Financial review

> In 2016, we delivered healthy financial results, driven by efficiency initiatives and improved market conditions. EBITDA reached US$1,542 million, up 7.2% from US$1,438 million in 2015, boosting the EBITDA margin from 16.4% to 20.0%, while free cash flow totalled US$659 million.
>
> **Nikolay Ivanov**
> Chief Financial Officer

Statement of operations

The Group's consolidated revenues decreased by 12.0% to US$7,713 million compared to US$8,767 million in 2015 primarily as a result of falling prices and decreased demand in Q1 2016, starting from Q2 2016 the situation on EVRAZ' main markets started to improve.

In 2016, the Steel segment's revenues (including inter-segment) decreased by 8.2% year-on-year to US$5,497 million or 63.6% of the Group's total before elimination. The reduction was mainly attributable to lower revenues from sales of steel products, which fell by 8.6% year-on-year, primarily due to a drop in prices (down 4.9%) in line with global benchmarks. Revenues from sales of steel products were also impacted by changes in the Group's sales volumes (down 3.7%), which decreased from 12.8 million tonnes in 2015 to 12.3 million tonnes in 2016 on the back of worsening conditions on key markets, lower output at EVRAZ ZSMK due to planned capital repairs of blast furnaces, and the deconsolidation of Evraz Highveld Steel and Vanadium in April 2015.

Revenues, US$ million

Segment	2016	2015	Change	Change, %
Steel	5,497	5,987	(490)	(8.2)
Steel, North America	1,464	2,270	(806)	(35.5)
Coal	1,322	1,068	254	23.8
Other operations	363	433	(70)	(16.2)
Eliminations	(933)	(991)	58	(5.9)
Total	**7,713**	**8,767**	**(1,054)**	**(12.0)**

The Steel, North America segment's revenues fell by 35.5% year-on-year. The segment's revenues from sales of steel products dropped by 35.9%, driven by lower sales volumes (down 24.8%) and prices (down 11.1%). The key drivers of these, in turn, were significant reductions in Evraz North America's oil country tubular goods (OCTG) sales, resulting from a market slump amid low oil prices, weak tubular and rail markets in North America, and delays in pipeline projects.

The Coal segment's revenues rose by 23.8% year-on-year, supported by higher sales prices (up 21.4%) and volumes (up 2.4%). The increase in volumes was the result of the completion of longwall moves, as well as more favourable geological conditions at the Erunakovskaya-8 mine, improved productivity at the Uskovskaya and Osinnikovskaya mines, and the launch of room-and-pillar mining operations at Mezhegeyugol.

In 2016, the Steel segment's EBITDA fell amid negative steel price trends and a reduction in sales volumes. This was partly offset by lower expenses in US dollar terms due to rouble depreciation, as well as the effects of cost-cutting initiatives implemented in 2016 as part of the ongoing productivity improvement programme.

Higher prices for coking coal and scrap in local currencies also contributed to the decrease in the Steel segment's EBITDA, which was partially countered by lower prices for iron ore and ferroalloys on the Russian market.

The Steel, North America segment's EBITDA was impacted by lower sales volumes and prices, stemming from a downturn in the OCTG and rail markets.

The Coal segment's EBITDA increased year-on-year on the back of higher sales prices and volumes, accompanied by the effects of cost-cutting initiatives and rouble depreciation, which was favourable for costs.

Eliminations mostly reflect unrealised profits or losses that relate to the inventories produced by the Steel segment on the Steel, North America segment's balance sheet, and coal inventories produced by the Coal segment on the Steel segment's balance sheet.

The following table details the effect of the Group's cost-cutting initiatives.

Revenues by region, US$ million

Region	2016	2015	Change	Change, %
Russia	3,080	3,104	(24)	(0.8)
Americas	1,722	2,566	(844)	(32.9)
Asia	1,372	1,354	18	1.3
CIS (excl. Russia)	630	664	(34)	(5.1)
Europe	640	815	(175)	(21.5)
Africa and rest of the world	269	264	5	1.9
Total	**7,713**	**8,767**	**(1,054)**	**(12.0)**

EBITDA, US$ million

Segment	2016	2015	Change	Change, %
Steel	1,004	1,081	(77)	(7.1)
Steel, North America	28	55	(27)	(49.1)
Coal	644	351	293	83.5
Other operations	17	14	3	21.4
Unallocated	(109)	(130)	21	(16.2)
Eliminations	(42)	67	(109)	n/a
Total	**1,542**	**1,438**	**104**	**7.2**

