



# Management Discussion and Analysis of the financial position and results of operations

*for the year ended 31 December 2020*

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*Forward-looking statement*

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*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 2020.*

*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*

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*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.*

## Executive overview

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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, Romania and Kazakhstan. We operate two R&D centers in Russia. Our global market presence is supported by a wide distribution network. In 2020, we delivered 76% of our tubular products to our customers located in Russia. We estimate our share on the global market of seamless OCTG at around 10%.

We are the largest exporter of pipes in Russia. Exports of pipes produced by our Russian plants accounted for 18% of our total sales in 2020.

In 2020, we sold 2,811 thousand tonnes of steel pipes. Seamless pipes comprised 72% of our sales volumes. Sales of seamless OCTG reached 1,198 thousand tonnes, a 29% year-on-year decrease. The decrease was mainly a result of IPSCO disposal. Sales of LDP were 30% lower year-on-year at 326 thousand tonnes.

In 2020, our total consolidated revenue decreased by 28% to 222 621 million roubles as compared to 2019. Adjusted EBITDA<sup>1</sup> was 42 480 million roubles as compared to 43 540 million roubles in the previous year. Adjusted EBITDA margin was 19% as compared to 14% in 2019.

## Market conditions for 2020

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The Russian pipe market declined by 9% compared to 2019, predominantly reflecting lower shipments of large diameter pipe. Deceleration in drilling activity and a lower share of horizontal drilling (50% in 2020 compared to 53% in 2019) resulted in some decline in total OCTG pipe market volume.

In 2020, European pipe market experienced a significant decline in consumption from key industries resulting from deterioration of business activity, caused by COVID-19 pandemic and lockdowns.

## Key events

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In January 2020, we sold 100% IPSCO Tubulars Inc. shares to Tenaris. As a part of the sale the parties entered into a 6-year agreement whereby, beginning on January 2, 2020, Tenaris became an exclusive distributor of TMK's OCTG and line pipe products in the United States and Canada.

As a result of the sale, S&P raised our long-term credit rating from «B+» to «BB-» with Stable outlook. Moody's changed outlook from Stable to Positive and confirmed credit rating at B1.

In January 2020, we commissioned a heat treatment line at STZ. The new facility provides heat treatment for 168–370 mm diameter pipes with 6,4–40 mm pipe walls. The total amount of investments was 5.5 billion roubles, 110 of new jobs were created. New line allows to produce premium tubular

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<sup>1</sup> Adjusted EBITDA - See "Selected financial data".

products for fields with hard to extract reserves and for wells with aggressive environment and extreme North conditions.

In February 2020, we have closed a \$500 million 7-year Eurobond issue with a coupon of 4.30%. The proceeds from the Eurobond offering were used to refinance \$500 million Eurobond matured in April 2020.

In April, a new finishing complex was commissioned at SinTZ. The equipment enables to perform main finishing operations in automatic mode.

On April 23, 2020 we completed the offering of Russian rouble bonds in the amount of 10 billion roubles. We used the proceeds to refinance our existing bonds and some bank loans. The placement had a positive effect on our maturity profile.

In August, we signed an agreement to supply pipes to Amursky Gas Chemical Complex, one of the world's largest polymer production enterprises, which is currently being constructed by SIBUR in the Amur region. According to the agreement we will deliver a set of complex solutions including seamless pipes, welded large-diameter pipes and pipeline parts in a total volume of more than 36 thousand tonnes in 2021-2023.

In October, we acquired 100% ownership interest in a casting and rolling complex, located in Yartsevo, Smolensk Region, TMK-YMZ (former-Parus, LLC). The complex has a production capacity of more than 300 thousand tonnes of rolled steel per year.

In October, we announced the completion of share buyback program of TMK ordinary shares that has been approved by the Board of Directors on 11 September 2020. The Program was performed by VTZ through the period of 15 September 2020 to 15 October 2020. As a result of the Program VTZ acquired 29,854,245 ordinary shares of TMK, which constitutes 2.89% of the total number of issued ordinary shares of TMK. The remaining shares in free-float are 4.4% of the total number of issued ordinary shares of TMK.

