



## **Management report**

### **Management's discussion and analysis of financial condition and results of operations for the first six months of 2010**

The following Management report (Management discussion and analysis of the Polyus Group's financial condition and results of operations) should be read in conjunction with the Polyus Group's interim condensed consolidated financial statements and the related notes.

The Polyus Group is an international mining company, the largest gold producer in the Russian Federation and among the largest gold mining companies in the world, based on mineral resources and production volumes.

Polyus Gold Shares are traded on the leading Russian stock exchanges, MICEX and RTS. Polyus Gold's ADRs are listed on the main market of the London Stock Exchange and are traded on the over-the-counter markets in the United States and off the listing at the Frankfurt Stock Exchange. Polyus Gold Shares are included in the key Russian stock exchange indices of MICEX and RTS, and international stock exchange indices such as FTSE Gold Mines, FTSE Russia, MSCI Russia, MSCI Emerging Markets, Dow Jones Global and Dow Jones Russia. The Polyus Group produced 1.3 million troy ounces of gold in 2009.

The following discussion and analysis represents management's opinion in relation to the Polyus Group's operating and financial results, including discussions of:

- key performance indicators;
- financial position as at 30 June 2010 and 31 December 2009;
- results of operations for the six months ended 30 June 2010 and 30 June 2009;
- the Polyus Group's liquidity, solvency and capital sources; and
- significant events affecting the Polyus Group's operating performance for these periods.

The Polyus Group's financial statements reflect the consolidation of the KazakhGold Group from 1 August 2009, following completion of the Partial Offer for 50.15% of the issued share capital of KazakhGold by Jenington International. To get more detailed information on financial performance of KazakhGold Group, the Polyus Group's subsidiary operating in the Republic of Kazakhstan, please refer to the KazakhGold's interim condensed consolidated financial statements and Management report for the six months ended 30 June 2010, which is available at the company's web-site: [www.kazakhgold.com](http://www.kazakhgold.com).

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## 1. The Polyus Group's operating results

### 1.1 External market factors affecting the Polyus Group's financial results

The results of the Polyus Group are significantly affected by movements in the national currency exchange rates, and the prices of commodities, such as gold, oil and steel.

The market price of gold is one of the major factors in determining the financial performance of the Polyus Group. During the first half of 2010, the global gold price significantly fluctuated in the range of USD 1,058 to USD 1,261 per troy ounce (London p.m. fixing). In the reporting period the average gold p.m. fixing price at the London market was USD 1,152 per ounce, compared to USD 915 per ounce in the 2009 comparative period.

Currency exchange rates may have a material impact on the Polyus Group's results. Polyus Group's revenue from gold sales is denominated in USD, whereas most of the Polyus Group's operating expenses and capital expenditures are denominated in the national currencies of Russia and Kazakhstan. In the first six months of 2010, the average USD/RUB exchange rate declined to RUB 30.07 per USD, compared to RUB 33.07 per USD in the first six months of 2009. This contributed to an increase in costs in USD terms during the first half of 2010 in comparison with the first half of 2009 for salaries and other expenses denominated in Russian Rubles, due to the effect of translation to the USD presentation currency. The closing USD/RUB rate as at 30 June 2010 didn't change materially from the rate at 30 June 2009. Since its acquisition of a controlling stake in KazakhGold Group in July 2009, the Polyus Group has also been exposed to USD/KZT exchange rate movements.

The Polyus Group's cost of sales are also directly or indirectly impacted by the prices of oil and steel. Movements in oil prices impact the prices of heating oil, diesel fuel, gasoline and lubricants for mining and construction equipment. Steel forms the basis for the price of all rolled metal products, pipes, machinery and vehicles. In the first half of 2010 average global prices for oil and steel substantially increased over the levels of the first half of 2009, driving consumables and spares costs higher.

The following table sets forth the average rates for key external market factors for the specified period:

Average price/ rate	Six months ended 30 June		Year ended 31
	2010	2009	December
			2009
London p.m. gold fixing price (USD per troy ounce) <sup>(1)</sup>	1152.2	915.2	972.4
Oil (Brent brand) (USD per barrel) <sup>(2)</sup> .....	81.1	58.0	62.4
Steel (hot rolled) (USD per tonne) <sup>(3)</sup> .....	644.1	491.0	582
Average USD/RUB rate <sup>(4)</sup> .....	30.07	33.07	31.72
Period end USD/RUB rate .....	31.20	31.29	30.24
Average USD/KZT rate <sup>(5)</sup> .....	147.24	n/a	147.50
Period end USD/KZT rate .....	147.46	n/a	148.36

1. Source: London Bullion Market Association.

2. Source: Bloomberg.

3. Source: Steel Business Briefing.

4. Source: The Central Bank of Russia.

5. Source: The National Bank of Kazakhstan.

## Summary of performance results

The following table shows the summary of performance results of the Polyus Group for the first six months of 2010:

USD'000	Six months ended 30 June		Change
	2010	2009	%
<b>Gold sales</b>	<b>607,567</b>	<b>441,686</b>	<b>37.6</b>
Other sales	14,879	10,273	44.8
Cost of gold sales	(345,219)	(209,358)	64.9
Cost of other sales	(14,368)	(9,248)	55.4
<b>Gross profit, including</b>	<b>262,859</b>	<b>233,353</b>	<b>12.6</b>
<b>Gross profit on gold sales</b>	<b>262,348</b>	<b>232,328</b>	<b>12.9</b>
<b>Gross profit margin</b>	<b>42.2%</b>	<b>51.6%</b>	<b>(18.2)</b>
Selling, general and administrative expenses	(75,709)	(45,542)	66.2
<b>Profit before income tax</b>	<b>141,247</b>	<b>191,297</b>	<b>(26.2)</b>
<b>Pre-tax margin</b>	<b>22.7%</b>	<b>42.3%</b>	<b>(46.4)</b>
Income tax expense	(36,625)	(41,284)	(11.3)
<b>Profit for the period</b>	<b>104,622</b>	<b>150,013</b>	<b>(30.3)</b>
Net loss attributable to non-controlling interests	(11,757)	(297)	3,858.6
<b>Net profit attributable to shareholders of the parent company</b>	<b>116,379</b>	<b>150,310</b>	<b>(22.6)</b>
<b>Net profit margin</b>	<b>16.8%</b>	<b>33.2%</b>	<b>(49.4)</b>
<b>Earnings per share – basic and diluted (USD)</b>	<b>0.65</b>	<b>0.84</b>	<b>(22.6)</b>

The following table shows the summary of performance results of the Polyus Group's operations for the first six months of 2010 expressed in non-GAAP financial measures:

USD'000	Six months ended 30 June		Change
	2010	2009	%
Operating profit <sup>(1)</sup>	169,230	176,178	(3.9)
Operating profit margin	27.2%	39.0%	(30.3)
EBITDA <sup>(2)</sup>	247,582	218,003	13.6
EBITDA margin	39.8%	48.2%	(17.4)

1. Operating profit is calculated as Gross profit, less Selling, general and administrative expenses, Research expenses and Other expenses, net.
2. For details of the calculation of EBITDA refer to section 2.1 of this document.

