Management Discussion and Analysis

of the financial position and results of operations

for the year ended 31 December 2017

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Forward-looking statement

The following review of our financial position and results of operations is based on, and should be read in conjunction with, our consolidated financial statements and related notes for the year ended 31 December 2017.

Certain information, including our forecasts and strategy, contains forward-looking statements and is subject to risks and uncertainties, domestically and internationally. In assessing these forward-looking statements, readers should consider various risk factors as the company's actual results may differ materially from the expected results discussed in this report.

Rounding

Certain monetary amounts, percentages and other figures included in this report are subject to rounding adjustments. On occasion, therefore, amounts shown in tables may not be the arithmetic accumulation of the figures that precede them, and figures expressed as percentages in the text and in tables may not total 100 percent. Changes for periods between monetary amounts are calculated based on the amounts in thousands of U.S. dollars stated in our consolidated financial statements, and then rounded to the nearest million or percent.

Executive overview

We are one of the world's leading producers of steel pipes for the oil and gas industry, a global company with extensive network of production facilities, sales companies and representative offices.

The principal activities of our company are the production and distribution of seamless and welded pipes, including pipes with the entire range of premium connections backed by extensive technical support.

Our plants produce almost the entire range of existing pipes used in the oil-and-gas sector, the chemical and petrochemical industries, energy and machine-building, construction and municipal housing, shipbuilding, aviation and aerospace, and agriculture.

We created an up-to date technological complex based on advanced scientific research, manufacturing high-quality competitive products.

Our operations are geographically diversified with manufacturing facilities in Russia, the United States, Canada, Romania, Kazakhstan and the Sultanate of Oman. We operate R&D centers in Russia and the U.S. Our global market presence is supported by a wide distribution network. In 2017, we delivered 64% of our tubular products to our customers located in Russia and 21% in North America. We estimate our share on global market of seamless OCTG at around 15%.

We are the largest exporter of pipes in Russia. Exports of pipes produced by our Russian plants accounted for 13% of our total sales in 2017.

In 2017, we sold 3,781 thousand tonnes of steel pipes. Seamless pipes comprised 71% of our sales volumes. Sales of seamless and welded OCTG reached 1,755 thousand tonnes, a 23% year-on-year increase, sales of LDP fell by 48% year-on-year to 267 thousand tonnes.

In 2017, our total consolidated revenue increased by 32% to $4,394 million as compared to 2016. Adjusted EBITDA[1] grew to $605 million as compared to $530 million in the previous year. Adjusted EBITDA margin decreased to 14% compared to 16% in 2016.

Market conditions for 2017

The Russian pipe market grew by 1% year-on-year driven by high demand for OCTG and industrial pipe. The market growth was partially offset by weak LDP demand in 1H2017, while in 2H 2017 LDP demand improved. OCTG consumption grew by 13% compared to 2016, supported by higher demand and growing drilling activity in Russia, which increased by 12% year-on-year, with the share of horizontal drilling being up to 41% in 2017 from 35% in 2016.

In the US, the average number of rigs in 2017 grew by 73% compared to 2016 (Baker Hughes), following the recovery in oil prices. OCTG consumption increased 86% year-on-year (Preston Pipe Report). Average composite OCTG seamless and welded pipe prices increased by 22% and 30% respectively compared to 2016 (Pipe Logix).

In 2017, the European market saw a substantial increase in pipe demand from both US and domestic customers, which supported high production capacity utilization, encouraged new investments in the sector and drove selling prices up.

Key events

In February, we placed 138,888,888 of existing ordinary shares of PAO TMK in a secondary public offering.

[1] Adjusted EBITDA - See "Selected financial data".

In April, we shipped the first batch of casing pipe with TMK UP MAGNA premium threaded connections and GreenWell lubricant-free coating to LUKOIL. The pipes were successfully sunk at the Y. Kuvykin field in the Caspian Sea with TMK supervisors' involvement. The shipment was a part of the comprehensive program to supply the entire casing, made of TMK's premium casing pipe with GreenWell lubricant-free coating.

In April and June, we placed a 5 billion rouble 10-year bond with 9.75% coupon rate payable on a semi-annual basis and a 10 billion rouble 10-year bond with 9.35% coupon rate payable on a semi-annual basis.

In June, we entered into a long-term contracts with Rosneft for the supply of casing and tubing pipes. The formula pricing based contracts term is over 5 years. Supplies to Rosneft under this contracts started in 2H 2017. During the contract term the share of TMK products will be over 50% of Rosneft's total casing and tubing pipe purchases.

On June 8, 2017, the general shareholders' meeting approved dividends for 2016 in the amount of 2,025 billion Roubles ($36 million at the exchange rate at the date of approval) or 1.96 Roubles per share ($0.03 per share). The total dividends in respect of 2016, including interim, amounted to 4,03 billion Roubles ($67 million).