In October, a casing string made up of premium threaded connection pipes manufactured by TMK was successfully lowered into a well from the Berkut offshore ice resistant stationary platform at the Sakhalin-1 project's Arkutun-Dagi field.

In October, we acquired a controlling stake in enterprises comprising Truby 2000. The acquisition will enable the expansion of the Group's partnership with the state corporation Rosatom and accelerate further development of our expertise in the segment of equipment for nuclear stations.

We developed unique pipes for Rosatom's mechanical engineering division for its BREST-OD-300 experimental demonstration power unit. A technology to produce extra-long heat-exchange pipes made of special durable, ductile steel was developed exclusively for the new power unit. The high-strength austenitic steel withstands both steam water and superheated steam, as well as liquid lead, which is used in a reactor as a coolant. As part of a project to establish the closed nuclear fuel cycle, TMK will produce over 200 thousand meters of pipe to equip the steam generators of a fast neutron reactor.

In December, we reached an agreement on expanding cooperation with the largest oil and gas company in Uzbekistan – JSC Uzbekneftegaz. The parties are discussing joint projects aimed at the development of the oil and gas industry in the Republic of Uzbekistan, as well as research and technical cooperation.

## **Business structure**

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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*: plants located in the Russian Federation, a finishing facility in Kazakhstan, oilfield service companies in Russia, traders located in Russia, the United Arab Emirates, the USA and Switzerland. 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*: plants and traders located in the USA and Canada. On January 2, 2020, the Group completed the disposal of IPSCO Tubulars Inc. and its subsidiaries which constituted the American division;
- *European division*: plants located in Romania and traders 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 2019 results

### Results of operations

In 2020, our results were largely impacted by IPSCO disposal and an economic slowdown due to COVID-19 pandemic, despite which our Adjusted EBITDA stayed in line with 2019.

|  | 2020                      | 2019      | Change   |
|--|---------------------------|-----------|----------|
|  | <i>in million roubles</i> |           |          |
| <b>Sales volume (in thousand tonnes)</b> | <b>2,811</b>              | 3,828     | (1,017)  |
| <b>Revenue</b>                           | <b>222,621</b>            | 308,378   | (85,757) |
| Cost of sales                            | <b>(174,051)</b>          | (246,736) | 72,685   |
| <b>GROSS PROFIT</b>                      | <b>48,570</b>             | 61,642    | (13,072) |
| <i>GROSS PROFIT MARGIN</i>               | <b>22%</b>                | 20%       |          |
| Net operating expenses <sup>1</sup>      | <b>(33,019)</b>           | (36,006)  | 2,987    |
| Impairment of assets                     | <b>(5,216)</b>            | (6,246)   | 1,030    |
| Foreign exchange gain/(loss), net        | <b>8,288</b>              | 2,098     | 6,190    |
| Finance costs, net                       | <b>(11,874)</b>           | (14,104)  | 2,230    |
| Gain/(loss) on disposal of subsidiaries  | <b>23,870</b>             | (13)      | 23,883   |
| Other non-operating income/(expenses)    | <b>(261)</b>              | (1,344)   | 1,083    |
| <b>PROFIT/(LOSS) BEFORE TAX</b>          | <b>30,358</b>             | 6,027     | 24,331   |
| Income tax benefit/(expense)             | <b>(6,057)</b>            | (2,081)   | (3,976)  |
| <b>NET PROFIT/(LOSS)</b>                 | <b>24,301</b>             | 3,946     | 20,355   |
| <i>NET INCOME MARGIN</i>                 | <b>11%</b>                | 1%        |          |
| <b>ADJUSTED EBITDA</b>                   | <b>42,480</b>             | 43,540    | (1,060)  |
| <i>ADJUSTED EBITDA MARGIN</i>            | <b>19%</b>                | 14%       |          |

<sup>1</sup> Net operating expenses include selling and distribution, general and administrative, advertising and promotion, research and development and net other operating income/(expense).

## Sales

In 2020, our consolidated revenue decreased by 85,757 million roubles or 28% mainly as a result of IPSCO disposal.

