

Mechel OAO  
Form 20-F  
April 26, 2017  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**Form 20-F**

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934**

**For the fiscal year ended December 31, 2016**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**OR**

**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**Commission file number 001-32328**

**MECHEL PAO**

**(Exact name of Registrant as specified in its charter)**

**RUSSIAN FEDERATION**

**(Jurisdiction of incorporation or organization)**

**Krasnoarmeyskaya Street 1, Moscow 125167, Russian Federation**

**(Address of principal executive offices)**

**Alexey Lukashov, tel.: +7-495-221-8888, e-mail: [alexey.lukashov@mechel.com](mailto:alexey.lukashov@mechel.com)**

**(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)**

**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

| <b>Title of Each Class</b>   | <b>Name of Each Exchange on Which Registered</b> |
|--|--|
| <b>COMMON AMERICAN DEPOSITARY SHARES, EACH COMMON ADS REPRESENTING TWO COMMON SHARES COMMON SHARES, PAR VALUE</b>                      | <b>NEW YORK STOCK EXCHANGE</b>                   |
| <b>10 RUSSIAN RUBLES PER SHARE</b>   | <b>NEW YORK STOCK EXCHANGE<sup>(1)</sup></b>     |
| <b>PREFERRED AMERICAN DEPOSITARY SHARES, EACH PREFERRED ADS REPRESENTING ONE-HALF OF A PREFERRED SHARE PREFERRED SHARES, PAR VALUE</b> | <b>NEW YORK STOCK EXCHANGE</b>                   |
| <b>10 RUSSIAN RUBLES PER SHARE</b>   | <b>NEW YORK STOCK EXCHANGE<sup>(2)</sup></b>     |

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**

**None**

**(Title of Class)**

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**

**None**

**(Title of Class)**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

416,270,745 common shares, of which 82,266,622 shares are in the form of common ADSs as of March 31, 2017

138,756,915 preferred shares (including 55,502,766 shares held by Skyblock Limited, a wholly-owned subsidiary of Mechel), of which 9,359,432 shares are in the form of preferred ADSs as of March 31, 2017

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer Accelerated filer Non-accelerated filer  
Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP International Financial Reporting Standards as issued by the International Accounting Standards Board Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

- (1) Listed, not for trading or quotation purposes, but only in connection with the registration of common ADSs pursuant to the requirements of the Securities and Exchange Commission.
- (2) Listed, not for trading or quotation purposes, but only in connection with the registration of preferred ADSs pursuant to the requirements of the Securities and Exchange Commission.

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Unless the context otherwise requires, references to Mechel refer to Mechel PAO, and references to Mechel group, our group, we, us or our refer to Mechel PAO together with its subsidiaries.

Our business consists of three segments: mining, steel and power. References in this document to segment revenues are to revenues of the segment excluding intersegment sales, unless otherwise noted. References in this document to our sales or our total sales are to third-party sales and do not include intra-group sales, unless otherwise noted.

For the purposes of calculating certain market share data, we have included businesses that are currently part of our group that may not have been part of our group during the period for which such market share data is presented.

The presentation currency of our consolidated financial statements is the Russian ruble. Before transition to IFRS, U.S. dollar was the presentation currency of our consolidated financial statements prepared under U.S. GAAP. The

reason of adopting the Russian ruble as the presentation currency in the consolidated statements

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under IFRS is to allow a greater transparency of our financial and operating performance as it more closely reflects the profile of our revenue and operating income that are mostly generated in Russian rubles.

References to Russian rubles, rubles or RUB are to the currency of the Russian Federation, references to U.S. dollars, \$ or USD are to the currency of the United States and references to euro, or EUR are to the currency of the member states of the European Union that participate in the European Monetary Union.

The term tonne as used herein means a metric tonne. A metric tonne is equal to 1,000 kilograms or 2,204.62 pounds. The term short ton is also used in this document. A short ton is equal to 907 kilograms or 2,000 pounds.

Certain amounts that appear in this document have been subject to rounding adjustments; accordingly, figures shown as totals in certain tables or in the text may not be an arithmetic aggregation of the figures that precede them.

CIS means the Commonwealth of Independent States.

The following table sets forth by business activity the official names and location of our key subsidiaries and their names as used in this document:

| <b>Name as Used in This Document</b> | <b>Official Name</b>                                 | <b>Location</b>                   |
|--------------------------------------|--|-----------------------------------|
| <b><i>Mining</i></b>                 |  |                                   |
| Mechel Mining                        | Mechel Mining AO <sup>(1)</sup>                      | Russia, Moscow                    |
| Southern Kuzbass Coal Company        | Southern Kuzbass Coal Company PAO <sup>(1)</sup>     | Russia, Kemerovo region           |
| Yakutugol                            | Yakutugol Joint-Stock Holding Company <sup>(1)</sup> | Russia, Sakha Republic            |
| Elgaugol                             | Elgaugol OOO   | Russia, Sakha Republic            |
| Korshunov Mining Plant               | Korshunov Mining Plant PJSC <sup>(1)</sup>           | Russia, Irkutsk region            |
| Moscow Coke and Gas Plant            | Moscow Coke and Gas Plant JSC <sup>(1)</sup>         | Russia, Moscow region             |
| Mechel Coke                          | Mechel Coke OOO                                      | Russia, Chelyabinsk region        |
| Port Posiet                          | Port Posiet JSC <sup>(1)</sup>                       | Russia, Primorsk Krai             |
| Port Temryuk                         | Port Mechel Temryuk OOO                              | Russia, Krasnodar Krai            |
| <b><i>Steel</i></b>                  |  |                                   |
| Chelyabinsk Metallurgical Plant      | Chelyabinsk Metallurgical Plant PAO <sup>(1)</sup>   | Russia, Chelyabinsk region        |
| Izhstal                              | Izhstal OAO  | Russia, Republic of Udmurtia      |
| Urals Stampings Plant                | Urals Stampings Plant PAO <sup>(1)</sup>             | Russia, Chelyabinsk region        |
| Beloretsk Metallurgical Plant        | Beloretsk Metallurgical Plant AO <sup>(1)</sup>      | Russia, Republic of Bashkortostan |
| Vyartsilya Metal Products Plant      | Vyartsilya Metal Products Plant ZAO                  | Russia, Republic of Karelia       |
| Mechel Nemunas                       | Mechel Nemunas UAB                                   | Lithuania                         |
| Bratsk Ferroalloy Plant              | Bratsk Ferroalloy Plant OOO                          | Russia, Irkutsk region            |
| Port Kambarka                        | Port Kambarka OAO                                    | Russia, Republic of Udmurtia      |





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| <b>Name as Used in This Document</b>     | <b>Official Name</b>             | <b>Location</b>            |
|--|----------------------------------|----------------------------|
| <b><i>Power</i></b>                      |                                  |                            |
| Southern Kuzbass Power Plant             | Southern Kuzbass Power Plant OAO | Russia, Kemerovo region    |
| Kuzbass Power Sales Company              | Kuzbass Power Sales Company OAO  | Russia, Kemerovo region    |
| Mechel Energo                            | Mechel Energo OOO                | Russia, Chelyabinsk region |
| <b><i>Marketing and Distribution</i></b> |                                  |                            |
| Mechel Carbon                            | Mechel Carbon AG                 | Switzerland, Baar          |
| Mechel Trading                           | Mechel Trading AG                | Switzerland, Baar          |
| Mechel Service Global                    | Mechel Service Global B.V.       | Netherlands                |
| Mechel Service                           | Mechel Service OOO               | Russia, Moscow             |
| <b><i>Other</i></b>                      |                                  |                            |
| Mecheltrans                              | Mecheltrans OOO                  | Russia, Moscow             |

- (1) The legal organizational form of our Russian subsidiaries and Mechel has been changed in accordance with the current legislation of the Russian Federation.

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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Matters discussed in this document may constitute forward-looking statements, as defined in the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. We wish to caution you that these statements are only predictions and that actual events or results may differ materially. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts. The words believe, expect, anticipate, intend, estimate, forecast, project, will, may, should and similar expressions identify forward-looking statements. Forward-looking statements appear in a number of places including, without limitation, Item 3. Key Information Risk Factors, Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects, and include statements regarding:

strategies, outlook and growth prospects;

the ability to maintain and generate sufficient cash and other liquid resources to meet our operating and debt service requirements;

our ability to comply with the financial covenants in our loan agreements as well as other covenants and restrictions imposed by the existing and future financing arrangements and our ability to attract new financing or refinancing of debt, including an outcome in the ongoing debt restructuring negotiations with our lenders;

the impact of competition;

costs of our acquisitions and ability to realize expected synergies and other benefits;

capital expenditures;

demand for our products;

economic outlook and industry trends;

transactions with related parties;

regulatory compliance;

developments in our markets;

future plans and potential for future growth;

the results of any legal procedures;

the impact of regulatory initiatives; and

the strength of our competitors.

The forward-looking statements in this document are based upon various assumptions, many of which are based, in turn, upon further assumptions, including without limitation, management's examination of historical operating trends, data contained in our records and other data available from third parties. Although we believe that these assumptions were reasonable when made, these assumptions are inherently subject to significant uncertainties and contingencies which are difficult or impossible to predict and are beyond our control and we may not achieve or accomplish these expectations, beliefs or projections. See Item 3. Key Information Risk Factors for a discussion of important factors that, in our view, could cause actual results to differ materially from those discussed in the forward-looking statements.

Except to the extent required by law, neither we, nor any of our agents, employees or advisers intend or have any duty or obligation to supplement, amend, update or revise any of the forward-looking statements contained or incorporated by reference in this document.

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**PART I**

**Item 1. *Identity of Directors, Senior Management and Advisers***

Not applicable.

**Item 2. *Offer Statistics and Expected Timetable***

Not applicable.

**Item 3. *Key Information***

**Selected Financial Data**

The financial data set forth below as of December 31, 2016, 2015 and 2014, and for the years then ended, have been derived from our consolidated financial statements. Our reporting currency is the Russian ruble and we prepare our consolidated financial statements in accordance with International Financial Reporting Standards ( **IFRS** ).

The consolidated financial statements for the year ended December 31, 2015 were the first we had prepared in accordance with IFRS. The date of transition to IFRS was January 1, 2014. For periods up to and including the year ended December 31, 2014, we prepared our consolidated financial statements in accordance with U.S. GAAP. Accordingly, we have prepared financial statements that comply with IFRS applicable as of December 31, 2016, together with the comparative periods data for the years ended December 31, 2015 and 2014.