In June, we started the production of casing pipe made from the corrosion-resistant chromium-nickel alloy TMK-C. We developed TMK-C alloy to manufacture pipes used in well construction at oil and gas fields with particularly high hydrogen sulfide (H2S) and carbon dioxide (CO2) content and partial pressure. Previously, pipe from this type of alloy had only been produced abroad. The first batch of 110 grade TMK-C pipe with TMK UP PF highly gas-tight premium threaded connections was produced at TAGMET and shipped to LUKOIL.

In August, we started the production of casing pipe with unique TMK UP CENTUM threaded connection with 100% tension and compression efficiency. Currently we are the only manufacturer of pipes with such connections. The first batch of the new product was shipped to NOVATEK's Arctic LNG 2 project. The pipes were successfully sunk at the Salmanovskoye (Utrenneye) oil and gas condensate field with the involvement of TMK supervisors.

In October, we entered into a long-term strategic cooperation agreement with Gazprom burenie. We became key supplier of drill pipes used by Gazprom burenie for drilling across Russia, including fields in Siberia, Far East and Yamal. The formula pricing based agreement term is until 2022.

In October, we won a tender to supply 18.4 thousand tonnes of casing pipes with TMK UP PF, TMK UP PF ET, TMK UP FMC, TMK UP GF, and TMK UP Centum premium threaded connections, including pipes made from the unique corrosion-resistant chromium-nickel alloy TMK-C and pipes with GreenWell lubricant-free coating to LUKOIL subsidiaries.

In November, we commenced production of casing pipes with the unique TMK UP ULTRA GX premium threaded connection, which allows to significantly increase the casing string safety in building directional wells. The first batch of the new product was shipped to Rosneft subsidiary Samaraneftegas.

In January 2018, we redeemed the loan participation notes in the total nominal value of $231 million. The $500 million eurobonds with a coupon rate of 7.75% and a 7-year maturity were issued by TMK Capital SA on January 27, 2011. Part of the issue in the amount of $269 million was repurchased earlier under tender offers and cancelled.

Business structure

Our operating segments reflect TMK's management structure and the way financial information is regularly reviewed. For management purposes, TMK is organised into business divisions based on geographical location and has three reporting segments:

- *Russian division*: manufacturing facilities located in the Russian Federation, Kazakhstan and the Sultanate of Oman, and oilfield service companies and trading companies in Russia, Kazakhstan, Switzerland and the United Arab Emirates. The Russian division is engaged in the production and supply of seamless and welded pipe, premium products and the provision of related services to oil and gas companies;
- *American division*: manufacturing facilities and trading companies located in the United States and Canada. The American division is engaged in the production and supply of seamless and welded pipe, premium products and the provision of related services to oil and gas companies;
- *European division*: manufacturing facilities located in Romania and trading companies located in Italy and Germany. The European division is engaged in the production and supply of seamless pipe and steel billets.

Year ended 31 December 2017 results

Results of operations

In 2017, our sales volumes and key financial indicators increased year-on-year, generally reflecting improved results of the American division.

	2017	2016	Change
	in million dollars		*in million dollars*
Sales volume ***(in thousand tonnes)***	**3,781**	3,458	323
Revenue	**4,394**	3,338	1 056
Cost of sales	**(3,521)**	(2,634)	(887)
GROSS PROFIT	**872**	704	169
GROSS PROFIT MARGIN	**20%**	*21%*	
Net operating expenses [1]	**(544)**	(437)	(107)
Impairment of assets	**(7)**	(3)	(4)
Foreign exchange gain/(loss), net	**28**	130	(102)
Gain/(loss) on changes in fair value of derivative financial instrument	**(3)**	9	(13)
Finance costs, net	**(268)**	(263)	(6)
Other non-operating income/(expenses)	**1**	29	(29)
PROFIT/(LOSS) BEFORE TAX	**78**	169	(92)
Income tax benefit/(expense)	**(48)**	(4)	(44)
NET PROFIT/(LOSS)	**30**	166	(136)
NET INCOME MARGIN	**1%**	*5%*	
ADJUSTED EBITDA	**605**	530	75
ADJUSTED EBITDA MARGIN	***14%***	*16%*	

[1] Net operating expenses include selling and distribution, general and administrative, advertising and promotion, research and development, share of profit in associate, gain on disposal of subsidiary and net other operating income/(expense).

Sales

In 2017, our consolidated revenue increased by $1,056 million or 32%. A positive currency translation effect[1] was $389 million. Excluding this effect our revenue increased by $666 million year-on-year.

Sales by reporting segments are as follows:

	2017	2016	Change	Change
	in thousand tonnes		*in thousand tonnes*	*in %*
Russia	**2,925**	3,001	(76)	(3)%
America	**671**	282	389	138%
Europe	**186**	175	10	6%
TOTAL PIPE	**3,781**	3,458	323	9%

	in million dollars		*in millions dollars*	*in %*
Russia	**3,157**	2,796	362	13%
America	**994**	368	627	170%
Europe	**242**	174	67	39%
TOTAL REVENUE	**4,394**	3,338	1,056	32%

[1] The currency translation effect on income/expense items illustrates the influence of different exchange rates we use to convert these items from functional currencies into the presentation currency, the U.S. dollar, in different reporting periods for financial reporting purposes.

