coal at three open-pit mines located in the Kuznetsk Basin, the largest coal mining region in Russia.

- **Karakansky-South,** which consists of three license properties (Karakansky-South, Karakansky-South 1 and Karakansky-South 2)
- **Vinogradovsky,** which consists of two license properties (Vinogradovsky and Vinogradovsky 2)
- **Cheremshansky,** which consists of the one, eponymous license property

IN ADDITION TO THE MINES, THE KTK PRODUCTION COMPLEX INCLUDES:

- Coal storage facilities with sorting units
- The Kaskad washing plant with capacity of 2 million tonnes per year
- A common administration and services complex
- A common fleet of mining equipment and automobile transport
- Common mechanized repair shops and maintenance infrastructure
- Railroad infrastructure, which belongs to subsidiary Meret Freight Forwarding Company
- Power infrastructure, which belongs to subsidiary Kaskad-Energo

All three mines are part of an integrated industrial complex with annual design capacity of 11 million tonnes of coal. The close proximity of the mines, which are within a distance of 5 km from one another, makes it possible to conduct many centralized operations, reducing overhead and other costs.

The Company plans to begin developing a fourth open-pit mine in the future that will include the recently acquired Bryansky property, which borders the Karakansky-South mine. The property has estimated C2 category resources of 250 million tonnes of coal, and its development will increase coal mining capacity from the current 11 million tonnes to 14 million-15 million tonnes per year.

All three mines produce quality thermal coal that is classified as D-rank (long flame) under the Russian classification system. The coal mined by the Company has low sulfur and phosphorous content and relatively high calorific value.

Reserves and characteristics of produced coal

	Category of reserves, mln tonnes						Coal characteristics		
Mine	$A+B+C_1$	C_2	Total	Mine life	Design capacity	kcal/kg	Ash content	Moisture content	Sulfur content
Karakansky-South	41.4	–	41.5	15 years	3 mln tonnes	4,900–5,300	13–15 %	14–17 %	0.27–0.30 %
Vinogradovsky	142.6	–	142.6	50 years	3 mln tonnes	4,900–5,500	14.5–18 %	14–17 %	0.27–0.30 %
Cheremshansky	146.9	18.4	165.3	35 years	5 mln tonnes	5,100–6,000	17 %	12.5–15 %	0.50–0.80 %
Total	**331.0**	**18.4**	**349.4**		**11 mln tonnes**				
Bryansky property (to be part of fourth mine)		250.2	250.2	30 years	3-4 mln tonnes	n/a	n/a	n/a	n/a

Source: KTK OJSC

Group structure*

PRODUCTION

OJSC KUZBASSKAYA TOPLIVNAYA COMPANY

VINOGRADOVSKY MINING coal mining infrastructure division	KARAKANSKY-SOUTH MINE	VINOGRADOVSKY MINE	CHEREMSHANSKY MINE	MINE BASED AT BRYANSKY

MARKETING AND SALES

Kaskad Management Company export sales	100 %
OJSC Kuzbasstoplivosbyt wholesale & retail coal sales in Kemerovo Region	100 %
LLC Transugol wholesale & retail coal sales in Omsk Region	52.04 %
LLC Altay Fuel Company wholesale & retail coal sales in Altay Territory	51 %
LLC Novosibirsk Fuel Corp wholesale & retail coal sales in Novosibirsk Region	51 %

TRANSPORTATION, ENERGY AND REAL ESTATE

LLC Meret Freight Forwarding Company (TEKM) railway freight company	100 %
OJSC Kaskad-Energo heat and power producer	100 %
LLC Kaskad Geo land acquisition	100 %
LLC Kuzbass Transport Company associated railway freight company	49.98 %

* The Company also owns several auxiliary and service assets that are not part of the core business and are not included in this diagram.

Coal mines

The first mine to be launched was Karakansky-South in 2000. Its share of total KTK production has steadily declined as the Company has developed new properties and mines. Vinogradovsky was launched in 2004 and Cheremshansky came on stream in 2008. As a result, Karakansky-South's share of KTK production has dropped from 100% to 37%, while Cheremshansky's share has rapidly increased with average annual growth of 60% in the past three years.

Karakansky-South and Cheremshansky now contribute about equally to total KTK's coal production – 37% and 43% respectively – and Vinogradovsky contributes 20%. Combined production at the three mines amounts to about 80% of design capacity.

KTK plans to produce the first coal at the Bryansky property in 2015 at the earliest. The company plans to complete exploration and acquire the necessary mining equipment to start developing the site by that time.

Production structure by mine

Produced in 2011

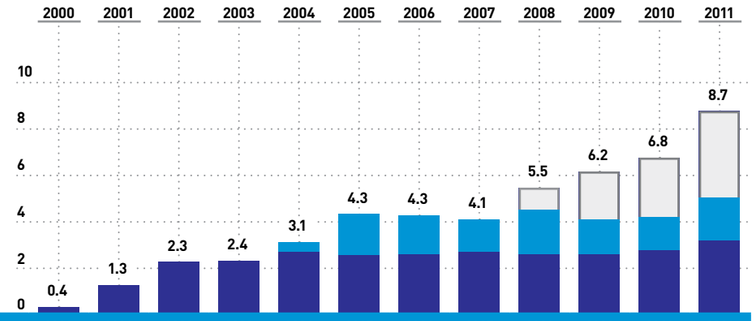
8.7

mln tonnes of coal

Rising

28.5%

compare to 2010



Mln tonnes	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Cheremshansky									1.0	2.1	2.6	**3.8**
Vinogradovsky					0.4	1.8	1.7	1.4	1.9	1.4	1.5	**1.8**
Karakansky-South	0.4	1.3	2.3	2.4	2.7	2.6	2.6	2.7	2.6	2.7	2.8	**3.2**

Source: KTK OJSC

Washing plants

The Kaskad washing plant with annual capacity of 2 million tonnes uses steeply-inclined separation technology to process diluted run-of-mine and high-ash coal that was previously dumped as a production loss in high quality washed coal. Covered storage has been built next to the plant in order to store washed coal. The plant operated at nearly 100% of capacity in 2011 and produced 740,000 tonnes of export quality coal.

Construction of a second plant, Kaskad-2, using steeply-inclined and dense medium gravity separation technology, began in 2011 and is scheduled for completion in the fourth quarter of 2012. The design capacity of the plant has been doubled to 4 million tonnes from the 2 million tonnes announced during the Company's IPO in 2010. Management made this decision after a detailed analysis of construction costs showed that expenditures on the main construction and installation work would not increase significantly if capacity were doubled. The increase in capacity will enable the Company to reduce per-unit construction costs and accommodate future growth of its resource base.

The increase in modern processing capacity will enable the Company to accommodate future growth of its resource base

Specifications of KTK washing plants

	KASKAD	KASKAD-2
LAUNCH	2010	2012
DESIGN CAPACITY	2 MLN TONNES	4 MLN TONNES
CALORIFIC VALUE OF COAL PRODUCED	5 300-5 750 KCAL	5 500-5 750 KCAL
TECHNOLOGY	STEEPLY-INCLINED SEPARATION	STEEPLY-INCLINED + DENSE MEDIUM GRAVITY SEPARATION
COST	$27 MLN	$81 MLN

Mining equipment

The Company's fleet of mining equipment includes 22 shovels, 88 trucks, 20 dozers, 34 loaders and four drill rigs. This equipment comes primarily from well-known firms such as Komatsu, P&H, Ingersoll Rand and Belaz. Due to their proximity, most equipment can be used at all three mines.

KTK is continually updating its fleet of mining and transport equipment with new, high-performance equipment. The Company acquired two shovels, one grader, 22 trucks, six dozers, two loaders and one drill rig in 2011 at a cost of 772.5 million rubles, or about 40% of the investment budget for 2011.

The Company also acquired options in 2011 to purchase mining machinery and equipment effective until 2013, which will enable it to minimize the negative impact of price fluctuations and guarantee delivery of equipment to mines on schedule.

KTK is continually updating its fleet of mining and transport equipment with new, high-performance equipment

THE COMPANY ACQUIRED NEW MINIG AND TRANSPORT EQUIPMENT IN 2011 AT A COST OF 772.5 MILLION RUBLES:

2 shovels	1 grader	22 trucks
6 dozers	2 loaders	1 drill rig

Infrastructure: Meret Freight Forwarding Company

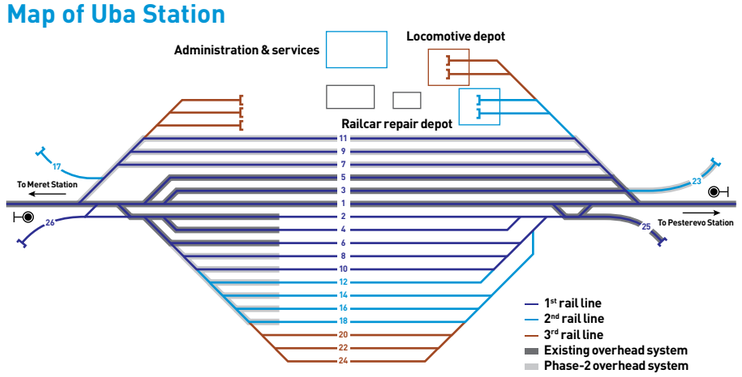
The coal produced by the Company is shipped from the mines to Russian Railways' (RZhD) public tracks by Meret Freight Forwarding Company (TEKM), a unit of the Kuzbasskaya Toplivnaya Company group.

Raw, sorted and washed coal is taken from production storage yards and the washing plant along the Company's own railroad to the internal station Uba, where cars are sorted. The trains then go to RZhD's Meret station, where the locomotives are replaced with RZhD locomotives and proceed to market.

In 2011, KTK completed a major overhaul of the Uba station, where railcars are sorted for subsequent shipment to RZhD's Meret station. The project included the launch of five receiving and departure tracks, the second phase of the overhead system, an administration building, railcar inspection building and treatment facilities, and the overhaul of the station's electric power system. This increased coal loading capacity from 500 to 700 cars per day, and expanded the station's throughput capacity from 12 million tonnes to 16.7 million tonnes per year.

TEKM carried a record 12.9 million tonnes of coal in 2011 up by 36% from 9.6 million tonnes in 2010

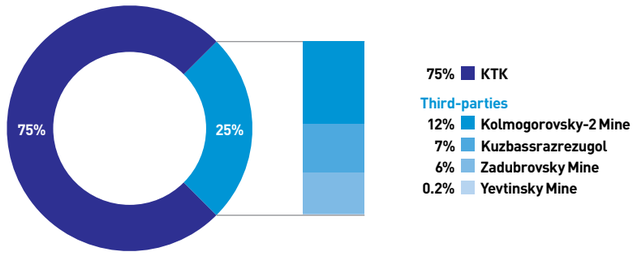
Map of Uba Station



TEKM had six stations (including three loading and one coal collection station), 85 km of railroad infrastructure and 12 locomotives (six owned and six leased) at the end of 2011.

TEKM carried a record 12.9 million tonnes of coal in 2011, up by 36% from 9.6 million tonnes in 2010. In addition to KTK's coal, TEKM also carries coal for third-party producers with nearby mines, such as Kuzbassrazrezugol, Zadubrovsky Mine and Kolmogorovsky-2 Mine, amongst others.

TEKM shipments by client in 2011



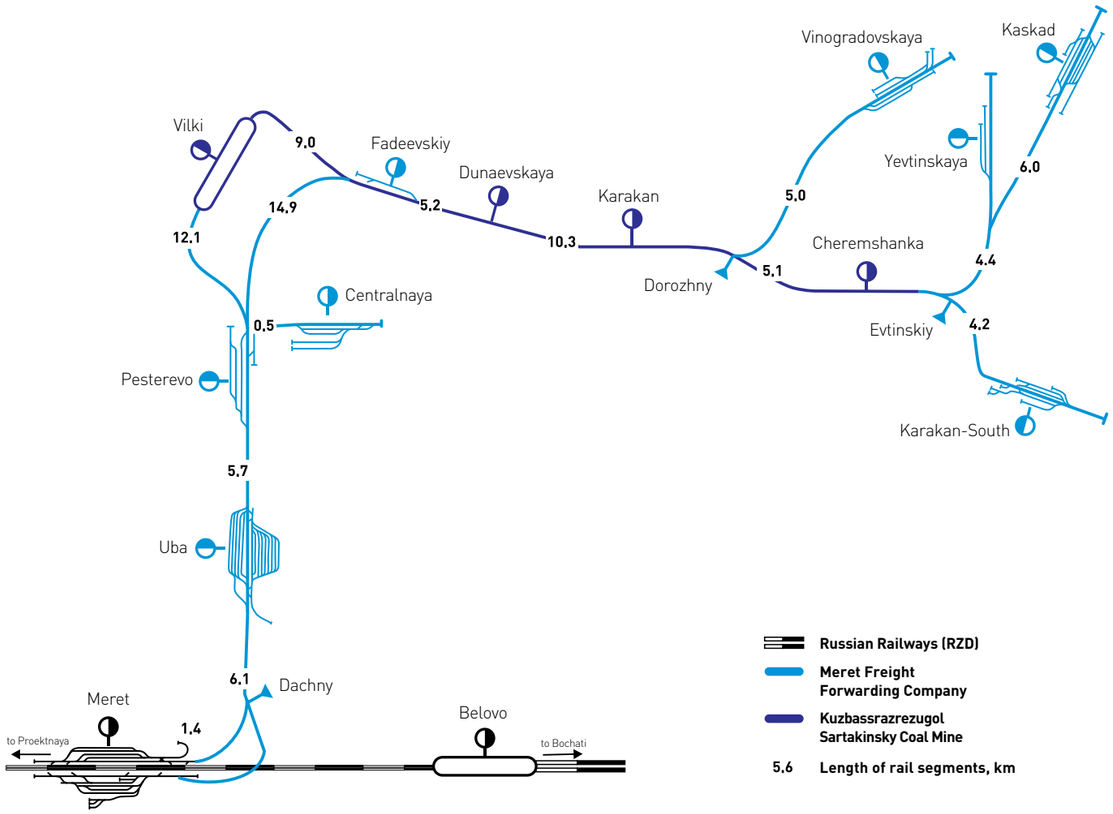
Source: KTK OJSC

TEKM freight shipments, mln tonnes

Млн т	2010	2011	Change
1. Shipments to RZD' Meret station	8.973	**12.265**	37 %
Kuzbasskaya Toplivnaya Company	6.398	**9.214**	44 %
Kuzbassrazrezugol Coal Company	1.127	**0.892**	–21 %
LLC Zadubrovsky Mine	0.438	**0.696**	59 %
CJSC Yevtinsky Mine	0.29	**0.024**	–92 %
LLC Kolmogorovskaya-2 Mine	0.72	**1.439**	100 %
2. Infrastructure & shipping services to other destinations	0.671	**0.709**	6 %
KTK Belovo Regional Power Station	0.172	**–**	–
LLC Belovopromzheldortrans	0.499	**0.709**	42 %
TOTAL	**9.644**	**12.974**	**35 %**

Source: KTK OJSC

Map of coal company rail lines linked to RZD's Belovo and Meret stations



MERET STATION

The Meret train station is part of the Kuzbass branch of the West Siberian Railway. It is a cargo station. Meret station releases and receives goods in small and carload shipments from non-public places and spur tracks. The main purpose is the formation of coal routes from Karakanskaya and Inskaya connections and releasing them to the Meret station.

BELOVO STATION

Belovo – major junction of the West-Siberian Railway road, with a capacity of about 11 thousand cars a day. It is a cargo station. Developed network of access tracks of industrial railroad transport enterprises servicing coal, industrial, and power plants. Developed infrastructure of car and engine sheds for freight car servicing.

Infrastructure: LLC Kuzbass Transport Company

By acquiring a stake in the associate, Kuzbass Transport Company, KTK has gained the opportunity to obtain coal transport services at a price based on a freight car leasing rate that is fixed for a period of ten years. The Company has thus been able to hedge against the risk of higher freight car leasing rates and late delivery of export freight due to shortages of cars on the market.

Kuzbass Transport Company had about 2,600 freight cars at the end of 2011, up from 2,200 a year earlier. The acquisition of an additional 500 freight cars was completed in March 2012, expanding the fleet to about 3,100.

Infrastructure: Land resources management

LLC Kaskad Geo manages Kuzbasskaya Toplivnaya Company's land resources. It owns land within mining allotments not yet used in production by KTK, and acquires land for prospective deposits that are likely to be offered at auction in future, giving the Company a competitive advantage at such auctions and enabling it to save on lease payments.

Land totaling 172.8 million rubles in value (not including VAT) was acquired in 2011.

Infrastructure: OJSC Kaskad-Energo

The KTK group includes Kaskad-Energo, a power company based in the Kemerovo Region town of Anzhero-Sudzhensk. Kaskad-Energo, formed on the basis of the Sudzhensk combined heat-and-power plant, is a reliable supplier of heat and electricity to local utilities, social infrastructure and industrial enterprises.

In 2011, there was a planned reduction in the production and sale of electricity as the thermal energy is in high demand, including from Anzhero-Sudzhensk town.