In the first half of 2010 the Polyus Group's profit margins declined due to increased cost of gold sales and selling, general and administrative expenses. This was largely affected by consolidation of financial results of the loss-making KazakhGold Group, a number of macroeconomic and external market factors and technical issues at the Group's mines, which resulted in a higher use of chemicals and materials, as well as an increase in labour costs. The Group was able to offset the effect of these factors in part by implementing cost control measures in order to maintain a competitive level of profitability. In the reporting period, a significant part of costs were of a non-cash nature, including depreciation and amortization, accruals, provisions and allowances, changes in fair value of financial assets, etc.

## 1.2 Gold sales

The following table shows the results and breakdown of the Polyus Group's gold sales for the six months ended 30 June 2010 and 2009:

	Six months ended 30 June		Change
	2010	2009	%
Gold sales (USD thousands)	607,567	441,686	37.6
Gold sales (thousand troy ounces) <sup>(1)</sup>	524	477	9.8
In the domestic market (thousand troy ounces) <sup>(2)</sup>	481	477	0.8
In the domestic market (%)	92	100	-
For export (thousand troy ounces)	43	-	-
Weighted-average gold selling price (USD per troy ounce)	1,160.3	926.0	25.3
Average p.m. gold fixing price in London (USD per troy ounce) <sup>(3)</sup>	1,152.2	915.2	25.9
Excess/(deficit) of average selling price over/(under) average p.m. fixing price (USD per troy ounce)	8.1	10.8	(25.1)

1. Sales volumes include 481 k oz of sold refined gold produced by the Polyus Group's mines in Russia and 43 k oz of gold produced and sold by KazakhGold Group in semi-finished products.
2. Sales on the domestic market comprise of sales by the Polyus Group's Russia subsidiaries on the Russian market. Export sales comprise of sales by KazakhGold on the international market.
3. Source: London Bullion Market Association.

In the first six months of 2010, the Polyus Group's gold sales amounted to USD 607,567 thousand, showing an increase of 38% compared to the first six months of 2009.

The increase in gold sales resulted from higher realized gold prices, as well as increased sales volumes. The sales volumes in the reporting period were 524 thousand troy ounces, including 43 thousand ounces sold for export by the Kazakhstan business unit. The comparable sales volume in the first half of 2009 (which was prior to the acquisition of KazakhGold) was 477 thousand troy ounces.

In the first six months of 2010 the Group produced 503 k oz of gold, compared to 477 k oz in the same period of the previous year.<sup>1</sup> The 5% growth of production volumes resulted from enhanced capacities of the Titimukhta project launched in 2009 and pre-commissioning operations at the Blagodatnoye mine. Additional production volumes of 46 thousand ounces also resulted from the effect of consolidation of KazakhGold since July 2009 and comparative amounts do not include results of KazakhGold.

In the reporting period, the weighted-average gold selling price was USD 1160.3 per troy ounce, showing a 25% growth as compared to the same period of the previous year. This was USD 8.1 per ounce higher than the average p.m. gold fixing price at the London market. The weighted-average gold selling price for the refined gold sold by the Polyus Group's Russian subsidiaries amounted to USD 1,175.5 per ounce. The lower selling price for the whole of the Polyus Group was due to KazakhGold Group's sale of semi-products at a discount of approximately 14% to gold market price.

<sup>1</sup> Production volumes include 456 k oz of refined gold produced by the Polyus Group's mines in Russia and 46 k oz of gold produced by KazakhGold Group in the form of sludge, flotation and gravitation concentrates and other semi-products.

### 1.3 Cost of gold sales

The following table shows the results of the Polyus Group's cost of gold sales for the six months ended 30 June 2010 and 2009:

USD '000	Six months ended 30 June		Change
	2010	2009	%
<b>Cash operating costs<sup>(1)</sup></b>	<b>351,014</b>	<b>212,952</b>	<b>64.8</b>
Consumables and spares, out of which:	156,650	101,832	53.8
<i>Materials and spares</i>	116,975	66,183	76.7
<i>Fuel</i>	39,675	35,649	11.3
Labour	96,968	53,657	80.7
Tax on mining	52,942	37,207	42.3
Utilities, out of which:	20,425	10,352	97.3
<i>Power</i>	20,098	10,076	99.5
<i>Other</i>	327	276	18.5
Outsourced mining services	2,062	2,132	(3.3)
Refining costs	2,201	1,793	22.8
Sundry costs	19,766	5,979	230.6
Amortisation and depreciation of operating assets	70,144	38,433	82.5
Deferred stripping costs expensed	30,824	6,277	391.1
Increase in gold-in-process and refined gold	(107,573)	(51,154)	110.3
Increase in provision for land restoration	810	2,850	(71.6)
<b>Cost of gold sales</b>	<b>345,219</b>	<b>209,358</b>	<b>64.9</b>

1. The presentation of cash operating costs is more detailed than that presented in the interim condensed consolidated financial statements. The amounts are derived from the management accounts, and agree in total with the amounts presented in the interim condensed consolidated financial statements.

In the first half of 2010, cost of gold sales increased by 65% to USD 345,219 thousand. The change resulted from the effect of consolidation of KazakhGold in the amount of USD 37,463 thousand, appreciation of the RUB relative to the USD, enhanced mining and processing works, the expensing of previously capitalised stripping costs, and a significant increase in gold-in-process and refined gold.

#### *Cash operating costs*

During the reporting period, cash operating costs totalled USD 351,014 thousand, compared to USD 212,952 thousand in the same period of the previous year.

In the first six months of 2010, the largest component of cash operating costs were consumables and spares. These included materials and spares (spare parts for trucks, excavators and for construction machinery, expenses on rolled metal products and cables, technological materials for plants and other materials and spare parts used during the mining, concentration and smelting) and fuel.

The cost of materials and spare parts consumed in the reporting period amounted to USD 116,975 thousand which was 77% higher than in the same period of the previous year. Consumption of grinding balls, pipes, rolled metal products, spare parts and chemical products increased, primarily due to the start-up of pre-commissioning operations at the Blagodatnoye mine and ramp-up of the Titimukhta capacities. Additional supplies of materials and chemicals were also required due to technical issues at the Olimpiada mine: during the first half of 2010, adjustment of heat-eliminating and aeration mechanisms in bio-leaching vats went on. Upgrade and renovation of processing plant equipment was implemented. The increase in costs for materials and spares was also affected by the growth in purchase prices for materials and components and increases in steel prices of over 30% and in prices for cyanides (mainly because of increase in export duties for toxic agents). The increase was also affected by the RUB appreciation. Expenses on materials and spare parts for the first half of 2010 also include purchases by the Kazakhstan business unit in the amount of USD 6,769 thousand.