Pursuant to the transitional relief granted by the U.S. SEC in respect of the first-time adoption of IFRS, we have only provided financial statements and financial information for two fiscal years ended December 31, 2015 in the previously filed annual report for the year ended December 31, 2015 as presented under IFRS, we have provided financial statements and financial information for three fiscal years ended December 31, 2016 herein. The selected financial information as of and for the years ended December 31, 2016, 2015 and 2014 set forth below should be read in conjunction with, and is qualified in its entirety by reference to Item 5. Operating and Financial Review and Prospects and our audited consolidated financial statements and the notes thereto included in this annual report.

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Our results of operations for the periods presented are affected by disposals. See note 1(a) to the consolidated financial statements. The financial data below should be read in conjunction with, and is qualified in its entirety by reference to, our consolidated financial statements and Item 5. Operating and Financial Review and Prospects.

|  | <b>Year Ended December 31,</b>                                  |                  |                  |
|--|---|------------------|------------------|
|  | <b>2016</b>   | <b>2015</b>      | <b>2014</b>      |
|  | <b>(In millions of Russian rubles, unless stated otherwise)</b> |                  |                  |
| <b>Consolidated statement of profit (loss) and other comprehensive income (loss) data:</b>           |   |                  |                  |
| Revenue  | 276,009   | 253,141          | 243,992          |
| Cost of goods sold   | (146,322)   | (151,334)        | (153,057)        |
| Gross profit   | 129,687   | 101,807          | 90,935           |
| Total selling, distribution and operating income and (expenses), net                                 | (86,997)  | (77,555)         | (90,028)         |
| Operating profit   | 42,690  | 24,252           | 907              |
| Total other income and (expense), net  | (28,539)  | (131,380)        | (131,994)        |
| Profit (loss) before tax from continuing operations  | 14,151  | (107,128)        | (131,087)        |
| Income tax (expense) benefit   | (4,893)   | (8,322)          | 8,822            |
| Profit (loss) for the year from continuing operations  | 9,258   | (115,450)        | (122,265)        |
| (Loss) profit after tax for the year from discontinued operations, net                               | (426)   | 822              | (11,702)         |
| Profit (loss) for the year   | 8,832   | (114,628)        | (133,967)        |
| Less: profit (loss) attributable to non-controlling interests  | 1,706   | 535              | (1,263)          |
| Profit (loss) attributable to equity shareholders of Mechel PAO                                      | 7,126   | (115,163)        | (132,704)        |
| Profit (loss) for the year   | 8,832   | (114,628)        | (133,967)        |
| Exchange differences on translation of foreign operations  | 431   | 287              | 1,168            |
| Net (loss) gain on available for sale financial assets   | (1)   | 8                | 2                |
| Re-measurement losses on defined benefit plans   | (23)  | (194)            | (127)            |
| <b>Total comprehensive income (loss) for the year, net of tax</b>                                    | <b>9,239</b>  | <b>(114,527)</b> | <b>(132,924)</b> |
| Total comprehensive income (loss) attributable to non-controlling interests                          | 1,710   | 537              | (1,249)          |
| Total comprehensive income (loss) attributable to equity shareholders of Mechel PAO                  | 7,529   | (115,064)        | (131,675)        |
| Earnings (loss) per share from continuing operations (in Russian rubles per share) basic and diluted | 18  | (278)            | (290)            |
|  | (1)   | 2                | (29)             |

(Loss) earnings per share from discontinued operations (in Russian rubles per share)

|  |    |       |       |
|--|----|-------|-------|
| Basic and diluted, earnings (loss) for the year attributable to common equity shareholders of Mechel PAO | 17 | (277) | (319) |
| Cash dividends per common share  |    |       |       |

Cash dividends per preferred share

|  |             |             |             |
|--|-------------|-------------|-------------|
| Weighted average number of common shares | 416,270,745 | 416,270,745 | 416,270,745 |
|--|-------------|-------------|-------------|

**Mining segment statement of profit (loss) data<sup>(1)</sup>:**

|                    |          |          |          |
|--------------------|----------|----------|----------|
| Revenue            | 121,555  | 108,723  | 100,558  |
| Cost of goods sold | (45,040) | (51,280) | (51,435) |

|              |        |        |        |
|--------------|--------|--------|--------|
| Gross profit | 76,515 | 57,442 | 49,123 |
|--------------|--------|--------|--------|

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|   | Year Ended December 31, |           |           |
|---|-------------------------|-----------|-----------|
|   | 2016                    | 2015      | 2014      |
| (In millions of Russian rubles, unless stated otherwise)  |                         |           |           |
| Total selling, distribution and operating income and (expenses), net  | (45,503)                | (41,437)  | (47,405)  |
| Operating profit  | 31,012                  | 16,005    | 1,718     |
| <b>Steel segment statement of profit (loss) data<sup>(1)</sup>:</b>   |                         |           |           |
| Revenue   | 168,893                 | 153,004   | 146,867   |
| Cost of goods sold  | (126,745)               | (119,610) | (115,485) |
| Gross profit  | 42,148                  | 33,394    | 31,382    |
| Total selling, distribution and operating income and (expenses), net  | (30,617)                | (24,868)  | (32,701)  |
| Operating profit (loss)   | 11,531                  | 8,526     | (1,319)   |
| <b>Power segment statement of profit (loss) data<sup>(1)</sup>:</b>   |                         |           |           |
| Revenue   | 40,625                  | 41,467    | 39,554    |
| Cost of goods sold  | (29,047)                | (30,178)  | (29,215)  |
| Gross profit  | 11,578                  | 11,289    | 10,339    |
| Total selling, distribution and operating income and (expenses), net  | (10,877)                | (11,250)  | (9,922)   |
| Operating profit  | 701                     | 39        | 417       |
| <b>Consolidated statement of financial position data (at period end):</b>   |                         |           |           |
| Total assets  | 325,465                 | 342,071   | 369,258   |
| Equity attributable to equity shareholders of Mechel PAO  | (260,274)               | (267,803) | (154,666) |
| Equity attributable to non-controlling interests  | 7,687                   | 5,948     | 8,253     |
| Interest-bearing loans and borrowings, including interest payable, fines and penalties on overdue amounts of RUB 38,594 million, RUB 47,475 million and RUB 14,615 million as of December 31, 2016, 2015 and 2014, respectively | 434,165                 | 491,674   | 386,518   |
| Non-current interest-bearing loans and borrowings   | 11,644                  | 4,308     | 9,346     |
| <b>Consolidated statement of cash flows data:</b>   |                         |           |           |
| Net cash provided by operating activities   | 53,207                  | 38,867    | 43,013    |
| Net cash used in investing activities   | (4,969)                 | (5,218)   | (14,494)  |
| Net cash used in financing activities   | (45,869)                | (34,433)  | (34,206)  |
| <b>Non-IFRS measures<sup>(2)</sup>:</b>   |                         |           |           |
| Consolidated Adjusted EBITDA  | 66,164                  | 45,730    | 29,759    |
| Mining Segment Adjusted EBITDA  | 41,884                  | 26,831    | 13,359    |
| Steel Segment Adjusted EBITDA   | 23,172                  | 17,127    | 14,906    |
| Power Segment Adjusted EBITDA   | 1,662                   | 2,090     | 1,403     |

- (1) Segment revenues and cost of goods sold include intersegment sales.
- (2) Adjusted EBITDA represents net profit (loss) attributable to shareholders of Mechel PAO before depreciation and depletion, foreign exchange (gain) loss, net, finance costs, including fines and penalties on overdue loans and borrowings and finance lease payments, finance income, net result on the disposal of non-current assets, impairment of goodwill and other non-current assets, write-off of accounts receivable, allowance for doubtful accounts, write-off of inventories to net realizable value, loss (profit) after tax for the year from discontinued operations, net, net result on the disposal of subsidiaries, profit (loss) attributable to non-controlling interests, income tax expense (benefit), pension service cost and actuarial loss, other related expenses, other fines and penalties, gain on write-off of accounts payable with expired legal term, other one-off items.



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Reconciliation of Adjusted EBITDA to net profit (loss) attributable to shareholders of Mechel PAO is as follows for the periods indicated:

|   | <b>Year Ended December 31,</b>         |               |               |
|---|--|---------------|---------------|
|   | <b>2016</b>                            | <b>2015</b>   | <b>2014</b>   |
|   | <b>(In millions of Russian rubles)</b> |               |               |
| <b>Consolidated Adjusted EBITDA reconciliation:</b>   |  |               |               |
| Net profit (loss) attributable to shareholders of Mechel PAO  | 7,126                                  | (115,163)     | (132,704)     |
| Add:  |  |               |               |
| Depreciation and depletion  | 13,714                                 | 14,085        | 14,429        |
| Foreign exchange (gain) loss, net   | (25,947)                               | 71,106        | 103,176       |
| Finance costs, including fines and penalties on overdue loans and borrowings and finance lease payments   | 54,240                                 | 60,452        | 28,110        |
| Finance income  | (1,176)                                | (183)         | (107)         |
| Net result on the disposal of non-current assets, impairment of goodwill and other non-current assets, write-off of accounts receivable, allowance for doubtful accounts and write-off of inventories to net realizable value | 8,447                                  | 4,772         | 12,710        |
| Loss (profit) after tax for the year from discontinued operations, net  | 426                                    | (932)         | 11,702        |
| Net result on the disposal of subsidiaries  | (194)                                  | 19            | 89            |
| Profit (loss) attributable to non-controlling interests   | 1,706                                  | 535           | (1,263)       |
| Income tax expense (benefit)  | 4,893                                  | 8,322         | (8,822)       |
| Pension service cost and actuarial loss, other related expenses   | (171)                                  | 50            | (6)           |
| Other fines and penalties   | 1,396                                  | 1,598         | 915           |
| Gain on write-off of accounts payable with expired legal term   | (115)                                  | (224)         | (38)          |
| Other one-off items   | 1,819                                  | 1,293         | 1,568         |
| <b>Consolidated Adjusted EBITDA</b>   | <b>66,164</b>                          | <b>45,730</b> | <b>29,759</b> |
| <b>Mining Segment Adjusted EBITDA reconciliation:</b>   |  |               |               |
| Net profit (loss) attributable to shareholders of Mechel PAO  | 1,797                                  | (71,120)      | (86,787)      |
| Add:  |  |               |               |
| Depreciation and depletion  | 7,912                                  | 9,106         | 8,747         |
| Foreign exchange (gain) loss, net   | (14,960)                               | 49,872        | 70,553        |
| Finance costs, including fines and penalties on overdue loans and borrowings and finance lease payments   | 39,345                                 | 33,880        | 15,045        |
| Finance income  | (2,482)                                | (1,030)       | (777)         |
| Net result on the disposal of non-current assets, impairment of goodwill and other non-current assets, write-off of accounts receivable, allowance for doubtful accounts and write-off of inventories to net realizable value | 2,584                                  | 900           | 1,357         |
| (Profit) loss after tax for the year from discontinued operations, net  |  | (764)         | 13,141        |
| Net result on the disposal of subsidiaries  |  |               |               |
| Profit (loss) attributable to non-controlling interests   | 511                                    | (444)         | (971)         |
| Income tax expense (benefit)  | 5,019                                  | 5,632         | (8,435)       |
| Pension service cost and actuarial loss, other related expenses   | (198)                                  | 125           | (5)           |
| Other fines and penalties   | 556                                    | 707           | 755           |
| Gain on write-off of accounts payable with expired legal term   | (19)                                   | (33)          | (2)           |

|                                |        |        |        |
|--------------------------------|--------|--------|--------|
| Other one-off items            | 1,819  |        | 741    |
| Mining Segment Adjusted EBITDA | 41,884 | 26,831 | 13,359 |