Sales by group of products are as follows:

	2017	2016	Change	Change
	in thousand tonnes		*in thousand tonnes*	*in %*
Seamless pipe	**2,668**	2,412	256	11%
Welded pipe	**1,113**	1,046	67	6%
TOTAL PIPE	**3,781**	3,458	323	9%

	in million dollars		*in millions dollars*	*in %*
Seamless pipe	**3,074**	2,340	735	31%
Welded pipe	**1,086**	833	253	30%
TOTAL PIPE	**4,161**	3,173	988	31%
Other operations	**233**	165	68	41%
TOTAL REVENUE	**4,394**	3,338	1,056	32%

Russia. The division's revenue increased by $362 million or 13% year-on-year as a result of a positive currency translation effect in the amount of $389 million. Excluding this effect revenue decreased by $27 million.

Revenue from sales of *seamless* pipe increased by $92 million mainly due to higher sales volumes of *industrial* and *OCTG*.

Revenue from sales of *welded* pipe decreased by $134 million as a result of significant drop in sales volumes primarily due to lower *LDP* demand.

Revenue from other operations increased by $15 million mainly as a result of higher *billets* sales.

America. In the American division revenue increased by $627 million or 170% year-on-year.

Significant growth in drilling activity combined with increased E&P spending in the North American market resulted in a considerable growth in sales volumes, primarily *OCTG*, and better pricing. Following an improved market environment, revenue from sales of both *seamless* and *welded* pipe increased by $321 million and $301 million respectively.

Revenue from other operations increased by $4 million.

Europe. In the European division revenue increased by $67 million or 39% year-on-year.

Revenue from sales of *seamless* pipe increased by $40 million as compared to the last year as a result of better pricing environment and higher sales volumes.

Revenue from other operations, mostly from *billets* sales, increased by $28 million as compared to previous year following higher sales volumes.

Gross profit

In 2017, our consolidated gross profit increased by $169 million or 24% year-on-year and amounted to $872 million. The favorable currency translation effect was $76 million. Excluding this effect our gross profit increased by $92 million. Gross profit margin was 20% compared to 21% in 2016.

Gross profit results by reporting segments are as follows:

	2017		**2016**		**Change**
	in million dollars	***in % to revenue***	***in million dollars***	***in % to revenue***	***in million dollars***
Russia	**655**	21%	746	27%	(91)
America	**169**	17%	(81)	(22)%	250
Europe	**48**	20%	38	22%	10
TOTAL GROSS PROFIT	**872**	20%	**704**	21%	169

Gross profit results by group of products are as follows:

	2017		**2016**		**Change**
	in million dollars	***in % to revenue***	***in million dollars***	***in % to revenue***	***in million dollars***
Seamless pipe	**732**	24%	606	26%	127
Welded pipe	**111**	10%	68	8%	43
TOTAL PIPE	**843**	20%	674	21%	169
Other operations	**29**	13%	30	18%	(1)
TOTAL GROSS PROFIT	**872**	**20%**	**704**	**21%**	**169**

Russia. The division's gross profit decreased by $91 million or 12%. The favorable currency translation effect was $76 million. Excluding this effect gross profit decreased by $168 million. Gross profit margin was 21% compared to 27% in 2016.

Gross profit from sales of *seamless* pipe declined by $106 million as the effect of higher sales volumes was offset by a hike in raw material prices.

Gross profit from sales of *welded* pipe decreased by $55 million following a drop in *LDP* sales volumes and higher raw material prices.

Gross profit from other operations decreased by $7 million mainly as a result of growth in raw material prices.

America. The American division's gross profit increased by $250 million and amounted to $169 million as compared to gross loss in the amount of $81 million in 2016. Gross profit margin amounted to 17% in 2017.

Significant growth in drilling activity combined with increased E&P spending in the North American market resulted in a considerable growth in sales volumes, primarily *OCTG*, and better pricing. Following an improved market environment, gross profit from *seamless* and *welded* pipe sales increased by $155 million and $91 million respectively. The effect of higher sales volumes and favorable pricing environment was partially offset by higher raw material prices.

Gross profit from other operations increased by $4 million.

Europe. Gross profit in the European division increased by $10 million mainly as a result of favorable pricing environment, which was partially offset by higher raw material prices, and higher sales of *seamless* pipe. Gross profit from *billets* sales stayed almost flat as compared to 2016. Currency translation effect was negligible. Gross profit margin amounted to 20% compared to 22% in 2016.

Net operating expenses

Net operating expenses were higher by $107 million or 24% primarily as a result of a negative currency translation effect and higher other operating expenses. The share of net operating expenses, expressed as a percentage of revenue, was 12% compared to 13% in 2016.

Adjusted EBITDA

In 2017, adjusted EBITDA increased by $75 million or 14% as compared to previous year. Adjusted EBITDA margin was 14% compared to 16% in 2016.