The cost of fuel, diesel oil and lubricants for trucks and excavators consumed during the first half of 2010 was USD 39,675 thousand, an increase of 11% in comparison to the first half of 2009. This was mainly a result of the RUB appreciation against the USD, as well as consolidation of the Kazakhstan business unit's expenses in the amount of USD 961 thousand. The RUB-denominated fuel costs at the Polyus Group's mine operating in Russia remained approximately at the level of the first half of 2009, as an increase in consumption of fuel was offset by lower fuel

prices at which the fuel expenses were recognized in cost of gold sales. Fuel consumed in the first half of 2009 was purchased in 2008 at considerably higher prices than fuel purchased in 2009 consumed for production needs in the first half of 2010.

Labour costs were the second largest component of cash operating costs. In the first six months of 2010, these costs increased by 81% to USD 96,968 thousand. The increase resulted from a combination of several factors, including

- 1) a substantial increase in the number of production personnel in comparison to the first half of 2009 relating mainly to pre-commissioning at Blagodatnoye (the personnel at Blagodatnoye received compensation in full during the ramp-up period);
- 2) effect of consolidation of KazakhGold for the full six months of 2010. KazakhGold is the dominant enterprise in the towns where its mines are located and is accordingly subject to commitments under trade union agreements. Although the KazakhGold Group believes that its staff levels, relative to current production volumes, are high, it believes that upon modernisation of operating facilities and the associated increase in production, the staff levels will gradually become more commensurate with the levels of its gold output;
- 3) the planned 7-8% increase in salaries for operational personnel throughout the Polyus Group;
- 4) accrual of employee benefit obligation under collective agreements; and
- 5) the effect of translation to presentation currency due to appreciation of the RUB relative to the USD.

In the first half of 2010, the Polyus Group accrued USD 52,942 thousand of tax on mining, which was USD 15,735 thousand more than in the same period of the previous year, as a result of higher average gold selling price and enhanced production volumes. In accordance with Chapter 26 of the Tax Code of the Russian Federation, the tax on mining base includes concentrate or any other semi-product containing precious metal obtained by extraction of this metal from ore, alluvial or industrial deposits, including gold produced by the Polyus Group. Concentrates and other semi-products containing gold are subject to the tax at the rate equal to 6% of the cost of these semi-products. The cost is determined based on selling prices for the relevant tax period. The tax is accruable on gold, which the ore under processing contains, and thus is payable not only on gold sold, but also on gold-in-process and gold lost during processing. By the end of the reporting period approximately 18 k oz of gold remained at the refinery, OJSC Krastsvetmet. In addition, significant volumes of unrefined gold produced in the first half of 2010 by the Krasnoyarsk business unit (Olimpiada mine and Blagodatnoye mine), were left at the Olimpiada mine storage. This gold is also subject to mining tax.

These mining tax charges also include USD 3,577 thousand attributable to KazakhGold Group's mines. Mining tax in the Republic of Kazakhstan is calculated with reference to the value of the reserves of commercially useful minerals which are contained in mineral raw materials, which are extracted. The value of the reserves of commercially useful minerals contained in mineral raw materials is determined on the basis of the average exchange price for such commercial minerals for the tax period. The average exchange price is the arithmetic mean of the daily average quotations for each commercial mineral recorded on the London Metal Exchange. The mining tax rate for gold from 1 January 2009 is 5%.

In the reporting period utilities expenses almost doubled mainly due to additional purchases of electricity by the Krasnoyarsk business unit following launch of the Blagodatnoye mine. Consolidation of the Kazakhstan business unit's expenses of USD 3,788 thousand also contributed to increased expenses on power and other utilities. Exchange rate changes also had a negative impact on the utilities costs.

#### *Amortisation and depreciation of operating assets*

Amortisation and depreciation of operating assets included in cost of sales increased by 83% from USD 38,433 thousand in the first half of 2009 to USD 70,144 thousand in the first half of 2010. This included USD 12,862 thousand of amortization and depreciation charges relating to the Kazakhstan business unit. The growth of the RUB-denominated depreciation charges resulted from the significant asset base enlargement on Blagodatnoye, as the major part of property, plant and equipment at the mine was commissioned in the first half of 2010.

#### *Deferred stripping costs expensed*

The Polyus Group's accounting policy stipulates that stripping costs incurred in the period are deferred to the extent that the current period stripping ratio exceeds the expected life-of-mine ratio. In case the current stripping ratio falls below the average life-of-mine stripping ratio, the stripping costs are charged to operating costs.

In the first half of 2010 due to technical difficulties in processing of sulfide ore and the decrease in the recovery ratio at Mills No. 2 and 3 of the Olimpiada mine, it was decided to increase the volumes of ore mining. Therefore, the share of waste in the rock mined at Olimpiada was much lower year-on-year and the stripping ratio significantly decreased. As a result, deferred stripping costs in the amount of USD 30,824 thousand were expensed in the reporting period.

### *Change in gold-in-process and refined gold*

In the first six months of 2010, the Polyus Group's metal inventories substantially increased throughout the Polyus Group's mines, with the highest growth shown at the Krasnoyarsk and Irkutsk alluvial business units. At the Olimpiada mine significant amounts of ore having a different quality compared to the currently processed ore were stockpiled until it becomes technically possible for them to be processed. Total gold-in-process and refined gold of USD 107,573 thousand were recorded to inventory from cost of gold sales.

### **1.4 Selling, general and administrative expenses**

The following table sets forth the selling, general and administrative expenses of the Polyus Group for the six months ended 30 June 2010 and 2009:

USD '000	Six months ended 30 June		Change
	2010	2009	%
Salaries	41,326	23,375	76.8
Taxes other than mining and income taxes	9,198	7,789	18.1
Professional services	11,379	2,096	442.9
Other	13,806	12,282	12.4
<b>Total</b>	<b>75,709</b>	<b>45,542</b>	<b>66.2</b>

In the first half of 2010, the Polyus Group's selling, general and administrative expenses increased by 66% from USD 45,542 thousand to USD 75,709 thousand. The major contributor to the growth was an increase in payroll costs. Newly acquired Kazakhstan business unit added USD 10,063 thousand to the Polyus Group's administrative expenses. Selling, general and administrative expenses were also negatively impacted by the exchange rate factor, as the average Russian rouble exchange rate relative to the US dollar was stronger during the first half of 2010 compared with the first half of 2009.

#### *Salaries*

In the reporting period, the Polyus Group's administrative labour costs increased by 77% to USD 41,326 thousand, primarily as a result of an increased number of administrative personnel added upon acquisition of the controlling stake in the KazakhGold Group and the launch of the Blagodatnoye mine. In the course of integration of the Kazakhstan business unit into the Polyus Group, the organisational structure of the company was streamlined and some measures to cut selling, general and administrative costs were undertaken. Another cost growth driver was the appreciation of the RUB against the USD, which was responsible for an approximately 9% increase in the administrative payroll expenses for the first half of 2010.