Effect of Group's cost-cutting initiatives in 2016, US$ million

Effect	2016
Cost-cutting initiatives and productivity improvements, including	**184**
Broad optimisation program (incl. services, yields, auxiliary materials' structure) across North American and Ukrainian assets	50
Increased productivity and cost reduction at iron ore assets	28
Yields, raw materials' structure and services optimisation at Russian steel assets	44
Productivity improvement and cost reduction at coal assets	56
Vanadium operations improvement	6
Optimisation of asset portfolio	**13**
Reduction of general and administrative (G&A) costs and non-G&A headcount	**119**
Total	**316**

Revenues, cost of revenue and gross profit by segment, US$ million

	2016	2015	Change, %
Steel segment			
Revenues	5,497	5,987	(8.2)
Cost of revenue	(4,068)	(4,431)	(8.2)
Gross profit	1,429	1,556	(8.2)
Steel, North America segment			
Revenues	1,464	2,270	(35.5)
Cost of revenue	(1,243)	(1,977)	(37.1)
Gross profit	221	293	(24.6)
Coal segment			
Revenues	1,322	1,068	23.8
Cost of revenue	(701)	(758)	(7.5)
Gross profit	621	310	100.3
Other operations – gross profit	85	111	(23.4)
Unallocated – gross profit	(7)	(6)	16.7
Eliminations – gross profit	(157)	(80)	96.3
Total	**2,192**	**2,184**	**0.4**

Gross profit, expenses and results, US$ million

Item	2016	2015	Change	Change, %
Gross profit	**2,192**	**2,184**	**8**	**0.4**
Selling and distribution costs	(623)	(728)	105	(14.4)
General and administrative expenses	(469)	(553)	84	(15.2)
Impairment of assets	(465)	(441)	(24)	5.4
Foreign-exchange gains/(losses), net	(48)	(367)	319	(86.9)
Other operating income and expenses, net	(124)	(119)	(5)	4.2
Profit/(Loss) from operations	**463**	**(24)**	**487**	**n/a**
Interest expense, net	(471)	(466)	(5)	1.1
Gain/(loss) on financial assets and liabilities, net	(9)	(48)	39	81.3
Gain on disposals classified as held for sale, net	–	21	(21)	n/a
Loss of control over a subsidiary	–	(167)	167	n/a
Other non-operating gains/(losses), net	(75)	(23)	(52)	n/a
Loss before tax	**(92)**	**(707)**	**615**	**(87.0)**
Income tax benefit/(expense)	(96)	(12)	(84)	n/a
Net loss	**(188)**	**(719)**	**531**	**(73.9)**

Selling and distribution expenses decreased by 14.4% in 2016 due to rouble weakening and lower sales volumes to third parties.

General and administrative expenses fell by 15.2% in 2016. This was caused by lower staff costs, mainly due to headcount optimisations at Evraz North America and the Russian steel and coal plants, as well as to rouble and hryvnia weakening.

Impairment losses during the reporting period mainly include the write-off of goodwill and of certain functionally obsolete items of property, plant and equipment at subsidiaries in the US and Canada totalling US$430 million. The major drivers that led to impairment were the changes in expectations of long-term prices for iron ore and steel products, the increase in forecast costs and changes in forecast production volumes.

Foreign exchange losses arose as a result of the depreciation of the Russian rouble, Ukrainian hryvnia, Kazakh tenge and Canadian dollar. The subsidiaries in these countries have US dollar-denominated debts, such as bonds and bank loans. In addition, there are some intra-group debts between subsidiaries with different functional currencies and, consequently, gains/(losses) of one subsidiary recognised in the statement of operations are not offset by the exchange differences of another subsidiary with a different functional currency.

Interest expenses incurred by the Group increased despite achieved debt reduction mainly due to growth of US dollar base rates that affects debt bearing variable interest rate and the larger portion of rouble-denominated debt, that bears higher nominal rates than debt denominated in US dollars. The interest expense for bank loans, bonds and notes amounted to US$439 million in 2016 and US$430 million in 2015.