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|   | <b>Year Ended December 31,</b>         |               |               |
|---|--|---------------|---------------|
|   | <b>2016</b>                            | <b>2015</b>   | <b>2014</b>   |
|   | <b>(In millions of Russian rubles)</b> |               |               |
| <b>Steel Segment Adjusted EBITDA reconciliation:</b>  |  |               |               |
| Net profit (loss) attributable to shareholders of Mechel PAO  | 6,399                                  | (41,438)      | (45,356)      |
| Add:  |  |               |               |
| Depreciation and depletion  | 5,435                                  | 4,650         | 5,391         |
| Foreign exchange (gain) loss, net   | (10,904)                               | 21,122        | 32,910        |
| Finance costs, including fines and penalties on overdue loans and borrowings and finance lease payments   | 17,411                                 | 25,645        | 12,966        |
| Finance income  | (2,234)                                | (344)         | (390)         |
| Net result on the disposal of non-current assets, impairment of goodwill and other non-current assets, write-off of accounts receivable, allowance for doubtful accounts and write-off of inventories to net realizable value | 5,389                                  | 2,122         | 10,658        |
| Profit after tax for the year from discontinued operations, net   | 406                                    | (168)         | (1,468)       |
| Net result on the disposal of subsidiaries  | (194)                                  | 19            | 89            |
| Profit (loss) attributable to non-controlling interests   | 1,056                                  | 812           | (408)         |
| Income tax (benefit) expense  | (265)                                  | 2,794         | (374)         |
| Pension service cost and actuarial loss, other related expenses   | 26                                     | (81)          | (7)           |
| Other fines and penalties   | 742                                    | 890           | 189           |
| Gain on write-off of accounts payable with expired legal term   | (95)                                   | (190)         | (35)          |
| Other one-off items   |  | 1,263         | 742           |
| <b>Steel Segment Adjusted EBITDA</b>  | <b>23,172</b>                          | <b>17,127</b> | <b>14,906</b> |
| <b>Power Segment Adjusted EBITDA reconciliation:</b>  |  |               |               |
| Net (loss) profit attributable to shareholders of Mechel PAO  | (517)                                  | (2,286)       | (651)         |
| Add:  |  |               |               |
| Depreciation and depletion  | 367                                    | 329           | 291           |
| Foreign exchange (gain) loss, net   | (83)                                   | 111           | (287)         |
| Finance costs, including fines and penalties on overdue loans and borrowings and finance lease payments   | 1,078                                  | 2,173         | 1,208         |
| Finance income  | (54)                                   | (55)          | (48)          |
| Net result on the disposal of non-current assets, impairment of goodwill and other non-current assets, write-off of accounts receivable, allowance for doubtful accounts and write-off of inventories to net realizable value | 474                                    | 1,751         | 696           |
| Loss after tax for the year from discontinued operations, net   | 20                                     |               | 29            |
| Net result on the disposal of subsidiaries  |  |               |               |
| Profit (loss) attributable to non-controlling interests   | 139                                    | 166           | 114           |
| Income tax expense (benefit)  | 139                                    | (103)         | (13)          |
| Pension service cost and actuarial loss, other related expenses   | 2                                      | 6             | 7             |
| Other fines and penalties   | 98                                     |               | (29)          |
| Gain on write-off of accounts payable with expired legal term   | (1)                                    | (1)           |               |
| Other one-off items   |  |               | 86            |
| <b>Power Segment Adjusted EBITDA</b>  | <b>1,662</b>                           | <b>2,090</b>  | <b>1,403</b>  |



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Adjusted EBITDA is a measure of our operating performance that is not required by, or presented in accordance with, IFRS. Adjusted EBITDA is not a measure of our operating performance under IFRS and should not be considered as an alternative to net income, operating income 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 as a measure of discretionary cash available to us to invest in the growth of our business.

Adjusted EBITDA has limitations as an analytical tool, and should not be considered in isolation or as a substitute for analysis of our operating results as reported under IFRS. Some of these limitations are as follows:

Adjusted EBITDA does not reflect the impact of depreciation and depletion on our operating performance. The assets of our businesses which are being depreciated and depleted (including, for example, our mineral reserves) will have to be replaced in the future and such depreciation and depletion expense may approximate the cost to replace these assets in the future. By excluding such expense from Adjusted EBITDA, Adjusted EBITDA does not reflect our future cash requirements for such replacements.

Adjusted EBITDA does not reflect the impact of foreign exchange gains and losses, which may recur.

Adjusted EBITDA does not reflect the impact of finance income and finance costs, including fines and penalties on overdue loans and borrowings and finance lease payments, which are significant and could further increase if we incur more debt, on our operating performance.

Adjusted EBITDA does not reflect the impact of the net result on the disposal of non-current assets on our operating performance, which may recur.

Adjusted EBITDA does not reflect the impact of impairment of goodwill and other non-current assets, which may recur.

Adjusted EBITDA does not reflect the impact of write-off of accounts receivable, which may recur.

Adjusted EBITDA does not reflect the impact of allowance for doubtful accounts, which may recur.

Adjusted EBITDA does not reflect the impact of write-off of inventories to net realizable value, which may recur.

Adjusted EBITDA does not reflect the impact of profits and losses after tax for the year from discontinued operations.

Adjusted EBITDA does not reflect the impact of net result on the disposal of subsidiaries.

Adjusted EBITDA does not reflect the impact of profits and losses attributable to non-controlling interests on our operating performance.

Adjusted EBITDA does not reflect the impact of income tax expenses and benefits on our operating performance.

Adjusted EBITDA does not reflect the impact of pension service cost and actuarial loss, other related expenses.

Adjusted EBITDA does not reflect the impact of other fines and penalties.

Adjusted EBITDA does not reflect the impact of gain on write-off of accounts payable with expired legal term.

Adjusted EBITDA does not reflect the impact of other one-off items.

Other companies in our industry may calculate Adjusted EBITDA differently or may use it for different purposes than we do, limiting its usefulness as a comparative measure.

We compensate for these limitations by relying primarily on our IFRS operating results and using Adjusted EBITDA only supplementally. See our consolidated statement of financial position, consolidated statement of profit (loss) and other comprehensive income (loss) and consolidated statement of cash flows included elsewhere in this document.

**Table of Contents****Exchange Rates**

The following tables show, for the periods indicated, certain information regarding the official exchange rate between the ruble and the U.S. dollar, based on data published by the Central Bank of the Russian Federation (the **CBR** ).

These rates may differ from the actual rates used in preparation of our financial statements and other financial information provided herein.

| Year Ended December 31, | Rubles per U.S. Dollar |       |                        |            |
|-------------------------|------------------------|-------|------------------------|------------|
|                         | High                   | Low   | Average <sup>(1)</sup> | Period End |
| 2016                    | 83.59                  | 60.27 | 67.03                  | 60.66      |
| 2015                    | 72.88                  | 49.18 | 60.96                  | 72.88      |
| 2014                    | 67.79                  | 32.66 | 38.42                  | 56.26      |
| 2013                    | 33.47                  | 29.93 | 31.85                  | 32.73      |
| 2012                    | 34.04                  | 28.95 | 31.09                  | 30.37      |

(1) The average of the exchange rates on the last business day of each full month during the relevant period.

|               | Rubles per U.S. Dollar |       |
|---------------|------------------------|-------|
|               | High                   | Low   |
| March 2017    | 59.22                  | 56.38 |
| February 2017 | 60.31                  | 56.77 |
| January 2017  | 60.66                  | 59.15 |
| December 2016 | 65.24                  | 60.27 |
| November 2016 | 65.86                  | 63.20 |
| October 2016  | 63.40                  | 62.05 |

The exchange rate between the ruble and the U.S. dollar on April 26, 2017 was 55.85 rubles per one U.S. dollar.

No representation is made that the ruble or U.S. dollar amounts in this document could have been or can be converted into U.S. dollars or rubles, as the case may be, at any particular rate or at all.

