

## КОНФЕРЕНЦ-ЗВОНОК ПО РЕЗУЛЬТАТАМ 3М 2009 г.

### ВЫСТУПЛЕНИЕ С.ПЛОЩЕНКО

Good afternoon ladies and gentlemen.

#### Slide 1 – Sales Overview

Despite the fact that challenges of the last quarter of 2008 did not abide in the 1<sup>st</sup> quarter of this year, the Group managed to demonstrate a certain improvement in the financial performance. While revenue decreased by 14% as compared to the previous quarter to 1 billion 180 million dollars, the gross margin improved from 25 to almost 32% as gross profit rose by 9% to 375 million dollars. That was largely the result of a successful cost-cutting program across all our segments and flexible sales policy. Export revenue increased to 54% of the total as opposed to 47% in the 4<sup>th</sup> quarter of 2008, helping to maintain stable sales and higher margins, especially in the mining segment.

The better performance on the top level made operating result recover into the black with almost 14 mln dollars profit vs 251 mln dollar loss in the previous quarter. The visible reduction in SG&A expenses also contributed to that. The selling and distribution expenses fell 34%, while general and administrative expenses reduced by 19%. At the same time while change in provision for bad debts in the 4<sup>th</sup> quarter 2008 comprised 88 mln dollars of additional losses, in the 1<sup>st</sup> quarter of 2009 this item saw a mere 418 thousand dollars. As a result the SG&A expenses fell to 31% of revenue in the 1<sup>st</sup> quarter vs 43% a quarter before. The selling and distribution expenses only fell to 21% of the revenue from 27% for the same period.

The positive operating result, however, was not sufficient to compensate for another 592 mln dollars of FX loss recorded in the 1<sup>st</sup> quarter, albeit a hundred mln dollars less than a quarter before. That resulted in a negative EBITDA of 474 mln dollars – almost twice as small as the EBITDA for the 4<sup>th</sup> quarter of 2008. The bottom line recorded a net 691 mln dollar loss vs almost a 500 mln dollar loss a quarter ago. It should be borne in mind however that in the 4<sup>th</sup> quarter the bottom line was affected by a 556 mln dollars income tax gain mostly arising from deferred tax gain, which was the result of the change of statutory income tax rate in Russia and Kazakstan since 01.01.2009 from 24% to 20% in Russia whereas in Kazakstan that rate went down from 30% to 20% in 2009, then to 17.5% in 2010 and further to 15% in 2011 and thereafter. Should that factor be stripped off the 4<sup>th</sup> quarter result, the 1<sup>st</sup> quarter result would show a 34% improvement.

#### Slide 2 – Steel Sales: Structure and Prices

The steel segment contributed almost a half of the 1<sup>st</sup> quarter sales with revenue of 643 mln dollars – virtually unchanged from the previous quarter. At the same time the lower input costs, cost-cutting initiatives, more optimal capacity utilization and lack of negative inventory value adjustments resulted in a 28% fall in cost of sales. The cash cost for the basic steel products like billet, wire rod and rebar fell 34%, to 330 dollars a tonne on average. As a result the gross profit of 55 mln dollars vs a 127 mln dollar loss in the previous quarter.

A price fall across virtually all the segment's products ranging from 12 to 42% and as much as 49% for coke was compensated by increased volumes of sales, especially in such products as billet – up 73% to 300 ths tonne, wire rod – up 33% to 90 ths tonne and rebar – up almost 10% to 430 ths tonne. This increase in sales volume was possible thanks to the increased demand in export markets, especially Middle East and South-East Asia, as well as better penetration of Mechel Service into its core market of Russia as well as growing presence in the new markets of Romania, Kazakhstan and Germany. Overall Mechel Service together with HBL contributed 187 mln dollars or almost 30% to the segment's revenue. As a result, the steel segment posted albeit a thin but positive gross margin of 8% in the 1<sup>st</sup> quarter.