Kaskad-Energo sales of heat and electricity

	2007	2008	2009	2010	2011	2010/2011
Thermal energy						
Thermal energy sales, '000 Gcal	208.5	211.0	219.8	267.4	276.5	3 %
Thermal energy sales, mln RUB	121.4	131.1	163.7	217	227.6	5 %
Electricity						
Electricity sales, '000 kWh	40,734	49,755	49,062	34,949	7,601	–78 %
Electricity sales, mln RUB	27.1	36.6	39.4	19.1	8.4	–56 %

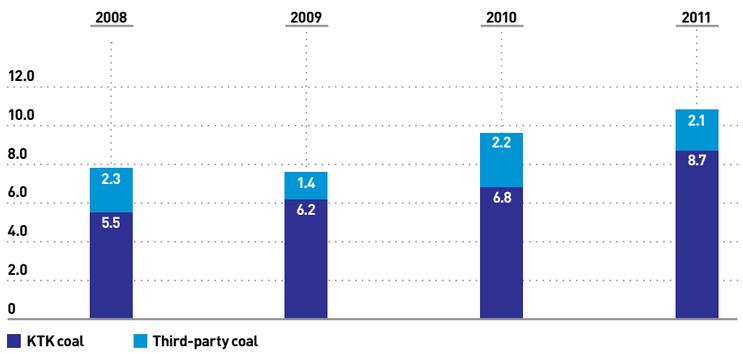
Source: KTK OJSC

6 DISTRIBUTION SYSTEM

Sales of third-party coal: REPUTATION AS A RELIABLE TRADER YIELDS REWARDS

KTK increased coal sales by 24.8% year-on-year to 10.66 million tonnes in 2011. The Company produced 8.74 million tonnes. The difference between production and sales was due to the sale of coal from third-party producers such as SUEK, Kuzbassrazrezugol and other major coal miners in the Kuznetsk Basin.

Structure of KTK sales by source of coal, mln tonnes



Source: KTK OJSC

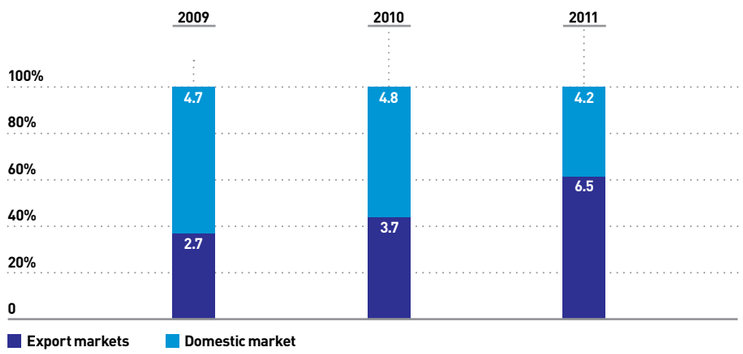
The share of third-party coal shrank to 19.5% of KTK's total sales in 2011 from 25% a year earlier.

Nonetheless, sales of third-party coal continue to make a considerable contribution to total sales and play an important role in KTK's sales policy. They allow the Company to build a more flexible distribution system and offset fluctuations in production and sales of its own coal in the course of the year. Third-party coal also provides additional sales volume to maintain the Company's leading positions in Western Siberia while allowing it to increase sales of its own high-calorie coal on export markets.

Exports: KTK ENTERS TOP FIVE

KTK's presence on foreign markets has been growing dramatically in recent years. Exports grew to 61% of total sales in 2011 and exceeded domestic sales for the first time. The share of exports doubled in the space of four years after growing from 28% in 2007 to 36% in 2009 and 44% in 2010.

Structure of KTK sales by destination market, mln tonnes



Source: KTK OJSC

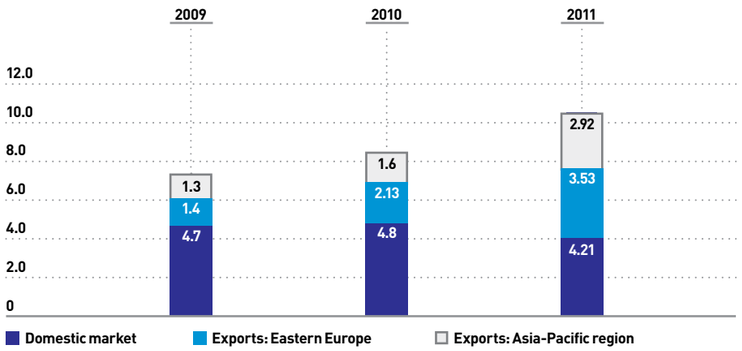
Exports grew 76% in 2011 and amounted to 6.45 million tonnes, making KTK Russia's fifth largest exporter of thermal coal.

The growth of coal exports was driven primarily by their high profitability – as in previous years, KTK's export prices exceeded domestic prices in 2011. Export quality coal is of higher quality, with the highest heat value and, consequently, commands the highest sales margin. The second reason for the growth in exports is the Company's drive to diversify not only its product line (with washing of top quality coal) but also the geography of sales.

Geography of exports: BETTING ON PROMISING MARKETS IN ASIA AND EUROPE

KTK is betting on the most promising and rapidly growing markets, which are expected to see the strongest growth in coal consumption. The Company is working on entering the markets of Japan and the Baltic nations.

Structure of KTK sales by region, mln tonnes



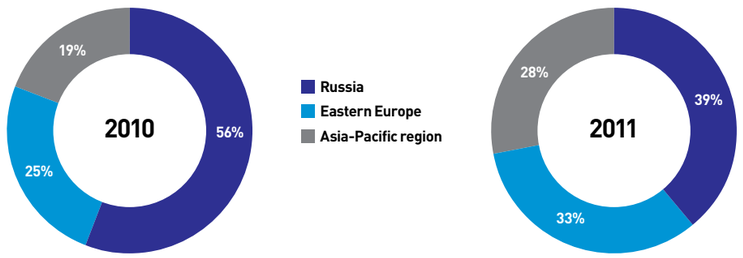
Source: KTK OJSC

As it brings new washing capacity on stream that will make it possible to produce premium quality coal, **the Company will expand on the markets of Taiwan, Japan and South Korea, as well as Western european countries, which traditionally have the highest coal standards.**

As it brings new washing capacity on stream that will make it possible to produce premium quality coal with ash content of less than 5% and heat value of 6,000 kcal/kg, the Company will expand on the markets of Taiwan, Japan and South Korea, as well as Western European countries, which traditionally have the highest coal standards. Potential demand for Russian coal in Taiwan alone is estimated at 4.5 million tonnes. KTK's competitive advantages on these markets will be flexible organization of shipments and its reputation as a stable and reliable supplier.

KTK's main export markets are still South Korea, China and Poland. Sales in Poland are conducted primarily through Krex Energo and Barter S. A., which have been the Company's partners on the Polish market for several years. KTK opened a representative office in Warsaw at the beginning of 2012, which will enable it to operate on the Polish market without intermediaries. Sales in China and South

Geography of KTK sales



Source: KTK OJSC

The Company intends to continue to pursue its **strategy of diversifying sales in order to ensure the sustainable growth of its business.**

Korea are conducted through leading international trader Glencore International AG. The coal exported to Asia is used primarily by power companies and cement producers, while the coal sold in Poland is used largely by retail consumers of sorted coal.

Exports to Asia surged 81.2% to 2.92 million tonnes in 2011, while exports to Eastern Europe jumped 65.6% to 3.53 million tonnes. The breakdown of coal exports between the Asia-Pacific region and Eastern Europe became more even at 46% and 54% respectively, resulting in effective diversification of total sales among three promising regions: sales in 2011 were approximately evenly split between Russia, Asia and Eastern Europe (not including Russia).

Sales in Russia: STRONG POSITIONS IN WESTERN SIBERIA

While expanding exports, KTK is continuing to strengthen its position on the stable domestic market. This strategy has already proven itself in crisis-hit 2009, when it helped the Company to mitigate the negative impact of the steep drop in demand and prices for thermal coal on world markets.

Although the situation on the world coal market improved in 2010-2011, the Company is continuing to pursue a sound and cautious sales policy. Therefore, although exports supplanted some domestic sales in 2011, resulting in coal deliveries to the Russian market dropping by 14% to 4.2 million tonnes, their share of total sales is still considerable at 39%.

Most domestic coal sales have traditionally been within the Siberian Federal District trought the retail network, which accounted for 91% of domestic sales. The Ural, Central, Northwest and Volga federal districts account for a small but growing share of sales. This share grew from 2.7% to 8.3% as KTK is expanding beyond its traditional market of Western Siberia.

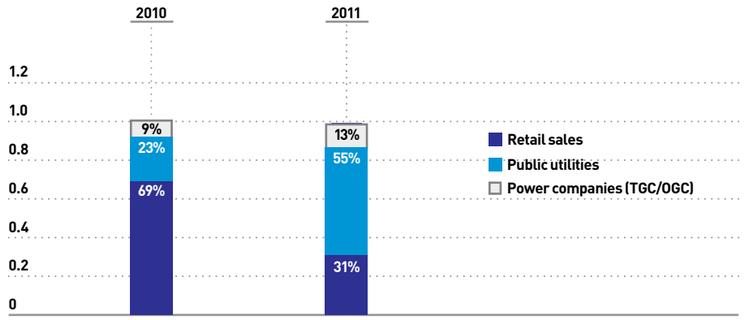
Distribution of sales in 2011

Source: KTK OJSC

Sector structure of sales: DIRECT SALES TO MAJOR CLIENTS GROW

The structure of domestic sales by sector changed dramatically in 2011.

Structure of KTK domestic sales by sector



Source: KTK OJSC

While before retail sales accounted for as much 70% of the total, in 2011 they shrank to 31%. The proportion of sales to public utilities, meanwhile, more than doubled to 55% from 23% in 2010. Sales to power companies grew to 13% of domestic sales in 2011 from 9% in 2010. The Company is interested in growing direct sales to major power companies and public utilities, as wholesale shipments are more stable and, as a rule, based on long-term relationships.

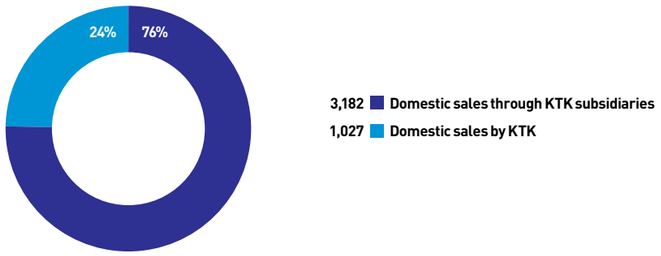
The biggest buyers of coal among generating companies are TGC-5, TGC-6 and TGC-9, which are part of the Integrated Energy Systems group, and TGC-14, which is controlled by Energopromsbyt. KTK also sells coal to its own power company, Kaskad-Energo, the main supplier of heat in the city of Anzhero-Sudzhensk.

Retail sales: DYNAMIC DEVELOPMENT OF DISTRIBUTION NETWORK

KTK has the largest distribution network in Western Siberia. Retail sales are conducted through the distribution network of KTK subsidiaries, which include :

> **Kuzbasstoplivosbyt** (100% ownership),
> **Altay Fuel Company** (51% ownership),
> **Transugol** (51% ownership),
> **Novosibirsk Fuel Corporation** (51% ownership).

Structure of KTK sales on domestic market, '000 t



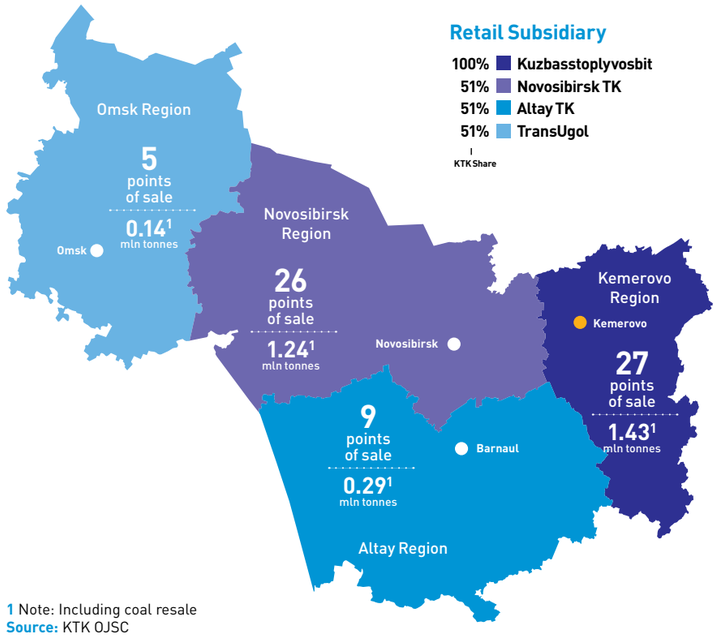
Source: KTK OJSC

The retail network now has 67 points of sales covering the Kemerovo, Novosibirsk and Omsk regions and Altay Territory, and **is the primary outlet for coal sales to households, municipal and regional organizations and public utilities.**

The retail network now has 67 points of sales covering the Kemerovo, Novosibirsk and Omsk regions and Altay Territory, and is the primary outlet for coal sales to households, municipal and regional organizations and public utilities. The companies within the distribution network sold 3.182 million tonnes of coal in 2011, which amounted to 76% of total sales on the domestic market. The other 24%, or 1.027 million tonnes were sold by KTK directly.

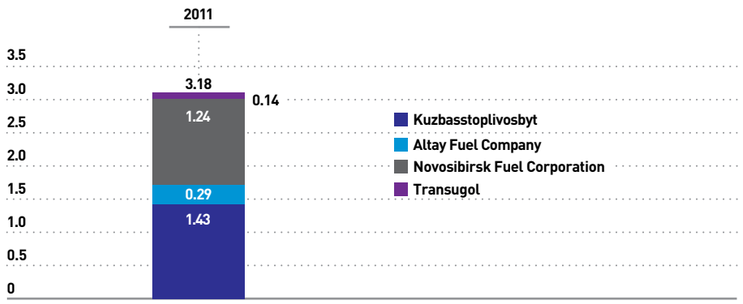
The rapid growth of the distribution network is being driven by the demand in Western Siberian regions for a stable supplier of quality coal who can provide a full range of sales and delivery services to consumers. An important advantage offered by KTK is that it also has the resources to meet additional demand for coal when necessary during unusually cold winters.

KTK retail network in Western Siberia



1 Note: Including coal resale
Source: KTK OJSC

Structure of KTK sales in Western Siberia through subsidiaries, mln tonnes



Source: KTK OJSC

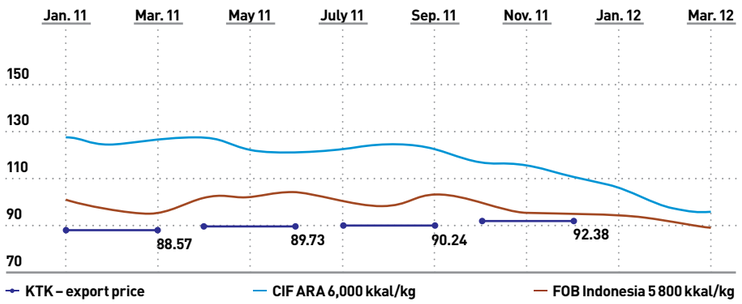
Another important factor is that the Company offers the retail market sorted coal that is superior in quality to the raw coal common on this market. Every outlet in the Company's chain currently sells both raw and sorted coal, which is growing in popularity despite its higher price.

The Company plans to expand its retail network in regions where it already has a presence, and expand sales in neighboring regions by working with outside coal trading companies. KTK opened two new points of sale in Altay in 2011, confirming its determination to further expand the retail network.

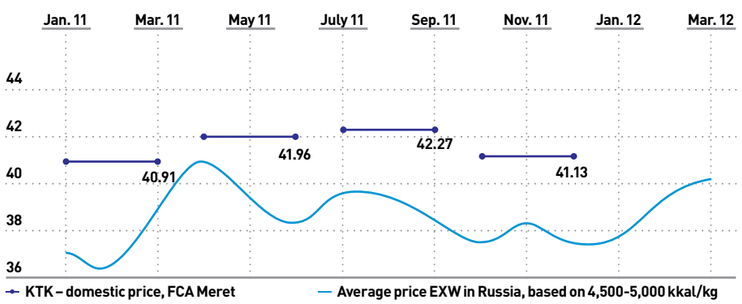
Coal prices: KTK'S AVERAGE REALIZED COAL PRICE GROWTH

Demand for coal continued to recover in 2011 on both the global market and in Russia. The growth of demand, the contraction of supply at the beginning of the year amid natural disasters in Australia and Indonesia, as well as concerns about a future coal shortage in the wake of the nuclear disaster in Japan pushed up world prices for thermal coal in 2011. KTK's realized coal prices rose along with world prices, though the growth was uneven due to the cyclicity of coal sales, net back prices were also affected by changes in railroad shipping tariffs for coal.

KTK realized export prices vs. international FOB and CIF bencmarks, $/tonne



KTK FCA prices vs. Russian EXW benchmark, $/tonne

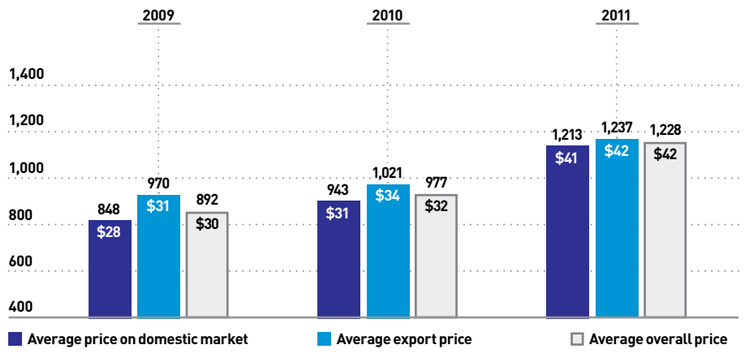


Source: KTK OJSC

KTK's realized coal price on the domestic market rose for most of the year – throughout the first three quarters. There was a drop of 6.9% in the fourth quarter compared to the previous quarter, which was in large part due to the warm weather in Russia in October-November 2011. Demand for thermal coal usually increases in the third and fourth quarters with the start of the heating season, which promotes growth of prices. In the first and second quarters, as outside temperatures rise, demand for coal usually begins to drop as consumers prefer to use up coal stocks left over from the winter.