**Risk Factors**

*An investment in our shares and ADSs involves a high degree of risk. You should carefully consider the following information about these risks, together with the information contained in this document, before you decide to buy our shares or ADSs. If any of the following risks actually occurs, our business, financial condition, results of operations or prospects could be materially adversely affected. In that case, the value of our shares or ADSs could also decline and you could lose all or part of your investment.*

**Risks Relating to Our Financial Condition and Financial Reporting**

*There is substantial doubt about our ability to continue as a going concern.*

As discussed in note 4 to our consolidated financial statements in Item 18. Financial Statements, because we have significant debt that we do not have the ability to repay without refinancing or restructuring, and our ability to do so is dependent upon continued negotiations with the banks, there is substantial doubt about our ability to continue as a going concern. We also note that there was a default on payments of principal and interest to certain lenders and lessors. In addition, we have been in non-compliance with certain financial and non-financial covenants in several loan agreements. See We face pressure on our liquidity, negatively influencing our working capital, which resulted from the acquisitions, substantial investment program, decrease



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in prices on commodity markets, global economic slowdown, difficulties with attracting new financing or refinancing of our debt and our need to service debt along with international sanctions against Russia and Russian state-owned banks, Our failure to comply with the payment and other obligations in our credit facilities caused some of our creditors to accelerate amounts due under their loan agreements and such failure, or like failure in the future, may cause the acceleration of our other outstanding debt, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects, If we are unable to restructure all of our indebtedness or fail to comply with the new terms of the restructured indebtedness, our lenders may claim for accelerated repayment, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects, We have a substantial amount of outstanding indebtedness with restrictive financial covenants and most shares and assets in our subsidiaries are pledged and We have not fulfilled our payment obligations under several of the group's lease agreements and a number of the respective lessors have required the return of the leased assets, which may materially adversely affect our business, financial condition, results of operations and prospects. Although as of December 31, 2016 restructuring agreements with our major lenders, such as Gazprombank, VTB Bank and Sberbank, were signed and became effective and restructuring agreements with our major lessors, such as Sberbank Leasing AO and VTB Leasing JSC, were entered into we still have a number of creditors to which the debt is overdue and such creditors could (have the legal right to) request for accelerated repayment of a significant portion of our debt and initiate legal procedures for enforcement of our debts. We do not have the resources to repay overdue debt or to enable us to comply with accelerated repayment requests immediately. Our plans, including the achievement of the restructuring with all of our lenders and aligning the servicing of our debt with new repayment schedules and projected cash flows to be generated by our group in 2017 and beyond, are discussed in Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Outlook for 2017 and note 4 to our consolidated financial statements in Item 18. Financial Statements. Our future is dependent on our ability to refinance or restructure our indebtedness successfully or otherwise address these matters. If we fail to do so for any reason, we would not be able to continue as a going concern and could potentially be forced to seek relief under applicable bankruptcy or insolvency procedures, in which case our shares and ADSs would lose all or a substantial amount of their value. However, given management's plans, our consolidated financial statements have been prepared on the basis that we will continue as a going concern entity, and no adjustments have been made in our consolidated financial statements relating to the recoverability and classification of the recorded value of assets, the amounts and classification of liabilities or any other adjustments that might result in any potential impact of us not being able to refinance our debt obligations as outlined in note 4 to our consolidated financial statements in Item 18. Financial Statements.

*We face pressure on our liquidity, negatively influencing our working capital, which resulted from the acquisitions, substantial investment program, decrease in prices on commodity markets, global economic slowdown, difficulties with attracting new financing or refinancing of our debt and our need to service debt along with international sanctions against Russia and Russian state-owned banks.*

Due, inter alia, to a substantial increase in our total indebtedness in 2007 and early 2008, together with a substantial decrease in prices on commodity markets, we experienced a liquidity shortage in late 2008 and early 2009 and in order to address the liquidity shortage during 2008 through 2011 we obtained significant loans.

Starting from the second half of 2012 and gradually worsening during 2013 and into 2014, a second phase of economic and financial difficulties unfolded. To alleviate the pressure on our liquidity, in 2013, we refinanced and restructured a number of major loans mainly with Russian state-owned banks and issued Russian ruble bonds in order to refinance our debts. Additionally, in December 2013, we restructured our \$1.0 billion pre-export facilities with a syndicate of banks.

In the first half of 2014, we experienced a shortage of liquidity and difficulties with refinancing of our debt; as a result, we failed to fulfill our payment obligations in connection with the servicing of interest and the repayment of our indebtedness. We held discussions with our creditors and applied for a standstill with respect to

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the payment of our financial obligations or a temporary reduction in servicing the loans which was not accepted. From the second half of 2014, the markets for our main products began to recover, and the depreciation of the ruble contributed to an increase in our operating profit and our available free cash flow for servicing our financial obligations. Despite of further decrease in prices on our main products during 2015 with further depreciation of the ruble we managed to maintain stable operation profit and used all earned profits for servicing of our financial obligations. We resumed making partial payments of current interest to the banks and agreed extension of the grace periods and new repayment schedules with our major creditors as well as partial capitalization of interest payments and restructuring of overdue interest and principal. In 2016, the market situation has been rapidly changing from quarter to quarter with coal prices rise over the second half of 2016 and correction of the steel prices in the third quarter of 2016. Positive dynamics of steel and coal prices allowed us to improve our financials and supported us in finalizing restructuring with majority of our creditors, including Russian state banks, bondholders and other Russian commercial banks. Our primary objective in negotiating the debt refinancing and restructuring relates to matching our projected available free cash flows with future financial and investment payments and resetting the financial covenants is to ensure a stable financial environment. We are aiming to lengthen the maturity profile and repayment grace periods of that part of our debt portfolio that currently remains not restructured.

For the year ended December 31, 2016, we had an operating income of RUB 42,690 million as compared to RUB 24,252 million for the year ended December 31, 2015. Net cash provided by operating activities was RUB 53,207 million for the year ended December 31, 2016 as compared to RUB 38,867 million for the year ended December 31, 2015. As of December 31, 2016, our total indebtedness was RUB 407,216 million, a decrease of RUB 41,292 million from December 31, 2015. The short-term portion of our total indebtedness was RUB 434,165 million as of December 31, 2016 as compared to RUB 491,674 million as of December 31, 2015. The working capital deficit amounted to RUB 441,581 million as of December 31, 2016 as compared to RUB 517,416 million as of December 31, 2015. Cash and cash equivalents as of December 31, 2016 were RUB 1,689 million as compared to RUB 3,079 million as of December 31, 2015. Our total liabilities exceeded total assets by RUB 252,588 million as of December 31, 2016.

Our ability to refinance existing debt is limited due to difficult conditions on the domestic and international capital markets and in the banking sector, together with sanctions imposed on certain Russian banks preventing them from raising additional long-term financing on the international capital markets. We have restructured major part of our debt portfolio, reduced the capital investment program and disposed of certain non-core or loss-making assets. See If we are unable to restructure all of our indebtedness or fail to comply with the new terms of the restructured indebtedness, our lenders may claim for accelerated repayment, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects and We will require a significant amount of cash to fund our capital investment program. These measures, if successful, should reduce the risk of facing a liquidity shortage in the medium term as well as allow us to reduce our debt leverage over time.

In October 2014, Moody's Investors Service downgraded our rating to Caa3 with negative outlook because of the increased risk of default under our credit facilities, high probability of a refinancing scenario and a weak coal market environment. Further, in December 2014, Moody's Investors Service added Ca-PD/LD to our rating due to litigation with VTB Bank. In March 2015, following Mechel's request, Moody's Investors Service withdrew our corporate family rating of Caa3, probability of default rating of Ca-PD/LD and long-term national scale rating of Caa2.ru. Downgrade and further absence of international rating may reduce our opportunities to raise necessary debt financing (including by accessing the debt capital markets), as well as potentially negatively impact the terms of such financing.

Any deterioration in our operating performance, including due to any worsening of prevailing economic conditions, fall in commodity prices (whether due to the cyclical nature of the industry or otherwise) and/or financial, business or

other factors (including the imposition of further international sanctions against Russian companies or individuals as well as certain industries, including steel and mining sectors), many of which are

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beyond our control, may adversely and materially affect our cash flow, liquidity and working capital position and may result in an increase in our working capital deficit and in our inability to meet our obligations as they fall due. Poor liquidity and working capital deficit could lead to debt repayments difficulties, defaults, enforcement of security and eventually insolvency. As a result we will not be able to expand our business, finance capital expenditures and would have to downgrade which could result in higher cost of borrowing. All these factors could lead to difficulties with refinancing or raising additional capital and would require further restructuring. See [Risks Relating to Our Business and Industry](#). If we are unable to restructure all of our indebtedness or fail to comply with the new terms of the restructured indebtedness, our lenders may claim for accelerated repayment, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects, [Risks Relating to Our Business and Industry](#). We operate in cyclical industries, and any local or global downturn, whether or not primarily affecting the mining and/or steel industries, may have an adverse effect on our business, financial condition, results of operations and prospects and [Risks Relating to the Russian Federation](#). The political and economic crisis in Ukraine as well as other politically related disagreements and allegations between Russia and other countries and sanctions imposed as a result thereof by the United States and the European Union may have a material adverse effect on our business, liquidity and financial condition, as well as the trading market for and value of our shares and ADSs. There is no guarantee that we would be successful in refinancing and restructuring of our debt or in raising additional capital (particularly if we fall under international sanctions preventing us from accessing foreign capital markets and supply of our products on certain export markets), or that we would be able to do so on a timely basis or on terms which are acceptable to us. Even if we were successful, the terms of such refinancing or new capital may be detrimental to holders of ADSs and shares including due to a dilution of their interest. Any such deterioration, affect or failure could have a material adverse effect on our business, financial condition, results of operations and the trading price of our ADSs and shares.

*Our failure to comply with the payment and other obligations in our credit facilities caused some of our creditors to accelerate amounts due under their loan agreements and such failure, or like failure in the future, may cause the acceleration of our other outstanding debt, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects.*

Most of the loan agreements under which we or our subsidiaries are borrowers contain various representations, undertakings, restrictive covenants and events of default. Furthermore, according to the terms of such agreements, certain of our actions aimed at developing our business and pursuing our strategic objectives, such as acquisitions, disposal of assets, corporate restructurings, investments into certain of our subsidiaries and others, require prior notice to or consent from the respective lenders. We have restrictions on our ability to pay dividends, incur additional indebtedness and make capital expenditures, as well as expand through further acquisitions and use proceeds from certain disposals.

During 2014 and 2015, VTB Bank and Sberbank decided to accelerate outstanding amounts under our credit facilities due to our payment defaults. Although we were able to settle with VTB Bank and Sberbank, such acceleration, in turn, would give our other creditors the right to trigger acceleration under their loan agreements. See [Risks Relating to Our Business and Industry](#). We may become subject to bankruptcy procedures, which may result in the inability of holders of our shares and ADSs to recover any of their investments.

In 2015, we signed agreements on restructuring of our debt with our major lenders, such as VTB Bank and Gazprombank. We also signed restructuring agreements with Sberbank in February-April 2016 which granted a grace period and extended repayments of our debt as well as waived all previous defaults. In December 2016, we signed the last set of the agreements with VTB Bank which provide extension of maturity of our credit lines until April 2022. Signing of these agreements was condition precedent to coming into effect of the similar provisions under agreements with Gazprombank and Sberbank. See [Risks Relating to Our Business and Industry](#). If we are unable to restructure all of our indebtedness or fail to comply with the new terms of the restructured indebtedness, our lenders may claim for accelerated repayment, which could lead to

cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects and Item 5. Operating and Financial Review and Prospects Restructuring of financial indebtedness.