	2017		**2016**		**Change**
	in million dollars	***in % to revenue***	***in million dollars***	***in % to revenue***	***in million dollars***
Russia	**465**	15%	578	21%	(113)
America	**111**	11%	(72)	(20)%	183
Europe	**28**	12%	24	14%	4
TOTAL ADJUSTED EBITDA	**605**	**14%**	**530**	**16%**	**75**

Russia. Adjusted EBITDA was lower by $113 million or 19% primarily as a result of a decrease in gross profit. Adjusted EBITDA margin was 15% compared to 21% in 2016.

America. Adjusted EBITDA increased by $183 million and amounted to $111 million compared to negative Adjusted EBITDA in 2016 following an improved market environment. Adjusted EBITDA margin amounted to 11%.

Europe. Adjusted EBITDA increased by $4 million as compared to 2016. An increase in gross profit was partially offset by growth in selling, general and administrative expenses. Adjusted EBITDA margin amounted to 12% as compared to 14% in 2016.

Impairment of assets

We tested our assets for impairment during the year. As at December 31, 2017, we recognised the impairment loss of $7 million compared to $3 million loss in 2016. The impairment loss in 2017 was $24 million and the reversal of impairment was $16 million.

Foreign exchange movements

In 2017, we recorded a foreign exchange gain in the amount of $28 million as compared to a $130 million gain in 2016. In addition, we recognised a foreign exchange gain from exchange rate fluctuations in the amount of $14 million (net of income tax) in 2017 as compared to a $69 million gain (net of income tax) in 2016 in the statement of other comprehensive income. The amount in the statement of comprehensive income represents the effective portion of foreign exchange gains or losses on our hedging instruments.

Net finance costs

Net finance costs increased by $6 million or 2%. The weighted average nominal interest rate was 8.16% as of 31 December 2017 as compared to 9.03% as of 31 December 2016.

Cash flows

The following table illustrates our cash flows:

	2017	2016	Change
	in million dollars		*in million dollars*
Net cash provided by operating activities	**312**	476	(164)
Payments for property and equipment	**(236)**	(175)	(61)
Other investments	**1**	94	(94)
Free Cash Flow	**77**	395	(318)
Change in loans	**318**	(53)	371
Interest paid	**(270)**	(258)	(11)
Other financial activities	**108**	(74)	182
Free Cash Flow to Equity	**233**	10	223
Dividends paid	**(36)**	(33)	(3)
Effect of exchange rate changes	**17**	(5)	22
Cash and cash equivalents at the beginning of period	**277**	305	(29)
Cash and cash equivalents at period end	**491**	277	215

Net cash flows provided by operating activities decreased by $164 million to $312 million from $476 million in the previous year. In 2017, working capital increased by $252 million compared to a $13 million increase in 2016. The increase was mainly a result of growth in inventories and trade receivables.

Net proceeds of borrowings amounted to $318 million as compared to $53 million of net repayment in 2016.

Decline in other investments was a result of disposal of subsidiaries in 2016.

Cash and cash equivalents at the end of the period amounted to $491 million as compared to $277 million at the end of 2016.

Indebtedness

Our overall financial debt increased from $2,836 million as of 31 December 2016 to $3,239 million as of 31 December 2017. Net proceeds of borrowings in 2017 was $318 million. The appreciation of the Rouble against the U.S. dollar also resulted in our debt increase. Our net debt amounted to $2,688 million as compared to $2,479 million as of 31 December 2016.

As of 31 December 2017, our debt portfolio comprised diversified debt instruments, including bank loans, bonds and other credit facilities. As of 31 December 2017, the U.S. dollar-denominated portion of our debt represented 46%, Rouble-denominated portion of debt represented 51%, euro-denominated portion of debt represented 2% of our total debt.

The share of our short-term debt increased to 18% as of 31 December 2017 compared to 9% as of 31 December 2016.

As of 31 December 2017, our debt portfolio comprised fixed and floating interest rate debt facilities. Borrowings with a floating interest rate represented $160 million or 5% of total debt, and borrowings with a fixed interest rate represented $3,105 million or 95% of our total debt.

As of 31 December of 2017, our weighted average nominal interest rate was 8.16%, which was an 86 basis point decrease compared to 31 December 2016.

Our most significant credit facilities as of 31 December 2017 were as follows:

Type of borrowing	Bank	Original currency	Outstanding principal amount	Maturity period
			in millions of U.S. dollars	
6.75% bonds		USD	500	April 2020
Loan	Sberbank of Russia	RUR	347	October 2019
Loan	Gazprombank	USD	270	June 2021
7.75% bonds		USD	231	January 2018
Loan	Gazenergobank	RUR	217	September 2025
Loan	VTB	RUR	174	December 2021
Bonds		RUR	174	May 2021
Loan	Gazprombank	RUR	156	March 2019
Loan	Alfa-bank	USD	150	January 2019
Loan	Sberbank of Russia	RUR	124	August 2022
			2,343	
Other credit facilities			909	
TOTAL LOANS AND BORROWINGS			**3,251**	

Development trends

In Russia, we believe seamless OCTG consumption will remain strong in 2018 with some upside potential. We expect LDP consumption to remain weak in 2018, due to the completion or rescheduling of a number of major pipeline construction projects.