Sales by reporting segments are as follows:

|                   | 2020                      | 2019         | Change                    | Change       |
|-------------------|---------------------------|--------------|---------------------------|--------------|
|                   | <i>in thousand tonnes</i> |              | <i>in thousand tonnes</i> |              |
| Russia            | 2,637                     | 3,120        | (483)                     | (15)%        |
| America           | -                         | 520          | (520)                     | (100)%       |
| Europe            | 174                       | 187          | (14)                      | (7)%         |
| <b>TOTAL PIPE</b> | <b>2,811</b>              | <b>3,828</b> | <b>(1,017)</b>            | <b>(27)%</b> |

  

|                      | 2020                      | 2019           | Change                     | Change       |
|----------------------|---------------------------|----------------|----------------------------|--------------|
|                      | <i>in million roubles</i> |                | <i>in millions roubles</i> |              |
| Russia               | 208,386                   | 235,269        | (26,883)                   | (11)%        |
| America              | -                         | 57,780         | (57,780)                   | (100)%       |
| Europe               | 14,234                    | 15,329         | (1,094)                    | (7)%         |
| <b>TOTAL REVENUE</b> | <b>222,621</b>            | <b>308,378</b> | <b>(85,757)</b>            | <b>(28)%</b> |

Sales by group of products are as follows:

|                   | 2020                      | 2019         | Change                    | Change       |
|-------------------|---------------------------|--------------|---------------------------|--------------|
|                   | <i>in thousand tonnes</i> |              | <i>in thousand tonnes</i> |              |
| Seamless pipe     | 2,026                     | 2,651        | (625)                     | (24)%        |
| Welded pipe       | 785                       | 1,177        | (392)                     | (33)%        |
| <b>TOTAL PIPE</b> | <b>2,811</b>              | <b>3,828</b> | <b>(1,017)</b>            | <b>(27)%</b> |

  

|                      | 2020                      | 2019           | Change                    | Change       |
|----------------------|---------------------------|----------------|---------------------------|--------------|
|                      | <i>in million roubles</i> |                | <i>in million roubles</i> |              |
| Seamless pipe        | 166,262                   | 221,031        | (54,770)                  | (25)%        |
| Welded pipe          | 40,362                    | 74,483         | (34,121)                  | (46)%        |
| <b>TOTAL PIPE</b>    | <b>206,624</b>            | <b>295,514</b> | <b>(88,890)</b>           | <b>(30)%</b> |
| Other operations     | 15,997                    | 12,863         | 3,134                     | 24%          |
| <b>TOTAL REVENUE</b> | <b>222,621</b>            | <b>308,378</b> | <b>(85,757)</b>           | <b>(28)%</b> |

**Russia.** The division's revenue decreased by 26,883 million roubles or 11% year-on-year.

Revenue from sales of *seamless* pipe decreased by 16,150 million roubles. Negative effect of lower sales volumes was partially offset by better product mix.

Revenue from sales of *welded* pipe decreased by 15,056 million roubles mainly as a result of lower *LDP* sales, which also had a negative impact on product mix.

Revenue from other operations increased by 4,323 million roubles mainly as a result of TMK-YMZ acquisition, which sells *steel bars*, and higher *billets* sales.

**Europe.** In the European division revenue decreased by 1,094 million roubles or 7% year-on-year. Favorable currency translation effect was 1,464 million roubles. Excluding this effect revenue fell by 2,558 million roubles.

Revenue from sales of *seamless* pipe decreased by 2,516 million roubles as compared to the last year as a result of unfavorable market environment influenced by COVID-19 pandemic.

Revenue from other operations decreased by 46 million roubles as compared to previous year mostly as a result of lower *billets* sales.

### Gross profit

In 2020, our consolidated gross profit decreased by 13,072 million roubles or 21% year-on-year and amounted to 48,570 million roubles. Gross profit margin was 22% compared to 20% in 2019.