#### *Taxes other than mining and income taxes*

In addition to tax on mining and income taxes, the Polyus Group pays property tax, VAT (which for the purpose of this item includes only non-recoverable VAT), unified social tax and other taxes. In the first six months of 2010, the Polyus Group accrued USD 9,198 thousand in federal and regional taxes other than tax on mining and income tax. The largest part of the charges related to property tax accruals, which increased due to a USD 923 thousand contribution by the KazakhGold Group, as well as the increased value of fixed assets at the Krasnoyarsk business unit and the effect of the RUB appreciation.

The following table shows the components of taxes, other than mining and income taxes, for the first six months of 2010 and 2009:

USD '000	Six months ended 30 June		Change
	2010	2009	%
<b>Taxes, other than mining and income taxes</b>	<b>9,198</b>	<b>7,789</b>	<b>18.1</b>
VAT	506	1,983	(74.5)
Property tax	7,136	5,072	40.7
Other taxes	1,556	734	112.0

#### *Professional services*

In the reporting period, professional services expenses experienced a multiple increase from USD 2,096 thousand in the first half of 2009 to USD 11,379 thousand in the first half of 2010. The increase in professional services expenses was mainly due to legal and consulting services provided to Polyus Gold and KazakhGold in connection with the Private Exchange Offer, the USD 100 million equity placement by KazakhGold, the investigation of activities of the previous management and preparation for the proceedings against the Assaubayev family and other defendants.

### 1.5 Research expenses

In the first six months of 2010, research costs amounted to USD 1,016 thousand, compared to USD 909 thousand in the first six months of 2009. The increase was mainly due to the effect of the RUB/USD exchange rate factor, as well as research and exploration works carried out at alluvial deposits in the Irkutsk region.

### 1.6 Other expenses, net

In the reporting period, other operating expenses increased by 58% from USD 10,724 thousand in the first half of 2009 to USD 16,904 thousand in the first half of 2010.

In the first half of 2010, KazakhGold recalculated its VAT liabilities for the previous years and as a result the company incurred additional tax charges. KazakhGold believes the VAT was previously illegally refunded out of the state budget by the former management of the company during 2007-2009 based on fictitious contracts. In addition, the Polyus Group recognized asset impairment charges in the amount of USD 4,002 thousand (Refer to Note 8 to the Condensed consolidated financial statements for the six months ended 30 June 2010). This was partly offset by a decrease in charity contributions by 78% and reduction in some other operating expenses.

### 1.7 Finance costs, income/(loss) from investments and foreign exchange gain/(loss)

The following table sets forth the components of financial and investment activity for the six months ended 30 June 2010 and 2009:

USD' 000	Six months ended 30 June		Change
	2010	2009	%
Finance costs	(19,883)	- 1,754	1,033.6
(Loss)/ income from investments	(8,900)	10,394	-
Foreign exchange gain	800	6,479	(87.7)

#### *Finance costs*

In the period under review, the Polyus Group's finance costs increased substantially from USD 1,754 thousand in the first half of 2009 to USD 19,883 thousand in the first half of 2010. The increase reflects interest on the KazakhGold Group's USD 200 million 9.375% senior notes due November 2013 (the "Senior Notes"), interest on loans provided to KazakhGold by its previous major shareholder, Gold Lion Holdings Limited ("Gold Lion"), and interest accrued on bank loans held at KazakhGold. These payments contributed 82% of the Polyus Group's total finance costs. The remaining 18% reflected the unwinding of the discount on decommissioning obligations.

#### *Income/(loss) from investments*

In the first half of 2010, the Polyus Group incurred a net loss from investments totaling USD 8,900 thousand, compared to a net income of USD 10,394 thousand in the first half of 2009.

As a part of acquisition of a 50.15% stake in KazakhGold, the Polyus Group obtained call options to acquire all rights and obligations under convertible loan agreements between KazakhGold and its previous major shareholder, Gold Lion. The call options for convertible loans are classified as financial assets and carried at fair value through profit and loss (Refer to paragraph 3.1.1 "Assets – Non-current assets – Derivative"). At the end of 2009, the fair value of call options was estimated at USD 109,911 thousand. As a result of the decline in KazakhGold share price in the first half of 2010, the fair value of the instrument decreased by USD 30,069 thousand, which was recognized in the interim condensed consolidated income statement.

This was partly offset by gain on disposal of available-for-sale investments represented by shares of Rosfund in the amount of USD 16,897 thousand and interest income on bank deposits totaling USD 3,894 thousand. Interest income received in the reporting period was considerably lower than in the comparative period, which resulted from reduced balances of bank deposits (Refer to paragraph 3.1.1 "Assets – Current assets – Investments in securities and other financial assets").

#### *Foreign exchange gain*

In the first six months of 2010, movements in the exchange rates of the national currencies of Russia and Kazakhstan led to a net foreign exchange gain of USD 800 thousand. In the first six months of 2009, the high volatility in the RUB/USD rate resulted in a foreign exchange gain of USD 6,479 thousand.

### **1.8 Income tax**

Income tax expense in the first half of 2010 was USD 36,625 thousand, which was 11% less than in the same period of the previous year. The lower income tax expense for the reporting period was attributable to the Polyus Group's mines operating in Russia and results from the decreased profit before taxation. The consolidation of the Kazakhstan business unit's financial results reduced the Polyus Group's profit before taxation, which resulted in an effective income tax rate (ratio of current and deferred tax expense to IFRS income before tax) of 26% (25% in the first half of 2009), whereas the statutory income tax rate in Russia was established at 20%. The decrease in the effective income tax rate was mainly a result of non-recognition of tax losses carried forward as deferred tax assets of KazakhGold and Kazakhaltyn due to uncertainty in respect of future taxable profits.

### **1.9 Other sales and cost of other sales**

Revenue from the sale of products other than gold and services grew by 45% in the first six months of 2010 and amounted to USD 14,879 thousand compared to USD 10,273 thousand in the previous period. This revenue includes sales of electricity, rent services sales, revenue from transportation, handling and storage services, exploration services, and other sales. The growth in other sales revenue resulted primarily from increased sales of electricity, rent and exploration services and was enhanced by appreciation of the RUB/USD rate.

Cost of other sales includes, in addition to electricity costs, payroll costs related to non-mining activities, expenses on materials and fuel, and depreciation. In the period under review, cost of other sales amounted to USD 14,368 thousand. In the first half of 2010 revenue from other sales exceeded the cost of their sales, which resulted in a net gain from other sales in the amount of USD 511 thousand, compared to USD 1,025 thousand in the same period of the previous year.

## 2. Non-GAAP financial measures

In its analysis of the Polyus Group's results, Polyus Gold uses key performance indicators which are not measures determined in accordance with IFRS.