Losses on financial assets and liabilities amounted to US$9 million and included, among other things, US$273 million of unrealised gains and US$250 million of realised losses on changes in the fair value of derivatives not designated as hedging instruments, accompanied by a realised gain amounting to US$14 million related to the interest portion of the change in fair value of the swaps-hedging instruments for rouble-denominated bonds. This effect was offset by a US$50 million loss on repaying debt, which is primarily a premium on repurchasing US dollar-denominated bonds.

In the reporting period, the Group had an income tax expense of US$96 million, compared with US$12 million in 2015. The change reflects the Group's better operating results.

Cash flow, US$ million

Item	2016	2015	Change	Change, %
Cash flows from operating activities before change in working capital	1,343	1,293	50	3.9
Changes in working capital	160	329	(169)	(51.4)
Net cash flows from operating activities	**1,503**	**1,622**	**(119)**	**(7.3)**
Short-term deposits at banks, including interest	4	4	–	–
Purchases of property, plant and equipment and intangible assets	(382)	(423)	41	9.7
Proceeds from sale of disposal classified as held for sale, net of transaction costs	27	44	(17)	(38.6)
Other investing activities	11	16	(5)	(31.3)
Net cash flows from / (used in) investing activities	**(340)**	**(359)**	**19**	**(5.3)**
Net cash flows from financing activities	**(1,369)**	**(962)**	**(407)**	**42.3**
Effect of foreign exchange rate changes on cash and cash equivalents	(10)	(12)	2	(16.7)
Net increase/(decrease) in cash and cash equivalents	**(216)**	**289**	**(505)**	**n/a**

Net cash flows from operating activities decreased by 7.3% compared with 2015 and US$160 million was attributed to the release in net working capital. Free cash flow for the period was US$659 million.

Calculation of free cash flow, US$ million

Item	2016	2015	Change	Change, %
EBITDA	1,542	1,438	104	7.2
EBITDA excluding non-cash items	**1,549**	**1,420**	**129**	**9.1**
Changes in working capital	160	329	(169)	(51.4)
Income tax accrued	(183)	(99)	(84)	84.9
Social and social infrastructure maintenance expenses	(23)	(28)	5	(17.9)
Net cash flows from operating activities	**1,503**	**1,622**	**(119)**	**(7.4)**
Interest and similar payments	(454)	(452)	(2)	0.4
Capital expenditures, including recorded in financing activities	(428)	(428)	–	–
Proceeds from sale of disposal groups classified as held for sale, net of transaction costs	27	44	(17)	(38.6)
Other cash flows from investing activities	11	16	(5)	(31.3)
Equity transactions	–	(3)	3	(100.0)
Free cash flow	**659**	**799**	**(140)**	**(17.5)**

For the definition of free cash flow, please refer to page 260

CAPEX and key projects

In 2016, EVRAZ maintained a low level of capital expenditures of US$428 million. Two projects at EVRAZ Regina in Canada made good progress with the launch scheduled in Q1 2017. The Mezhegey coal mine project launched in Q2 2016 and is now ramping up production volumes. EVRAZ NTMK continued implementing its grinding ball mill construction project (in 2016 the engineering work was finished) and also started implementing the blast furnace 7 project (first iron is scheduled at the end of 2017).

Capital expenditures (including those recognised in financing activities) for 2016 in millions of US dollars can be summarised as follows.

Capital expenditures in 2016, US$ million

Steel mill upgrade Upgrade of EVRAZ Regina steel mill. In progress since Q2 2015. The aim is to improve steel quality, increase capacity for casting by 110 kt and rolling by 250 kt, and result in a crown yield saving from 0.75% to 1.1%.	82
Construction of an LDP mill Construction of a new mill at EVRAZ Regina has been in progress since Q2 2015 and is due to be completed in Q1 2017. Expected to add 150 kt of tubular product capacity.	24
Blast furnace 7 Construction of blast furnace 7 at EVRAZ NTMK has been in progress since Q3 2016. It is an alternative to the halt of blast furnace 6 for category-1 repairs.	10
Iron ore capacity expansion The Sheregesh mine's output is due to reach 4.8 mtpa of raw ore.	5
Coal deposit development Mezhegey (phase 1) was launched in Q2 2016. Capacity of 1.5 mtpa.	4
Grinding ball mill construction Construction of a new grinding ball mill at EVRAZ NTMK has been in progress since Q2 2015 and is due to be completed in Q3 2018. Expected to increase ball production to 300 kt by 2018.	2
Other development projects	37
Maintenance	**264**
Total	**428**

DEBT reduction

Financing and liquidity

At the beginning of 2016, total debt was US$6,724 million. The Group continued to focus its efforts on reducing debt and extending the maturity profile.