KTK's export price also rose for most of the year. There was only a drop of 3% in the second quarter net back price due to an increase in railroad shipping costs. This increase due to the transfer of RZD's railcar fleet to subsidiaries, which led to the emergence of hundreds of new operators on the railroad transport market, shortages of railcars for the most popular destinations and an increase in tariffs. In order to counter the growth of transport costs, the Company increased the fleet of freight cars leased from Kuzbass Transport Company at fixed rates.

KTK average realized coal price, RUB/tonne and $/tonne



Source: KTK OJSC[7]

The average realized price for KTK coal rose by 25.7% in 2011 to 1,228 rubles ($41.80) per tonne, excluding VAT and deducting out the cost of railroad tariffs to customers. The average net back export price (price paid by customer less transport costs) increased by 21.2% to 1,237 rubles ($42.10) per tonne, and the price on the domestic market rose by 28.6% to 1,213 rubles ($41.30) per tonne on an ex works basis net of VAT from 943 rubles. As a result, the gap between export and domestic prices narrowed dramatically from previous years. One of the main reasons for the more rapid growth of the domestic price was the increase in the share of sized coal in KTK sales.

7 Here and subsequently, prices in dollars calculated at the Central Bank of Russia's average exchange rate for each given period: 31 rubles/$1 in 2009; 30.38 rubles/$1 in 2010; 29.39 rubles/$1 in 2011.

Coal transportation: A LONG ROAD TO THE CONSUMER

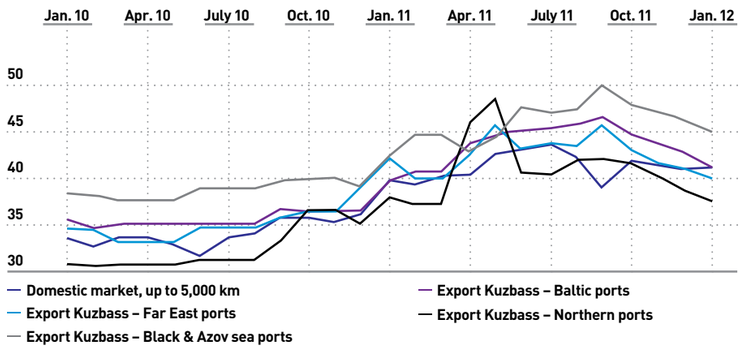
Coal produced by KTK usually travels a long distance to reach its consumer. In Russia, coal is delivered to customers by rail, and the average shipping distance for Kuzbass coal within the country is about 2,500 km.

Export coal is shipped by rail to ports, and then by sea to customers abroad. The distance from Kuzbass mines averages 4,500-5,000 km to ports on the Baltic and Black seas and 6,000 km to ports in the East.

Coal is first taken from the Company's storage depots and the washing plant along its own railroad network to the Uba internal station, where freight cars are sorted. The sorted trains then proceed to RZD's Meret station, where the locomotives are switched and RZD takes over further shipment. The price and terms of shipping coal differ considerably depending on whether the coal is bound for export or the domestic market.

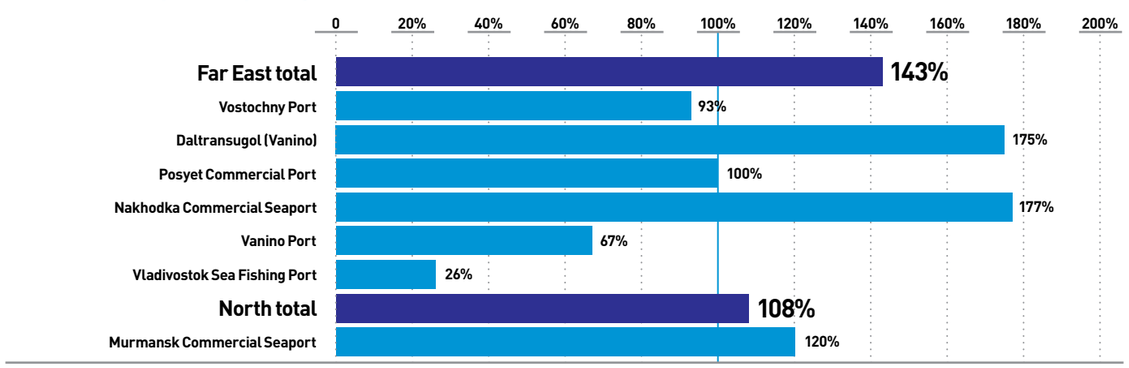
The potential growth of Russian coal exports is constrained not only by growing railroad tariffs and the capacity of the country's railroads, but also the throughput capacity of seaports in the

Changes in railroad tariffs for domestic and export coal shipments, $/t



Source: Metal Expert

Utilization of port capacity in Far East and North, %



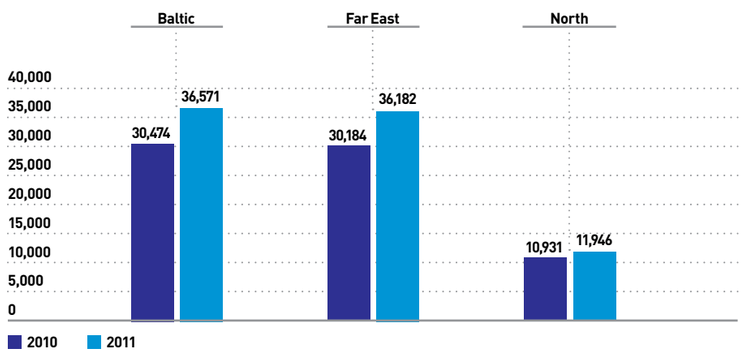
Source: Metal Expert

	Domestic supplies	Exports	
		Western destinations	Eastern destinations
PRICING	**PRICE OF DELIVERY** = 1) RZD tariff for providing infrastructure and locomotive haulage to buyer (reviewed once a year taking into account inflation) + 2) Price for using (leasing) freight cars, provided by owner of cars (reviewed depending on lease terms)	**PRICE OF DELIVERY** = 1) RZD tariff for providing infrastructure and locomotive haulage + 2) Price of leasing freight cars of private companies In order to reduce the freight car component of shipping rates, KTK is investing heavily in its own fleet of freight cars. The Company expects to completely transition to using the freight cars of joint venture Kuzbass Transport Company in the next few years. In that case, the leasing rate for freight cars will be fixed for 10 years, and shipping costs will vary only depending on the distance and the RZD tariff for shipping coal. KTK's current fleet of about 3,100 freight cars is sufficient to cover about half of export shipments	
DELIVERY TERMS	**FCA (free carrier)**, Meret Station, Kemerovo Region Seller delivers the goods to the carrier named by the buyer at the named place KTK usually uses the services of Freight One for coal deliveries to customers. Freight One is Russia's largest rail freight carrier and its rates are used as a benchmark by most government-funded organizations that are customers of KTK	**DAF (delivered at frontier)** to Polish border with Belarus or Ukraine Seller is responsible for delivery to the border and payment of duties Buyer is responsible for customs clearance and delivery from border to required destination Risks pass upon the goods reaching the border	**CPT (carriage paid to)** Vostochny Port Seller pays for railroad delivery to named destination. Buyer pays for transfer and storage at port, freight and insurance. Risks pass from seller to buyer upon delivery to port
PRICE OF DELIVERY IN 2011	**1,213 rubles ($41[8]) per tonne**	• **1,430 rubles ($49) per tonne** relating to railcar usage • **2,944 rubles ($100) per tonne,** railcar usage plus railroad tariff	• **1,095 rubles ($37) per tonne** relating to railcar usage • **2,317 rubles ($79) per tonne,** railcar usage plus railroad tariff

Source: KTK OJSC

8 At Central Bank of Russia average exchange rate of 29.39 rubles/$1 for 2011.

Growth of coal shipments through selected ports, '000 t



Source: Metal Expert

Far East and the North. Most ports in these regions are already operating at more than 100% of capacity, though transshipment of coal continues to grow. Ports in Russia's Far East handled 20% more coal in 2011, and ports in the North handled 9% more.

In light of the growth of coal exports and shortage of port capacity to handle them, the Russian government announced plans at the beginning of 2012 to build a new port in the Far East that will be able to handle 20 million tonnes of coal per year. Deputy Transport Minister Viktor Olersky said areas around Vanino, Nakhodka-Vostochny and Posyet are being considered as possible locations for the new port. Ports in the region are currently designed to handle about 40 million tonnes of coal, so capacity could be expanded by 50%.

Many private companies have also announced plans to build major coal terminals in the Far East. SUEK has plans to double its terminal at the Vanino Port to 24 million tonnes, and Evraz Group plans to double the capacity of its Nakhodka Commercial Seaport to 5 million tonnes per year by 2013. Mechel has plans to expand cargo turnover at the Posyet port from 3.3 million tonnes to 7 million-9 million tonnes in 2012, as well as begining construction of a new coal terminal near the Vanino Port in Muchka Bay with capacity of 25 million tonnes. Independent operators have also announced port projects in the Far East. The most ambitious of these is a project by Summa Group to build a complex at the Vostochny Port with capacity of 18 million tonnes (mostly coal) by 2013. The Global Ports group also intends to build a terminal at this port, with capacity of 1 million tonnes. Sibuglemet announced plans in 2011 to build a coal terminal with capacity of up to 8 million tonnes in Sukhodol Bay. Throughput capacity will also expand once the second automated complex of the coal terminal in Ust-Luga, with annual capacity for 12.4 million tonnes of thermal and coking coal, reaches full capacity in 2012.

The implementation of the plans to build new and expand existing facilities could completely eliminate the problem of export coal congestion at Russian ports.

7 RISK MANAGEMENT

KTK's business is subject to a number of risks, the most significant of which are listed below.
The Company is continually taking steps to create an effective system of risk management, aimed at providing a sufficient level of confidence that strategic and short-term goals will be achieved and reasonable guarantees of protection from potential losses.

COUNTRY AND REGIONAL RISKS

KTK's production activities are concentrated in the Kemerovo Region of Russia and are therefore exposed to risks related to both the situation in the Kemerovo Region and Russia in general. The current socioeconomic situation in the Kemerovo Region and regulatory policy in the coal industry show that the region is quite stable. Gross regional product in 2011, according to preliminary figures, grew 5.8%, industrial production rose 3.9%, average monthly wages increased by 13.9% and capital investment grew by 31.4% to 134 billion rubles. The region is geographically removed from areas of potential local armed conflicts in other parts of Russia. Therefore, the probability of military conflicts, imposition of a state of emergency or widespread strikes in the Company's region of operations is low.

However, Russia is part of the global economy and negative changes in the economies of other countries and on the global commodities market (oil, natural gas, metals) could weaken Russia's economy and reduce its investment appeal. This in turn would impact the Company's performance, as it would dampen demand for products from potential customers and constrain the Company's ability to raise finance at favorable rates and in the required amount. This was the case in 2008-2009, when demand for commodities fell and international financial markets were closed for a time even for the most reliable borrowers.

There was an upturn in both the global and Russian economies in 2010-2011. The global economy grew 3.9% in 2011 and Russia's GDP expanded by 4.3%, and the IMF is forecasting growth of respectively 3.5% and 3.9% for 2012. Demand on commodity markets is recovering, including with the help of government measures. Nonetheless, the global economy is still vulnerable to the following risks: the growth of budget deficits and debt in European countries, the long-term rollback of stimulus packages in the United States and other countries, slower growth in China, and greater volatility on commodity markets due to unrest in the Middle East. New financial shocks are possible, but their negative impact may be mitigated by the measures of the government and financial institutions to ensure sufficient liquidity to weather potential problems.

It is also important to keep in mind that the Company exports to various countries, particularly Poland, South Korea and China. Countries in which KTK has a presence have various levels of political and economic stability and, consequently, different degrees of probability that business activities will be constrained. Such constraints could arise due to expropriation of assets or nationalization at marked down prices, changes in the currency system introduced by the authorities, protective trade barriers or other measures that could have a negative impact on the

Company's export operations. Political risks such as potential military conflicts, acts of terrorism, social unrest and imposition of states of emergency could also affect the Company's business. However, the chances of such events occurring in the medium-term are believed to be small.

KTK's efforts to manage country and regional risks are aimed at diversifying the geography of sales. Geographic diversity of markets minimizes the potential negative impact of economic risks. The Company's sales in 2011 were approximately evenly divided among the markets of Russia, Asia and Eastern Europe (not including Russia). Within Russia, diversification by region is also growing, though Western Siberia remains the main market.
The Company's ability to flexibly change the geography of its sales enables it to quickly respond to changes in the situation in the global economy and protect itself from potential regional crises. The Company's management is continually monitoring the situation in countries where KTK has a presence so as to fully take into account potential negative changes on world markets.

SECTOR RISKS

The Company's main sector risks are related to a possible deterioration of the situation in the coal industry as a whole. Coal prices and demand on the domestic and foreign markets depend on many factors and have a direct impact on the Company's financial health. Prices in 2011 moved within an upward trend due to the recovery of demand for coal on the world market, a tightening of supply amid natural disasters (flooding in Australia), and anticipated shortages of coal on the world market in the wake of the Fukushima nuclear disaster in Japan.

The main factors that could affect the situation adversely, and how KTK can deal with these factors are listed below.

DECLINE IN COAL PRICES ON WORLD AND DOMESTIC MARKETS

KTK measures to manage risk
KTK cannot directly influence world coal prices. However it can mitigate the cyclicity of prices by entering into long-term contracts if coal prices are forecast to fall in future and switch to spot deliveries if prices are forecast to rise.
The Company can also flexibly change the structure of sales in favour of either exports or the domestic market, depending on where the realized coal price is highest.

GOVERNMENT CONSTRAINTS ON PRICES OF PRODUCTS OF COAL CONSUMERS (PUBLIC UTILITIES, POWER COMPANIES), LEADING TO ARTIFICIAL CONSTRAINTS ON GROWTH OF PRICES FOR KTK COAL

KTK measures to manage risk
KTK is diversifying the sector structure of its coal sales. Customers in the non-energy sector are expected to grow following the start of production of premium coal (following the launch of the Kaskad-2) washing and retail sales are increasing. Coal briquettes could become a successful niche product on the retail market.
The Company mitigates the loss of revenues resulting from government regulation by tightly controlling costs, growing the share of products with high added value (sorted, washed coal), partially shifting sales from the domestic market to export markets, and maintaining a reliable and stable retail network on the domestic market.

DECREASE IN PRICES FOR NATURAL GAS AS AN ALTERNATIVE FUEL FOR POWER GENERATION, WHICH WOULD UNDERMINE COAL'S PRICE ADVANTAGE AND REDUCE DEMAND FOR COAL PRODUCTS FROM END CONSUMERS

KTK measures to manage risk
KTK cannot directly affect gas prices. However, the Company's coal production costs are among the lowest in the world, which gives it a considerable edge in competing with natural gas for a place in the country's fuel balance. The Company is continuing to implement a set of measures to further reduce per-unit costs in order to maintain its price advantage. Production costs could be reduced by increasing the amount of coal shipped in the Company's own freight cars, setting up production of diesel fuel for internal needs, reducing the stripping ratio and so on.

SLOWDOWN OF ECONOMIC GROWTH IN CHINA AND OTHER ASIAN COUNTRIES THAT ARE LEADING IMPORTERS OF COAL (SOUTH, KOREA, TAIWAN, ETC.)

KTK measures to manage risk

The result of this risk being realized will be a drop in export prices for coal. KTK's actions in this case are described above in this table.

If demand for coal declines among actual KTK customers in Asia, the Company can shift sales to other markets. KTK has the ability to flexibly change the structure of its sales thanks to its strategy of geographic market diversification. In addition, the Company has longstanding, well-established relationships with foreign counterparties, which helps to reduce this risk.

In the case of a more negative scenario resulting in a steep drop in demand for coal on foreign markets, KTK would respond by rapidly adjusting its investment and production programs, which would involve partial or complete suspension of individual program items until the situation improves.

STEEP INCREASE IN THE TRANSPORT COMPONENT OF COSTS (FASTER THAN ANTICIPATED GROWTH OF RAIL FREIGHT TARIFFS, FREIGHT CAR LEASING RATES)

KTK measures to manage risk

The cost of shipping coal has two components.

1. Payment for the use of RZD infrastructure (60-70%). The Company has no influence over RZD tariffs, as they are set by the government.
2. Payment for use of freight cars (30-40%). In order to reduce the freight car component of the cost the Company is expanding the fleet of railcars owned by joint venture Kuzbass Transport Company, which then leases the cars to KTK under contracts with lease rates fixed for 10 years. Kuzbass Transport Company's own fleet (about 3,100) currently enables it to cover about half of its export shipments. For the other half, the Company strives to secure long-term contracts with carriers. In 2011, such contracts were signed with Sibugletrans and RG Trans.

KTK plans to expand its railcar fleet to 5,000 and then to 10,000 so that the transport cost will change only depending on the RZD tariffs.

LACK OF TRANSPORT INFRASTRUCTURE CAPACITY USED IN SHIPPING COAL TO CUSTOMERS, WHICH COULD CONSTRAIN PLANS TO EXPAND COAL PRODUCTION

KTK measures to manage risk

KTK is investing in the modernization of its own railroad infrastructure. In 2011, KTK completed the overhaul of the Uba transfer station, where railcars are sorted into trains for subsequent shipment to market. The overhaul resulted in an increase to the station's throughput capacity from 12 million tonnes to 16.7 million tonnes, boosting freight car turnover from 500 to 700 cars per day. The Company plans to invest a total of 663.5 million rubles (net of VAT) in railroad infrastructure in 2012-2016.