### 2.1 EBITDA

"EBITDA" is defined by Polyus Gold as profit before finance costs, income tax, income/(loss) from investments, depreciation and amortisation, and is further adjusted by certain items included in the table below. As these line items are not of a recurring nature, Polyus Gold has made these adjustments in calculating EBITDA to provide a clearer view of the performance of its underlying business operations and to generate a metric that it believes will give greater comparability over time with peers in its industry. Polyus Gold believes that EBITDA is a meaningful indicator of its profitability and performance. This measure should not be considered as an alternative to profit for the period and operating cash flows based on IFRS and should not necessarily be construed as a comprehensive indicator of the Polyus Group's measure of profitability or liquidity.

The following table sets forth the Polyus Group's EBITDA for the six months ended 30 June 2010 and 2009:

USD'000	Six months ended 30 June	
	2010	2009
Profit for the period	104,622	150,013
+ Income tax charged	36,625	41,284
+ Depreciation and amortisation for the period	73,632	40,454
+ Interest expense	19,883	1,754
- Interest income	(5,927)	(6,817)
- Gain on disposal of investments	(16,897)	-
+ Gain from investments in listed companies held for trading	(378)	(3,577)
+ Impairment of available-for-sale investments		
- Foreign exchange gain	(800)	(6,479)
+ Loss from disposal of property, plant and equipment and work-in-progress	718	1,371
+ Impairment of property, plant and equipment	4,002	-
+ Charge from share option plan obligations		-
+ Change in fair value of derivative	30,069	-
<b>EBITDA</b>	<b>247,582</b>	<b>218,003</b>

The Polyus Group's EBITDA in the first half of 2010 was USD 247,582 thousand. The increase of 14% over the levels of the first half of 2009 reflects the growth in gold selling prices and higher sales volumes.

### 2.2 Total Cash Costs

The Polyus Group presents the financial items "total cash costs" ("TCC") and "total cash costs per troy ounce". These measures are calculated and presented by management, as management considers TCC presentation is common industry practice, although its calculations of these items may differ from those of its industry peers. These items are not IFRS measures. An investor should not consider these items in isolation or as alternatives to cost of gold sales, profit for the period attributable to shareholders of the parent company, net cash generated from operating activities or any other measure of financial performance presented in accordance with IFRS. The calculation of total cash costs may vary significantly among gold mining companies, and by themselves do not necessarily provide a basis for comparison with other gold mining companies.

Total cash costs are defined by the Polyus Group as cost of gold sales reduced by amortisation and depreciation of operating assets, accrual of annual vacation payment, and provision for land rehabilitation, and are adjusted by non-monetary changes in inventories and non-monetary changes in deferred stripping costs. Total cash costs per troy ounce are the attributable total cash costs divided by the attributable troy ounce of gold sold.

The following table shows the Polyus Group's TCC for the six months ended 30 June 2010 and 2009:

USD'000, unless otherwise indicated	Six months ended 30 June		Change
	2010	2009	%
Cost of gold sales	345,219	209,358	64.9
– property, plant and equipment depreciation	(70,144)	(38,433)	82.5
– provision for annual vacation payment	(3,883)	(2,509)	54.8
– employee benefit obligation	(9,514)		-
– provision for land rehabilitation	(810)	(2,850)	(71.6)
+ non-monetary changes in inventories <sup>(1)</sup>	14,143	6,755	109.4
+ non-monetary changes in deferred stripping costs <sup>(2)</sup>	(5,108)	-	-
TCC	269,904	172,321	56.6
Gold sales (thousand troy ounces)	524	477	9.8
<b>TCC (USD/oz)</b>	<b>515</b>	<b>361</b>	<b>42.8</b>
TCC (RUB/oz)	15,499	11,935	29.9

1. “Non-monetary changes in inventories” is a calculation to estimate the non-cash portion of costs included in the change in the amount of inventory, primarily representing depreciation and amortisation.
2. “Non-monetary changes in deferred stripping costs” is a calculation to estimate the non-cash portion of costs included in the change in the amount of deferred stripping costs, primarily representing depreciation and amortisation.

In the first six months of 2010, TCC per troy ounce grew by 30% on a RUB basis. The increase on a USD basis was even more significant due to the strengthening of the Russian rouble.

The increase in TCC resulted from the increase in cost of gold sales due to increased material requirements at the Krasnoyarsk business unit, consolidation of KazakhGold Group’s operating expenses, which was not part of the Polyus Group in the first half of 2009, enhanced mining and processing works (Refer to paragraph 1.3 “Cost of gold sales”).

At the same time, production, and therefore, sales volumes of the Group suffered from the decline in output at the Olimpiada mine due to on-going challenges in achieving targeted recovery rates and at Kuranakh mine due to ore transportation matters. During the first half of 2010 adjustment of bio-oxidation technology for the refractory sulphide ores of Olimpiada continued, and a number of measures were undertaken to raise operational efficiency of the mine within the adopted modernization program. At the Kuranakh mine the decline in production volumes resulted from the decreased volumes of ore processing, as the poor state of the pit roads in the spring period hindered stable supply of ore mined to the plant. As a result, the increase in gold sales volumes was not sufficient to meet the increase in costs, which led to a material increase in the Group’s TCC indicator.

### 2.3 Analysis of profitability indicators

Adjusted net profit is defined as net profit attributable to shareholders of the parent company adjusted for income from investments in listed companies held for trading, gain on disposal of available-for-sale investments and change in fair value of derivative financial asset. Adjusted return on assets is calculated as the adjusted net profit divided by the average assets for the period. Adjusted return on equity is calculated as the adjusted net profit divided by the average equity attributable to shareholders of the parent for the period. Adjusted return on invested capital is calculated as the adjusted net profit divided by the sum of the average equity attributable to shareholders of the parent and average non-current and current loans and borrowings for the period.

Polyus Gold has made these adjustments as these items are not of a recurring nature, to provide a clearer view of the performance of its underlying business operations and to generate a metric that it believes will give greater comparability over time with peers in its industry. Polyus Group believes that adjusted net profit, adjusted return on assets, adjusted return on equity and adjusted return on invested capital are meaningful indicators of its profitability and performance. These measures should not be considered alternatives to profit for the period and operating cash flows based on IFRS and should not necessarily be construed as a comprehensive indicator of Polyus Group’s measure of profitability or as a measure of liquidity. The following table shows the Polyus Group’s calculation of adjusted net profit, adjusted return on assets, adjusted return on equity and adjusted return on invested capital for the six months ended 30 June 2010 and 2009:

<b>USD'000, unless otherwise indicated</b>	<b>Six months ended 30 June</b>		<b>Change</b>
	<b>2010</b>	<b>2009</b>	<b>%</b>
Net profit attributable to shareholders of the parent company	116,379	150,310	(22.6)
– Gain on disposal of available-for-sale investments	(16,897)	-	-
– Gain from investments in listed companies held for trading	(378)	(3,577)	(89.4)
+ Loss on derivatives classified as held for trading	30,069	-	-
<b>Adjusted net profit</b>	<b>129,173</b>	<b>146,733</b>	<b>(12.0)</b>
Assets (average for the period)	3,827,444	3,112,817	23.0
Equity attributable to shareholders of the parent (average for the period)	3,070,411	2,768,276	10.9
Non-current and current loans and borrowings (average for the period)	199,356	-	-
<b>Adjusted return on assets</b>	3.37%	4.71%	(28.4)
<b>Adjusted return on equity</b>	4.21%	5.30%	(20.6)
<b>Adjusted return on invested capital</b>	3.95%	5.30%	(25.5)

In the first half of 2010, the Polyus Group's profitability indicators declined as a result of a 12% decrease in net profit adjusted for net loss from investments. The asset base in the first half of 2010 was considerably larger than in the first half of 2009 as a result of acquisition of KazakhGold Group, construction of new plants and a significant increase in inventories. A combination of these two factors led to the decrease in the adjusted return on assets.