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As of December 31, 2016, we had significant amount of overdue debt and we were in breach of certain financial and non-financial covenants in several loan agreements and defaulted on our loans allowing the relevant creditors to claim for accelerated repayment of all amounts of outstanding at any time, however we have not received any notices from the creditors as of December 31, 2016. See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Restrictive Covenants, Item 5. Operating and Financial Review and Prospects Description of Certain Indebtedness, Item 10. Additional Information Material Contracts and Item 13. Defaults, Dividend Arrearages and Delinquencies.

Currently we continue to be in default under a number of our facilities, mainly under credit facilities with international lenders (pre-export facility agreements and export credit agreements), and are negotiating with our lenders refinancing and restructuring thereof. Our international lenders have not so far waived their rights in respect of or granted their consent to our breaches. We have received notification on defaults under the facilities with our international lenders, however the lenders under the export credit agreements did not claim for accelerated repayment. In December 2016, pre-export facility agreements with a syndicate of banks have matured without being repaid. In February 2017, a number of lenders under pre-export facility agreements filed 14 requests for arbitration. The 14 requests claim amounts allegedly due, including during the arbitration, plus expenses and any other amounts awarded by the arbitral tribunal. See Item 8. Financial Information Litigation Debt litigation. These claims as well as the refusal of any one lender to grant or extend a waiver or amend the loan documentation, even if other lenders may have waived covenant defaults under the respective credit facilities, could result in substantially all of our indebtedness being accelerated. If our indebtedness is accelerated in full or in part, it would be very difficult in the current financing environment for us to refinance our debt or obtain additional financing, and we could lose our assets, including fixed assets and shares in our subsidiaries, if our lenders foreclose on their liens, which would adversely affect our ability to conduct our business and result in a significant decline in the value of our shares and ADSs.

Our ability to continue to comply with our financial and other loan covenants in the future and to continue to service and refinance our indebtedness will depend on our results of operations and our ability to generate cash in the future and attract new financing and refinance the existing indebtedness, which will depend on several factors, including lenders credit decisions, limitations on the ability of Russian companies to access international capital markets as a result of a tightening of international sanctions against Russian companies and individuals and general economic, financial, competitive, legislative and other factors that are beyond our control. We cannot assure you that any breach of financial and other covenants in our loan agreements, including defects in security, will not result in new demands from our lenders for acceleration of our loan repayment obligations or related litigation, including as a result of cross-defaults. If we fail to comply with our financial and other covenants contained in any of our loan agreements, including compliance with financial ratios and other covenants, or fail to obtain prior consent of lenders for certain actions, or fail to obtain extensions or waivers in respect of any breaches of our loan agreements or amend our loan agreements, such failure would constitute an event of default under the relevant loan agreement and a cross-default under most of the others. Any event of default under our loan agreements could result in acceleration of repayment of principal and interest under the relevant loan agreement and, via cross-default provisions, under our other facilities, reduced opportunities for future borrowing, debt service obligations in excess of our ability to pay, liability for damages or inability to further develop our business and pursue our strategic objectives, any of which could have a material adverse effect on our business, financial condition, results of operations and prospects.

*If we are unable to restructure all of our indebtedness or fail to comply with the new terms of the restructured indebtedness, our lenders may claim for accelerated repayment, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects.*

We have a number of facilities with Russian and international lenders which we have been in non-compliance. We are negotiating restructuring of indebtedness under these agreements in order to extend the repayment schedule and final maturity as well as to decrease our current interest payments. If we fail to negotiate



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restructuring of these agreements, lenders thereunder could claim acceleration of repayment which we may not be able to make. This could lead to cross-default under other agreements and could have a material adverse effect on our business, financial condition, results of operation and prospects.

We have signed restructuring agreements with our major Russian lenders which became effective during the period from October 2015 to December 2016. See Item 5. Operating and Financial Review and Prospects Restructuring of financial indebtedness.

Our major lenders, such as Gazprombank, VTB Bank and Sberbank, require that all the loans provided to our subsidiaries shall be secured with the suretyship or pledge of assets of Mechel PAO. In accordance with the Joint-Stock Companies Law, such transactions exceeding 2% (10% starting from January 1, 2017) of the balance sheet value of the company's assets determined under Russian accounting standards require participation and obtaining of approval from a majority of disinterested shareholders of the company. Such security is an additional guarantee for our lenders which they require for restructuring of our debt. On March 4, 2016, we convoked the extraordinary general shareholders' meeting to approve a number of interested party transactions but we did not manage to obtain the required quorum to approve such transaction. Although we managed to obtain the required quorum on May 26, 2016 and February 27, 2017, we cannot predict whether we could obtain such shareholders' approval in order to secure our loans in the future or we could get a waiver from the banks for the amendment of the security structure.

During 2016, we have successfully restructured our ruble bonds, however we might need to negotiate with the bondholders extension of maturities thereof and new amortization schedules in case of liquidity shortage in the future. If we fail to agree with the bondholders on a restructuring and we will not have liquidity to finance buy-back of these bonds, payment default will occur. Payment default under any of ruble bonds may result in cross-default under all other bond issues as well as cross-default under restructured credit facilities. The bondholders also could litigate us after the restructuring and this could lead to termination of the restructuring.

If we fail to comply with the new terms and conditions, our lenders could claim acceleration of repayment which we may not be able to make and enforce the security which had been pledged to those banks. See We have a substantial amount of outstanding indebtedness with restrictive financial covenants and most shares and assets in our subsidiaries are pledged. This could further lead to cross-default under other agreements and could have a material adverse effect on our business, financial condition, results of operation and prospects.

We still have a number of facilities with international lenders to be restructured in order to extend the repayment schedule and final maturity. In February 2017, a number of lenders under pre-export facility agreements filed requests for arbitration with the London Court of International Arbitration ( **LCIA** ). See Item 8. Financial Information Litigation Debt litigation. These recent claims trigger an event of default and cross-default under various loan agreements and our lenders may claim for accelerated repayments. We have requested our major Russian lenders to waive cross-default provisions in this respect, however we have no clarity when and whether such waivers will be granted. If no waivers are granted, lenders will have a right to claim for immediate acceleration of our indebtedness. We do not have the resources to repay overdue debt or to enable us to comply with accelerated repayment requests immediately. See also Our failure to comply with the payment and other obligations in our credit facilities caused some of our creditors to accelerate amounts due under their loan agreements and such failure, or like failure in the future, may cause the acceleration of our other outstanding debt, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects.

*We have a substantial amount of outstanding indebtedness with restrictive financial covenants and most shares and assets in our subsidiaries are pledged.*

We have a substantial amount of outstanding indebtedness, primarily consisting of debt we incurred in connection with the financing of our acquisitions of Yakutugol and Oriel Resources in 2007 and 2008, as well as debt we incurred to finance our investment program in recent years, including the development of the Elga coal deposit and the universal rolling mill installation, and our working capital needs which have been significant in

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recent years due to the depressed demand and volatile pricing for our main products. Most of this debt has restrictive financial covenants. See Item 5. Operating and Financial Review and Prospects Restrictive Covenants, Item 5. Operating and Financial Review and Prospects Description of Certain Indebtedness and Item 10. Additional Information Material Contracts. As of December 31, 2016, our consolidated total debt, including finance lease obligations and the put option of Gazprombank, was RUB 492,602 million, of which RUB 444,340 million was short-term debt (including RUB 427,350 million with loan covenant violations, of which RUB 260,653 million was long-term debt reclassified to short-term debt due to defaults and cross-defaults under our loan agreements). Our finance costs for the year ended December 31, 2016 were RUB 54,240 million, net of the amount capitalized.

In order to secure bank financings, we have pledged shares in certain our subsidiaries, including 100%-1 share of Yakutugol, 75%+4 shares of Southern Kuzbass Coal Company, 91.66% of Chelyabinsk Metallurgical Plant, 50%+2 shares of common shares of Beloretsk Metallurgical Plant, 80%+3 shares of Korshunov Mining Plant, 62.5% of Mechel Mining, 80%-5 shares of Urals Stampings Plant, 33.33%+1 share of common shares of Izhstal, 25%+1 share of Port Posiet, 50.99% of Elgaugol, 25% of registered capital of Mecheltrans, 100% of registered capital of Fincom-invest OOO, 25% of registered capital of Port Temryuk, 25% of registered capital of Bratsk Ferroalloy Plant, 1.99% of registered capital of MecheltransVostok OOO and 1.99% of registered capital of Elga-road OOO as of December 31, 2016. In January 2017, we pledged 5% of all issued preferred shares of Mechel. Also, property, plant and equipment and certain other assets of our subsidiaries are pledged to the lenders. As of December 31, 2016, the carrying value of property, plant and equipment, inventory and accounts receivable pledged under our loan agreements amounted to RUB 120,953 million. See note 10.1(h) to the consolidated financial statements. Should we be in payment defaults, breaches of covenants and restrictions under our financial agreements and fail to receive waivers, the security may be enforced, which could have a material adverse effect on our business, financial condition, results of operations and prospects. For a description of defaults and acceleration events, see Our failure to comply with the payment and other obligations in our credit facilities caused some of our creditors to accelerate amounts due under their loan agreements and such failure, or like failure in the future, may cause the acceleration of our other outstanding debt, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects.

Our ability to make payments on our indebtedness depends upon our operating performance, which is subject to general economic and market conditions, commodity prices, and financial, business and other factors (including the maintenance or extension of international sanctions against Russian companies and individuals as well as sanctions imposed on certain industrial sectors), many of which we cannot control. See We face pressure on our liquidity, negatively influencing our working capital, which resulted from the acquisitions, substantial investment program, decrease in prices on commodity markets, global economic slowdown, difficulties with attracting new financing or refinancing of our debt and our need to service debt along with international sanctions against Russia and Russian state-owned banks.

Among other things, high levels of indebtedness, the restrictive financial covenants in our credit facilities and breaches thereof as well as default on our loans, could potentially: (1) limit our ability to raise capital through debt financing; (2) limit our flexibility to plan for, or react to, changes in the markets in which we compete; (3) disadvantage our group relative to our competitors with superior financial resources; (4) lead to a loss of assets pledged as security; (5) render us more vulnerable to general adverse economic and industry conditions; (6) require us to dedicate all or a substantial part of our cash flow to service our debt; and (7) limit or eliminate our ability to pay dividends.

*We may become subject to bankruptcy procedures, which may result in the inability of holders of our shares and ADSs to recover any of their investments.*

Our future is dependent on our ability to refinance, restructure and service our indebtedness successfully. If we fail to do so for any reason, we could be forced to seek relief under applicable bankruptcy procedures, in which case our shares and ADSs may lose all or substantial amount of their value. See [Table of Contents](#) There is substantial doubt about our ability to continue as a going concern.

