

PRINCIPAL RISKS AND UNCERTAINTIES

Effective risk management is critical for fulfilling EVRAZ strategic priorities.

Risk Management System

(For more information, see the Risk Management and Internal Control section of the Corporate Governance Report, pages 115-117)



Viability statement

As a global steel and mining group, EVRAZ is exposed to a range of risks and inherent uncertainties that are explained more fully in this section. The Group's principal risks and its approach to managing them, together with the latest financial forecasts and five year strategic plan, have formed the basis for our assessment of longer term viability.

In accordance with provision C.2.2 of the UK Corporate Governance Code 2014, the Board has assessed the prospects of the Group over the period of the current strategic plan to December 2020 and consider it possible to form a reasonable expectation of the Group's viability over this five year period.

The assessment included consideration of the stress testing detailed below, with particular attention paid to the forecast cash position and compliance with financial maintenance covenants in each scenario and the mitigation plan developed by management.

The assessment was underpinned by scenarios that encompass a wide spectrum of potential outcomes. These scenarios are designed to explore the Group's resilience to the significant risks set out on pages 30-31 and combinations of correlated risks. The key scenarios can be summarised as:

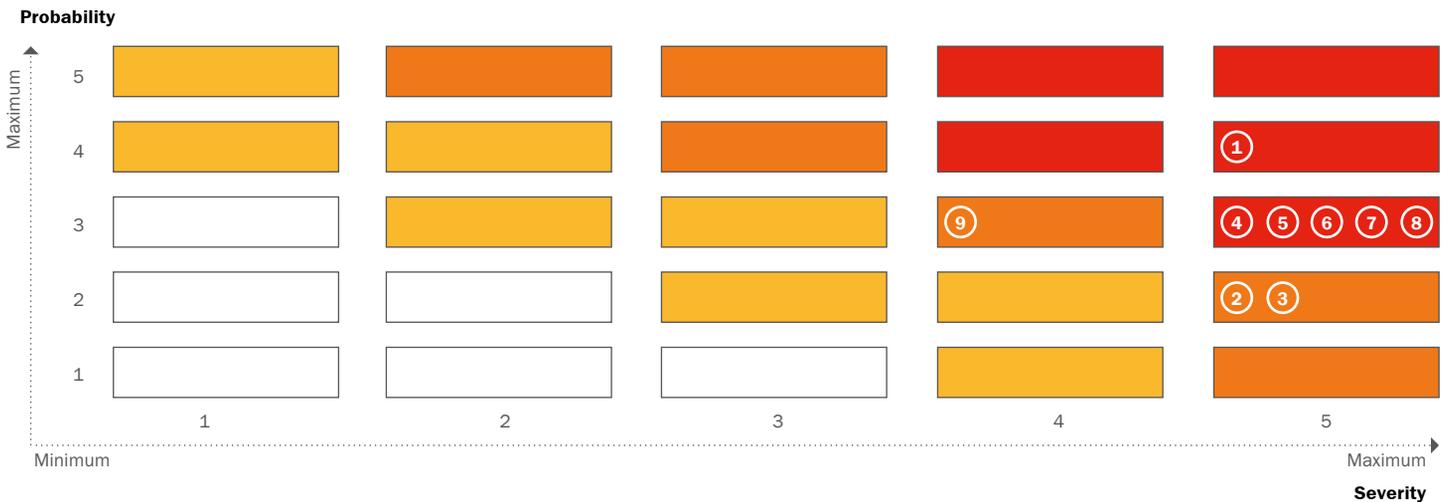
- Base scenario: the key assumptions as disclosed in note 6 to the financial statements under Impairment of assets on page 191; future pricing of steel and raw materials is based upon the upper end of the external analyst forecasts set out in Note 6; annual steel volumes are assumed not to exceed the 2015 level over the five year period to December 2020;
- Global economic decline: steel and raw material prices and exchange rates during 2016 are assumed to be lower than the level of January 2016; demand during 2016 is assumed to remain at the level of January 2016 with a gradual recovery in subsequent periods; future pricing assumptions are at the lower end of the external analyst forecast set out in Note 6;



RISK MANAGEMENT

Detailed risk assessments and risk evaluations were conducted at the plant and mine levels. The Risk Committee last reviewed the Group's risk profile in September 2015 and finalised the assessment in February 2016.