Gross profit results by reporting segments are as follows:

|                           | 2020                      |                        | 2019                      |                        | Change                    |
|---------------------------|---------------------------|------------------------|---------------------------|------------------------|---------------------------|
|                           | <i>in million roubles</i> | <i>in % to revenue</i> | <i>in million roubles</i> | <i>in % to revenue</i> | <i>in million roubles</i> |
| Russia                    | 47,040                    | 23%                    | 55,382                    | 24%                    | (8,342)                   |
| America                   | -                         | -                      | 2,983                     | 5%                     | (2,983)                   |
| Europe                    | 1,530                     | 11%                    | 3,276                     | 21%                    | (1,746)                   |
| <b>TOTAL GROSS PROFIT</b> | <b>48,570</b>             | <b>22%</b>             | <b>61,642</b>             | <b>20%</b>             | <b>(13,072)</b>           |

Gross profit results by group of products are as follows:

|                           | 2020                      |                        | 2019                      |                        | Change                    |
|---------------------------|---------------------------|------------------------|---------------------------|------------------------|---------------------------|
|                           | <i>in million roubles</i> | <i>in % to revenue</i> | <i>in million roubles</i> | <i>in % to revenue</i> | <i>in million roubles</i> |
| Seamless pipe             | 44,125                    | 27%                    | 55,397                    | 25%                    | (11,272)                  |
| Welded pipe               | 3,292                     | 8%                     | 5,628                     | 8%                     | (2,336)                   |
| <b>TOTAL PIPE</b>         | <b>47,417</b>             | <b>23%</b>             | <b>61,025</b>             | <b>21%</b>             | <b>(13,608)</b>           |
| Other operations          | 1,153                     | 7%                     | 617                       | 5%                     | 536                       |
| <b>TOTAL GROSS PROFIT</b> | <b>48,570</b>             | <b>22%</b>             | <b>61,642</b>             | <b>20%</b>             | <b>(13,072)</b>           |

**Russia.** The division's gross profit decreased by 8,342 million roubles. Gross profit margin was 23% compared to 24% in 2019.

Gross profit from sales of *seamless* pipe fell by 4,509 million roubles as a result of lower sales volumes, the negative effect of which was partially offset by improved product mix. Raw material prices also had a negative impact on our gross profit.

Gross profit from sales of *welded* pipe decreased by 4,431 million roubles as a result of significant drop in *LDP* sales volumes, which also had a negative impact on product mix.

Gross profit from other operations increased by 597 million roubles mainly as a result of TMK-YMZ acquisition, which sells *steel bars*, and higher *billets* sales.

**Europe.** Gross profit in the European division decreased by 1,746 million roubles or 53%. Favorable currency translation effect was 157 million roubles. Excluding this effect gross profit decreased by 1,903 million roubles. Gross profit margin amounted to 11% compared to 21% in 2019.

Gross profit from sales of *seamless* pipe fell by 1,909 million roubles as a result of unfavorable market environment. Gross profit was also affected by lower sales volumes.

Gross profit from other operations stayed almost flat as compared to 2019.

### Net operating expenses

Net operating expenses were lower by 2,624 million roubles or 7%. The share of net operating expenses, expressed as a percentage of revenue, was 15% compared to 12% in 2019.

### Adjusted EBITDA

In the third quarter 2020, the management changed the approach to the calculation of Adjusted EBITDA by including foreign exchange gains and losses on operations. The comparative information was adjusted accordingly. In 2020, adjusted EBITDA decreased by 1,060 million roubles or 2% as compared to previous year. Adjusted EBITDA margin was 19% compared to 14% in 2019.

|                              | 2020               |                 | 2019               |                 | Change             |
|------------------------------|--------------------|-----------------|--------------------|-----------------|--------------------|
|                              | in million roubles | in % to revenue | in million roubles | in % to revenue | in million roubles |
| Russia                       | 41,950             | 20%             | 40,055             | 17%             | 1,895              |
| America                      | -                  |                 | 1,968              | 3%              | (1,968)            |
| Europe                       | 530                | 4%              | 1,517              | 10%             | (987)              |
| <b>TOTAL ADJUSTED EBITDA</b> | <b>42,480</b>      | <b>19%</b>      | <b>43,540</b>      | <b>14%</b>      | <b>(1,060)</b>     |

**Russia.** Adjusted EBITDA was higher by 1,895 million roubles as lower gross profit was offset by foreign exchange gain on operations. Adjusted EBITDA margin was 20% compared to 17% in 2019.