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Our creditors, including the Federal Tax Service of the Russian Federation, may file a bankruptcy petition with a court seeking to declare us insolvent if we are unable to make payments to our creditors in excess of 300,000 rubles within three months of such payments becoming due. In most cases, for such petition to be accepted, the outstanding indebtedness must be confirmed by a separate court decision or arbitral award that has already entered into force. However, under recent amendments to the Federal Law No. 127-FZ On Insolvency (Bankruptcy) dated October 26, 2002 (the **Bankruptcy Law**), financial (credit) organizations, which include our major creditors, may file a petition for bankruptcy without such separate court decision. In this case, the financial organization is required to notify the debtor and its creditors in writing at least 15 days from the date of publication of the bankruptcy petition in the Unified Federal Register of Information on Facts of Business Activity of Legal Entities. On March 7, 2015, VTB Bank published a notification of its intention to initiate bankruptcy proceedings against us. On March 12, 2015, VTB Bank further informed our main creditors of its intention to proceed with such bankruptcy petition. The restructuring documents have been signed in September 2015 and currently there is no further development regarding this issue from VTB Bank side. On April 24, 2015, VTB Bank and VTB Capital Plc filed a claim with the High Court of Justice Queen's Bench Division Commercial Court in England seeking for injunctive relief under pre-export facility agreements with a syndicate of banks. This claim and court proceedings were put on hold until June 1, 2017. VTB Bank and VTB Capital Plc terminated Russian court proceedings and recalled all of their Russian claims against us in October 2015, once restructuring agreements with VTB Bank became effective. See Item 8. Financial Information Litigation Debt litigation. If any other creditor initiates court proceedings seeking to declare us insolvent or if the bank is granted with aforementioned preliminary injunctions, it could have a material adverse effect on our prospects and on the value of our shares and ADSs and may ultimately result in the inability of holders of our shares and ADSs to recover any of their investments.

From time to time, the group's suppliers, services providers and other third parties which we may owe operating debt to may file bankruptcy claims based on the formal debt limit provided by the Bankruptcy Law, however, we settle such claims before court consideration. Nevertheless, the overall debt of our group companies is still substantial. Therefore, there is a risk that our creditors (including suppliers, services providers, etc.) may file bankruptcy petitions, and our shareholders and ADS holders may lose all or substantial part of their investment.

The Bankruptcy Law is still developing and it remains subject to varying interpretations. While the Bankruptcy Law establishes the principle of adequate protection of creditors, debtors, shareholders and other stakeholders in bankruptcy, it often fails to provide instruments for such protection that are available in other jurisdictions with more developed bankruptcy procedures. Bankruptcy proceedings in Russia are often not conducted in the best interests of shareholders or creditors. In addition, Russian courts that conduct bankruptcy proceedings may be subject to a greater degree of political interference and may employ a more formalistic, and less commercially sophisticated, approach to rendering decisions than like court in other jurisdictions. Russian insolvency proceedings in the past have shown a bias towards liquidation and not rehabilitation or restructuring.

The Bankruptcy Law provides for the following order of priority for the satisfaction of creditor claims: (i) personal injury claims; (ii) employment claims (wages and severance payments) and royalty claims under copyright agreements; and (iii) all other claims. The claims of secured creditors are satisfied in accordance with a special procedure, that is, out of the proceeds of sale of the pledged or mortgaged assets. Equity claims of shareholders or ADSs holders may be satisfied only if any assets remain after all creditors have been paid in full. Therefore, there is a risk that our shareholders and ADS holders may lose all or substantial part of their investment. This risk is even more significant for ADS holders whose status in the bankruptcy proceedings is unclear.

*We have not fulfilled our payment obligations under several of the group's lease agreements and a number of the respective lessors have required the return of the leased assets, which may materially adversely affect our business, financial condition, results of operations and prospects.*

Some of our group companies have entered into various lease agreements with different leasing companies for the mining equipment, trucks, railcars, etc.

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Each of the lease agreements has a certain payment schedule. Starting from the second quarter of 2014, we began to delay the regular payments under several of these lease agreements. According to the Civil Code of the Russian Federation, as amended (the **Civil Code**), and the Federal Law No. 164-FZ On Financial Leasing dated October 29, 1998, as amended, a lessor is generally entitled to apply to a court for the early termination of a lease agreement if the lessee fails to make two consecutive payments under the lease agreement. The lessor is required to notify the lessee in writing and request fulfillment of its obligations under the lease agreement within a reasonable time before applying to the court.

The lease agreements we have entered into generally provide for a stricter procedure, whereby the lessor is also entitled to terminate the contract unilaterally, without applying to the court, by way of sending a notification to the lessee in case of non-payment within a specified period of time. The lessor is entitled to receive penalties in case of a delay in payment and early termination of the lease agreement due to the lessee's default. Upon termination of the lease agreement, the lessor is entitled to request the return of the leased equipment. If the lessee fails to return the equipment, the lessor is entitled to receive rental payments covering the time of the delay and compensation for damages if not covered by rental payments.

In particular, we failed to fulfill our payment (as well as certain other) obligations under the lease agreements with Sberbank Leasing AO. Between May and August 2014, we received payment demands from Sberbank Leasing AO, requiring us to settle the overdue amounts under the respective lease agreements. In September-October 2014, Sberbank Leasing AO filed lawsuits for the recovery of the overdue amounts under the lease agreements concluded with Korshunov Mining Plant, Mechel Materials, Yakutugol, Southern Kuzbass Coal Company and Metallurgshakhtspetsstroy. In February 2015, Sberbank Leasing AO sent termination notices to the lessees under the respective lease agreements for the total amount of 4.2 billion rubles. According to such notices, unless the payments are made within 15 days from the date of the notice, the respective lease agreements shall be deemed terminated. The payments were not made, and in April 2015, Sberbank Leasing AO requested through the courts accelerated repayment of amounts due under the lease agreements as well as the return of the leased assets. During the period from December 2015 to May 2016, we signed settlement agreements with Sberbank Leasing AO which waived our previous defaults and restructured our future payment schedules. The settlement agreements became effective in 2016. We have further signed new versions of certain settlement agreements revising payment schedules and we expect their approval by the court in April-May 2017.

During the period from May to August 2015, following our failure to fulfill payment obligations under the respective lease agreements, Caterpillar Financial OOO sent termination notices to the lessees (Yakutugol, Mechel Engineering, Korshunov Mining Plant, Mechel Materials, Metallurgshakhtspetsstroy, Tomusinsky Open Pit and Southern Kuzbass Coal Company). We have not settled the claims and Caterpillar Financial OOO filed lawsuits with the court against our subsidiaries and Mechel (as the guarantor under four lease agreements) seeking termination of lease agreements, withdrawal of leasing assets and recovery of debt in an aggregate amount of approximately \$5.0 million and 313.9 thousand. In July 2016, Caterpillar Financial OOO filed another lawsuit seeking recovery of debt and withdrawal of a leasing asset. Currently, these lawsuits are considered by the courts of various instances while we continue negotiations with Caterpillar Financial OOO.

During the period from May to November 2016, VTB Leasing JSC filed several lawsuits with the court against Mecheltrans seeking recovery of debt under lease payments and the court sustained the plaintiff's claims. We repaid part of the debt and signed settlement agreements for the remaining overdue debt. As of the date hereof, all settlement agreements have been approved by the court. See Item 8. Financial Information Litigation Debt litigation for a description of the court proceedings mentioned above.

During 2016, we breached payment schedules with Sberbank Leasing AO, Caterpillar Financial OOO, VTB Leasing JSC and Gazprombank Leasing JSC, however we managed to substantially decrease our overdue lease payments and agreed on the repayment profile of the remaining overdue debts. As of December 31, 2016, we fully repaid the overdue lease payments to Gazprombank Leasing JSC.



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In the event the leased equipment is returned to the lessor, there is a risk that our operating activities (for the group companies that are lessees under the delinquent leases) will be adversely affected, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

*We will require a significant amount of cash to fund our capital investment program.*

Our business requires maintenance capital expenditures in order to maintain production levels adequate to meet the demand for our products, as well as other capital expenditures to implement our business strategy. We spent 4,570 million rubles during 2016 on our capital expenditures (including 2,060 million rubles in maintenance capital expenditures). In planning for 2017, we followed our current investment policy focusing only on those items that are either close to completion or are of major importance for our operations. Our capital investment program currently contemplates capital spending of up to 12,544 million rubles in 2017 (including up to 6,412 million rubles in maintenance capital expenditures). A considerable part of the planned capital expenditures relate to the renewal of mining-and-transport equipment and to the development of the Elga coal deposit. The Elga capital expenditures are planned in the amount of approximately 5.8 billion rubles to be financed from our own funds in 2017-2019. Overall, we plan to spend up to 35.7 billion rubles for the three-year period of 2017-2019 on capital investments (including up to 17.7 billion rubles in maintenance capital expenditures). See Item 4. Information on the Company Capital Investment Program.

Our ability to undertake and fund planned capital expenditures will depend on our ability to generate cash in the future and access debt financing. Lack of liquidity may jeopardize capital expenditure plans, see We face pressure on our liquidity, negatively influencing our working capital, which resulted from the acquisitions, substantial investment program, decrease in prices on commodity markets, global economic slowdown, difficulties with attracting new financing or refinancing of our debt and our need to service debt along with international sanctions against Russia and Russian state-owned banks. This, to a certain extent, is subject to general economic and market conditions, financial, competitive, legislative, regulatory and other factors (including the status of international sanctions against Russian companies and individuals as well as sanctions imposed on certain types of products in different sectors) that are beyond our control. Raising debt financing for our capital expenditures on commercially reasonable terms may be particularly challenging given our current high levels of indebtedness and restrictive covenants imposed under the loan agreements. Any deterioration in our operating performance, including due to any worsening of economic conditions, fall in commodity prices and/or financial, business or other factors, many of which are beyond our control, may adversely and materially affect our cash flow which may leave us unable to conduct our capital expenditure plans as necessary or required, which could adversely affect our operating facilities and ability to comply with applicable regulations.