In the US, we expect our American division will demonstrate further improving results for 2018 supported by stable OCTG demand on the back of resumed increase in the number of rigs and a higher share of rigs used for horizontal drilling.

We expect the European division’s financial results to further improve in 2018 due to stable pipe demand, better product mix and pricing environment.

While EBITDA margin is expected broadly in line with FY 2017, we anticipate higher EBITDA for FY 2018 supported by further improvements in performance of the American division.

Selected financial data

Adjusted EBITDA

Reconciliation of income before tax to Adjusted EBITDA for the twelve months ended:

	31 December 2017	30 September 2017	30 June 2017	31 March 2017	31 December 2016
			in million dollars		
Income before tax	**78**	178	148	220	169
Depreciation and amortisation	**263**	261	261	255	242
Finance costs, net	**268**	265	264	268	263
Impairment of assets	**7**	3	3	3	3
Loss/(gain) on changes in fair value of derivative financial instrument	**3**	(24)	(40)	(23)	(9)
Foreign exchange (gain)/loss, net	**(28)**	(55)	(60)	(129)	(130)
Loss/(gain) on disposal of property, plant and equipment	**21**	14	13	(2)	(3)
Movement in allowances and provisions (except for provisions for bonuses)	**(25)**	(38)	(37)	(27)	11
Other non-operating income/(expenses)	**17**	(14)	(14)	(15)	(16)
Other non-cash items	**0**	(8)	0	0	0
Adjusted EBITDA	**605**	585	536	549	530

Adjusted EBITDA is not a measure of our operating performance under IFRS and should not be considered as an alternative to gross profit, net profit or any other performance measures derived in accordance with IFRS or as an alternative to cash flow from operating activities or as a measure of our liquidity. In particular, Adjusted EBITDA should not be considered to be a measure of discretionary cash available to invest in our growth. Adjusted EBITDA has limitations as an analytical tool, and potential investors should not consider it in isolation, or as a substitute for analysis of our operating results as reported under IFRS.

The following limitations of Adjusted EBITDA as an analytical tool should be considered:

• Adjusted EBITDA does not reflect the impact of financing or finance costs on our operating performance, which can be significant and could further increase if we were to incur more debt;

• Adjusted EBITDA does not reflect the impact of income taxes on our operating performance;

• Adjusted EBITDA does not reflect the impact of depreciation and amortisation on our operating performance. The assets that are being depreciated and/or amortised will have to be replaced in the future and such depreciation and amortisation expense may approximate the cost to replace these assets in the future. By excluding this expense from Adjusted EBITDA, it does not reflect our future cash requirements for these replacements; and

• Adjusted EBITDA does not reflect the impact of other non-cash items on our operating performance, such as foreign exchange (gain)/loss, impairment/(reversal of impairment) of non-current assets, movements in allowances and provisions, (gain)/loss on disposal of property, plant and equipment, (gain)/loss on changes in fair value of financial instruments, share of (profit)/loss of associate and other non-cash items.

Net Debt

Net debt has been calculated as of the dates indicated:

	31 December 2017	30 September 2017	30 June 2017	31 March 2017	31 December 2016
			in million dollars		
Loans and borrowings less interest payable	**3,239**	3,161	3,021	3,149	2,836
Net of:					
Cash and short-term financial investments[1]	**(551)**	(450)	(455)	(509)	(357)
NET DEBT	**2,688**	2,711	2,567	2,640	2,479
NET DEBT TO EBITDA (LTM[2])	**4.44**	4.64	4.79	4.81	4.68

Net Debt is not a measure under IFRS, and it should not be considered to be an alternative to other measures of financial position. Other companies in the pipe industry may calculate Net Debt differently and therefore comparability may be limited. Net Debt is a measure of our operating performance that is not required by, or presented in accordance with, IFRS. Although Net Debt is a non IFRS measure, it is widely used to assess liquidity and the adequacy of a company's financial structure. Management believes Net Debt provides an accurate indicator of our ability to meet our financial obligations, represented by gross debt, from available cash. Net Debt demonstrates investors the trend in our net financial position over the periods presented.

[1] Cash and short-term financial investments include Cash and cash equivalents, Other financial assets and short-term loans issued.
[2] Net Debt-to-EBITDA ratio is defined as the quotient of Net Debt at the end of the given reporting date divided by the Adjusted EBITDA for the 12 months immediately preceding the given reporting date. Adjusted EBITDA – see "Selected financial data".

Principal risks and uncertainties

Industry risks

Dependence on the oil and gas industry

The oil and gas industry is the principal consumer of steel pipe products worldwide and accounts for most of our sales, in particular sales of OCTG, line pipe and large-diameter pipe. In 2017, sales volumes of pipes used in oil and gas industry accounted for approximately 77% of our tubular products.