**Europe.** Adjusted EBITDA decreased by 987 million roubles as compared to 2019 following a decrease in gross profit, which was partially offset by lower operating expenses. Adjusted EBITDA margin amounted to 4% as compared to 10% in 2019.

### Impairment of assets

In the year ended December 31, 2020, we recognised the impairment loss of 5,216 million roubles compared to 6,246 million roubles loss in 2019.

### Foreign exchange movements

In 2020, we recorded a foreign exchange gain in the amount of 8,288 million roubles as compared to a 2,098 million roubles gain in 2019.

### Net finance costs

In 2020, net finance costs decreased by 2,230 million roubles or 16%. The weighted average nominal interest rate was 6.07% as of 31 December 2020 as compared to 6.95% as of 31 December 2019.

## Cash flows

The following table presents our cash flows:

|   | 2020                      | 2019     | Change   |
|---|---------------------------|----------|----------|
|   | <i>in million roubles</i> |          |          |
| <b>Cash provided by operating activities before working capital changes</b> | <b>34,305</b>             | 42,636   | (8,331)  |
| Decrease/ (increase) in inventories   | (2,668)                   | (3,197)  | 529      |
| Decrease/ (increase) in settlements with customers                          | 46,128                    | 406      | 45,722   |
| Increase/ (decrease) in settlements with suppliers                          | (21,601)                  | 2,588    | (24,189) |
| Income tax paid   | (7,512)                   | (4,425)  | (3,087)  |
| <b>Net cash provided by operating activities</b>                            | <b>48,652</b>             | 38,008   | 10,644   |
| Payments for property and equipment   | (10,524)                  | (14,183) | 3,659    |
| Acquisition of subsidiaries   | (14,439)                  |          | (14,439) |
| Other investments   | 55,106                    | (9,308)  | 64,414   |
| <b>Free Cash Flow</b>   | <b>78,795</b>             | 14,517   | 64,278   |
| Change in loans   | (1,426)                   | (3,312)  | 1,886    |
| Interest paid   | (12,698)                  | (14,153) | 1,455    |
| Other financing activities  | (22,498)                  | 2,113    | (24,611) |
| <b>Free Cash Flow to Equity</b>   | <b>42,173</b>             | (835)    | 43,008   |
| Dividends paid  | (3,259)                   | (2,736)  | (523)    |
| Effect of exchange rate changes   | 11,998                    | (1,526)  | 13,524   |
| <b>Cash and cash equivalents at the beginning of period</b>                 | <b>22,124</b>             | 27,221   | (5,097)  |
| <b>Cash and cash equivalents at period end</b>                              | <b>73,036</b>             | 22,124   | 50,912   |

Cash provided by operating activities before working capital changes decreased by 8,331 million roubles and amounted to 34,305 million roubles. The positive cash flow from working capital changes was 21,859 million roubles in 2020 as compared to a negative cash flow in the amount of 203 million roubles in 2019. Working capital change in 2020 was mainly attributable to an increase in advances from customers.

Net repayment of borrowings amounted to 1,426 million roubles as compared to net repayment in the amount of 3,312 million roubles in 2019.

Cash and cash equivalents at the end of the period amounted to 73,036 million roubles as compared to 22,124 million roubles at the end of 2019.

## Indebtedness

Our total debt increased to 199,075 million roubles as of 31 December 2020 from 186,058 million roubles as of 31 December 2019. Net repayment of borrowings in 2020 was 1,426 million roubles. The increase in debt was a result of the rouble depreciation against the U.S. dollar. Our Net debt amounted to 98,674 million roubles as compared to 154,931 million roubles as of 31 December 2019.

As of 31 December 2020, our debt portfolio comprised diversified debt instruments, including bank loans, bonds and other credit facilities. As of 31 December 2020, the U.S. dollar-denominated portion of our debt represented 20%, Rouble-denominated portion of debt represented 75%, euro-denominated portion of debt represented 5% of our total debt.

The share of our short-term debt was 37% as of 31 December 2020 compared to 45% as of 31 December 2019.

As of 31 December of 2020, our weighted average nominal interest rate decreased by 88 basis points to 6.07% compared to 31 December 2019.

