EVRAZ

Chief executive officer's letter

Dear shareholder,

Last year was one of considerable volatility, beginning with steel and raw material prices falling to multi-year lows and ending with a four-fold increase in coking coal prices and an 80% increase in steel prices compared with the beginning of the year.

Many of the market movements were driven by Chinese government measures, such as investment stimulus, limitations on coal production and ongoing steelmaking capacity optimisation.

While the market did not anticipate these developments, we tend to see China's efforts as positive for the global metals and mining industry. Ultimately, they should lead to more effective capacity utilisation and healthier margins worldwide. The results of 2016 support this view: on average, the dynamics of steel, coal and iron ore prices improved year-on-year.

Given the volatile nature of the industry, we believe that our efforts should remain focused on our long-term vision and be less dependent on short-term market fluctuations. EVRAZ creates value by serving infrastructure clients, mainly in the CIS and North America, and delivering coking coal to customers in Russia, Ukraine and Asia. As such, each year, the Group strives to reinforce its leading positions in these markets through higher quality, better service and greater efficiency.

In this light, in 2016, EVRAZ' strategy remained the same: to focus on business sustainability, develop the product portfolio, retain a low-cost position, make prudent CAPEX investments and reduce debt.

EVRAZ considers safety to be the number-one priority. In 2016, we continued to improve injury reporting transparency and implement standard safe work procedures across our operations.

EVRAZ also continued to focus on developing its steel product portfolio and premium coking coal sales at home and abroad, which had a total financial effect of US$169 million. Our cost position regarding steel and coking coal products remains one of the lowest in the world; in 2016, our cost-cutting programme brought an overall effect of US$316 million.

In addition, by maintaining a strategic approach to implementing investment projects and prudent financial discipline, we maintained CAPEX at US$428 million in 2016, the same level as a year before. We reduced net debt by US$547 million, from US$5,349 million on 31 December 2015 to US$4,802 million on 31 December 2016.

Overall, thanks to numerous improvement initiatives based on our long-term vision and more favourable market conditions, we delivered fairly strong financial results. EBITDA reached US$1,542 million, up 7.2% from US$1,438 million in 2015, driving the EBITDA margin from 16.4% to 20.0%, while free cash flow totalled US$659 million.

Steel segment

EVRAZ remains the largest producer of long steel products in Russia, with its market share in 2016 ranging from 14% for rebar to 72% for rails.

In 2016, Russian Railways, one major domestic customer, substantially increased its rail purchases due to its rail track maintenance cycle, a modernisation drive and underinvestment over the last couple of years. We continue to develop a joint technical partnership and customer focus initiatives with this important client.

As a market leader in construction steel, the Group supplied products for a number of infrastructure initiatives in Russia, including football stadiums for the 2018 World Cup, the Yamal-SPG natural gas project, the Zvezda shipyard in the Far East and the Zaryadye landscape park in Moscow.

EVRAZ exported 75 thousand tonnes of rails from its Russian mills in 2016, up 2.8 times from 27 thousand tonnes in 2015. In the reporting year, the Group also certified its rails for use in Europe, India and the Middle East and wheels for Europe, Latin America and Kazakhstan. Through a continuous focus on developing new products, EVRAZ became the first Russian company to master the production of 100-metre rails in accordance with European standards.

To maintain the competitiveness of our assets, in 2016, EVRAZ further decreased its semi-finished steel cash costs by 4.7% to US$185 per tonne through production yield improvements, labour optimisation and energy efficiency initiatives.

In addition, the Group launched a new project to build blast furnace 7 at EVRAZ NTMK. This will allow EVRAZ to shut down blast furnace 6 instead of performing category-1 repairs and maintain stable pig iron output.

Crude steel production volumes at the Group's mills in Russia and Ukraine remained primarily unchanged in 2016, totalling 12.2 million tonnes. Output of railway products increased to 1,166 thousand tonnes, up 16.5% year-on-year, as a result of operational improvements at EVRAZ ZSMK rolling mill and more favourable demand. The Group also resumed rolling operations at Palini e Bertoli due to good plate market fundamentals in Europe. For the year, the Steel segment's EBITDA amounted to US$1,004 million, down 7.1% from US$1,081 million in 2015.

Coal segment

In 2016, EVRAZ secured its leading position in the domestic coal market, with market shares for high-volatile hard and semi-hard coking coal grades of 33% and 51% respectively, and enhanced its presence in premium coal export markets. The Group's coal sales to Ukraine increased by 42% to 2.0 million tonnes, while sales to premium Asian markets totalled 2.6 million tonnes. Moreover, a customer-focused initiative to switch to formula-based contracts with domestic clients enabled EVRAZ to benefit from the surge in global coking prices during the year.

In 2016, investment activity focused primarily on maintaining current production volumes and ramping up the Mezhegey project. EVRAZ' coking coal cash cost position remained mostly unchanged as a result of productivity improvements and labour optimisation.

In addition, by effectively optimising mining process, the Group boosted raw coking coal production to 22.3 million tonnes, up 6.6% year-on-year. Driven by a surge in coking coal prices towards the year-end, and the implementation of customer-focused and cost-cutting initiatives, the Coal segment's EBITDA increased by 83.5% to US$644 million.

Steel, North America segment

Despite unfavourable demand dynamics in key product segments in North America, EVRAZ secured its position as the largest producer of large-diameter pipes (LDP) and rails, with respective domestic market shares of 27% and 28%. In 2016, the Group continued to focus on developing its product portfolio in key segments. EVRAZ completed major construction works for investment projects at the new LDP mill and a steelmaking upgrade in Regina, Canada, as well as created a tube coating joint venture. At present, the Group is qualifying new LDP grades and wall thicknesses with key customers. In addition to that, the research and development team launched three new tubular premium and semi-premium connections for OCTG products.

In 2016, the segment's crude steel output decreased by 23.7% to 1.4 million tonnes, while LDP production fell to 296 thousand tonnes amid demand issues relating to delays in approval for key pipelines. However, late in the year, the Canadian government approved the Kinder Morgan Trans Mountain Expansion Project and the Enbridge Line 3 Replacement Program, which will support demand for EVRAZ products in 2017. Low activity in the oil and coal industries led to the decline of railway shipments and consequently Class-I railways CAPEX. As a result, rail demand in North America was weaker than in 2015 and output of the segment's railway products decreased to 328 thousand tonnes. The segment's EBITDA totalled US$28 million.

Management

In 2016, Pavel Tatyanin, the CFO of EVRAZ, submitted his resignation to pursue other interests. I would like to thank Pavel for his leadership and valued contribution to EVRAZ over the last 15 years.

Replacing Pavel is Nikolay Ivanov, who joined the management team in November. I would like to welcome him and believe that his broad experience will help EVRAZ to successfully implement its financial strategy and take the support processes to the next level.

Outlook for 2017

As we progress into 2017, while market sentiment is positive, the outlook should remain cautious. Key risks include the pace of steel capacity optimisation in China and the general health of the country's economy.

In any market development scenario, EVRAZ will continue to act in accordance with the strategic priorities that will support its position as a leader in infrastructure steel products globally and in the Russian coking coal market.

Alexander Frolov
Chief Executive Officer