DRAMATIC INCREASE IN COMPETITION IN THE SECTOR

KTK measures to manage risk

The coal industry is already fairly competitive. Due to the capital-intensive nature of coal production, a dramatic increase in the number of new industry players is unlikely.

KTK's competitors currently include SUEK, Kuzbassrazrezugol and Siberian Business Union, among others.

KTK's competitive advantages:

- Reputation as a reliable coal supplier, firmly established by the Company over many years of doing business
- Diversification of business, both geographical and in terms of product line
- Low production costs
- High productivity thanks to use of modern equipment and the latest technology
- In-house railroad infrastructure and freight car fleet
- High level of information openness compared to competitors.

FINANCIAL RISKS

The main financial risks that the Company could face in future are the following:

CHANGES IN INTEREST RATES, a general increase in interest rates in the economy would increase the cost of servicing the Company's current debt.

CHANGES IN THE EXCHANGE RATE could also have a significant impact on KTK's financial performance since a large proportion of the Company's revenue is generated on export markets, in foreign currency. Gradual changes in the exchange rate should not have a major impact, but a sudden strengthening of the rouble could reduce profits. On the other hand, the negative impact in this case would be partially offset by a decrease in the cost of servicing the debt portfolio, more than 80% of which is denominated in foreign currency.

INFLATION RISKS could increase the Company's core costs and could impair the successful implementation of the Company's investment and production programs.

KTK MANAGES FINANCIAL RISKS by constantly monitoring and analyzing the situation on financial markets, and making prompt management decisions based on this analysis: review of financing structure, optimization of expenditures, review of capital investment, and efforts to improve turnaround of receivables.

In the case of a significant acceleration of inflation, for example, the Company can reduce the size and duration of receivables. If interest rates rise, the Company can seek more favorable lending terms outside of Russia. The Company has protected itself against the risk of higher interest rates on most of its current loans (93%) by entering into fixed-rate agreements. The Company also maintains tight control over its net debt/EBITDA ratio. The ceiling for this ratio has been set at 2, which will prevent excessive dependence on interest rates. The Company also conducts medium- and long-term planning in order to factor in potential risks as much as possible.

However, it should be noted that some financial risks are beyond the Company's control because they depend on the general economic situation in the country. In this case, the Company can only do its best to effectively adapt to changing conditions.

The Company has a high level of financial stability to weather short-term negative economic changes. Should there be significant economic instability that would have an adverse impact on the Company's business, KTK will implement a number of crisis management measures to strengthen its business and minimize the negative impact on it.

IMPACT OF FINANCIAL RISKS ON FINANCIAL STATEMENT INDICATORS

HIGHER INTEREST RATES

Impact on financial statement
Cost of borrowing would increase, which could result in growth of interest payments and reduce net profit.

CHANGES IN RUBLE EXCHANGE RATE

Impact on financial statement
Exchange rate volatility could increase the Company's costs and reduce profit. The Company's operating costs are primarily denominated in rubles, while a large proportion of revenue is denominated in U.S. dollars (export sales). Therefore, strengthening of the dollar would increase profit, but this positive impact would be offset by growth in interest rates on loans when expressed in rouble terms, as more than 80% of debt is denominated in dollars.

HIGHER INFLATION

Impact on financial statement
Most costs (wages, inputs, electricity, spare parts, fuel, etc.) would increase. On the other hand, prices for sold product would rise, increasing revenue. The ultimate impact on net profit would depend on the relative rates at which revenues and costs increase.

OPERATIONAL RISKS

RISKS RELATED TO INDUSTRIAL ACCIDENTS AND DISASTERS

Coal mining involves the operation of hazardous production sites at which the Company conducts strip mining operations. Although the Company observes all laws and regulations governing occupational health and safety, it is impossible to exclude the possibility of industrial accidents occurring due to either objective or subjective reasons. However, the probability of such accidents is significantly lower than in shaft mining operations.
The Company's operations are conducted in strict adherence to plans developed by specialized design organizations. The Company has special units responsible for compliance with safety rules that conduct regular inspection patrols; workers are trained in safety protocol; and there are regular medical checkups as required by law. The Company provides accident insurance to production personnel, and insures its liability as the owner of hazardous facilities for damages to third parties resulting from an accident at such facilities.

RISKS RELATED TO CURRENT COURT PROCEEDINGS INVOLVING THE COMPANY

The Company is not currently involved in court proceedings that could result in significant expenses or have a negative impact on its business. However, such a possibility cannot be completely ruled out due to judicial errors and the unpredictability of court decisions. The Company does not foresee any potential court proceedings or lawsuits that could have a major impact on its performance or financial position.

RISKS RELATED TO POSSIBLE LOSS OF MAJOR CUSTOMERS

The Company has an extensive client base, and there is no excessive dependence on one or several major customers. There is only one customer whose share of total accounts receivable exceeds 10%. Furthermore, the Company has longstanding and well-established relationships with most of its wholesale customers, including coal importers, so these risks are low.

LEGAL RISKS

Doing business in Russia, the Company is exposed to risks related to changes in currency, tax and antimonopoly legislation, and customs and licensing regulations.

CHANGES IN CURRENCY REGULATION

Regulation of currency regulation in Russia does not currently have a tight administrative framework. Changes in regulation could affect the Company's operations. In order to avoid potential risks, the Company's legal department constantly monitors for possible changes in currency legislation.

CHANGES IN TAX LEGISLATION

Tax legislation in Russia is subject to frequent changes, and also leaves room for varying interpretations of many terms, which can make tax planning more difficult. Potential changes in tax legislation could increase the Company's expenditures on payment of taxes and levies, which could reduce net profit and cash flow. In order to avoid such risks, the Company conducts tax planning and monitoring of tax legislation.

CHANGES IN CUSTOMS REGULATIONS AND DUTIES

Since the commodity produced by the Company is exported, the Company's business is subject to customs regulation. Due to potential changes in regulations governing customs control and duties, there is a risk of decisions being adopted that complicate customs declaration. In order to avoid these risks, the Company monitors customs legislation.

CHANGES IN REQUIREMENTS FOR LICENSING of core activities or rights to use assets with limited transferability (including natural resources). The Company holds all the necessary licenses to conduct its business and has no problems renewing these licenses. The Company complies with license requirements and takes all possible steps to minimize the possibility of licenses being suspended or revoked. If requirements for licensing of business activities and use of assets with limited transferability are changed, the Company will take all necessary steps to meet the amended requirements.

CHANGES IN ANTIMONOPOLY LEGISLATION

Russian antimonopoly legislation has been undergoing fundamental changes recently due to the tightening of control over compliance with regulations in this area. The Company operates in a competitive market and does not benefit from a monopoly position. Furthermore, the Company does not pursue any actions that restrict competition on the Russian coal market, and competes fairly and openly. Therefore, this risk is seen as minimal.

8 RESEARCH & DEVELOPMENT

KTK is placing a great deal of emphasis on studying new technologies that emerge on the world coal market, and is independently investing in research and development that is producing unique technologies for subsequent application at units of Kuzbasskaya Toplivnaya Company.

The Company conducted prefeasibility studies in the following areas in 2011.

DEVELOPMENT OF A NEW TYPE OF FUEL FROM WASHED COAL

Development of a new type of fuel from washed coal – so-called "solid natural gas." This refers to small coal briquettes with higher heat value produced using the latest technologies. This fuel is called solid natural gas because it burns like gas, without soot, smoke or ash.

The manufacturing process for fuel briquettes, as a rule, consists of several main stages: 1) screening of coal (to sort by size); 2) crushing of coal (in two stages – preliminary and principal crushing); 3) reduction of coal to micron size (usually 100-200 microns); 4) heating of the resulting material at a temperature of 200-300°C (so-called bertinization process); 5) pressing (without binding agent, that is without glue, etc.) of the resulting coal dust into briquettes, the heat value of which is about 1,000 kcal per kg higher than that of the original coal.

KTK and specialists from LLC Ugol-S, a company that specializes in coal washing technologies, have jointly developed a fundamentally new technology with fewer stages. After crushing, the coal is fed into a mechanochemical reactor that, thanks to its special design, pulverizes and bertinizes the coal simultaneously, eliminating the need for thermal processing. The resulting product is a very dry powder with 3-6% moisture content and about 1,000-1,200 kcal per kg higher heat value. The powder is then pressed into briquettes.

Coal briquette production process

Original material
COAL OR COAL FINES

PREPARATION
↓
SCREENING
CRUSHING
PULVERIZATION
↓
HEATING
↓
PRESSING
↓

These two stages can be combined into one with KTK's special technology

Finished product
COAL BRIQUETTES

KTK management has worked out a fundamental position on future financing for the briquette production project. Demand for the new product will be secured by the unique properties of this "solid natural gas."

- High heat value (6,000-6,700 kcal) per kg, significantly increasing the burning time. A 30-gram briquette can burn for 5 hours. Another important factor is the constant burning temperature
- Environmentally friendly – the absence of any additives and minimal ash content eliminate unpleasant odors and harmful emissions (including carbon monoxide) during burning
- High density, extending the burning time of the briquettes and allowing them to be stored indefinitely in humid conditions
- High permeability, making it possible to retrieve all of the coal's thermal energy. This alone results in fuel savings of up to 30%
- Compactness of the briquettes results in savings on transportation
- Identical size of the briquettes ensures even operation of boilers and furnaces, extending their service life
- Almost complete absence of smoke from burning the briquettes, which allows them to be used in residential environments
- Absence of sparks when burning and almost complete absence of flame, which reduces fire hazards
- Almost complete absence of burn waste. The small amount of residue left after burning the briquettes can be used to make bricks (by adding cement)
- Low moisture content, which reduces heat loss to generation of steam and results in fuel savings
- High durability
- Use of KTK's coal briquettes generates total savings of 50-100%.

The properties of the briquettes listed above are bound to generate stable long-term demand for this product. The briquettes can be used by private individuals, as well as power and utility companies because they are an excellent fuel for all types of boilers, including pulverized coal-fired boilers and bed boilers (with fluidized bed and circulating fluidized bed).

Many companies on the Russian market currently offer consumers coal briquettes, but they are produced with obsolete technology and the properties of the pressed coal differ little from the original coal. There are no products on the Russian market like what KTK plans to produce, and globally only two Australian plants make similar briquettes, but using a different technology.

Revealingly, KTK's technology is more progressive, involving mechanochemical processing of the coal as opposed to the thermal process used by the Australian plants. The former allows more intensive processing and pulverization of the coal to 50 microns – nearly nano particle level, while typical pulverization produces 100-200 micron particles.

The Company plans to design a pilot plant with capacity of 5 tonnes to fine-tune the technology, and find standard equipment that can be used in the process. It is also considering buying an Australian plant, which would help accelerate the process of introducing the technology. The plant could be built in 18 months. If the project is successful, the Company could transition to a large plant that would process 300,000 to 1 million tonnes of per year as early as in two years. This is a preliminary timetable that may change upon further study.

PROCESSING OF HIGH-ASH WASTE FROM COAL PRODUCTION

The second potential project is processing of high-ash waste from coal production, which is currently dumped, into light, strong construction materials. Mineralogical tests have shown that KTK's washing waste (so-called cake) can be recycled into high-quality bricks. Such bricks are light due to their porous structure, but are fairly strong, at least as durable as M75 grade bricks. The grade of the brick indicates the material's ability to withstand stress and strain without breaking. The M75 grade means that the brick is guaranteed to withstand a load of 75 kg per 1 cm^2.

M75 bricks are one of the most popular brands on the construction market today, both among major construction companies and private builders, due to their strong technical characteristics and reasonable price.

KTK's bricks, comparable in quality to M75 grade bricks, can also be used in various applications, including construction of low-rise buildings, exterior and load-bearing walls, fences, dividing walls, plinths and foundations. The bricks are versatile thanks to their high strength, moisture and temperature resistance and light weight. Laying these bricks does not require any special skills.

Given their versatility and the popularity of lightweight, strong bricks among construction companies, there is no doubt that there would be demand for KTK's bricks. Their light weight would enable builders to save money, as lighter structures require a smaller foundation and lighter load-bearing structures. The thermal and sound insulation ratings of the bricks that KTK could produce are far higher than those of regular bricks. It is particularly gratifying that the Company intends to manufacture a quality product for which there is guaranteed steady demand with core production waste for which there was previously no application.

The timetable for the implementation of this project has not been determined yet. The Company plans to obtain a ruling from certification authorities concerning the quality of the bricks before it makes a decision on which production line it would be best to acquire and when.

PRODUCTION OF SYNTHETIC DIESEL FUEL FROM COAL

The third potential project is production of synthetic diesel fuel from coal based on gasification of coal and synthesis. The Company is looking at a fairly large foreign chemical company, the potential purchase of which would enable KTK to begin production of diesel for its own needs that would be superior to Arctic diesel. Arctic diesel is a class A fuel that has minimal density and viscosity and can be used in extremely low temperatures (up to –55 °C) without gelling.

In-house production of diesel would enable the company to significantly reduce fuel costs, which accounted for about 7% of production costs in 2011, and ensure a stable, continuous supply of fuel. Thirdly, imported heavy equipment will operate much better on high-quality diesel, and repair costs will decrease.

The timetable for this project has also not been decided yet. The project is capital-intensive and is linked to the acquisition of a large company (that has been in operation for more than 10 years), new equipment and a gas generator unit.

Work on all three projects will continue in 2012, and financing will increase significantly.

All areas of KTK's research are advanced for Russia as well as by world standards. The implementation of these technologies will give the Company a competitive edge and take it to a whole new level of development by increasing productivity, improving efficiency and optimizing costs. Furthermore, all of KTK's projects are being developed taking into account the toughest and latest environmental standards, giving them considerable social importance.

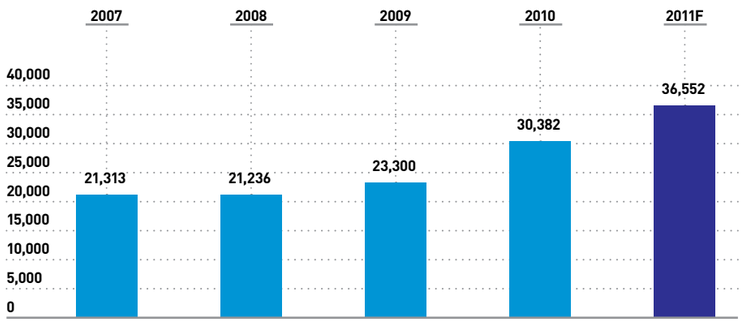
THE FOLLOWING PROJECTS ARE SUCCESSFUL EXAMPLES OF KTK'S APPLICATION OF NEW TECHNOLOGY.

- Construction of the Kaskad-2 washing plant using technology that involves simultaneous use of steeply-inclined and heavy medium separation, which is new to the coal industry. The project is not only effective in economic terms, as it reduces per-unit costs, but is also better for the environment because it reduces the use of magnetite in production.
- The launch in 2011 of an environmentally friendly pumping and filtration station that can clean runoff water to the quality of drinking water, the first of its kind in Russia's coal industry. KTK plans to use such stations at all of the group's units, which will make it possible to discharge water of high quality and minimize the Company's impact on the environment.

9 HUMAN RESOURCES MANAGEMENT

SIZE OF WORKFORCE AND WAGES

Average wage at KTK, RUB



Source: KTK OJSC

The Kuzbasskaya Toplivnaya Company group's workforce grew by 4.5% in 2011 to 3,933 at the end of the year as production rose and processing capacity expanded. The number of employees involved in coal production and on the payroll of Kuzbasskaya Toplivnaya Company OJSC totaled 2,169 in December 2011, with the remaining employees being employed by subsidiaries.

Despite the high population density in the Kemerovo Region, demand for qualified personnel remains strong due to the large number of coal mining companies in the region. In order to retain employees and attract new staff the Company keeps wages at competitive levels and provides incentives with social security and other benefits.

Wage expenses across the group of companies rose by an average of 20% in 2011 compared to the previous year, and amounted to 36,522 rubles per employee per month, compared to 30,382 rubles in 2010.

REMUNERATION AND SOCIAL SECURITY

The Company has a rating system for remuneration under which the wages of various categories of employees are differentiated depending on the conditions, intensity and nature of work and the difficulty of the duties performed.

THE RATING SYSTEM OF REMUNERATION IS BASED ON:

BASE RATES AND SKILLS RATES FOR JOBS AND OCCUPATIONS OF WORKERS	STANDARD POSITION SALARIES AND JOB DESCRIPTIONS FOR MANAGERS, SPECIALISTS AND OTHER EMPLOYEES	PREMIUMS AND INCREMENTS TO BASE RATES AND SALARIES

IN CASE OF PERMANENT INJURY OR DEATH OF AN EMPLOYEE AS A RESULT OF AN ACCIDENT AT WORK, THE COMPANY PAYS:

- Lump sum compensation for loss of occupational capacity as a result of work-related injury or work-related illness
- Benefits to help cover funeral expenses
- Moral damages to the family of the deceased
- A lump sum benefit to each family member who was a dependent of the deceased
- A monthly benefit to children of the deceased until they reach 18 years of age.

The Company in 2010 signed a collective agreement with the union organization that is recognized as the authorized representative for all of its employees. Under this agreement, the Company provides the following benefits and compensation to its employees:

- Monetary compensation equivalent to 0.5 liter of milk per shift
- Free coal for household needs or partial compensation for cost of heating in the price of housing and utility services
- Lump sum payment for years of service in the coal industry
- Monthly payment for years of service
- Compensation for the cost of return travel to a destination within Russia (by any form of transport, including personal car, other than taxi) for vacation purposes once in three years for the employee and two family members
- Payment for medical recovery of employees' children
- Payment for medically prescribed health resort treatment (recovery) of employees and their children within the scope of the allocated budget
- Lump sum payment to retiring employees.