SG&A expenses also fell both in size – or by 41% and as a share of revenue – to 20% vs 32% a quarter ago. While dynamics of selling and distribution expenses were in line with those of revenue, general and administrative expenses fell from 9% of revenue to 7% as a result of salary cuts and administrative personnel idling at some subsidiaries and the holding company. The expenses for provision for doubtful accounts also fell from 68 mln dollars in the 4<sup>th</sup> quarter of 2008 to less than a million for the reported period. As a result, the operating loss in the steel segment reduced from 363 mln dollars a quarter ago to 85 mln dollars. The steel segment was the second most affected by the FX loss of 236 mln dollars as a result of ruble depreciation after the ferroalloy segment. That resulted in a negative EBITDA of 260 mln dollars - almost a half of the 4<sup>th</sup> quarter negative result. The bottom line posted a loss of 358 mln dollars vs a 404 mln net loss a quarter ago. However, as I mentioned before, the net result of the 4<sup>th</sup> quarter was positively affected by the deferred tax income due to a change in the corporate tax rate in Russia. If we compare profit before tax, the item for the 1st quarter 2009 was almost a half of that in the 4th quarter of 2008.

### **Slide 3 – Mining Sales: Structure and Prices**

The 1<sup>st</sup> quarter of 2009 was probably the worst for the mining segment, both in comparison to the other ones and to the 4<sup>th</sup> quarter of 2008. Nevertheless, the achieved efficiency cushion and high degree of vertical integration ensured that even in such conditions the segment managed to show a positive operating result. While the revenue from sales to the 3<sup>rd</sup> parties fell by 32% to 344 mln dollars – mostly as a result of significant fall in average sales prices - the segment posted a gross margin of 53% on the gross profit of 211 mln dollars. While we resumed sales of coal from Southern Kuzbass to the domestic market in the 1<sup>st</sup> quarter, the sales of high quality coking coal from Yakutugol fell considerably due to the fact that in the 1<sup>st</sup> quarter the seaborne market was looking to the new bearing in the wake of resumed negotiations between largest world producers and consumers. As a result of the fall in production at Yakutugol, the cash cost of coking coal rose to 53 dollars a tonne. At the same time the cash cost per tonne of coking coal at Southern Kuzbass fell to 36 dollars as production steadied, on the one hand, and rouble has depreciated on the other hand. At the same time the reduction in sales of coking coal was more than compensated by increased production and sales of steam coal. In the 1<sup>st</sup> quarter of 2009 we increased output of steam coal at Yakutugol by 14% by changing the mining plan and shifting equipment and workforce from coking coal production. The cash cost per tonne fell to 13 dollars at Southern Kuzbass and remained virtually flat at 22 dollars at Yakutugol. Overall, the sales volumes of coking coal fell by 41% to 591 ths tonne vs 4<sup>th</sup> quarter, while the volumes of steam coal sales increased by the same rate. As a result, the revenue from coking coal sales fell by 140 mln dollars, while the revenue from steam coal only by 7.7 mln dollars and that was mainly to a fall in sales prices. The sales of iron ore concentrate also grew volume-wise by 73% as sales both to domestic market and Northern China stabilized although the average FCA price remained almost unchanged on the level of 50 dollars per tonne resulted in net 11 mln dollars increase in revenue. The cash cost of a tonne fell from 30 dollars in the 4th quarter to 25 dollars.

The share of SG&A expenses in the segment's revenue remained flat at 41%, though the share of selling and distribution expenses fell from 34% in the 4<sup>th</sup> quarter of 2008 to 29% in the reported period due to the decrease of average railway freight rates as a result of rouble depreciation. That resulted in an operating profit of 50 mln dollars and an operating margin of 12.6%. Despite a 60 mln FX loss the segment still recorded a positive EBITDA of almost 42 mln dollars. The interest expense grew 85% to 50 mln dollars. That was the result of the 3-year 1 bln dollar loan drawn from Gazprombank, which was attributed to the mining segment. That resulted in a net loss of 66 mln dollars for the reported period.

#### **Slide 4 – Ferroalloy Segment**

While the price dynamics in the ferroalloy segment were still negative in the 1<sup>st</sup> quarter, especially for FeCr, it was visibly less than in the steel and mining segment. At the same a relative stabilization in the sales markets for nickel, ferrosilicon and to certain extent in FeCr, coupled with optimization of the cost base, which decreased by 76 mln dollars, allowed us to increase sales volumes to 3<sup>rd</sup> parties significantly: nickel by 35%, FeCr by 127%, FeSi by 97%. That led to an almost 70% increase in the segment revenue in the reported period and an 87% reduction in the gross loss to a mere 15 mln dollars.