The increase in equity was primarily the result of the growth in retained earnings and issuance of treasury shares as part of the consideration for KazakhGold shares. Besides, on acquisition of KazakhGold the Polyus Group assumed its borrowings. The increased value of equity attributable to shareholders of the parent and invested capital contributed to the decrease in the adjusted return on equity and invested capital.

### 3. Review of financial sustainability and solvency

#### 3.1 Analysis of statement of financial position items

The table below sets forth key items from the Polyus Group's consolidated statement of financial position as at 30 June 2010 and 31 December 2009:

USD '000	As at 30 June 2010	As at 31 December 2009	Change, %
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	2,301,209	2,299,071	0.1
Goodwill	133,847	132,906	0.7
Investments in securities and other financial assets	84,292	114,792	(26.6)
Deferred stripping costs	73,144	106,088	(31.1)
Inventories	162,193	40,732	398.2
Long-term portion of reimbursable VAT	6,369	5,899	8.0
<b>Total non-current assets</b>	<b>2,761,054</b>	<b>2,699,488</b>	<b>2.3</b>
<b>Current assets</b>			
Inventories	414,914	415,238	(0.1)
Investments in securities and other financial assets	162,446	312,733	(48.1)
Cash and cash equivalents	300,884	173,360	73.6
Other current assets <sup>(1)</sup>	224,711	190,060	18.2
<b>Total current assets</b>	<b>1,102,955</b>	<b>1,091,391</b>	<b>1.1</b>
<b>TOTAL ASSETS</b>	<b>3,864,009</b>	<b>3,790,879</b>	<b>1.9</b>
<b>EQUITY AND LIABILITIES</b>			
Equity attributable to shareholders of the parent company	3,064,721	3,076,100	(0.4)
Non-controlling interests	48,168	64,871	(25.7)
<b>TOTAL EQUITY</b>	<b>3,112,889</b>	<b>3,140,971</b>	<b>(0.9)</b>
<b>Total non-current liabilities</b>	<b>311,899</b>	<b>313,427</b>	<b>(0.5)</b>
<b>Current liabilities</b>			
Short-term borrowings	171,609	173,437	(1.1)
Trade and other payables and accrued expenses	42,651	116,812	(63.5)
Other current liabilities <sup>(2)</sup>	224,961	46,232	386.6
<b>Total current liabilities</b>	<b>439,221</b>	<b>336,481</b>	<b>30.5</b>
<b>TOTAL LIABILITIES</b>	<b>751,120</b>	<b>649,908</b>	<b>15.6</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>3,864,009</b>	<b>3,790,879</b>	<b>1.9</b>

1. Other current assets consist of reimbursable value added tax, accounts receivable, advances paid to suppliers, income tax receivable and other current assets.
2. Other current liabilities consist of contingent consideration on acquisition of subsidiaries, income tax payable and other taxes payable.

### 3.1.1 Assets

#### *Non-current assets*

##### *Property, plant and equipment*

The table below sets forth the components of the Polyus Group's property, plant and equipment at 30 June 2010 and 31 December 2009:

<b>USD '000</b>	<b>As at 30 June 2010</b>	<b>As at 31 December 2009</b>	<b>Change, %</b>
Exploration and evaluation assets	250,200	240,900	3.9
Mining assets	1,635,431	1,567,117	4.4
Non-mining assets	36,329	36,816	(1.3)
Capital construction-in-progress	379,249	454,238	(16.5)
<b>Total property, plant and equipment</b>	<b>2,301,209</b>	<b>2,299,071</b>	<b>0.1</b>

In the first half of 2010 the value of property, plant and equipment didn't change materially and totalled USD 2,301,209 thousand at 30 June 2010, compared to USD 2,299,071 thousand at 31 December 2009.

The value of mining assets increased by 4% in the reporting period due to additions and transfers from capital construction-in-progress which primarily reflected construction of the Blagodatnoye mine in the Krasnoyarsk region, as well as upgrade and renovation works carried out at the production facilities in Kazakhstan. The closing balance of the Polyus Group's mining assets was USD 1,635,431 thousand at 30 June 2010, compared to USD 1,567,117 thousand at 31 December of 2009. The value of capital construction-in-progress decreased from USD 454,238 thousand in 2009 to USD 379,249 thousand in the first half of 2010, due to significant transfers to mining assets related mainly to Blagodatnoye construction. Exploration and evaluation assets increased by 4% and amounted to USD 250,200 thousand as at 30 June 2010. The major part of exploration works that were implemented during the period were in the Krasnoyarsk region at the Poputnenskoye deposit, Panimbinskaya and Razdolinskaya ore fields, in the Republic of Sakha (Yakutia) at the Nezhdaninskoye deposit, in the Irkutsk region at the Zapadnoye deposit and in the Magadan region at the Degdekan deposit. In addition, during the first half of 2010, exploration works were carried out at Aksu, South Karaultube and Zholymbet in the Republic of Kazakhstan. The value of non-mining assets at 30 June 2010 remained approximately at the level of 31 December 2009.

##### *Goodwill*

As a result of acquisition of a controlling stake in KazakhGold Group, the Polyus Group recognized goodwill, which at the end of 2009 was estimated at USD 132,906 thousand. At 30 June 2010 the value of goodwill increased to USD 133,847 thousand as a result of the KZT/USD exchange rate movements.

##### *Non-current investments in securities and other financial assets*

Non-current investments in securities and other financial assets consist mostly of derivative financial asset. Following the acquisition of a 50.15% stake in KazakhGold Group, the Polyus Group obtained call options to acquire all rights and obligations under convertible loan agreements between KazakhGold and its previous major shareholder Gold Lion. Under the loan agreements the lender may convert the principal amounts of USD 31,025 thousand together with accrued interest into ordinary shares of KazakhGold at the price of USD 1.50 per share. The call options are carried at fair value. The fair value is determined by financial modeling, with reference to the market price of KazakhGold shares. As a result of the decline of KazakhGold share price in the reporting period at 30 June 2010 the fair value of call options for convertible loans amounted to USD 79,842 thousand. The decrease in fair value of the instrument in the amount of USD 30,069 thousand was recognized in the interim condensed consolidated income statement.