TRAINING AND PROFESSIONAL DEVELOPMENT

The Company aspires to create an environment that promotes the professional development of employees and the realization of their professional potential, and foster a corporate culture that values experience, personal initiative and responsibility.

Employees have many opportunities for personal and professional growth and development. We encourage a passion for learning and development and seek to instill it in our management culture. We work methodically to identify and meet needs for training, helping employees acquire the necessary knowledge and skills.

In 2011, 447 employees from our core production staff underwent training at the Company's expense at the Belovo Polytechnic College and Kuzbassrazrezugol Training Center in various fields: mine worker, coal loader, driver, road construction machinery and tractor mechanic, electrical fitter and so on. The Company plans to continue funding the education of its employees.

In addition, 257 employees underwent knowledge assessments and professional development courses in 2011 at the Belovo Polytechnic College, Kuzbass State Technical University, Kemerovo Regional Professional Development Institute of the Russian Energy Ministry, the Kemerovo branch of the Siberian Center for Scientific & Technical Support of Occupational, Environmental and Energy Safety, and the engineering and technical division of the Vinogradovsky mine in the following areas:

1. Occupational safety – 87 employees
2. Industrial safety – 60 employees
3. Resource conservation – 3 employees
4. Operation of hydraulic engineering works – 6 employees
5. Design and safe operation of hoisting equipment – 46 employees
6. Certification in knowledge of standard safety rules for explosives work – 17 employees
7. Industrial safety standards for transportation of hazardous materials – 6 employees
8. Professional development courses for non-production employees – 34 employees.

10 SOCIAL RESPONSIBILITY

Corporate social responsibility is an integral part of Kuzbasskaya Toplivnaya Company's business.

The Company's philosophy of social responsibility is rooted in the essence of the coal industry itself. The electricity and heat generated with the Company's coal are essential to people's livelihoods. In addition, by paying taxes and creating well-paid jobs the Company contributes to the development of Kemerovo Region and other regions where it has a presence.

KTK ADHERES TO KEY PRINCIPLES OF SOCIAL RESPONSIBILITY:

PROFESSIONAL DEVELOPMENT AND SOCIAL SUPPORT FOR PEOPLE	STIMULATING THE SOCIOECONOMIC DEVELOPMENT OF THE REGION IN WHICH IT OPERATES	INDUSTRIAL SAFETY AND ENVIRONMENTAL PROTECTION

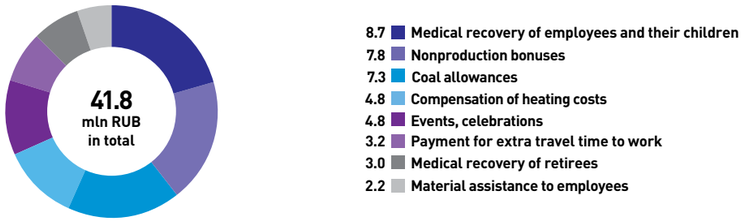
Under this agreement, the Company pledged to retain highly qualified personnel in 2011, provide employment in the production process and increase the average level of wages by 10% compared to 2010. In reality, due to production growth in 2011, the Company increased its workforce by 4.5% and indexed wages twice, by 10% in February and 5% in October 2011.

In addition, in the fourth quarter wages for drivers of mining and transport equipment were raised by up to 15%, and bonuses were paid to employees for years of service. Overall, the average monthly wage across the Company rose by 20.4% in 2011 to 36,552 rubles.

KTK and the Kemerovo Region Administration in February 2011 signed a socioeconomic cooperation agreement for 2011. The goals of the agreement included:

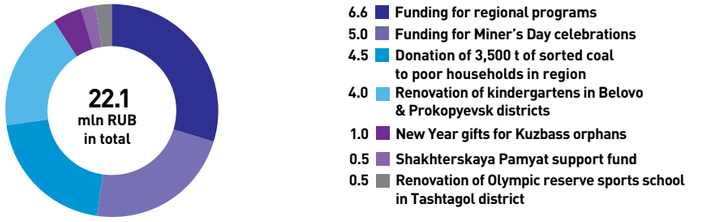
- Cooperation in the implementation of government programs in education, health care and housing construction in the Kemerovo Region
- Creation of favorable conditions for the socioeconomic development of Kemerovo Region and the Company based on the development and implementation of joint projects
- Coordination of government and Company action to fulfill industrial safety requirements
- Coordination of government and Company action to implement the region's social programs
- Coordination of action to resolve issues concerning coal supplies to consumers in the region
- Ensuring full and timely payment by consumers for coal and other energy resources supplied by the Company.

Social support for employees in 2011, mln RUB



Source: KTK OJSC

Social support for the region in 2011, mln RUB



Source: KTK OJSC

KTK provided a total of 41.8 million rubles in funding for social and charity programs in 2011, up from 25.5 million rubles in 2010.

In the area of social support for its staff, the Company is working on improving the health of employees, maternity and child support, organizing leisure and recreational activities, social support for retired workers and veterans, retraining and professional development, as well as social benefits for the best employees.

At the regional level, KTK is implementing strategic programs in areas such as employment, youth policy, support for culture and sport, and aid to disadvantaged groups. The Company cooperates with local authorities under these programs. KTK provided a total of 22.1 million rubles in funding for social programs and initiatives in the Kemerovo Region in 2011.

THE COMPANY'S TAX PAYMENTS into the region's consolidated budget are supposed to total 631 million rubles in 2012. The Company plans to increase social benefit payments to its employees and retired workers by 8% to 45 million rubles in 2012, and maintain funding for regional social programs and initiatives at 22.1 million rubles. KTK will deliver 350,000 tonnes of coal to regional public utilities at fixed prices in 2012, and deliver 3,500 tonnes of donated sorted coal to poor households in the Kemerovo Region.

The Company also arranged the delivery of about 1.15 million tonnes of coal (including 395,000 tonnes of its own coal) at fixed prices to public utilities in the Kemerovo Region.

The Company's tax payments also support the region by providing a reliable and stable source of revenue for the regional budget. The Company paid a total of 857.35 million rubles in taxes (including land lease payments) to the region's consolidated budget in 2011, which was an increase of 66% from 517.2 million rubles in 2010.

KTK met all of its obligations under the 2011 socioeconomic cooperation agreement in full.

In February 2012, the Company signed a similar agreement with the Kemerovo Region Administration for 2012, agreeing to raise average wages by up to 10% over 2011 by increasing labor productivity. The average monthly wage at the Company will therefore reach 40,174 rubles.

11 OCCUPATIONAL HEALTH & SAFETY AND ENVIRONMENTAL PROTECTION

OCCUPATIONAL HEALTH & SAFETY

KTK is implementing its occupational health and safety policy by:

- increasing occupational health and safety at production sites and in operational processes
- improving working conditions, taking into account workplace and operational risk assessments
- providing workers with the latest certified personal protective equipment (special clothing, footwear, etc.)
- conducting regular medical checkups and providing preventative care to reduce occupational health risks
- improving the system for providing occupational health and safety training to employees
- integrating the occupational health and safety management system into the Company's overall management based on best practices
- strictly complying with the Russian Federal Law on Industrial Safety.

THIS POLICY HAS RESULTED IN A LOW LEVEL OF WORK-RELATED INJURIES AND ILLNESSES, WHICH ALSO GIVES THE COMPANY A COMPETITIVE ADVANTAGE.

	2007	2008	2009	2010	2011
Accidents	1	1	–	1	–
Fatalities	–	1	–	2*	–

* A motor vehicle accident that did not occur at the workplace but while employees were being taken from the workplace to their place of residence.

Source: KTK OJSC

The Company's operations are conducted in strict adherence to plans developed by specialized design organizations. The Company has special units responsible for compliance with safety rules that conduct regular inspection patrols; workers are trained in safety protocol; and there are regular medical fitness checks, both in the form of health monitoring before and after shifts, and periodic medical examinations as required by law. In 2011, company employees underwent training in occupational safety (87 employees), industrial safety (60 employees), operation of hydraulic engineering works and hoisting equipment (6 and 46 employees respectively), and industrial safety standards for transportation of hazardous materials (6 employees). In addition, 17 employees underwent certification in knowledge of standard safety rules for explosives work.

As required by law, the Company provides accident insurance to production personnel, and insures its liability as the owner of hazardous facilities for damages to third parties resulting from accidents at such hazardous facilities.

Compliance with occupational safety standards is monitored by an occupational health and safety service that answers to the chief engineer. The deputy site manager at every mining site is responsible for occupational safety.

ENVIRONMENTAL PROTECTION

The Company's operations involve production processes that have a negative impact on the environment. This is manifested in disturbance of land for mining and stripping operations, dumping of large amounts of overburden in external dumps, air pollution and runoff.

KTK puts great emphasis on environmentally safe production practices and protection of the environment.

The Company is fully aware of its role in preserving the environment for future generations and is doing everything in its power to minimize its negative impact.

THE COMPANY'S EFFORTS TO MINIMIZE THE ENVIRONMENTAL IMPACT OF ITS OPERATIONS INCLUDE:

- COMPLIANCE WITH CURRENT LEGISLATION, INDUSTRY AND CORPORATE STANDARDS REGULATING COMPANY ACTIVITIES IN THE AREA OF ENVIRONMENTAL PROTECTION
- GRADUAL REDUCTION OF EMISSIONS AND DISCHARGE OF POLLUTANTS, AND EXPANSION OF THE SCOPE AND VOLUME OF PRODUCTION WASTE RECYCLING
- SOUND MANAGEMENT OF NATURAL RESOURCES
- IMPLEMENTATION OF PROGRESSIVE, ENVIRONMENTALLY FRIENDLY TECHNOLOGIES
- OPERATIONAL PLANNING TAKING INTO COMPLIANCE WITH ESTABLISHED ENVIRONMENTAL IMPACT STANDARDS

Environmental impact issue	Company efforts to minimize negative impact
AIR POLLUTION	Every five years the Company receives permits from the authorities for maximum allowable atmospheric emissions, and adheres to these limits. Emissions from mining and transport equipment are included in overall emissions. The acquisition of modern, lower-emission equipment and use of high quality diesel fuel reduces overall emissions. Scrubbing filters are being installed at heat and electricity generating facilities.
DISCHARGE OF POLLUTED WATER	The Company is working on replacing obsolete and inefficient technology using holding ponds and rock filtering dams with treatment of water by modern pumping and filtration stations. The first such station was launched in 2011 and can clean runoff to drinking water quality. The Company plans to build another four such stations over the next few years, enabling it to discharge clean water and minimize its environmental impact.
HAZARDOUS PRODUCTION WASTE	The Company has classified 25 types of hazardous waste (such as batteries, mercury vapor lamps, tires, etc.) for which safe disposal contracts have been signed with subcontractors. Kaskad-Energo has been conducting multi-stage cleaning of turbine oil from thermal generators since 2009, thus reducing disposal of dirty oil.
LAND DISTURBANCE	The Company reclaims land disturbed by strip mining. The area of disturbed land subject to reclamation, the nature of the reclamation and the reclamation schedule are defined in project documentation before development of mining sites begins. Before the start of any industrial work that disturbs the land surface, the layer of fertile soil is removed to a depth of 30 cm and stored at specially designated sites until reclamation begins. Reclamation of disturbed land is carried out in two stages: filling in the mining site and grading; and the biological stage, which involves applying the topsoil, fertilizing it and planting perennial grasses. The technical phase of the first reclamation is scheduled to begin in 2014 at the Karakansky-South open-pit mine.

12 CORPORATE GOVERNANCE

CORPORATE GOVERNANCE SYSTEM

The continual improvement of Kuzbasskaya Toplivnaya Company's corporate governance system is a key element in the success of the Company's business. The corporate governance system is based on standards set out in Russian legislation, but the Company also strives to comply with the latest world standards in corporate governance and apply best world practices.

In its efforts to improve corporate governance practices, KTK also adheres to the Code of Corporate Conduct recommended by the Federal Securities Commission of Russia (FCSM).

The high corporate governance standards adopted by KTK assure shareholders and investors that their legal rights and interest will be observed, and help to improve the process of making management decisions aimed at preserving assets and maximizing the Company's profits and market capitalization.

KTK'S CORPORATE GOVERNANCE SYSTEM IS BASED ON THE FOLLOWING PRINCIPLES:

- Equitable treatment of Company shareholders, observation and protection of their rights in accordance with current legislation
- An effective system of internal control and audit
- Information and financial transparency
- Observation of ethical standards of business conduct
- Productive collaboration with Company employees in tackling social issues and providing appropriate working conditions.

KTK'S FUNDAMENTAL INTERNAL REGULATORY DOCUMENTS IN THE AREA OF CORPORATE GOVERNANCE ARE:

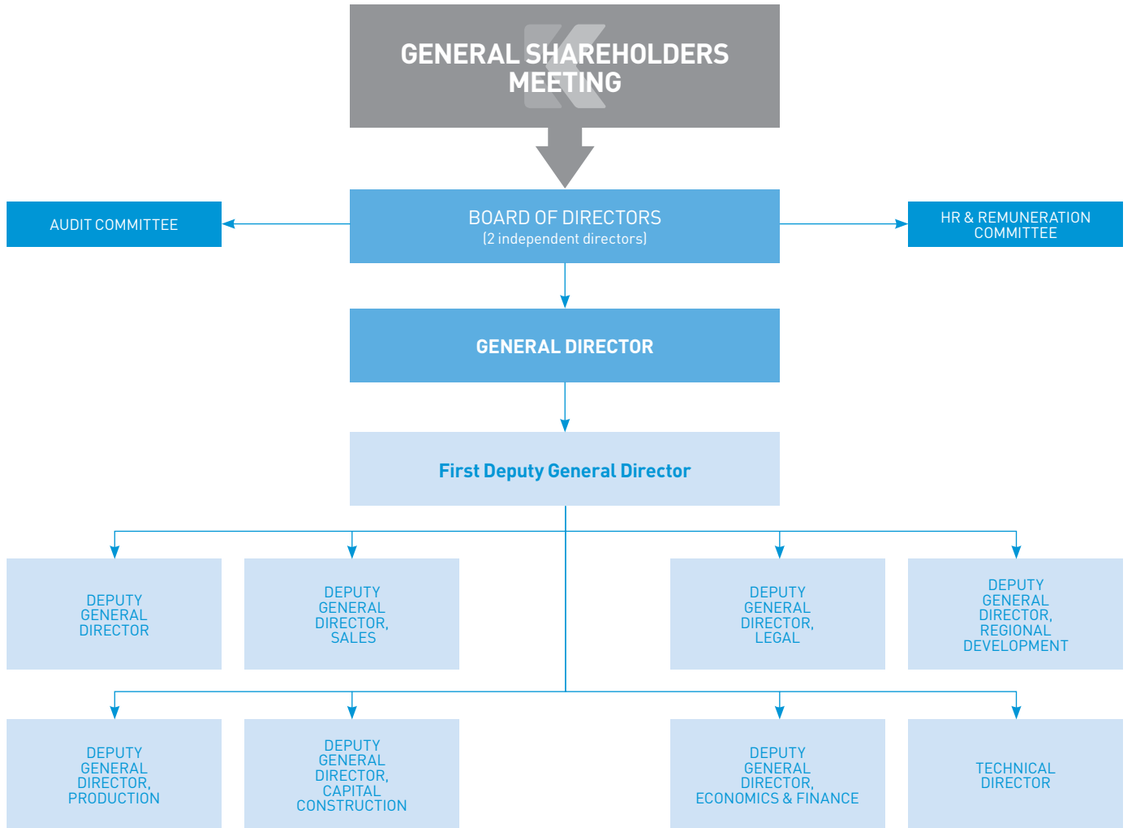
- The Charter
- Regulation on the General Shareholders Meeting
- Regulation on the Board of Directors
- Regulation on the General Director
- Regulation on the Audit Committee
- Regulation on Internal Control
- Regulation on the Human Resources and Remuneration Committee
- Regulation on Insider Information
- Code of Business Conduct
- Regulation on Dividend Policy.

These documents can be found on Kuzbasskaya Toplivnaya Company's website, in the Disclosure section, at hhttp://oaoktk.ru/en/investors/disclosure/.

IN LINE WITH THE FEDERAL LAW ON JOINT STOCK COMPANIES AND KUZBASSKAYA TOPLIVNAYA COMPANY'S CHARTER, THE COMPANY'S SYSTEM OF MANAGEMENT BODIES CONSISTS OF THE FOLLOWING LEVELS:

1. GENERAL SHAREHOLDERS MEETING
2. BOARD OF DIRECTORS
3. GENERAL DIRECTOR

Corporate governance structure



GENERAL SHAREHOLDERS MEETING

The Company's highest management body is the General Shareholders Meeting. The Company holds an annual general meeting of shareholders once a year. General shareholders meetings held in addition to the annual meeting are extraordinary.

The 2011 annual general meeting of shareholders was held on June 23. At this meeting, shareholders approved the Company's annual report and annual financial statements for 2010, elected the Board of Directors and confirmed the auditor to Russian Accounting Standards for 2011. Shareholders voted to pay out 297,775,065 rubles (3 rubles per share) in dividends for 2010.

They also approved the following documents:

- A new version of Kuzbasskaya Toplivnaya Company's Charter
- A new version of the Regulation on the General Shareholders Meeting
- A new version of the Regulation on the Board of Directors
- A new version of the Regulation on the General Director
- A Regulation on the Internal Audit Commission.