The oil and gas industry has historically been volatile and downturns in the oil and gas markets can adversely affect demand for our products, which largely depends on the number of oil and gas wells being drilled, completed and reworked, the depth and drilling conditions of wells and the construction of oil and gas pipelines. The level of such industry specific activities in turn depends on the level of capital spending by major oil and gas companies. The level of investment activities of oil and gas companies, which is largely driven by prevailing prices for oil and natural gas and their stability, significantly affects the level of consumption of our products.

A decline in oil and gas exploration, drilling and production activities in Russia, the U.S., and more globally (including as a result of the volatility of oil and natural gas prices), adversely affects our results of operations.

Thus, the decline in oil and gas exploration, drilling and production activities, prices for energy commodities and other economic factors beyond our control could adversely affect our results of operations.

Increases in the cost of raw materials

We require substantial quantities of raw materials to produce steel pipes. The principal raw materials used in production processes include scrap and ferroalloys for use in steelmaking operations, steel billets used for the production of seamless pipe and steel coils and plates for the production of welded pipe. The demand for the principal raw materials we utilize is generally correlated with macroeconomic fluctuations, which in turn are affected by global economic conditions.

Prices for raw materials and supplies have a key influence on our production costs and are one of the main factors affecting our results of operations. There are many factors which influence raw materials prices, including oil and gas prices, worldwide production capacity, capacity utilization rates, inflation, exchange rates, trade barriers and developments in steelmaking processes. In 2017, the cost of scrap metal in Russia in Rouble-terms increased on average by 28%, and the cost of coils increased by 10%. At the same time, we are negotiating new contract terms with our major clients based on pricing formulas, which secure us against growing raw materials prices. The share of raw materials' and consumables' costs in the total cost of production in 2017 was 64%. The increase in prices for scrap, coils and other raw materials, if not passed to customers can adversely affect our profit margins and results of operations.

Our plants also consume significant quantities of energy, particularly electricity and gas. In 2017, energy and utility costs comprised approximately 8% of our total cost of production. The prices for electricity for our plants increased by 9% in Rouble-terms compared to 2016, while the average prices for domestic natural gas for our plants increased by 2% in Rouble-terms. If we are required to pay higher prices for gas and electricity in the future, our costs will rise and this could have a material adverse effect on our business, financial condition, results of operations and prospects.

Dependence on a small group of customers

As we focus on supplying primarily the oil and gas industry, our largest customers are oil and gas companies. In 2017, our five largest customers were Rosneft, Gazprom, Surgutneftegas, B&L PIPECO SERVICES and CTAP LLC, which together accounted for 37% of our total sales volumes.

The increased dependence of pipe sales on a single large customer bears the risk of an adverse effect on results of operations in the event that our relationship with any of these major customers deteriorates.

Our LDP business is largely dependent on one of our largest customers, Gazprom. In 2017, 57% of our LDP were sold for Gazprom projects. Increased competition in the supply of LDP or a change in relationships with Gazprom could negatively affect our competitive position in the large-diameter pipe market, resulting in decreased revenues from sales of these products and adversely affecting our business, financial position and results of operations. Additionally, large-diameter pipe business depends significantly upon the level of construction of new oil and gas pipelines in Russia and the CIS. The delay, cancellation or other changes in the scale or scope of significant pipeline projects, or the selection by the sponsors of such projects of other suppliers could have an adverse effect on our sales of LDP, and thus on the results of operations and financial position.

Competition

The global market for steel pipe products, particularly in the oil and gas sector, is highly competitive. In the Russian and CIS markets, we face competition primarily from ChTPZ, OMK, and the Ukrainian and Chinese pipe producers.

After accession to the WTO Russia had adjusted its national legislation in full accordance with WTO rules and regulations, what allowed Russia along with the EEU (Eurasian Economic Union) to use WTO trade defense mechanism for the national market protection. To date, the following antidumping measures are effective in EEU: antidumping duties in the amount 18.9%-19.9% on imports of Interpipe (Ukraine) pipe production that were extended till 2021, anti-dumping duties ranging from 4.32% to 18.96% on imports of seamless stainless steel cold- and hot- rolled tubes and pipes originating from Ukraine, antidumping duties in the amount 19.15% on imports of cold-drawn stainless steel pipes originated from China, antidumping duties 12.23%-31% in respect to OGTG originated from China.

Outside Russia and the CIS, we compete against a limited number of premium-quality pipe products producers, including Tenaris, Vallourec, Sumitomo, Voestalpine and Chinese producers.

In the United States according to the DOC's findings in August 2014 antidumping duties were imposed at the following levels in respect Oil Country Tubular Goods: India 2.05%-9.91%; Turkey 35.86%; South Korea 3.98%-6.495%, Taiwan 2.34%, Vietnam 25.18%-111.47%, the countervailing duties were 5.67%-19.57% for India and 2.39% for Turkey. The highest anti-dumping and countervailing duties were set in relation to OCTG originating from China that were 31.99%-137.62% and 12.26%-15.87% respectively

In October 2015, the anti-dumping and countervailing duties, in respect of welded API line pipe from South Korea and Turkey the final antidumping and countervailing duties were set at the following level: for Turkey 6.66%-22.95%, for Korea 2.53%-6.23%, the final countervailing duties for Turkey were set at level of 1.31%-152.20%, for Korea 0.28%-0.44% the Department of Commerce reached a negative determination in the countervailing duty investigation and therefore countervailing duties were not imposed .