EVRAZ 2015 heat map



Risk migration in 2015

Successful implementation of skill development programmes has led to a re-assessment of the HR risk as a non-principal risk.

Risks of increased competition and cost effectiveness are reported separately, as the Group considers them as partly internal risks, as opposed to mostly external as in previous years.

Developments in 2015:

- Introduction of viability analysis and related statement as response to new FRC requirements
- Detailed analysis of cyber risk
- Regular semi-annual reassessment of risks

- ① Global economic factors, industry conditions
- ② Competition
- ③ Cost effectiveness
- ④ Treasury: availability of finance
- ⑤ Functional currency devaluation
- ⑥ HSE: environmental
- ⑦ HSE: health, safety
- ⑧ Potential action by governments
- ⑨ Business interruption

- Increased conversion costs in the CIS;
- Limited access to capital markets;
- Appreciation of local operating currencies;
- Business interruption: lost production and restoration costs; and
- Combinations of correlated risks/scenarios.

The scenarios are designed to be severe but plausible. They take full account of the potential actions available to mitigate the occurrence and impact of the risk, and the likely effectiveness of such action. The process makes certain assumptions about the normal level of capital recycling likely to occur and considers whether additional financing facilities will be required and available in each scenario.

EVRAZ considers that this stress-testing based assessment of its prospects is reasonable given the risks and inherent uncertainties facing the business.

The Directors confirm that their assessment of the principal risks facing the Group is robust. Based upon this robust assessment and the stress testing of Group prospects in a number of risk related scenarios, the Directors have a reasonable expectation that EVRAZ will be able to continue in operation and meets its liabilities as they fall due over the five year period to December 2020.

In making this statement, the Directors have made the following key assumptions:

- the continued availability of funding or refinancing, by way of capital market, bank debt and asset financing, of up to half the current debt level in all the scenarios considered; and
- financial maintenance covenants can continue to be managed if and when necessary through repayment of certain borrowings, financial covenant resets, a waiver from lenders and/or refinancing of certain borrowings.
- selling prices remain in line with prevailing market assumptions.

Principal risks

| Risk | Description |
|--|--|
| <p>1</p> <p>Global economic factors, industry conditions</p> | <p>EVRAZ' operations are dependent on the global macroeconomic environment and economic and industry conditions, e.g. the global supply and demand balance for steel and particularly for iron ore and coking coal, which can affect both product prices and volumes across all markets.</p> <p>As EVRAZ' operations involve substantial fixed costs, global economic and industry conditions can impact the Group's operational performance.</p> |
| <p>2</p> <p>Competition</p> | <p>Excessive supply in global market and greater competition.</p> <p>Increasing competition in the rail product segment from Mechel and a new rail producer in Kazakhstan.</p> |
| <p>3</p> <p>Cost effectiveness</p> | <p>The majority of the Group's steel production remains sensitive to costs and prices.</p> <p>Maintaining a low-cost position is one of EVRAZ' key business objectives in steelmaking and the iron ore and coking coal mining businesses.</p> <p>Key steel and coking coal assets are in the first quartile of the cost curve, which helps to maintain profitability even during market downturns.</p> |
| <p>4</p> <p>Treasury: availability of finance</p> | <p>Impact from the possible introduction of limitations on repatriation of foreign-currency export revenues, as well as additional regulations or limitations on cross-border capital flows.</p> <p>Potential government action, including economic sanctions impacting Russian entities, might increase the Group's capital market risk regarding additional funding.</p> |
| <p>5</p> <p>Functional currency devaluation</p> | <p>Any significant fluctuation in subsidiaries' functional currencies relative to the US dollar could have a significant effect on the Group's financial accounts, which might impact its ability to borrow.</p> |
| <p>6</p> <p>HSE: environmental</p> | <p>Steel and mining production carry an inherent risk of environmental impact and incidents relating to issues as diverse as water usage, quality of water discharged, air emissions, waste recycling, tailing management, air emissions (including greenhouse gases), and community satisfaction.</p> <p>Consequently, EVRAZ faces risks including regulatory fines, penalties, adverse impact on reputation and, in the extreme, the withdrawal of plant environmental licences, which would curtail operations indefinitely.</p> |
| <p>7</p> <p>HSE: health, safety</p> | <p>Potential danger of fire, explosions and electrocution, as well as risks specific to individual mines: methane levels, rock falls and other accidents could lead to outage or production delays, loss of qualified personnel, loss of material, equipment or product, or extensive damage compensation.</p> <p>Breach of any HSE laws, regulations and standards may result in fines, penalties, suspension of production, or other sanctions.</p> <p>Prolonged outages or production delays, especially in coal mining, could have a material adverse effect on the Group's operating performance.</p> |
| <p>8</p> <p>Potential action by governments</p> | <p>New laws, regulations or other requirements could limit the Group's ability to obtain financing in international markets, sell its products and purchase equipment.</p> <p>Risk of capital controls that affect the Group in terms of free flow of capital.</p> <p>EVRAZ may also be adversely affected by government sanctions against Russian business or otherwise reducing its ability to conduct business with counterparties.</p> <p>Risk of adverse geopolitical situation in countries of operation.</p> |
| <p>9</p> <p>Business interruption</p> | <p>Prolonged outages or production delays, especially in coal mining, could have a material adverse effect on the Group's operating performance, production, financial condition and future prospects.</p> <p>In addition, long-term business interruption may result in a loss of customers and competitive advantage, and damage to the Group's reputation.</p> |