The Company held a General Shareholder Meeting in April 2012, at which shareholders reviewed the results of 2011, and approved the annual report and annual financial statements for 2011. They voted to pay dividends for 2011 of 595,550,130 rubles (6 rubles per share). CJSC Balance Consulting Group was again confirmed as KTK's auditor for 2012. Shareholders also elected a new Board of Directors, details on which can be found in the section on the Board of Directors.

BOARD OF DIRECTORS

The Board of Directors is a collegial body that is responsible for general management of the Company's business with the exception of issues that Russian legislation and the Company Charter reserve for the authority of the General Shareholders Meeting.

Members of the Board of Directors are elected by a general meeting of shareholders for a term until the next general meeting of shareholders. If the annual general meeting is not held within the timeframe defined by the Company Charter, the powers of the Board of Directors are suspended with the exception of the authority to prepare, call and conduct a general meeting of shareholders.

In accordance with the Code of Corporate Conduct recommended by the FCSM of Russia, independent directors have been elected to the Company's Board of Directors since 2010.

KTK's current Board of Directors was elected at the annual General Shareholders Meeting on April 16, 2012 and includes:

VADIM DANILOV
Chairman of the Board

Mr. Danilov, born in 1968, graduated from the Novosibirsk Humanities Institute with a degree in Economics.

Prior to joining Kuzbasskaya Toplivnaya Company, Mr. Danilov held senior management positions as a deputy director for sales, vice president for sales and general director.

His work in the Kemerovo Region's coal industry has been recognized with awards for his contribution to the development of the Kuznetsk Basin and business innovation, among others.

Vadim Danilov has been the Company's deputy general director since December 2002 and chairman of the company's board since October 2008.

Mr. Danilov controlled 15.6% of the Company's shares as of December 31, 2011. He also serves as a director on the boards of Kuzbasstoplivosbyt, Altay Fuel Company and Transugol.

IGOR PROKUDIN
Board Member

Mr. Prokudin, born in 1955, graduated as a mining engineer from the Kuzbass Polytechnic Institute in 1982 and earned a PhD in economics in 2006.

In his early career he worked as a mine crew foreman, process manager, mining district supervisor, deputy director of production and chief engineer at the Chernigovsky open-pit mine. From 1991 to 1995 he held the post of deputy head of the Kemerovo Region administration, and from 1997 to 2000 he was deputy general director and vice president at Kuzbassrazrezugol Holding Company.

In 2004 the regional administration awarded him the honorary title of Distinguished Miner of Kuzbass, and in 2008 the Kemerovo Region Governor awarded him the Kuzbass Gold Badge. In the course of his long and productive career in the Kuzbass coal industry Mr. Prokudin has also earned other awards, including in recognition of his contribution to the development of the Kuznetsk Basin and work in the mining industry.

He holds the Miner of Russia gold badge and in March 2010 the President of Russia issued a decree awarding him the honorary title Distinguished Miner of the Russian Federation.

Igor Prokudin has held the position of General Director of KTK since 2001.

Mr. Prokudin controlled 50.01% of KTK's shares directly or as a beneficiary as of December 31, 2011.

EDUARD ALEXEENKO
Board Member

Mr. Alexeenko, born in 1976, graduated from the Kuzbass State Technical University with a major in economics and mining industry management.

Prior to joining the Company, from 1997 to 2000, Mr. Alexeenko worked as chief engineer in the finance and economic analysis department, chief economist in the financial planning and analysis department and as head of the financial planning and analysis department of Kuzbassrazrezugol Holding Company.

Eduard Alexeenko joined state enterprise Kuzbasskaya Toplivnaya Company in August 2000 as head of the finance and economics department. In 2001 he was appointed deputy general director for finance at Kuzbasskaya Toplivnaya Company OJSC, the state firm's successor, and in 2006 he became the Company's deputy general director for economics and finance. In 2009, he was named first deputy general director.

His work in the Kemerovo Region's coal industry has been recognized with several awards, including for contributions to the development of the Kuznetsk Basin.

YURY FRIDMAN
Independent Director

Mr. Fridman, born in 1944, graduated from the Kuzbass Polytechnic Institute in 1967 with a major in basic organic and petrochemical synthesis technology and qualification as a chemical engineer. He earned a PhD in economics in 1987 and was named a professor in the management department in 1990. He has studied economic planning at Stanford University, and corporate and organizational management at Penn State University in the United States, as well as business consulting at Sema Group in Belgium.

Yury Fridman has been working at the Institute for Economics and Organization of Industrial Production at the Siberian Branch of the Russian Academy of Sciences since 1968 and has authored more than 200 publications in the course of his career.

He did not own any shares in the Company as of December 31, 2011.

ALEX WILLIAMS
Independent Director

Mr. Williams, born in 1968, graduated from the University of St. Andrews with a Bachelor's degree in theoretical physics, and earned an MBA from City University London.

Mr. Williams previously worked at Vostok Nafta, a major investment fund focused on the energy sector, where he was involved in protection of minority shareholder rights at a number of Russian companies, and has also worked in the area of private equity investment in the Russian resource sector. Earlier, he worked in the consulting department of PricewaterhouseCoopers and an auditing services group in Moscow.

Alexander Arthur John Williams currently serves as an independent director at a number of Russian companies in the resource sector.

Mr. Williams, a citizen of the UK, did not own any shares in KTK as of December 31, 2011.

Remuneration to members of the Board of Directors

Remuneration to members of the Board of Directors amounted to 20 million rubles for 2011. Combined with salary, bonuses and other incentives, compensation to members of the Board of Directors totaled 97.3 million rubles.

Remuneration, other compensation paid to members of the Board of Directors in 2011, RUB	
Remuneration	20,044,118
Salary	47,835,280
Bonuses	25,511,135
Commissions	0
Benefits	0
Paid expenses	684,081
Other material provisions	0
Other	3,278,671
TOTAL	**97,353,285**

Source: KTK OJSC

Board Committees

In order to improve its efficiency, the Board of Directors created the following committees.

> **AUDIT COMMITTEE,** main goal of which is to help the Board of Directors to fulfill its responsibilities and make decisions concerning financial reporting, audits and internal control.

> **HUMAN RESOURCES AND REMUNERATION COMMITTEE,** the purpose of which is to develop and present recommendations to the Board of Directors on in the area of human resources and remuneration for senior executives, and on the Company's policies and standards for selection of candidates to management bodies.

GENERAL DIRECTOR

The Company's chief executive body is the General Director, who is elected at a general meeting of shareholders for a term of five years in accordance with the Charter. The activities of the General Director are governed by the Regulation on the General Director.

Igor Prokudin has held the position of General Director of Kuzbasskaya Toplivnaya Company since 2001.

Mr. Prokudin, born in 1955, graduated as a mining engineer from the Kuzbass Polytechnic Institute in 1982 and earned a PhD in economics in 2006.

In his early career he worked as a mine crew foreman, process manager, mining district supervisor, deputy director of production and chief engineer at the Chernigovsky open-pit mine. From 1991 to 1995 he held the post of deputy head of the Kemerovo Region administration, and from 1997 to 2000 he was deputy general director and vice president at Kuzbassrazrezugol Holding Company.

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Mr. Prokudin controlled 50.01% of KTK's shares directly or as a beneficiary as of December 31, 2011.

SENIOR MANAGEMENT

EDUARD ALEXEENKO
First Deputy General Director

Mr. Alexeenko, born in 1976, graduated from the Kuzbass State Technical University with a major in economics and mining industry management.

Prior to joining the Company, from 1997 to 2000, Mr. Alexeenko worked as chief engineer in the finance and economic analysis department, chief economist in the financial planning and analysis department and as head of the financial planning and analysis department of Kuzbassrazrezugol Holding Company.

Eduard Alexeenko joined state enterprise Kuzbasskaya Toplivnaya Company in August 2000 as head of the finance and economics department. In 2001 he was appointed deputy general director for finance at Kuzbasskaya Toplivnaya Company OJSC, the state firm's successor, and in 2006 he became the Company's deputy general director for economics and finance. In 2009, he was named first deputy general director.

His work in the Kemerovo Region's coal industry has been recognized with several awards, including for contributions to the development of the Kuznetsk Basin.

ALEXANDER ARTEMENKO
Technical Director

Mr. Artemenko, born in 1954, graduated from the Kuzbass Polytechnic Institute with a major in strip mining technology and mechanization.

Alexander Artemenko joined Kuzbasskaya Toplivnaya Company as technical director in 2003. He was later transferred to the position of deputy general director for development, and then again returned to the role of technical director.

IVAN GEPTING
Deputy General Director, Sales

Mr. Gepting was born in 1976 and graduated from the Kemerovo State University in 1998 with a major in finance and credit.

Ivan Gepting has held the position of deputy general director for sales at Kuzbasskaya Toplivnaya Company since 2001. He has also held the post of general director at management company CJSC Kaskad since 2001, and sits on the boards of directors at Kaskad-energo, Transugol and Altay Fuel Company.

SERGEY KOVALENKO
Deputy General Director, Production

Mr. Kovalenko, born in 1954, graduated from the Kuzbass Polytechnic Institute with a major in strip mining technology and mechanization.

Sergey Kovalenko joined Kuzbasskaya Toplivnaya Company in 2005 as director of the Vinogradovsky mine, and was appointed deputy general director for production in 2009.

ANDREY MAGAEV
Deputy General Director, Economics and Finance

Mr. Magaev, born in 1958, graduated from the novosibirsk electrotechnical Institute in 1981 and holds a PhD in technical sciences. From 1993 to 1997 he worked at various major financial institutions in novosibirsk, and from 1997 to 2004 he was deputy director for investment and general director of the RATM group in Novosibirsk.

Andrey Magaev, who joined Kuzbasskaya Toplivnaya Company in 2005, was appointed deputy general director for finance in 2009 and became deputy general director for economics and finance in 2011.

MAXIM SKOROKHODOV
Deputy General Director, Legal Issues

Mr. Skorokhodov was born in 1975 and graduated from the law faculty of Kemerovo State University in 1998. After graduating he worked at Kuzbassenergo.

In 2000, Mr. Skorokhodov studied under the presidential management training program. He earned a management diploma from the Institute of Management and Marketing at the Russian Government's economics Academy.

Maxim Skorokhodov was appointed deputy general director for legal issues at Kuzbasskaya Toplivnaya Company in 2010. From 2005 to 2010 he worked as director for legal support at Siberian Cement Holding Company.

SERGEY SUKHANOV
Deputy General Director, Capital Construction

Mr. Sukhanov, born in 1958, graduated from the Kuzbass Polytechnic Institute in 1991 and has worked in the Kuznetsk Basin construction sector since 1997.

Sergey Sukhanov has been deputy general director for capital construction at Kuzbasskaya Toplivnaya Company since 2006.

VLADIMIR FRANTSEN
Deputy General Director, Regional Development

Mr. Frantsen, born in 1958, graduated from the construction faculty of the Altay Polytechnic Institute. He went on to do post graduate studies and earned a doctorate. He was appointed head of the Construction Materials department at Altay State Technical University in 1989 and became a professor in 1998. Mr. Frantsen worked as deputy general director at Sibirenergouglesnab from 1993 and became general director of this company in 2004. In 2006 he was appointed head of Altay Fuel Company, which was set up jointly with Kuzbasskaya Toplivnaya Company.

Vladimir Frantsen was appointed deputy general director for regional development in 2010.

ALEXEY ALEXEEV
Director, LLC Novosibirsk Fuel Corporation

Mr. Alexeev was born in 1964 and graduated from the economics faculty of novosibirsk State University in 1990. He began his professional career in 1992 as a senior engineer and then worked as a deputy director of finance and financial director. Since 1998, he has held the positions of economic analysis department head at RATM, and director of economics, deputy executive director and deputy general director for economics at RATM Group. In 2000, he was appointed deputy general director for economics at RATM-energo, where he was first promoted to first deputy general director and then, in 2001, general director.

Alexey Alexeev joined Kuzbasskaya Toplivnaya Company in 2007 as head of the regional development department, and was appointed director of LLC novosibirsk Fuel Corporation in 2010.

MAXIM OVCHAROV
General Director of OJSC Kuzbasstoplivosbyt, General Director of OJSC Altay Fuel Company

Mr. Ovcharov, born in 1977, graduated from the Kuzbass Polytechnic Institute. In 1999, he was hired as a specialist in the distribution department of Kuzbasskaya Toplivnaya Company.

Maxim Ovcharov has been general director of Kuzbasstoplivosbyt since 2004 and was appointed general director of Altay Fuel Company in 2010.

ANDREY TROFIMOV
General Director, LLC Transugol

Mr. Trofimov, born in 1970, holds three higher vocational certifications. He was appointed head of the sales department at LLP Industrial Ventilation in 1994. In 1996, he moved to the Omsk branch of Inkombank, and subsequently became a manager in the client development department of the corporate banking division. In 1999, he was appointed head of licensing at the Regional State Oil Inspection Office for the Omsk Region. In 2001, he was appointed head of the fuel and lubricants department at Omsk Fuel Company and in 2002 he became head of this firm.

Andrey Trofimov has been general director of Transugol since 2004.

SERGEY MESHCHERYAKOV
General Director, LLC Meret Freight Forwarding Company

Mr. Meshcheryakov, who was born in 1968, graduated from the Omsk State Railways Academy with a major in locomotives. He has been working in the Kuznetsk Basin coal (Kuzbass) industry since 1989, in the area of industrial railroad transport, holding positions ranging from assistant locomotive engineer to freight car depot director and railroad transport division head.

Sergey Meshcheryakov joined Meret Freight Forwarding Company (TeKM) in 2005 and was appointed general director in 2010.

PAVEL RYBKO
General Director, OJSC Kaskad-Energo

Mr. Rybko, born in 1957, graduated from the S.M. Kirov Polytechnic Institute in Tomsk in 1980 as an electrical engineer. After graduation he worked in Turkmenistan for the elektrosibmontazh state trust, and from 1985 to 1991 he worked as a foreman and then as chief power engineer at the Anzhero-Sudzhensk chemical and pharmaceutical plant.

Pavel Rybko has been general director of the Anzhersk Combined Heat-and-Power Plant, now known as Kaskad-energo, since 1991.

CONTROL AND AUDIT

Internal control at the Company is implemented jointly by the Board of Directors, the Audit Committee, the General Director, the Internal Control Committee and other employees to monitor compliance with procedures intended to achieve set goals in the following areas:

- **Efficient and effective business operations**
- **Reliable and accurate reporting**
- **Compliance with regulations and the Company's internal documents.**

In the interests of complying with the listing conditions of Russia's Moscow Exchange MICEX-RTS, based on the Russian Federal Financial Markets Service's Regulation on the Organization of Trading on the Securities Market, the Company has a department that monitors compliance with internal control procedures: the Internal Control Committee, which operates on the basis of the Regulation on Internal Control.

The Internal Control Committee's responsibilities include direct assessment of the adequacy, sufficiency and effectiveness of the internal control system, as well as monitoring of compliance with procedures set out in the Regulation on Internal Control.

In pursuit of the goals mentioned above, the Internal Control Committee conducts audits and internal investigations in key areas of the Company's financial and business operations; analyzes the results of such audits and investigations; maintains a record of detected violations and reports on such violations to the Audit Committee of the Board of Directors and to the General Director; monitors the elimination of violations; analyzes the results of Company audits; and prepares proposals to improve internal control procedures.

External audits are conducted by independent auditors to Russian and international financial reporting standards. The auditor to Russian accounting standards is appointed by the General Shareholders Meeting on the recommendation of the Board of Directors. The auditor of financial statements prepared to international standards is appointed by the General Director on instructions from the Board of Directors.

The audit of the Company's financial statements for 2011 prepared to Russian Accounting Standards was done by CJSC Balance Consulting Group. ZAO KPMG was appointed to conduct the audit of financial statements for 2011 prepared to International Financial Reporting Standards.

COMPANY AUDITOR FOR RUSSIAN STATUTORY FINANCIAL STATEMENTS:

CJSC Balance Consulting Group
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13 COMPANY HISTORY

The Company took its current form following the restructuring of OJSC Kuzbasskaya Toplivnaya Company after its merger with KeNoTEK in 2006.

HISTORY OF LLC KENOTEK

The administrations of the Kemerovo and Novosibirsk regions decided in April 1999 to set up coal mining company LLC KeNoTEK in the city of Kemerovo in order to provide a reliable supply of coal to households and organizations in these regions. The same year, the company secured the license to the Karakansky-South strip mining property and began developing it, including construction of rail lines linking the property to the Russian Railways Ministry's Meret station.

The Karakansky-South mine produced its first coal in 2000.

In 2001, the company's management bought out the stakes held by the Kemerovo and Novosibirsk regions. The same year, the company built two railroad coal collection stations: Uba with access to the mainline of Russian Railways and Karakanskaya South. Rail lines at the Karakansky-South mine totaled 10.5 km.

KeNoTEK secured the license to the Karakansky-South-1 property in 2003 and began strip mining coal at the property in 2005.

In 2006, KeNoTEK was reorganized into an open joint stock company and merged with Kuzbasskaya Toplivnaya Company.

HISTORY OF KUZBASSKAYA TOPLIVNAYA COMPANY OJSC

The Kemerovo Region administration founded the wholly government-owned Kuzbasskaya Toplivnaya Company in 2000.

In 2001, this company was reorganized into an open joint stock company and all its shares were bought out by management.

In 2003, Kuzbasskaya Toplivnaya Company secured the license to the Vinogradovsky strip mining property. The same year, the Company and the Kemerovo Region Administration founded OJSC Kuzbasstoplivosbyt to develop retail sales, and OJSC Kaskad-Energo was founded on the basis of the Anzhero-Sudzhensk combined heat-and-power plant to supply power to local residents and enterprises.