Decisions and determinations subsequent to results of the investigations mentioned above are expected to ensure the alignment of conditions of the competition in the market of pipe products in Russia and America in 2017 and contribute to the improvement of market positions of Russian and American plants.

We may not be able to compete effectively against existing or potential producers and preserve our current share of the various geographical or product markets in which we operate. A failure to compete effectively in

one or more of these markets could have a material adverse effect on our business, financial condition, results of operations and prospects.

Financial risks

Liquidity risk

Liquidity risk is the risk that TMK will not be able to meet its financial obligations as they fall due. TMK's approach to managing liquidity is to ensure that it will always have sufficient liquidity assets to meet its obligations when due.

TMK manages liquidity risk by maintaining adequate cash reserves and borrowing facilities, by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

As of December 31, 2017, our total debt increased to $3,239 million as compared to $2,836 million at the end of 2016, partially due to the Rouble depreciation against the U.S. dollar. Net proceeds amounted to $318 million. As of December 31, 2017, our Net-Debt-to-EBITDA ratio was 4.44x.

Improving liquidity profile remains one of our priorities, and we continue to carry out measures to maintain sufficient liquidity and improve loan portfolio structure. TMK maintains credit lines and other financial resources that can be incurred to meet short and long terms needs and for refinancing purposes. As of 31 December 2017, we committed credit lines in Russian, European and American banks with the available limit of $812.3 million.

Nevertheless, there can be no assurance that our efforts to improve liquidity profile and reduce leverage will prove successful. The negative debt market reaction on deteriorating global political and financial situation, US and EU sanctions, economic situation in Russia may have an adverse impact on our ability to borrow in banks or capital markets, and may put pressure on our liquidity, significantly increase borrowing costs, temporary reduce the availability of credit lines or lead to and possibility to incur financing on acceptable terms.

Compliance with covenants

Certain amount of our loan agreements and public debt securities currently include financial covenants. Some covenants impose financial ratios that must be maintained, others impose restrictions in respect of certain transactions, including restrictions in respect of indebtedness, pledging of assets and material asset disposals. A breach of financial or other covenants in existing debt facilities, if not resolved by means such as obtaining a waiver from the relevant lender and/or making amendments to debt facilities, could trigger a default under our obligations.

As of 31 December 2017, we were in compliance with lenders' requirements under covenants.

Nevertheless, in case financial markets or economic situation on the markets, where we operate, deteriorate in the future, we may not comply with relevant covenants. In case of possible breach we will apply best efforts to obtain all necessary waivers or standstill letters. We do not expect the occurrence of such events in the near future.

Interest rate risk

Some of our loans and borrowings are subject to variable rates of interest. Accordingly, we remain subject to interest rate risk resulting from fluctuations in the relevant reference rates for such debt. Some loan agreements contain a right of creditors at its sole discretion to change interest rates including in case of change of credit indicators by the Central Bank of Russia and in some other cases.

The increase in such interest rates will result in an increase in our interest expense and could have a material adverse effect on our financial condition, results of operations or prospects.

Currency risk

Our products' prices as well as our costs are nominated both in Roubles and in other currencies (generally, in U.S. dollars and euro).We hedge our net investment in operations located in the United States and Oman against foreign currency risks using U.S. dollar denominated liabilities. Gains or losses on the hedging instruments relating to the effective portion of the hedge are recognised as other comprehensive income while any gains or losses relating to the ineffective portion are recognised in the income statement. In 2017, we incurred foreign exchange gain from spot rate changes in the total amount of $45 million, including $ 28 million recognised in the income statement and $18 million (before income tax) recognised in the statement of comprehensive income.

Also TMK is exposed to currency risk on the borrowings that are denominated in currencies other than the functional currencies of the respective TMK's members. The currencies in which these transactions are denominated are primarily Rubles, US dollars and euro. As of December 31, 2017, 46% of our loans were denominated in U.S. dollar. In this regards, as well as taking into consideration continuing volatility of the Rouble against U.S. dollar, the risk of losses owing to the Rouble devaluation remains sufficiently high. Depreciation of the Rouble against the U.S. dollar could adversely affect our net profit as coherent losses will be reflected in our consolidated income statements. Nevertheless, TMK is partly secured from currency risks as foreign currency denominated sales occasionally are used to cover repayment of foreign currency denominated borrowings.

Inflation risk

A significant amount of our production activities are located in Russia, and a majority of direct costs are incurred in Roubles. We tend to experience inflation-driven increases in certain costs, such as raw material costs, transportation costs, energy costs and salaries that are linked to the general price level in Russia. In 2017, inflation in Russia decreased to 2.1% as compared to 5.4% in 2016. In spite of the measures of the Russian government to contain inflation, growth of inflation rates may be significant in the short-term outlook. We may not be able to increase the prices sufficiently in order to preserve existing operating margins.