## Management Discussion and Analysis

For the year ended 31 December 2020

Our most significant credit facilities as of 31 December 2020 were as follows:

| Type of borrowing                 | Bank        | Original currency | Outstanding principal amount | Maturity period |
|-----------------------------------|-------------|-------------------|------------------------------|-----------------|
|                                   |             |                   | <i>in million roubles</i>    |                 |
| Eurobonds                         |             | USD               | 36,938                       | February 2027   |
| Loan                              | Gazprombank | RUR               | 20,000                       | August 2025     |
| Loan                              | Sberbank    | RUR               | 14,000                       | October 2023    |
| Loan                              | VBRR        | RUR               | 12,500                       | July 2022       |
| Loan                              | Gazprombank | RUR               | 11,200                       | March 2022      |
| Bonds                             |             | RUR               | 10,000                       | May 2021        |
| Bonds                             |             | RUR               | 10,000                       | April 2022      |
| Loan                              | VTB         | RUR               | 9,000                        | March 2022      |
| Loan                              | Alfa-bank   | RUR               | 6,000                        | July 2021       |
| Loan                              | Sberbank    | RUR               | 6,000                        | December 2021   |
|                                   |             |                   | 135,638                      |                 |
| Other credit facilities           |             |                   | 63,990                       |                 |
| Unamortised debt issue costs      |             |                   | (553)                        |                 |
| <b>TOTAL LOANS AND BORROWINGS</b> |             |                   | <b>199,075</b>               |                 |

## Development trends

In Russia, we expect demand for OCTG pipe from oil and gas companies to remain stable, supported by continued development of their existing and new projects, as well as increased complexity of hydrocarbons production in Russia.

In Europe, we expect consumption of industrial pipe to recover gradually after the lifting of massive COVID-19 lockdowns and due to implemented government measures to support industrial companies in the eurozone countries.

## Selected financial data

### Adjusted EBITDA

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

|   | 31 December 2020          | 30 September 2020 | 30 June 2020  | 31 March 2020 | 31 December 2019 |
|---|---------------------------|-------------------|---------------|---------------|------------------|
|   | <i>in million roubles</i> |                   |               |               |                  |
| Income before tax   | 30,358                    | 27,701            | 21,400        | 25,448        | 6,027            |
| Depreciation and amortisation   | 12,651                    | 11,750            | 11,706        | 11,805        | 13,282           |
| Finance costs, net  | 11,874                    | 12,350            | 13,174        | 13,901        | 14,104           |
| Impairment of assets  | 5,216                     | 11,373            | 10,986        | 10,673        | 6,246            |
| Foreign exchange (gain)/loss, net   | (8,288)                   | (9,772)           | (3,838)       | (2,027)       | (2,098)          |
| Foreign exchange gain/(loss) from operations                              | 6,942                     | 8,223             | 2,787         | 5,388         | (597)            |
| Loss/(gain) on disposal of property, plant and equipment                  | 347                       | 797               | 862           | 783           | 898              |
| Movement in allowances and provisions (except for provisions for bonuses) | 5,679                     | 5,102             | 4,575         | 4,813         | 2,848            |
| Gain on disposal of subsidiaries  | (23,870)                  | (23,864)          | (23,895)      | (26,552)      | 13               |
| Other non-operating income/(expenses)                                     | 1,671                     | 2,040             | 2,344         | 2,473         | 2,555            |
| (Gain)/losses from associates   | (100)                     | (59)              | (2)           | 38            | 263              |
| <b>Adjusted EBITDA</b>  | <b>42,480</b>             | <b>45,641</b>     | <b>40,099</b> | <b>46,743</b> | <b>43,541</b>    |

In the third quarter 2020, the management changed the approach to the calculation of Adjusted EBITDA by including foreign exchange gains and losses on operations. The comparative information was adjusted accordingly. We believe that this approach objectively reflects our results against high volatility in foreign exchange markets.

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.