In 2004, Vinogradovsky mined its first coal, and the Company launched 7.3 km of approach rail lines and opened the Vinogradovskaya coal transfer station.

In 2005, the Company acquired the license to the Cheremshansky strip mining property, as well as the licenses to develop the Karakansky-South 2 and Vinogradovsky 2 properties, which are cutbacks of the main properties.

In 2006, KTK was restructured following its merger with KeNoTEK. The same year, the Company began exploration work at Cheremshansky, and 15.4 km of rail lines were launched that made it possible to double coal shipments from mines in central Kemerovo Region.

In 2007, the Company completed exploration work and began building the Cheremshansky open-pit mine. It also set up Altay Fuel Company to sell coal in Altay Territory.

In 2008, the Company launched the Cheremshansky mine, the largest open-pit mine by design capacity to be opened in the Kuznetsk Basin in the past 20 years. The Company also launched 10 km of approach lines at the Cheremshansky mine and the Kaskad coal transfer station. In addition, Novosibirsk Fuel Corporation was founded to sell the Company's coal in the Novosibirsk Region.

In 2009, KTK began construction of its first washing plant, Kaskad at the Cheremshansky mine, with capacity of 2 million tonnes per year.

In 2010, the Kaskad plant opened and produced its first 200,000 tonnes of washed coal. The same year, KTK held an IPO on the Russian stock market, offering investors 38.3 million shares (including 14.9 million new shares and 23.4 million existing shares). As a result of the IPO, the majority shareholders' interest in the Company decreased to 65% from 89%.

In 2011, KTK began building a second washing plant at the Vinogradovsky mine with capacity of 4 million tonnes, and completed a major overhaul of the Uba coal transfer station that expanded its throughput capacity from 12 million tonnes to 16.7 million tonnes. The Company also acquired the license to develop the Bryansky section of the Karakanskoye coal field, which borders on the Karakansky-South mine and holds category C2 coal reserves of 250 million tonnes.

14 FINANCIAL RESULTS

KEY FINANCIAL AND OPERATING RESULTS OF THE GROUP

RUB MLN	2007	2008	2009	2010	2011
Coal production, mln tonnes	**4.1**	**5.48**	**6.15**	**6.8**	**8.7**
Change, %		34 %	12 %	11 %	29 %
Coal sales, mln tonnes	**5.4**	**7.54**	**7.41**	**8.54**	**10.7**
Change, %		40 %	–2 %	15 %	25 %
Including coal resale, mln tonnes	**1.46**	**2.3**	**1.38**	**2.16**	**2.1**
Change, %		57 %	–40 %	56 %	–4 %
Revenue	**3,864**	**8,557**	**10,658**	**14,160**	**23,939**
Change, %		121 %	25 %	33 %	69 %
EBITDA	**475**	**2,172**	**2,178**	**2,134**	**3,911**
EBITDA margin	12 %	25 %	20 %	15 %	16 %
Net profit (loss)	**–106**	**1 102**	**663**	**823**	**2,018**
Net margin	–3 %	13 %	6 %	6 %	8 %
Production cash cost per tonne of coal, RUB	**334**	**377**	**432**	**509**	**652**
Change, %		13 %	15 %	18 %	28 %
Net debt	**3,087**	**3,370**	**3,773**	**1,754**	**2,663**
Net debt/EBITDA	6.5	1.6	1.7	0.8	0.7

KTK increased coal production and sales in 2011, moving closer toward achieving its long-term goals. Coal production rose 29% to 8.7 million tonnes thanks to the steady growth of extraction at the Company's three open-pit mines, propelling KTK into the ranks of Russia's top ten producers of thermal coal. The strongest growth was at the Cheremshansky mine, which has the highest quality coal produced by the Company. This mine produced 3.8 million tonnes of coal in 2011, up from 2.6 million tonnes in 2010.

The Kaskad washing plant, which was launched in August 2010, achieved full capacity in 2011 and produced 0.74 million tonnes of export quality coal, compared to 0.2 million tonnes in 2010. Coal sorting at mobile crushing and sorting units increased by 36% to 5.6 million tonnes. As a result, the share of run-of-mine coal not processed and sorted fell below 30% for the first time, dropping to 28% in 2011 from 37% in 2010.

KTK's coal sales in all markets grew by 25% to 10.7 million tonnes in 2011 from 8.5 million tonnes in 2010. The growth was driven primarily by exports, which grew to 61% of sales in 2011 from 44% in 2010. The Company exported 6.45 million tonnes of coal, making it Russia's fifth largest coal exporter. Due to the strong demand for thermal coal on international markets and growth of exports, the Company reduced coal sales on the domestic market by 14%. Nonetheless, in order to preserve leading positions on the domestic market, particularly in Western Siberia, the Company maintained purchases and resale of third-party coal at approximately the same level: 2.1 million tonnes in 2011 compared to 2.2 million tonnes in 2010.

The average price of coal sold by the Company (both export and domestic) rose by 25.7% in 2011 to 1,228 rubles per tonne net of VAT and excluding railroad tariffs, from 977 rubles in 2010. The average price on the domestic market rose faster than the export price, climbing 28.6% to 1,213 rubles per tonne from 943 rubles. The average export price increased by 21.2% to 1,237 rubles in 2011 from 1,021 rubles in 2010. As a result, the spread between export and domestic prices narrowed to almost zero in 2011, while in previous years it was substantial. An important reason for the more rapid growth of the domestic price was the increase in the proportion of sorted coal in the Company's sales structure, the sales margin on which is considerably higher.

The growth in sales volume and prices in 2011 had a positive impact on the Company's financial results. Revenue grew by 69% to 23.939 billion rubles in 2011 from 14.160 billion rubles in 2010. However, the Company's main expenses also increased. Transportation costs per tonne of coal rose 56% to 996.50 rubles from 637 rubles in 2010 as coal transport tariffs increased and the share of exports on DAF and CPT terms grew. Production cash costs increased by 28% to 652 rubles per tonne in 2011 from 509 rubles in 2010 due to higher personnel expenses, an increase in the stripping ratio and a change in mining and geological conditions that pushed up expenses on blasting work and coal transportation. In addition, the price of coal purchased from third parties rose 42% to 1,052 rubles per tonne from 740 rubles in 2010.

As revenue grew faster than costs in 2011, the Company's gross profit jumped 68% to 4.535 billion rubles from 2.703 billion rubles in 2010. Selling, administrative and other operating expenses rose more slowly, so operating profit more than doubled, growing 114% to 2.895 billion rubles in 2011 from 1.353 billion rubles in 2010. EBITDA grew by 83% to 3.911 billion rubles in 2011 from 2.134 billion rubles in the previous year. The U.S. dollar equivalent of EBITDA increased by 90% to $133 million[9], which was in line with management forecasts.

The Company increased net profit by 145% in 2011, to 2.018 billion rubles from 823 million rubles in 2010. This was not only due to the growth of sales and average coal prices, but also to the reduction of the effective profit tax rate to 21% from 23%. Key profitability indicators also grew in 2011, with the net profit margin reaching 8% and the EBITDA margin increasing to 16%.

The growth in operating and financial results was accompanied by an increase in the total debt, which rose to 4.547 billion rubles in 2011 from 2.211 billion rubles at the end of 2010. The net debt grew by 52% to 2.663 billion rubles. However, the Company's debt burden remains low, and the net debt/EBITDA ratio dropped to just 0.68 as of December 31, 2011 from 0.82 a year earlier. Interest payments on loans are covered by profit before taxes and interest by a factor of 13, and the average effective borrowing rate dropped from 7.7% to 5.2% in 2011, which will enable the Company to save on debt servicing.

The total debt amounts to 50% of the Company's equity, which is high thanks to 43% growth of retained earnings in 2011 and additional paid-in capital of 2.829 billion rubles following the 2010 IPO.

The Company continued to implement its long-term investment program in 2011. Cash flow spent on investment in plant and equipment and intangible assets totaled 2.581 billion rubles, which was up 3.3% from 2.499 billion rubles in 2010. During 2011 KTK;

- acquired the license to develop the Bryansky section of the Karakanskoye thermal coal field;
- began construction of a second washing plant with capacity of 4 million tonnes;
- completed an overhaul of the Uba sorting station; and
- acquired modern mining and transport equipment.

The capital expenditures were easily covered by operating cash flow (2.844 billion rubles) and cash flow from financing activities (1.906 billion rubles). As a result, the net increase in cash and cash equivalents amounted to 1.440 billion rubles in 2011, compared to 436 million rubles in 2010.

9 At Central Bank of Russia's average exchange rate of 29.39 rubles/$1 for 2011.

FINANCIAL RESULTS ANALYSIS

Revenue

RUB MLN	2011	2010	CHANGE	STRUCTURE, 2011
Revenue	**23,939**	**14,160**	**69 %**	**100 %**
Of which by segment:				
Export sales of coal produced	17,127	8,178	109 %	72 %
Domestic sales of coal produced	4,026	3,144	28 %	17 %
Resale of third-party coal	2,227	2,273	–2 %	9 %
Other operations	559	565	–1 %	2 %

KTK's consolidated revenue grew 69% in 2011 to 23.939 billion rubles from 14.160 billion rubles in 2010, as the volume of coal sales increased by 25% and the average realized coal price (net of VAT and railroad tariffs) rose by 25.7% compared to the previous year. Revenue net of delivery costs included in the price of coal for end consumers grew by 57%.

Exports made the greatest contribution to overall revenue growth in 2011. Revenue in this segment more than doubled to 17.127 billion rubles in 2011 from 8.178 billion rubles in 2010, as export shipments increased by 74.4% and the average realized export price, net of transportation costs, rose by 21.2%. Prices rose as world demand for coal recovered. Export revenue net of transportation costs included in the price of coal grew 108.4% year-on-year.

Revenue from domestic sales of produced coal grew by 28% to 4.026 billion rubles in 2011 from 3.144 billion rubles in 2010. Coal deliveries to the domestic market decreased by 14% year-on-year as the sales focus for produced coal shifted to external markets, but the 28.6% increase in the realized price on the domestic market offset the drop in sales volume. Revenue also grew due to an increase in the overall transport costs of delivering coal to Russian customers, as the average shipping distance increased. The Siberian Federal District accounted for 91% of coal sold in Russia in 2011, down from 97% in 2010. The other 9% was shipped to other regions more distant from the Kuznetsk Basin.

In order to preserve and strengthen its leading positions on the domestic market, particularly given the reduction in sales of produced coal in Russia, KTK maintained purchases and resale of third-party coal in 2011 at about the same level as in the previous year. Resale volume decreased by 4% and revenue in this segment slipped 2% to 2.227 billion rubles in 2011 from 2.273 billion rubles in 2010.

Total revenue from coal sales in Russia grew 15% to 6.253 billion rubles in 2011 from 5.417 billion rubles in the previous year. Revenue on the domestic market net of transportation costs included in the price of coal increased by 13%.

Revenue from other operations in 2011 was little changed at 559 million rubles, compared to 565 million rubles in 2010. This segment saw an increase in revenue from sales of heat generated at the Anzhero-Sudzhensk combined heat-and-power plant by 5% year-on-year to 248 million rubles, and a 26% increase in storage services to 63 million rubles. Revenue from transporting coal for neighboring producers along the Company's own railroad infrastructure decreased by 17% to 141 million rubles.

Cost of sales

RUB MLN	2011	2010	CHANGE	STRUCTURE, 2011
Cost of sales	**19,404**	**11,457**	**69 %**	**100 %**
including:				
Railroad tariff and transportation services	10,623	5,437	95 %	55 %
Production cash costs of KTK	5,702	3,462	65 %	29 %
Purchased coal	2,189	1,595	37 %	11 %
Depreciation	965	755	28 %	5 %
Other costs	405	370	9 %	2 %
Change in provisions for land reclamation	–20	3	–767 %	
Change in coal inventories	–460	–165	179 %	

KTK's cost of sales increased by 69% in 2011 to 19.404 billion rubles from 11.457 billion rubles in 2010. This was primarily due to a dramatic increase in transportation costs, growth of production cash costs and increase in the cost of coal purchased for resale.

Transportation costs rose by 95% to 10.623 billion rubles and amounted to 55% of the Company's total cost of sales, up from 47% in 2010. These costs grew as the volume of coal exported on DAF and CPT terms increased by 74.4% to 2.79 million tonnes, RZD tariffs rose (by 20.1% to 1,421 rubles per tonne for export shipments) and leasing rates increased for freight cars to ship coal to customers. As a result, transportation costs per tonne of sold coal rose by 56%, from 637 rubles to 996.50 rubles per tonne.

In order to reduce the freight car component of the transport tariff, KTK is investing heavily in its own fleet of freight cars. The Company has formed the joint venture Kuzbass Transport Company in partnership with a leading Russian railroad transport company. This venture is actively expanding its fleet of freight cars, which KTK leases at fixed rates under long-term contracts. KTK intends to completely transition to using freight cars leased from the joint venture, in which case leasing rates will be fixed for a period of 10 years and shipping costs will only change depending on the distance and the RZD tariff for shipping coal. The Company now has about 3,100 of its own freight cars, which cover about half of its export shipments.

Production cash costs rose 65% in 2010, primarily due to higher personnel costs and growth of coal extraction costs. The latter, in turn, was driven by a 220% increase in the volume of stripping work (which the Company outsourced), an increase in the price of this work and higher diesel fuel prices. Cash costs were also pushed up by a 35.6% increase in coal sorting volume, changes in the mining and geological conditions that increased the stripping ratio, and an increase in rock blasting and coal transport costs within the mining area.

The change in mining and geological conditions involved the recalculation of the optimal incline of a pit wall from 40 to 17 degrees due to appearance of cracks in the course of extraction. This lead to an increase in the stripping ratio, but reduced the risk of the mine wall collapsing. There was additional stripping at the Vinogradovsky mine in order to ensure a sufficient supply for the second washing plant to be launched in the fourth quarter of 2012, the design capacity of which has been doubled from 2 million to 4 million tonnes.

The additional stripping of overburden at the Cheremshansky mine in 2011-2012 will subsequently be treated as stripping of future periods, because mining operations will be conducted at this section of the pit side. Therefore, in the long-term the stripping ratio should see a decline.

Key production indicators affecting growth of cash costs

	2011	2010	%
Coal production, mln tonnes	8.7	6.8	29 %
Stripping volume, mln m³	68.1	49.5	38 %
Blasted rock, mln m³	32.8	25.4	29 %
Stripping ratio, t/m³	7.8	7.3	7 %
Average overburden transport distance, km	2.9	2.7	6 %

The 38% increase in stripping volume and 6% increase in the average overburden transportation distance pushed up expenditures on equipment repairs and purchases of new equipment. This in turn increased fuel expenses, both due to greater consumption and higher prices. Market prices for diesel fuel jumped 23.4% in the fourth quarter of 2011, and rose by 41.2% in the year overall. This was compounded by a 10-15% increase in fuel consumption by all mining and transportation equipment in the fourth quarter due to the switch to winter consumption rates.

Salary expenses, which make up a considerable share of production costs, increased as the Company indexed wages by 10% in February and by 5% in October 2011, raised wages for drivers of mining and transport equipment by up to 15% in the fourth quarter, and in December paid bonuses to employees for years of service. The Company's workforce itself also grew with the launch of new equipment and operation of the Kaskad washing plant at full capacity (the staff of the plant affected costs in only one quarter in 2010, but in 2011 for the whole year).

The cost of spare parts and equipment maintenance rose by more than 50% in 2011. This was primarily due to the increase in the amount of equipment, and secondly to the Company's efforts to conduct the maximum number of scheduled repairs of mining equipment and machinery in the second quarter in order to reduce equipment downtime and ensure continuous operation in the third and fourth quarters in anticipation of production growth.

This proved prescient and the expenses on repairs and maintenance justified as production in the second half of the year grew by 30% compared to the first half.

The factors mentioned above increased cash costs per tonne of coal produced by 28%, to 652 rubles per tonne from 509 rubles. These costs were virtually unchanged as a share of total costs, remaining at 30%.

RUB MLN	2011	2010	%
Consolidated cost of sales	**19,404**	**11,457**	**69 %**
Less:			
Cost of sales of subsidiaries	–2,198	–2,261	–3 %
KTK cost of sales	**17,206**	**9,196**	**87 %**
Less:			
Depreciation	–907	–687	32 %
Purchased coal	–549	–595	–8 %
Change in inventory	132	181	–27 %
Railroad tariff and transportation expenses	–10,180	–4,633	120 %
TOTAL PRODUCTION CASH COSTS	**5,702**	**3,462**	**65 %**
Coal production, mln tonnes	8.74	6.8	29 %
Production cash costs, RUB/t	**652**	**509**	**28 %**

The cost of coal purchased from third parties, which amounted to 11% of cost of sales, increased by 37% to 2.189 billion rubles in 2011, net of changes in coal inventories, from 1.595 billion rubles in 2010. The volume of coal purchases from third parties was little changed in 2011, so the growth of this cost item was due to a 42% increase in the price of purchased coal. The realized coal price on the domestic market rose more slowly, which reduced the operating margin on sales of third-party coal. Nonetheless, these operations are extremely important for the Company because they enable it to build a more flexible distribution system and mitigate fluctuations in the volume of production and sales of KTK's own coal over the course of the year. Purchased coal also gives the Company additional sales volume to maintain its leading positions in Western Siberia, while still allowing it to increase exports of its own high-calorie coal.

Other cost of sales items

Depreciation included in the cost of sales increased by 28% to 965 million rubles in 2011 from 755 million rubles in 2010. This growth was due to the launch of a considerable amount of capital assets related to the modernization of the Uba coal transfer station, construction of a mobile facility to produce emulsion explosives, and the acquisition of various mining and transport equipment and machinery. Depreciation amounted to 5% of KTK's cost of sales in 2011.