| Mitigating/risk management actions in 2015 | Risk direction |
|---|----------------|
| <p>Downscaling of inefficient assets and suspension of production in low-growth regions. Focused investment policy aimed at reducing and managing the cost base with the objective of being among the sector's lowest-cost producers. Expansion of product portfolio and sales geography to better serve current and future customers.</p> | ↑ |
| <p>Expansion of product portfolio and penetration of new geographic and product markets. Development and improvement of loyalty and customer focus programmes and initiatives. Quality improvement initiatives.</p> | ↑ |
| <p>For both the mining and steelmaking operations, the Group executes cost reduction projects to increase the competitiveness of assets. Focused investment policy aimed at reducing and managing the cost base. Further expansion and control of the Group's Russian steel distribution network. Development of high-value-added products.</p> | ← → |
| <p>Action to extend the debt maturity profile and diversify sources of funding. Liquidity risk is managed by revisiting capital expenditure plans, cost optimisation programmes, asset portfolios and the dividend policy.</p> | ← → |
| <p>EVRAZ works to reduce the amount of intergroup loans denominated in Russian roubles and Ukrainian hryvnias to limit the possible devaluation effect on its consolidated net income.</p> | ↑ |
| <p>Implementation of air emission and water use reduction programmes at plants. Waste management improvement programmes. The majority of EVRAZ' operations are certified under ISO 14001 and the Group continues to work towards bringing the remaining plants to ISO 14001 requirements. EVRAZ is currently compliant with REACH requirements.</p> | ← → |
| <p>Management KPIs place significant emphasis on safety performance and the standardisation of critical safety programmes. Implementation of energy isolation programme. Introduction of a programme of behaviour safety observations drives a more proactive approach to preventing injuries and incidents. Introduction of contractual safety programme, reduction of number of contractors. A series of health and safety initiatives related to underground mining. Maintenance and repair modernisation programmes, downtime management system.</p> | ← → |
| <p>While these risks are mostly not within the Group's control, EVRAZ and its executive teams are members of various national industry bodies. As a result, they contribute to the development of such bodies and, when appropriate, participate in relevant discussions with political and regulatory authorities.</p> | ← → |
| <p>The Group has defined and established disaster recovery procedures which are subject to regular review. Business interruptions in mining mainly relate to production safety. Measures to mitigate these risks include methane monitoring and degassing systems, timely mining equipment maintenance, employee safety training and development of geodynamic monitoring systems. Detailed analysis of causes of incidents is performed in order to develop and implement preventative actions. Records of minor interruptions are reviewed to identify any more significant underlying issues.</p> | ← → |