The share of SG&A expenses in the revenue also fell sharply from 41% in the last quarter of 2008 to only 17% in the 1<sup>st</sup> quarter. That was largely the result of a 58% fall in the expenses for provision for doubtful accounts and a similar reduction in administrative expenses, which came as a result of salary and consultancy work cuts. Consequently, the operating loss reduced by 81% to 25 mln dollars. As I mentioned before, the ferroalloy segment was the biggest casualty of the FX loss due to the fact that it is attributed the 1.5 bln dollar bridge finance facility raised to finance the acquisition of Oriel resources and a part of the original 2 bln dollar facility raised to finance the acquisition of Yakutugol. The FX posted a 296 mln dollar figure, which resulted in a negative EBITDA of 307 mln dollars – albeit a 38% improvement over the previous quarter. The net result posted a 329 mln loss, which is still a 38% improvement on a pre-tax basis.

#### **Power Segment**

The Power segment continued to demonstrate a relative stability in the changing economic environment. While revenue fell by 18% to 138 mln dollars mostly as a result of lower output and prices, the gross margin remained at healthy 30%. The share of SG&A expenses in revenue also fell from 32% in the 4<sup>th</sup> quarter of 2008 to 24% in the reported period. That was largely the result of a 50% cut in general and administrative expenses and lack of expenses for provision on doubtful accounts, which affected the result of the previous quarter by 8 mln dollars. All that filtered down to a 12 mln dollar operating profit and improvement in the operating margin from 4.14% last quarter to 5.75% in the reported quarter. The FX effect on the segment's result was negligible and EBITDA recorded an almost 14 mln dollar positive figure – a 5% growth over the previous quarter and an improvement in the EBITDA margin from 5.3% to 6.6%. The net result virtually broke even, affected by intersegmental interest expense and income tax of 2.3 mln dollars vs income tax gain of 3 mln dollars due to the reasons described above in the previous quarter.

It would be fair to say that increased seasonal heat and electricity demand helped the power segment in the two compared quarters despite overall contracted market due to economic crisis. That said we expect the reduced seasonal factor in the following quarters to be partially

compensated by increased power generation using blast furnace and coke oven gas from the relaunched facilities at Chelyabinsk plant, Mechel Coke and Moskoks in the 2<sup>nd</sup> quarter.

### **Cash generation capacity**

Although the Group has returned to the net positive operational level of profitability, the 1<sup>st</sup> quarter of 2009 still was challenging for the operating cashflow. In these circumstances we focused primarily on working capital management and in particular inventory, through which we achieved a release of 130 mln dollars. That eventually kept the cash flow from operation in a positive territory with 40 mln dollars. That was entirely used to repay some of the expensive dollar-denominated short-term debt. Around 108 mln dollar were spent on investments, almost entirely on capex and last installment for HBL. That was entirely financed through additional long-term debt dedicated to capex financing. In the 1<sup>st</sup> quarter we also drew on the 3-year 1 bln dollar Gazprombank loan, which we partially used to prepay some of the short-term debt and partially reserved for future debt repayment. That resulted in the cash of 953 mln dollars in our accounts as of the end of the reporting period.

### **Debt profile**

As reported at the last conference call, the company has reclassified a portion of the long-term debt, primarily the syndicated facilities raised in 2007 and 2008 to finance the acquisition of Yakutugol and Oriel Resources, as short-term as a result of violation of certain covenants. According to that reclassification, the debt structure as of the end of the 1st quarter of 2009 is shown at the slide number 13.

The Board of Directors meeting and the general shareholder meeting held on June the 30<sup>th</sup> approved the terms of restructuring of these two facilities, today we are finalizing the documentation and we expect to announce the conclusion of the deal in the very near future. The terms of the restructuring will also reflect the current financial situation of the company in terms of the adjusted covenants. As a result of this restructuring some US\$2,7 bln dollar of the existing debt will be reclassified as long term (with around US\$410mln as a current portion of long term debt as of July 15, 2009).

### **FY2008 Results overview**

To recap, the 1<sup>st</sup> quarter of this year was probably the most challenging one in the last few years. It was all reflected in the production and operating cash flow levels. Nevertheless, the fact that we managed through that quarter without significant damage to the production capacity and further managed to increase the capacity utilization significantly in the 2<sup>nd</sup> quarter bringing most of our operations to the precrisis level as sales improved is an ultimate proof of the resilience of the business model we have built and strength of our going concern.

Thank you for your attention, ladies and gentlemen, and now we will be pleased to answer your questions.