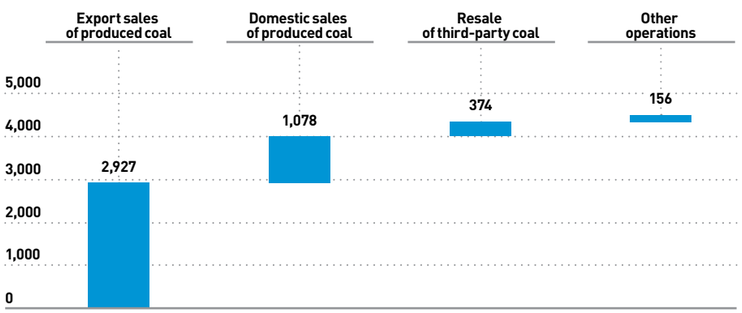
Other costs, including leasing of equipment, electricity and other expenses, rose by 9% to 405 million rubles, primarily driven by the growth of electricity consumption due to increased power supplies for the washing plant.

Coal inventories at the Company's warehouses increased by 460 million rubles in 2011, compared to 165 million rubles in 2010. This was due to an increase in coal purchases to form reserves for 2012, as well as to lower than expected retail sales in December 2011 because of the relatively warm weather.

Gross profit

RUB MLN	2011	2010	%
Gross profit	**4,535**	**2,703**	**68 %**
Gross margin	19 %	19 %	–0.1 %
Of which by segment:			
Export sales of produced coal	**2,927**	**1,271**	**130 %**
Gross margin	17 %	16 %	1.6 %
Domestic sales of produced coal	**1,078**	**711**	**52 %**
Gross margin	27 %	23 %	4.2 %
Resale of purchased third-party coal	**374**	**487**	**–23 %**
Gross margin	17 %	21 %	–4.6 %
Other operations	**156**	**174**	**–10 %**
Gross margin	28 %	31 %	–2.9 %

KTK gross profit by segment, RUB mln



As revenue grew more rapidly than costs in 2011, the Company's gross profit increased by 68% to 4.535 billion rubles from 2.703 billion rubles in 2010. The gross margin remained unchanged at 19%.

Export sales of produced coal made the largest contribution to gross profit: 65% in 2011 compared to 47% in 2010. However, the highest gross margin among the Company's core activities was in domestic sales of produced coal. The margin in this segment jumped 4 percentage points to 27% in 2011, as domestic coal prices rose faster than export prices and the Company increased the share of sorted coal in total sales. The gross margin in resale of purchased coal, meanwhile, fell to 17% from 21% in 2010 as prices for coal purchased from third parties rose dramatically. Other operations – primarily electricity generation by subsidiary Kaskad-Energo and provision of coal storage and transportation services – make a relatively modest contribution to overall gross profit, but have high a gross margin.

Distribution, administrative and other operating expenses

RUB MLN	2011	2010	%
Distribution, administrative & other operating expenses	**1,640**	**1,350**	**21 %**
Including:			
Distribution expenses	654	540	21 %
Administrative expenses	1,010	849	19 %
Other operating expenses (income)	–24	–39	–38 %
Distribution, administrative & other operating expenses/Revenue	**7 %**	**10 %**	**–3 %**

Distribution, administrative and other operating expenses rose by 21% to 1.640 billion rubles in 2011 from 1.350 billion rubles a year earlier. Distribution and administrative personnel costs increased by 32.2% to 812 million rubles from 614 million rubles in 2010 due to indexation of salaries by 10% in the first half of 2011 and another 5% in the second half, an unscheduled increase in salaries for selected categories of employees and the expansion of the workforce due to the growth of sales and operation of the washing plant. Service expenses rose by only 3.0% to 413 million rubles thanks to sound management. Expenses on property tax and other taxes increased by 18.7% to 146 million rubles, largely due to the launch of a large amount of capital assets in the course of the year. The growth of distribution and administrative expenses was driven primarily by growth in sales volume.

In the case of distribution expenses there is a direct link, while in the case of administrative expenses the correlation is also evident, though to a lesser degree.

Despite the cost increases, the ratio of overhead expenses to revenue dropped to 7% in 2011 from 10% in the previous year.

Operating profit, EBITDA and net profit

KTK's operating profit more than doubled in 2011, growing 114% to 2.895 billion rubles from 1.353 billion rubles in 2010. EBITDA grew by 83% to 3.911 billion rubles in 2011 from 2.134 billion rubles in the previous year. EBITDA in the U.S. dollar equivalent increased by 90% to $133 million[10], which was in line with management forecasts. Net profit grew by an impressive 145% to 2.018 billion rubles in 2011 from 823 million rubles in 2010, as sales volume increased and the average coal price (net of VAT and the railroad tariff) rose. Net profit also increased due to the reduction of the effective profit tax rate to 21% from 23%.

RUB MLN	2011	2010	%
Operating profit	**2,895**	**1,353**	**114 %**
Operating margin	12 %	10 %	3 %
Adjustments:			
Depreciation charge	1,039	820	27 %
Impairment loss	–1	7	–114 %
(Profit)/loss from disposal of property, plant & equipment	–22	–46	–52 %
EBITDA	**3,911**	**2,134**	**83 %**
EBITDA margin	16 %	15 %	1 %
Net profit	**2,018**	**823**	**145 %**
Net margin	8 %	6 %	3 %

Profitability indicators rose across the board in 2012. The operating margin increased to 12% from 10% in the previous year, the EBITDA margin was up by one percentage point to 16% and the net margin rose to 8% from 6%.

10 At Central Bank of Russia's average exchange rate of 29.39 rubles/$1 for 2011.

Indebtedness

RUB MLN	2011	2010	%
Long-term loans and credits	2,794	1,676	67 %
Short-term loans and credits	1,753	535	228 %
Total debt, including:	**4,547**	**2,211**	**106 %**
Ruble-denominated	647	228	184 %
Foreign currency-denominated	3,900	1,983	97 %
Cash and cash equivalents	1,884	457	312 %
Net debt	**2,663**	**1,754**	**52 %**
Interest expense	207	275	-25 %

The Company increased its loan portfolio in 2011 as the scale of its business grew. Long-term debt grew by 1.113 billion rubles in 2011 to 2.794 billion rubles, and short-term debt more than tripled to 1.753 billion rubles from 535 million rubles in 2010. The Company's total debt stood at 4.547 billion rubles as of December 31, 2011. Long-term loans, the terms of which are fixed for a long period, make up 61.4% of the total debt, which enables the Company to more precisely forecast cash flow for several years into the future. About 86% of loans are denominated in U.S. dollars, and only 14% are denominated in rubles.

Despite the substantial increase in the loan portfolio, the Company's debt burden remains low. The net debt amounts to 2.663 billion rubles, and the net debt/EBITDA ratio dropped to just 0.68 as of December 31, 2011 from 0.82 a year earlier. A ratio of higher than 3 is considered to be dangerous, while the ceiling set by management to control the debt burden is 2.

The the average effective borrowing rate dropped from 7.7% to 5.2% in 2011 following the restructuring of the foreign currency part of the Company's debt. KTK's finance department is working continually to optimize the loan portfolio. The drop in debt servicing costs reduced interest expenses by 24.7% to 207 million rubles in 2011 from 275 million rubles a year earlier.

KTK has a reputation as a reliable borrower, which helps the Company to maintain effective relationships with lending institutions.

Cash flow

RUB MLN	2011	2010	%
Cash flow from operations before tax on income and interest	2,844	2,321	23 %
Cash flow from operations	2,074	2,031	2 %
Cash flow used in investing activities	–2,540	–2,435	4 %
Cash flow from financing activities	1,906	840	127 %
Net increase (decrease) in cash and cash equivalents	**1,440**	**436**	**na**

Operating cash flow before income tax and interest increased by 22.5% to 2.844 billion rubles in 2011 as net profit grew while interest expenses decreased, while cash flow from operations rose by only 2% to 2.074 billion rubles in 2011 from 2.031 billion rubles in 2010 due to an increase in cash flow used to finance working capital.

Cash flow used in investing activities increased by 4% to 2.540 billion rubles from 2.435 billion rubles in 2010, as the Company continued to implement its ambitious long-term investment program: KTK began construction of a second washing plant (Kaskad-2) with a capacity of 4 million tonnes at the Vinogradovsky mine; completed the construction of a mobile facility to produce emulsion explosives; completed an overhaul of the Uba sorting station; and built a plant to treat domestic and industrial waste water and runoff. In December 2011, the Company acquired the license to develop the Bryansky section of the Karakanskoye coal field. Also, throughout the year KTK acquired new mining and transport equipment and machinery for its mines, including 22 Belaz trucks, loaders, dozers, shovels and drill rigs. Overall cash flow spent on investment in plant and equipment and intangible assets increased by 3.3% to 2.581 billion rubles in 2011 from 2.499 billion rubles in the previous year.

Cash flow from financing activities increased to 1.906 billion rubles in 2011 from 865 million rubles in 2010. Over the year there was a net inflow of cash due to a net increase in debt in the amount of 2.204 billion rubles, and an outflow of cash due to dividend distribution of 298 million rubles.

As a result of these cash flows, there was a net increase in cash and cash equivalents of 1.440 billion rubles in 2011, compared to 436 million rubles in 2010.

Balance sheet

RUB MLN	2011	2010	CHANGE	STRUCTURE, 2011
Non-current assets	10,455	8,852	18 %	65 %
Current assets	5,673	2,787	104 %	35 %
Total assets	**16,128**	**11,639**	**39 %**	**100 %**
Equity, including:	**8,525**	**6,835**	**25 %**	**53 %**
Retained earnings	5,672	3,975	43 %	35 %
Additional paid-in capital	2,829	2,829	0 %	17 %
Non-current liabilities	3,837	2,472	55 %	24 %
Current liabilities	3,766	2,332	61 %	23 %
Total liabilities	**7,603**	**4,804**	**58 %**	**47 %**
Equity and liabilities	**16,128**	**11,639**	**39 %**	**100 %**

The Company's total assets stood at 16.128 billion rubles at the end of 2011, up by 39% from 11.639 billion rubles a year earlier.

Non-current assets grew by 18% over the year to 10.455 billion rubles from 8.852 billion rubles at the end of 2010. This was largely due to an increase in the value of property, plant and equipment, which grew by 17.6% to 10.358 billion rubles from 8.804 billion rubles a year earlier. Non-current assets declined to 65% of total assets at the end of 2011 from 76% at the end of 2010.

Current assets grew by 104% in 2011 to 5.673 billion rubles from 2.787 billion rubles at the end of 2010. Inventories rose by 68% to 1.275 billion rubles due to coal in storage and en route; receivables increased by 48% to 1.562 billion rubles because of VAT due for refund; and advances and prepaid expenses rose by 108% to 916 million rubles. In addition, cash and cash equivalents quadrupled over the year to 1.884 billion rubles, 1.846 billion rubles of which was held in a short-term deposit. Interest rates on the Company's short-term deposits ranged from 5.6% to 8.5% in 2011, compared to 2.3-3.0% in 2010.

The Company's equity grew by 25% in 2011, to 8.525 billion rubles from 6.835 billion rubles, as retained earnings increased by 43% to 5.672 billion rubles from 3.975 billion rubles in 2010. Equity amounted to 53% of total liabilities at the end of 2011, which indicates the Company's high equity ratio. This was achieved with the placement of additional shares in an IPO in 2010, proceeds from which totaling 2.829 billion rubles formed KTK's additional paid-in capital. The amount of additional paid-in capital did not change in 2011.

The Company's total liabilities excluding equity grew by 58% to 7.603 billion rubles in 2011 from 4.804 billion rubles in 2010. Non-current and current liabilities increased by 55% and 61% respectively to 3.837 billion rubles and 3.766 billion rubles. The growth was primarily driven by the increase of the Company's loan portfolio, which is described in detail in the Indebtedness section. Liabilities also grew as payables increased by 11% to 1.955 billion rubles with the receipt of advances for coal deliveries in 2012.

Key financial ratios

LIQUIDITY RATIOS

Current ratio

RUB MLN	2011	2010	%
Current assets	5,673	2,787	104%
Current liabilities	3,766	2,332	61%
CURRENT RATIO *	**1.5X**	**1.2X**	**0.3X**

* Current assets to current liabilities

Quick ratio

RUB MLN	2011	2010	%
Quick assets (current assets net of inventories)	4,398	2,028	117 %
Current liabilities	3,766	2,332	61 %
QUICK RATIO *	**1.2X**	**0.9X**	**0.3X**

* Quick assets to current liabilities.

TURNOVER RATIOS

Asset turnover

RUB MLN	2011	2010	%
Revenue	23,939	14,160	69%
Total assets at start of period	11,639	9,415	24%
Total assets at end of period	16,128	11,639	39%
ASSET TURNOVER *	**1.7X**	**1.3X**	**0.4X**

* Revenue / ((Total assets at start of period + total assets at end of period)/2)

Inventory turnover

RUB MLN	2011	2010	%
Cost of sales	19,404	11,457	69%
Inventory at start of period	759	405	87%
Inventory at end of period	1,275	759	68%
Inventory turnover*	19.1x	19.7x	–0.6x
INVENTORY TURNOVER PERIOD, DAYS**	**19.1**	**18.5**	**0.6**

* Cost of sales/((inventory at start of period + inventory at end of period)/2)

** 365 days/inventory turnover

PROFITABILITY RATIOS

Return on Equity (ROE)

RUB MLN	2011	2010	%
Net profit	2,018	823	145%
Equity at start of period	6,835	3,467	97%
Equity at end of period	8,525	6,835	25%
RETURN ON EQUITY*, %	**26%**	**16%**	**10%**

* Net profit/((equity at start of period + equity at end of period)/2)

Return on Investment (ROI)

RUB MLN	2011	2010	%
Net profit	2,018	823	145%
Equity at start of period	6,835	3,467	97%
Equity at end of period	8,525	6,835	25%
Total debt at start of period	2,211	3,859	-43%
Total debt at end of period	4,547	2,211	106%
RETURN ON INVESTMENT*, %	**18%**	**10%**	**8%**

* Net profit/((equity at start of period + equity at end of period + total debt at start of period + total debt at end of period)/2)

LEVERAGE RATIOS

Total debt to equity

RUB MLN	2011	2010	%
Total debt	4,547	2,211	106 %
Equity	8,525	6,835	25 %
TOTAL DEBT TO EQUITY	**0.5X**	**0.3X**	**0.2X**

Interest coverage ratio

RUB MLN	2011	2010	%
Profit before interest and taxes	2,763	1,524	81%
Interest expense	207	275	–25%
INTEREST COVERAGE RATIO*	**13.3X**	**5.5X**	**7.8X**

* Profit before interest and taxes/Interest expense

KTK's complete consolidated financial statement for the year ended December 31, 2011 is available on the Company's website, in the Investors section:

http://oaoktk.ru/investors/ – Russian language,

http://oaoktk.ru/en/investors/ – English language.

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DISCLAIMER

This Annual Review may contain statements that are or could be considered "forward-looking statements" as defined by U.S. federal securities laws and, consequently, these statements fall under provisions of these laws that provide release from liability for acts committed in good faith.

Examples of such statements include, but are not limited to, forecasts, projections, strategies, plans, targets, expectations, estimates, intentions and beliefs of the Company, including in regard to acquisitions, sales of goods or services, operating results, financial position, liquidity, prospects and dividend policy; statements concerning future production and business operations; other statements that do not strictly apply to events (facts), both past and present; and assumptions on which such statements are based.

Forward-looking statements are inherently subject to risks and uncertainties, both general and specific, as well as risks that these statements will not be realized. In addition to other factors, forward-looking statements are based on many assumptions concerning the current and future strategy of the Company, as well as the circumstances in which the Company will be conducting business in the future.

The Company cautions that certain important factors could result in the Company's assumptions being incorrect and could cause actual results to differ materially from the forecasts, projections, strategies, plans targets, expectations, estimates, intentions and beliefs of the Company expressed in these forward-looking statements.

These factors include:

- changes in political, social, legal or economic conditions in Russia as a whole or in regions of Russia where the Company conducts business, including changes in the level of spending on and demand for some or all of the Company's goods
- growth of market share of competitors, reduction of prices by competitors, unforeseen actions by competitors that could affect market share, growth of expenses or hinder the growth of the Company
- ability to conduct mergers, acquisitions, transfer of companies and shares, both present and future, and achieve integration and expected benefits from joint operations and/or synergies
- level of spending on market research, promotion of goods and innovation by the Company and its competitors
- ability of the Company to protect its rights to intellectual property
- changes in legislation and regulations, changes in the policies of the Russian government and regional authorities, including taxation
- changes in the cost of resources and labor
- renewal of rights to distribution of goods and contracts on favorable terms following their expiration
- technological changes that could affect distribution of goods
- changes on the financial and securities markets, including significant fluctuations in interest rates and currency exchange rates, that could affect the Company's access to financial resources, increase the cost of financing or affect the Company's financial results
- changes in reporting standards, applied policies and practices
- availability of qualified personnel, including accounting personnel
- ability to determine other risks related to the Company's operations and avoid risks based on the above factors

This list of factors is not comprehensive. Readers of this Annual Review should carefully review these factors and other uncertainties and events that apply particularly to the political, economic, social and legal environment in which the Company conducts its business. These forward-looking statements are only relevant as of the date of this Annual Report, and the Company does not assume any obligation to update or revise any of them.

Readers should not place undue reliance on forward-looking statements. The Company is not making any assertions, assurances or forecasts that the expected results specified in such forward-looking statements will be achieved. Such statements represent, in each case, only one possible case scenario and should be viewed as the more probable or standard case scenarios.

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