##### *Inventories*

In the first half of 2010 the Polyus Group recorded stocks of ore which is of different quality compared to the currently processed ore at the Krasnoyarsk business unit (5,145 thousand tonnes) and Irkutsk hard rock business unit (2,030 thousand tonnes) to long-term inventories, until the technical possibility to process this ore is obtained. This resulted in a multiple increase of the item in the statement of financial position. The closing balance at 30 June 2010 was USD 162,193 thousand, compared to USD 40,732 thousand at 31 December 2009.

##### *Deferred stripping costs*

Pursuant to the Polyus Group's accounting policy, in 2009 the Polyus Group began to expense previously capitalized deferred stripping costs, related to excessive stripping works implemented at the Krasnoyarsk business unit, in order to access the sulfide ore body after the depletion of the oxide ores of Olimpiada. In the first half of 2010 due to technical difficulties in processing of sulfide ore and the decrease in the recovery ratio at the Olimpiada mine, it was decided to enhance ore mining. The share of waste in the rock mined at Olimpiada was much lower year-on-year

and the stripping ratio significantly decreased. As a result of the expensing of deferred stripping costs in the first half of 2010 this item declined by 31% from USD 106,088 thousand at 31 December 2009 to USD 73,144 thousand at 30 June 2010.

### ***Current assets***

At 30 June 2010 the value of the Polyus Group's current assets remained approximately at the level of 31 December 2009. But the asset structure changed mostly due to reallocation of funds between cash and cash equivalents and investments in securities and other financial assets, and reclassification of stockpiles at the Olimpiada mine to non-current inventories.

#### *Cash and cash equivalents*

At 30 June 2010, the balance of cash and cash equivalents amounted to USD 300,884 thousand, which is USD 127,524 thousand more than at 31 December 2009. The source of the increase in cash balance was strong operating cash inflow during the period, as well as cash withdrawn from short-term investments.

#### *Inventories*

During the first half of 2010, some work-in-process at the Irkutsk hard rock and Krasnoyarsk business units was reclassified from short-term to long-term inventories. This was partly offset by an increase in gold-in-process at the Irkutsk alluvial, Yakutsk Kuranakh and Kazakhstan business units. As a result, metal inventories decreased by net USD 16,650 thousand.

A further USD 8,357 thousand decline in metal inventories was due to the decrease in finished goods. At 31 December 2009 stocks of unsold refined gold at the refinery in the Krasnoyarsk region were estimated at USD 14,609 thousand, while at 30 June 2010 the value of finished goods amounted to USD 6,252 thousand, which related to the Kazakhstan business unit.

Stores and materials (net of allowance for obsolescence), which form the largest part of current inventories, increased by 12% on the back of growing material requirements due to pre-commissioning operations at the Blagodatnoye mine, ramp-up of production at Titimukhta and modernisation and refurbishment works at the Kazakhstan business unit.

#### *Investments in securities and other financial assets*

At 30 June 2010, the short-term investments in securities and other financial assets totalled USD 162,446 thousand, compared to USD 312,733 thousand as at 31 December 2009, reflecting a 48% decrease. These were represented by available for sale equity investments, bank deposits and equity investments in listed companies held for trading.

Movements in short-term investments during the six months ended 30 June 2010 are presented in the table below:

<b>USD '000</b>	<b>As at 30 June 2010</b>	<b>As at 31 December 2009</b>	<b>Movements</b>
Available-for-sale investments	102,652	203,376	The Group's available-for-sale investments are mainly represented by shares of Rosfund. During the reporting period, the Polyus Group disposed of 56.5% of shares for USD 122,000 thousand of these investments with a gain of USD 16,897 thousand, which was reflected in the interim condensed consolidated income statement. In the reporting period, the fair value of these investments increased by USD 21,270 thousand. This increase, net of gain on disposal of available-for-sale investments, was recognized in equity through an increase in the investment revaluation reserve.
Equity investments in listed companies held for trading	32,236	39,199	Investments in listed companies held for trading are represented by financial assets carried at fair value through profit and loss. During the first half of 2010, the Polyus Group disposed of USD 5,251 thousand of these investments. By the end of the reporting period, the value of held for trading investments increased by USD 378 thousand, which was recognized as an investment income.
Bank deposits	26,223	70,158	In the reporting period, the Polyus Group withdrew cash from its bank accounts in the net total amount of USD 43,935 thousand. The released funds were partly reallocated to current bank accounts and partly used to

fund operating activities and capital expenditures.

Other	1,335	-
<b>Total investments in securities and other financial assets:</b>	<b>162,446</b>	<b>312,733</b>

### 3.1.2 Capital and liabilities

#### *Capital and reserves*

As at 30 June 2010, capital and reserves were USD 3,112,889 thousand compared to USD 3,140,971 thousand as at 31 December 2009. This resulted from an increase in translation reserve due to appreciation of RUB against USD, partly offset by growth in retained earnings and in the investment revaluation reserve.

During the reporting period, the Polyus Group' retained earnings increased by USD 62,106 thousand, reflecting a net profit attributable to the parent company of USD 116,379 thousand less dividends accrued in respect of the 2009 results in the amount of USD 54,273 thousand.

The investment revaluation reserve increased by USD 4,373 thousand in the first half of 2010 as a result of an increase in the fair value of available-for-sale investments, net of realized gain on disposal of available-for-sale investments.

Due to the RUB/USD and KZT/USD exchange rate movements, the translation reserve increased by USD 77,858 thousand and amounted to USD 168,265 thousand as at 30 June 2010.

Non-controlling interest decreased by USD 16,703 thousand to USD 48,168 thousand as at the end of the reporting period, reflecting total comprehensive loss for the period attributable to non-controlling interests in the amount of USD 14,269 thousand (relating mainly to non-controlling interests of KazakhGold Group) and dividends declared to shareholders of non-controlling interests by OJSC Lenzoloto, Irkutsk alluvial business unit, in the amount of USD 2,434 thousand.

#### *Non-current liabilities*

Long-term borrowings were assumed by the Polyus Group upon acquisition of KazakhGold Group and at the reporting date were represented by loans payable to Gold Lion, previously KazakhGold's major shareholder, which are due in November 2014.

In the first half of 2010 environmental obligations didn't change materially and at 30 June 2010 amounted to USD 92,534 thousand.

Deferred tax liabilities slightly decreased from USD 180,989 thousand at the beginning of the period to USD 172,742 thousand at the end of the period.

Other non-current liabilities at 30 June 2010 included employee benefit obligations of USD 13,222 thousand, obligations under finance lease and certain other liabilities attributable to the Kazakhstan business unit.

#### *Current liabilities*

Current liabilities increased from USD 336,481 thousand at 31 December 2009 to USD 439,221 thousand at 30 June 2010, which was primarily a result of dividend payable accruals, an increase in other taxes payable and an increase in trade payables.