Inflation rates in the United States, with respect to our American division operations, are historically much lower than in Russia. In 2017, inflation in the United States was 2.1% and remained at the level of the previous year

High rates of inflation, especially in Russia, could increase our costs, decrease our operating margins and adversely affect our business and financial position.

Legal risks

Changes in tax legislation and tax system

Our subsidiaries make significant tax and non-budgetary funds payments, in particular, profit tax, VAT, property tax and payments to social security funds. Changes in tax legislation could lead to an increase in tax payments and, consequently, to a lowering of financial results. As significant part of the operations is located in Russia, the main risks relate to changes in the legislation of the Russian tax system. The Russian Government continually reviews the Russian tax legislation. The new laws generally reduce the number of taxes and the overall tax burden on business while simplifying tax legislation. Nevertheless, should the Russian taxation system suffer any changes related to increasing of tax rates, this could adversely affect our business.

Moreover, the Russian oil industry is subject to substantial taxes, including significant resources production taxes and significant export customs duties. Changes to the tax regime and customs duties rates may adversely affect the level of oil and gas exploration and development in Russia, which can adversely affect the demand for our products in Russia.

Changes in environmental law

We meet the requirements of national environmental laws at our industrial capacities location areas: the directives and regulations of Russian, the United States, the European Union, Romanian, Kazakhstan and Omani legislation.

The main ecological-and-economical risks of our Russian plants are related to changes and tightening of the Russian environmental protection laws. Environmental legislation in Russia is constantly developing. The imposition of a new law and regulation system may require further expenditures to install new technological and waste disposal equipment, pollution and wastewater control equipment, as well as will lead to growth of the rate of payments for negative impact on the environment. It is expected that compliance with the regulations will be accompanied by stricter control by state monitoring authorities.

We estimate that the environmental legislation of the European Union and the United States, Romania, Kazakhstan and Oman will not undergo any material changes in the near future. Nevertheless, if such changes arise, the cost of compliance with new requirements could have a material adverse effect on our business.

Other risks

Equipment failures or production curtailments or shutdowns

Our production capacities are subject to equipment failures and to the risk of catastrophic loss due to unanticipated events, such as fires, explosions and adverse weather conditions. Our manufacturing processes depend on critical pieces of steel-making and pipe-making equipment. Such equipment may, on occasion, be out of service as a result of unanticipated failures, which could require us to close part or all of the relevant production facility or cause us to reduce production on one or more of our production lines. Any interruption in production capability may require us to make significant and unanticipated capital expenditures to effect repairs, which could have a negative effect on our profitability and cash flows. Any recoveries under insurance coverage that we may obtain may not offset the lost revenues or increased costs resulting from a disruption of our operations. A sustained disruption to our business could also result in delays to or cancellations of customer orders and contractual penalties, which may also negatively impact our reputation among our customers. Any or all of these occurrences could have a material adverse effect on our business, results of operations, financial condition and prospects.

Insurance against all potential risks and losses

We maintain insurance against losses that may arise in case of property damage including business interruption insurance, accidents, transportation of goods. We also maintain corporate product liability and directors and officers liability insurance policies.

We maintain obligatory insurance policies required by law and provide employees with medicalinsurance as part of our compensation arrangements with our employees.

Nevertheless, we do not carry insurance against all potential risks and losses, and our insurance might be inadequate to cover all of our losses or liabilities or may not be available on commercially reasonable terms.

Ability to effect staff alterations and shortages of skilled labor

Our Russian subsidiaries are in many regions the largest employers in the cities in which they operate, such as Volzhsky, Taganrog, Kamensk-Uralsky and Polevskoy. While we do not have any specific legal social obligations or responsibilities with respect to these regions, the ability to effect alterations in the number our employees may nevertheless be subject to political and social considerations. Any inability to make planned reductions in the number of employees or other changes to operations in such regions could have an adverse effect on the results of operations and prospects.

Competition for skilled labor in the steel pipe industry remains relatively intense, and labor costs continue to increase moderately, particularly in the CIS, Eastern Europe and the United States. We expect the demand and, hence, costs for skilled engineers and operators will continue to increase, reflecting the significant demand from other metallurgical companies and other industries. Continual high demand for skilled labor and continued increases in labor costs could have a material adverse effect on our business, financial position and results of operations.

Responsibility statement

We confirm to the best of our knowledge that:

1. the consolidated financial statements prepared in accordance with International Financial Reporting Standards and presented together with this Management Discussion and Analysis of financial condition and results of operation give a true and fair view of the assets, liabilities, financial position and profit or loss of PAO “TMK” and its consolidated subsidiaries, taken as a whole; and

2. the Management Discussion and Analysis includes a fair review of the development and performance of the business and the position of PAO “TMK” and its consolidated subsidiaries, taken as a whole.

Alexander G. Shiryaev
Chief Executive Officer, PAO “TMK”

Tigran I. Petrosyan
Chief Financial Officer, PAO “TMK”

01 March 2018