Management Discussion and Analysis

For the year ended 31 December 2020

**Net Debt**

Net debt has been calculated as of the dates indicated:

|  | 31 December 2020 | 30 September 2020 | 30 June 2020              | 31 March 2020  | 31 December 2019 |
|--|------------------|-------------------|---------------------------|----------------|------------------|
|  |                  |                   | <i>in million dollars</i> |                |                  |
| Loans and borrowings less interest payable             | 199,075          | 205,872           | 183,327                   | 218,209        | 186,058          |
| <i>Net of:</i>   |                  |                   |                           |                |                  |
| Cash and short-term financial investments <sup>1</sup> | (100,401)        | (97,175)          | (80,230)                  | (109,658)      | (31,127)         |
| <b>NET DEBT</b>  | <b>98,674</b>    | <b>108,697</b>    | <b>103,097</b>            | <b>108,551</b> | <b>154,931</b>   |
| <b>NET DEBT TO EBITDA (LTM<sup>2</sup>)</b>            | <b>2.32</b>      | <b>2.38</b>       | <b>2.57</b>               | <b>2.32</b>    | <b>3.56</b>      |

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.

<sup>1</sup> Cash and short-term financial investments include Cash and cash equivalents, Other financial assets, short-term loans issued and the bank promissory notes with a maturity more than 1 year.

<sup>2</sup> 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 2020, sales volumes of pipes used in oil and gas industry accounted for approximately 74% 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.

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. 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 sales in 2020 was 66%. In 2020, the cost of scrap metal for TMK's plants in Russia in Rouble-terms increased on average by 6%, and the cost of coils decreased by 4%. 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 2020, energy and utility costs comprised approximately 10% of our total cost of sales. The prices for electricity for our plants increased by 5% in Rouble-terms compared to 2019, 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 2020, our five largest customers in Russia were Rosneft, Gazprom, Surgutneftegas, Gazpromneft and Lukoil, which together accounted for 41% 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 2020, 31% 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, Chinese pipe producers, as well as from ZTZ in the LDP segment.

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 some types of steel tubes and pipes originated from Ukraine that were extended till 2021, anti-dumping duties ranging from 4.32% to 18.96% on imports of seamless corrosion resistant steel tubes and pipes originating from Ukraine, antidumping duties in the amount 19.15% on imports of cold-drawn stainless steel pipes originated from China and Malaysia, 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.

Higher competition 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 we will not be able to meet our financial obligations as they fall due. Our approach to managing liquidity is to ensure that it will always have sufficient liquidity assets to meet its obligations when due.

We manage 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, 2020, our total debt increased to 199,075 million roubles as compared to 186,058 million roubles at the end of 2019 as a result of the Rouble depreciation against the US dollar. Net repayment amounted to 1,426 million roubles. As of December 31, 2020, our Net-Debt-to-EBITDA ratio was 2.32x.

As of December 31, 2020, we committed credit lines in Russian, European and American banks with the available limit of 96,105 million roubles.

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 on 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.

We are in compliance with 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**

Loans and borrowings at variable interest rate create an exposure to interest rate risk, that is, fluctuations of cash flows due to changes in market interest rates. The exposure of interest rate risk did not materialise for us in the reporting period, as substantially all of our loans and borrowings bore interest at fixed rates or the CBR key rate increased by a fixed margin.

### **Currency risk**

Our products' prices as well as our costs are nominated both in Roubles and in other currencies (generally, in US dollars and euro). 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 2020, we incurred foreign exchange gain from spot rate changes in the total amount of 8,288 million roubles. In addition, we recognised the

reclassification of foreign currency reserves to the income statement in the amount of 6,022 million roubles (net of income tax) in the statement of other comprehensive income. The reclassification was a result of IPSCO sale. Also we are exposed to currency risk on the borrowings that are denominated in currencies other than the functional currencies of the respective Group's members. The currencies in which these transactions are denominated are primarily Rubles, US dollars and euro. As of December 31, 2020, 20% of our loans were denominated in US dollar. In this regards, as well as taking into consideration continuing volatility of the Rouble against US dollar, the risk of losses owing to the Rouble devaluation remains sufficiently high. Depreciation of the Rouble against the US dollar could adversely affect our net profit as coherent losses will be reflected in our consolidated income statements. Nevertheless, we are 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 2020, inflation in Russia increased to 4.9% as compared to 3.0% in 2019. 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.

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 European Union and Kazakhstan 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 Kazakhstan 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 medical insurance 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 key 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.