Following the acquisition of a controlling stake in KazakhGold, the Polyus Group recorded KazakhGold's outstanding Senior Notes and bank loans obtained by KazakhGold's principal subsidiary, JSC "MMC KazakhAltyn", at fair value. In connection with the acquisition of KazakhGold, Polyus Gold became a guarantor of the Senior Notes. The Senior Notes are carried at amortized cost and classified as a current liability, as a result of KazakhGold Group's default under certain terms of the Senior Notes. These defaults were waived in a consent subscription that was completed on 27 July 2010. At 30 June 2010, the fair value of the liability under the Senior Notes amounted to USD 166,978 thousand. In addition, KazakhGold has secured and unsecured USD-denominated loans that are required to be repaid in the second half of 2010 totalling USD 4,631 thousand.

Trade payables increased from USD 24,332 thousand at 31 December 2009 to USD 42,651 thousand at 30 June 2010. This related mainly to the Krasnoyarsk business unit and was due to negotiation of after-delivery payments with suppliers.

At 21 May 2010 Polyus Gold declared dividends of RUB 9.28 per share in respect of the year 2009 results. Dividends in the amount of USD 56,280 thousand remained unpaid at 30 June 2010 and were repaid in July 2010.

In the reporting period, income tax payable decreased to USD 1,070 thousand. Other taxes payable increased substantially from USD 43,623 thousand at 31 December 2009 to USD 67,207 thousand at 30 June 2010. The increase

was partly attributable to VAT accruals by KazakhGold and increased mining tax accruals throughout the Polyus Group.

### 3.2 Cash flow analysis

The following table sets forth the main components of the Polyus Group's interim condensed consolidated statement of cash flows for the six months ended 30 June 2010 and 2009:

USD '000	Six months ended 30 June	
	2010	2009
<b>Operating activities</b>		
<b>Profit before income tax</b>	<b>141,247</b>	<b>191,297</b>
Adjustments <sup>(1)</sup>	147,393	36,551
<b>Operating profit before working capital changes</b>	<b>288,640</b>	<b>227,848</b>
Changes in working capital	(128,000)	(41,084)
<b>Cash flows from operations</b>	<b>160,640</b>	<b>186,764</b>
Interest paid	(9,911)	-
Income tax paid	(25,806)	(31,508)
<b>Net cash generated from operating activities</b>	<b>124,923</b>	<b>155,256</b>
<b>Investing activities</b>		
Capital expenditures, acquisition of subsidiaries and deferred stripping costs <sup>(2)</sup>	(148,988)	(116,314)
Other investing activities <sup>(3)</sup>	174,416	7,476
<b>Net cash generated from/(used in) investing activities</b>	<b>25,428</b>	<b>(108,838)</b>
<b>Net cash used in financing activities</b>	<b>(14,587)</b>	<b>-</b>
<b>Net increase in cash and cash equivalents</b>	<b>135,764</b>	<b>46,418</b>
<b>Cash and cash equivalents at beginning of the period</b>	<b>173,360</b>	<b>398,826</b>
Effect of translation to presentation currency	(8,240)	(3,877)
<b>Cash and cash equivalents at end of the period</b>	<b>300,884</b>	<b>441,367</b>

1. Adjustments for non-cash items include: amortisation and depreciation, finance costs, loss on disposal of property, plant and equipment, impairment of property, plant and equipment, expensed stripping costs, change in allowance for reimbursable value added tax, income/(loss) from investments, change in fair value of derivative, net foreign exchange gain and other items.

2. Capital expenditures, acquisition of subsidiaries and deferred stripping costs include purchases of property, plant and equipment, deferred stripping costs capitalised and proceeds from sale of property, plant and equipment.

3. Other investing activities include interest received, purchase of promissory notes and other financial assets, proceeds from sale of promissory notes and other financial assets.

In the first six months of 2010, the Polyus Group received profit before income tax in the amount of USD 141,247 thousand. Operating profit before working capital changes amounted to USD 288,640 thousand, which was 27% more than in the same period of the previous year. In the reporting period changes in working capital were impacted mainly by growth in metal inventories (Refer to paragraph 3.1.1 "Assets – Non-current assets - Inventories" and "Assets – Current assets - Inventories"). Net cash generated from operating activities in the period under review reduced by USD 30,333 thousand to USD 124,923 thousand.

The major investment cash outflows during the reporting period included capital expenditures and placement of bank deposits with original maturity of more than three months, presented as acquisition of financial assets. Capital expenditures and deferred stripping costs totalled USD 148,988 thousand, compared to USD 116,314 thousand in the same period of the previous year. In the first half of 2010 the Polyus Group deposited cash into current bank accounts with original maturity of more than three months, which resulted in a USD 37,876 thousand cash outflow. These cash outflows were strongly offset by proceeds from disposal of financial assets in the amount of USD 207,738 thousand as the Polyus Group closed a number of bank deposits, partly withdrew funds from its available-for-sale investments, and lesser amounts were withdrawn from held for trading investments. In addition, the Group received USD 4,554 thousand of interest. As a result, the Polyus Group received USD 25,428 thousand in investment activities in the first half of 2010, while in the first half of 2009 it used USD 108,838 thousand.

Cash outflow from financing activities in the six months ended 30 June 2010 totalled USD 14,587 thousand, which included payment of dividends to non-controlling shareholders by OJSC Lenzoloto (Irkutsk alluvial business unit) amounting to USD 2,395 thousand and repayment of borrowings and a bank guarantee by KazakhGold for the total amount of USD 12,192 thousand.

### 3.3 Capital expenditures and deferred stripping costs

Capital expenditures represent the Polyus Group's purchase of property, plant and equipment adjusted for the proceeds from the sale of property, plant and equipment. The Polyus Group also presents capitalised deferred stripping costs as a part of investing activities.

The following table shows the Polyus Group's capital expenditures, acquisition of subsidiaries and deferred stripping costs for the six months ended 30 June 2010 and 2009:

USD'000	Six months ended 30 June	
	2010	2009
+ Purchase of property, plant and equipment	148,261	117,373
– Proceeds from sale of property, plant and equipment	(657)	(1,059)
<b>Net capital expenditures</b>	<b>147,604</b>	<b>116,314</b>
<b>Deferred stripping costs</b>		
+ Deferred stripping costs capitalised	1,384	-
<b>Total capital expenditures and deferred stripping costs</b>	<b>148,988</b>	<b>116,314</b>

In the first six months of 2010, the Polyus Group cash outflow on purchase of property, plant and equipment and stripping costs capitalised amounted to USD 148,988 thousand, which was 28% more than in the first half of 2009.

In the reporting period the Polyus Group continued implementation of its extensive capital expenditure program. The major part of its investments was allocated to the construction of the Blagodatnoye and Verninskoye mines, modernisation of production facilities at Olimpiada and upgrading of KazakhGold's operating assets. Total net cash outflow on the purchase of property, plant and equipment amounted to USD 147,604 thousand.

In the first half of 2010, the Polyus Group capitalised stripping costs in the amount of USD 1,384 thousand.