*Changes in the exchange rate of the ruble against the U.S. dollar and in interest rates may materially adversely affect our business, financial condition and results of operations.*

Part of our sales are denominated in U.S. dollars, whereas the majority of our direct costs are incurred in rubles. In addition, we have foreign currency loans that are denominated mainly in U.S. dollars. Depreciation in real terms of the ruble against the U.S. dollar may result in a decrease in our costs relative to our export revenues assuming stable level of prices for our products. Also depreciation in real terms of the ruble against the U.S. dollar may result in a reduction in our ability to service debt obligations denominated in foreign currencies in case of sharp decline in sales in general and sales denominated in foreign currencies in particular. Conversely, appreciation in real terms of the ruble against the U.S. dollar may materially adversely affect our results of operations if the prices we are able to charge for our products do not increase sufficiently to compensate for the increase in real terms in our ruble-denominated expenditures. In 2015, the ruble depreciated against foreign currencies, decreasing to 72.88 rubles per one U.S. dollar on December 31, 2015. In 2016, the ruble-U.S. dollar exchange rate was very volatile, reaching RUB 60.66 as at

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December 31, 2016 and strengthened by 16.8% from December 31, 2015. As of March 31, 2017, the ruble-U.S. dollar exchange rate was 56.38 (a 16.6% decline compared to March 31, 2016) and the ruble-euro exchange rate was 60.60 (a 20.8% decline compared to March 31, 2016), according to the CBR.

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In an effort to protect the country's foreign currency reserves from substantial depletion, the CBR moved to a free floating exchange rate regime on November 20, 2014. In response to continuing ruble depreciation, the CBR in an unexpected, emergency meeting increased its key rate, which determines the borrowing costs for commercial banks, from 10.5% to 17% subsequently lowering the rate to 9.75% during 2015-2017. Upon restructuring, interest rates under our ruble-denominated facilities with Russian state banks are linked to the CBR key rate (plus a margin above the key rate). Should the CBR key rate increase again, or should interest rates under our existing facility agreements otherwise increase, we will face higher borrowing costs, which could have a material adverse effect on our business, cash flows, financial condition, results of operations and prospects.

*Inflation could increase our costs and decrease operating margins.*

In 2016, 2015 and 2014, the inflation rate in Russia was 5.4%, 12.9% and 11.4%, respectively, according to the Russian Federal State Statistics Service ( **Rosstat** ). The increase of inflation in 2014 followed by further increase in 2015 may be attributed to international sanctions imposed on Russian companies and individuals, the significant fall in the ruble against the U.S. dollar and euro and high growth of prices on consumer goods and services. A record low level of inflation in Russia in 2016 was due to the tight monetary policy of the CBR and slowing growth of prices on consumer goods and services. Inflation increases our operating costs on monetary items, which are sensitive to rises in the general price level in Russia, including fuel and energy costs, cost of production services and salaries (as under existing collective agreements wage indexation is carried out taking into account inflation). Inflation could also potentially increase the prices we can charge for our products. The impact of inflation on our operating margins depends on whether we can charge higher prices corresponding with the increase in costs. Nevertheless, there is a high risk that inflation will have an overall negative impact on our operating margins.

*If limitations on the conversion of rubles into foreign currencies in Russia are imposed, this could cause us to default on our obligations.*

Part of our indebtedness and part of our capital expenditures are payable in various foreign currencies, including the U.S. dollar and euro. Russian legislation currently permits the conversion of ruble revenues into foreign currency without limitation. If the Russian authorities were to impose limitations on the convertibility of the ruble or other restrictions on operations with rubles and foreign currencies in the event of an economic crisis or otherwise, there may be delays or other difficulties in converting rubles into foreign currency to make a payment or delays in or restrictions on the transfer of foreign currency. This, in turn, could limit our ability to meet our payment and debt obligations, which could result in the loss of suppliers, acceleration of debt obligations and cross-defaults and, consequently, have a material adverse effect on our business, financial condition, results of operations and prospects.

*Our business could be materially adversely affected if creditors of certain of our subsidiaries accelerate their debt.*

If we decide to merge certain subsidiaries for operational reasons from time to time, under Russian law such mergers are considered to be a reorganization and the merged subsidiaries are required to publish the information regarding this reorganization twice: the first publication due at the beginning of the reorganization and the second to follow one month after the first publication. Russian law also provides that, for a period of 30 days after the date of latest publication, the creditors of merging subsidiaries have a right to file a claim seeking acceleration of the reorganized subsidiaries' indebtedness and demand reimbursement for applicable losses, except in cases where the creditors have adequate security or are provided with adequate security within 30 days after filing of such claim. In the event that we undertake any such merger and all or part of our subsidiaries' indebtedness is accelerated, we and such subsidiaries may not have the ability to raise the funds necessary for repayment, which could have a material adverse effect on our business, financial condition, results of operations and prospects.



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*Russian law restrictions on depositary receipt programs limit our access to equity capital and constrain our refinancing options.*

Russian companies are limited in their ability to place shares in circulation outside of Russia, including in the form of depositary receipts such as our common American Depositary Shares ( **common ADSs** ) and our global depositary shares representing our common shares ( **GDSs** ), as well as our preferred American Depositary Shares representing our preferred shares ( **preferred ADSs**, and together with the common ADSs, the **ADSs** ) due to Russian securities regulations. We have received permission from the Russian Federal Financial Markets Service ( **FFMS** ) for up to 40% of our common shares to be circulated abroad through depositary receipt programs, which was the maximum amount allowed at that time. Later we also received FFMS permission for a total of 41,627,074 preferred shares to be circulated through depositary receipt programs, representing 30% of the total number of issued preferred shares, which was the maximum amount allowed at that time. Currently, Russian securities regulations provide that no more than 25% of the total number of a Russian company's shares may be placed and circulated abroad through depositary receipt programs or otherwise. It is unclear whether the FFMS's approvals of higher amounts prior to the establishment of this lower limit will be allowed to remain in place. As of December 31, 2016, our common ADSs and GDSs together accounted for approximately 33% of our common shares, and accordingly we believe we cannot raise additional equity financing through placement of common shares in the form of depositary receipts. If the current limit is enforced Deutsche Bank Trust Company Americas (the **depositary** ) may be forced to cancel some of our common ADSs and GDSs and deliver a corresponding number of the underlying common shares to holders of common ADSs or GDSs. The Russian government or its agencies may also impose other restrictions on international financings by Russian issuers.

*We had in the past material weaknesses in our internal control over financial reporting, and we make no assurances that additional material weaknesses will not be identified in the future.*

Management identified a material weakness in our internal control over financial reporting as defined in the Exchange Act Rule 12b-2 and Rule 1-02 of Regulation S-X that affected our financial statements for the year ended December 31, 2016. The material weakness in our internal control over financial reporting identified as of December 31, 2016 is described in Item 15. Controls and Procedures. Due to the effect of this material weakness, our auditors have opined that we have not maintained effective internal control over financial reporting as of December 31, 2016 under Section 404 of the Sarbanes-Oxley Act of 2002. Our auditors have also opined that we did not maintain effective internal control over financial reporting as of each of December 31, 2006, 2007, 2008, 2009, 2010, 2011 and 2015 due to the effect of the material weaknesses identified as of those dates.

Notwithstanding the steps we have taken and continue to take that are designed to remedy the material weakness identified in Item 15. Controls and Procedures, we may not be successful in remedying this material weakness in the near or long term and we make no assurances that additional significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified in the future. Our failure to implement and maintain effective internal control over financial reporting could result in errors in our financial statements that could result in a restatement of financial statements, cause us to fail to meet our reporting obligations and cause investors to lose confidence in our reported financial information, leading to a decline in the market price of our shares and ADSs.

*We may incur impairments to goodwill or other non-current assets which could negatively affect our future profits.*

We assess, at each reporting date, whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, we estimate the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or a cash-generating unit's fair value less costs of disposal and its value in use. The recoverable amount is determined for an individual asset, unless the asset



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does not generate cash inflows that are largely independent of those from other assets or groups of assets. When the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

In assessing value in use, we use assumptions that include estimates regarding the discount rates, growth rates and expected changes in selling prices, sales volumes and operating costs, as well as capital expenditures and working capital requirements during the forecasted period. The estimated future cash flows expected to be generated by the asset, when the quoted market prices are not available, are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. The growth rates are based on our growth forecasts, which are largely in line with industry trends. Changes in selling prices and direct costs are based on historical experience and expectations of future changes in the market. In determining fair value less costs of disposal, recent market transactions are taken into account.

We base our impairment calculation on detailed budgets and forecast calculations, which are prepared separately for each of our group's cash-generating units to which the individual assets are allocated. These budgets and forecast calculations generally cover a period of five years. A long-term growth rate is calculated and applied to project future cash flows after the fifth year.

For a cash-generating unit involved in mining activity future cash flows include estimates of recoverable minerals that will be obtained from proved and probable reserves, mineral prices (considering current and historical prices, price trends and other related factors), production levels, capital and reclamation costs, all based on the life of mine models prepared by our engineers.

Impairment losses of continuing operations are recognized in the consolidated statement of profit (loss) and other comprehensive income (loss) in expense categories consistent with the function of the impaired asset.

For assets excluding goodwill, an assessment is made at each reporting date to determine whether there is an indication that previously recognized impairment losses no longer exist or have decreased. If such indication exists, we estimate the asset's or the cash-generating unit's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of profit (loss) and other comprehensive income (loss) unless the asset is carried at a revalued amount, in which case, the reversal is treated as a revaluation increase.

Goodwill is tested for impairment annually as of December 31 and when circumstances indicate that the carrying value may be impaired.

Impairment is determined for goodwill by assessing the recoverable amount of each cash-generating unit (or group of cash-generating units) to which the goodwill relates. When the recoverable amount of the cash-generating unit is less than its carrying amount, an impairment loss is recognized. Impairment losses relating to goodwill cannot be reversed in future periods.

Based on the results of the impairment analysis of goodwill we performed as of December 31, 2016, impairment loss of RUB 2,930 million was recognized. According to the results of the impairment analysis of non-current assets as of December 31, 2016, impairment loss of RUB 2,272 million was recognized. See note 18 to the consolidated financial statements.

The amount of goodwill on our balance sheet as of December 31, 2016 that is subject to impairment analysis in the future is RUB 18,355 million or 6% of our total assets. This amount includes goodwill of Yakutugol,



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Southern Kuzbass Power Plant, Kuzbass Power Sales Company and Port Posiet of RUB 13,399 million, RUB 2,382 million, RUB 1,026 million and RUB 756 million, respectively, as of December 31, 2016. See note 18 to the consolidated financial statements.

Based on the results of the impairment analysis of goodwill we performed as of December 31, 2015, impairment loss of RUB 1,444 million was recognized. According to the results of the impairment analysis of non-current assets, impairment loss of non-current assets of RUB 5,983 million was recognized. See note 18 to the consolidated financial statements. Based on comparison of carrying value and recoverable value as of December 31, 2015, excess of recoverable value over carrying value was identified therefore reversal of previously recoded impairment loss as of December 31, 2014 was recognized in the amount of RUB 5,966 million.