In March, EvrazHolding-Finance LLC issued RUB15 billion (around US$221 million at the exchange rate on the transaction date) in five-year exchange-traded bonds due in 2021 with a 12.60% coupon payable semi-annually.

In April, EVRAZ entered into a multi-currency facility agreement with VTB Bank governing the general terms and conditions of loans of up to seven years with a total borrowing limit of US$300 million equivalent. During 2016, two tranches amounting to US$150 million and US$99 million were utilised under the facility in the form of loans repayable in 12 equal quarterly instalments starting April and September 2020, respectively.

In June, Evraz Group S.A. issued a US$500 million Eurobond due in 2022 with a 6.75% coupon payable semi-annually.

In October, EVRAZ utilised an additional US$85 million under its Framework agreement with Alfa-Bank repayable in 10 equal quarterly instalments starting in October 2020.

Proceeds from these new borrowings from banks and capital markets were used to refinance EVRAZ' existing maturities, primarily those coming due in 2017 and 2018, thus not increasing overall debt and extending the repayment schedule.

During 2016, in order to reduce total debt and interest expense, as well as to extend the maturity profile, EVRAZ prepaid several bank facilities, namely US$120 million of its US$500 million syndicated pre-export financing facility, US$81 million of the total principal of its US$125 million facility with Unicredit, US$87 million of its US$100 million facility with Nordea Bank, and the loan from Development Bank of Kazakhstan with a principal amount of US$90 million together with capitalised interest of US$23 million.

In April, EVRAZ prepaid €60 million of the outstanding principal under its credit facility with Gazprombank, and later in August 2016, the Group signed new loans with Gazprombank with amounts of approximately RUB18 billion and €180 million. During the following several months after signing, EVRAZ refinanced its existing credit facility with this bank: upon completion of the refinancing process, the maturity of this facility split into tranches of 30% and 70% of the principal was moved to 2021 and 2022, respectively.

During 2016, EVRAZ partly repurchased during two tender offers (in April and June), as well as from the open market, US$496 million of the outstanding principal of its 2018 Eurobonds, US$160 million of Raspadskaya's Eurobonds, and US$109 million of its 2017 Eurobonds. The remaining US$177 million principal of its 2017 Eurobonds was called in full and settled in August.

As a result of these actions, as well as scheduled drawings and repayments of bank loans, total debt fell by US$763 million to US$5,961 million as at 31 December 2016, while net debt dropped by US$547 million to US$4,802 million, compared with US$5,349 million as at 31 December 2015.

Due to the larger portion of rouble-denominated debt and growth of US dollar base rates during 2016, interest expenses accrued in respect of loans, bonds and notes were US$439 million in 2016, compared with US$430 million in 2015.

Net debt to EBITDA stood at 3.1 times, compared with 3.7 times as at 31 December 2015.

As at 31 December 2016, debt with financial maintenance covenants comprised a syndicated pre-export financing facility and various bilateral facilities with a total outstanding principal of around US$1,829 million. The maintenance covenants under these facilities include the two key ratios calculated on the basis of EVRAZ plc's consolidated financials: a maximum net leverage and a minimum EBITDA interest cover. In H1 2016, EVRAZ signed amendments to these facilities, whereby the testing of financial ratios was suspended for three semi-annual testing periods starting 30 June 2016, subject to compliance with certain additional restrictions on indebtedness and dividends. As a result, currently only one of the outstanding facilities has the minimum EBITDA interest cover ratio tested against a comfortable level of 1.5x.

As at 31 December 2016, EVRAZ was in full compliance with its financial covenants. Cash amounted to US$1,157 million and short-term loans and the current portion of long-term loans stood at US$392 million. Cash-on-hand and committed credit facilities are sufficient to cover all of EVRAZ' debt principal maturing in 2017 and 2018.

Key recent developments

In January 2017, EVRAZ made a partial prepayment of its US$500 million syndicated pre-export financing facility, settling another US$110 million of principal. The remaining outstanding under this facility is US$270 million.