We continue to monitor relevant circumstances, including consumer levels, general economic conditions and market prices for our products, and the potential impact that such circumstances might have on the valuation of our goodwill and non-current assets. It is possible that changes in such circumstances, or in the numerous variables associated with our judgments, assumptions and estimates made in assessing the appropriate valuation of goodwill and recoverable value of non-financial assets, could in the future require us to further reduce our goodwill and non-financial assets and record related non-cash impairment charges. If we are required to record additional impairment charges, this could have a material adverse impact on our results of operations or financial position.

*Given the competition for qualified accounting personnel in Russia, we may be unable to retain our key accounting staff, which could disrupt our ability to timely and accurately report IFRS financial information.*

Our subsidiaries maintain their books and records in local currencies and prepare accounting reports in accordance with local accounting principles and practices. In particular, each of our Russian subsidiaries maintains its books in rubles and prepares separate unconsolidated financial statements in accordance with Russian accounting standards. For every reporting period, we translate, adjust and combine these Russian statutory financial statements to prepare consolidated financial statements in accordance with IFRS. This is a time-consuming task requiring us to have accounting personnel experienced in internationally accepted accounting standards. We believe there is a shortage in Russia of experienced accounting personnel with knowledge of internationally accepted accounting standards. Moreover, there is high demand for such personnel as many Russian companies prepare financial statements on the basis of internationally accepted accounting standards. Such competition may make it difficult for us to hire and retain such personnel, and our accounting staff may have high turnover.

***Risks Relating to Our Business and Industry***

*We operate in cyclical industries, and any local or global downturn, whether or not primarily affecting the mining and/or steel industries, may have an adverse effect on our business, financial condition, results of operations and prospects.*

Our mining segment sells coal (metallurgical and steam), iron ore concentrate and coke. These commodities are traded in markets throughout the world and are influenced by various factors beyond our control, such as global economic cycles and economic growth rates. Prices of these products have varied significantly in the past and could vary significantly in the future. For example, in 2016, coal prices were highly volatile due to coal supply management policy in China which has caused a fall in production that has driven a rise in prices, despite demand dropping globally. After a sharp rise of coal prices in July-November 2016, Chinese government made some changes to the coal production policy allowing Chinese companies to produce more coal and prices started to decline.

Our steel segment sells steel products, including semi-finished products, long products of a wide range of steel grades, carbon and stainless flat products, wire products, forgings and stampings and others, as well as

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ferrosilicon. Ferrosilicon is primarily used in the manufacture of steel and its market demand generally follows the cycles of the steel industry. The steel industry is highly cyclical in nature because the industries in which steel customers operate are subject to changes in general economic conditions. The demand for steel products thus generally correlates to macroeconomic fluctuations in the economies in which steel producers sell products, as well as in the global economy. The prices of steel products are influenced by many factors, including demand, worldwide production capacity, capacity-utilization rates, raw materials costs, exchange rates, trade barriers and improvements in steel-making processes. Steel prices have experienced, and in the future may experience, significant fluctuations as a result of these and other factors, many of which are beyond our control. For example, in 2015, steel market in China experienced turbulence as the steel prices collapsed and the demand decreased. Although the demand for steel in China has gradually started to recover through 2016 and the steel prices follow this trend, they remain volatile and far from the peak levels.

Our power segment generates and supplies power resources. Power demand in Russia depends on its consumption by the industrial sector. In Russia, the steel and mining industries are major consumers of power and the level of production of steel and mining companies impact demand for power. Market demand for the power produced by our power segment is affected by many of the same factors and cycles that affect our mining and metals businesses.

As a result of the 2008-2009 global economic crisis and the subsequent 2010-2011 global economic slowdown, the demand and prices for our products sharply declined. The continuing stagnation of the economy of the European region, the 2012-2016 economic slowdowns in the Asian region, primarily in China, as well as the existing uncertainty as to global economic recovery in the near future and international sanctions against Russia and Russian individuals or businesses may have adverse consequences for our customers and our business as a whole. See [Risks Relating to the Russian Federation](#). The political and economic crisis in Ukraine as well as other politically related disagreements and allegations between Russia and other countries and sanctions imposed as a result thereof by the United States and the European Union may have a material adverse effect on our business, liquidity and financial condition, as well as the trading market for and value of our shares and ADSs.

Prices for our products, including coal, iron ore, metals, ferrosilicon and power, as well as the prices of coal, iron ore, ferroalloys, power and natural gas and other commodities and materials we purchase from third parties for the production of our products, fluctuate substantially over relatively short periods of time and expose us to commodity price risk. We do not use options, derivatives or swaps to manage commodity price risk. We use our vertically integrated business model and intersegment sales, as well as short-term and long-term purchase and sales contracts with third party suppliers and customers, to manage such risk. In addition, the length and pricing terms of our sales contracts on certain types of products are affected and can be regulated by orders issued by Russian antimonopoly authorities. In particular, pursuant to a directive issued to us by the Russian Federal Antimonopoly Service ( **FAS** ) in August 2008, we entered into long-term contracts for supply of certain grades of our coking coal with a formula of price calculation and with fixed volumes for the entire period of the contract. See [Antimonopoly regulation could lead to sanctions with respect to the subsidiaries we have acquired or established or our prices, sales volumes and business practices](#). Terms of sales of other types of our products may also be affected by regulations of the authorities. We cannot assure you that our strategies and contracting practices will be successful in managing our pricing risk or that they will not result in liabilities. If our strategies to manage commodity price risk and the impact of business cycles and fluctuations in demand are not successful, it could have a material adverse effect on our business, financial condition, results of operations and prospects.

*The steel and mining industries are highly competitive, and we may not be able to compete successfully.*

We face competition from Russian and international steel and mining companies. Consolidation in the steel and mining sectors globally has led to the creation of several large producers, some of which have greater financial

resources and more modern facilities than our group. We also face price-based competition from

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producers in emerging market countries, including, in particular, Brazil (in the export of raw materials for metallurgy) and China, Ukraine, Belarus, Turkey and Kazakhstan (in the export of semi-finished products and rolled products). Increased competition could result in more competitive pricing and reduce our operating margins.

Our competitiveness is based in part on our operations in Russia having a lower cost of production than competitors in higher-cost locations. We have been facing a consistent upward trend in the past several years in production costs, particularly with respect to wages and transportation. For example, our rail transportation costs increased consistently during previous years with the more recent rail tariff increases of 10.0% in 2015 and 9.0% in 2016. Starting from January 29, 2015, railway export tariffs for all goods were increased by additional 13.4%, except for certain grades of coal and middlings for which additional indexation amounted to only 1.3%. In 2017, railway tariffs were increased by 6.08%. See A limited capacity of the railway infrastructure and an increase in railway tariffs expose us to uncertainties regarding transportation costs of raw materials and steel products, Increasing costs of electricity, natural gas and labor could materially adversely affect our operating margins and Inflation could increase our costs and decrease operating margins. If these production costs continue to increase in the jurisdictions in which we operate, our competitive advantage will be diminished, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

*Changes in our estimates of reserves or failure to implement mine development plans could result in lower than expected revenues, higher than expected costs or decreased operating margins.*

We base our reserve information on engineering, economic and geological data which is assembled, analyzed and reviewed by our staff, which includes various engineers and geologists, annually and which is reviewed by independent mining engineers as of the acquisition dates as part of business combinations. The reserve estimates as to both quantity and quality are periodically updated to reflect production from reserves and new drilling, engineering or other data received. There are numerous uncertainties inherent in estimating quantities and qualities and the costs to mine recoverable reserves, including many factors beyond our control. Estimates of economically recoverable reserves and net cash flows necessarily depend upon a number of variable factors and assumptions, such as geological and mining conditions which may not be fully identified by available exploration data or which may differ from our experience in current operations, projected rates of production in the future, historical production from the area compared with production from other similar producing areas, the assumed effects of regulation and taxes by governmental agencies and assumptions concerning prices, operating costs, mining technology improvements, mineral extraction and excise tax, development costs and reclamation costs, all of which may vary considerably from actual results. In addition, it may take many years from the initial phase of drilling before production is possible. During that time, the economic feasibility of exploiting a discovery may change as a result of changes in the market price of the relevant commodity. Mine development plans may have to be revised due to geological and mining conditions and other factors described above, as well as due to shortages in capital funding. Our planned development projects also may not result in significant additional reserves and we may not have continuing success developing new mines or expanding existing mines beyond our existing reserves.

The financial performance of our mining segment depends substantially on our ability to mine coal reserves that have the geological characteristics that enable them to be mined at competitive costs and to meet the quality needed by our customers. Actual tonnage recovered from identified reserve areas or properties and revenues and expenditures with respect to our reserves may vary materially from estimates. Replacement reserves may not be available when required or, if available, may not be capable of being mined at costs comparable to those characteristic of the depleting mines. Our ability to obtain other reserves through acquisitions in the future could be limited by restrictions under our existing or future loan agreements, competition from other mining companies for attractive properties, the lack of suitable acquisition candidates or the inability to acquire mining properties on commercially reasonable terms. Furthermore, we may not be able to mine all of our reserves as profitably as we do at our current operations due to

increases in wages, power and fuel prices and other factors.

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Therefore, changes in our estimates of reserves or failure to implement mine development plans could result in lower than expected revenues, higher than expected costs or decreased operating margins.

*The development of the Elga coal deposit is subject to certain risks due to the substantial amount of capital costs involved in developing the required infrastructure.*

The risks associated with the development of the Elga coal deposit have the potential to impact the project's legal or economic viability. Key risks that have been identified include the following: (1) the early termination, suspension or restriction of the right of subsoil use of the Elga coal deposit in case of violation of the requirements of the deposit development technical plan; (2) the project requires significant capital expenditures to develop the required production and washing facilities and infrastructure, and increases in planned capital and operating costs could make the project uneconomical because of the project's sensitivity to these costs; (3) the economic viability of the project is dependent upon the full use of the rail line; (4) the project is very sensitive to market prices for coal because of the high initial capital costs; and (5) the insufficient capacity of ports in the Russian Far East where the Elga deposit is located may limit the distribution of coal mined at the Elga deposit. In addition, capital expenditures for the rail line were not considered in the calculation of reserves estimates as we do not plan to use the rail line solely for delivery of coal from the Elga deposit. The realization of any of these risks could have a material adverse effect on our business, financial condition, results of operations and prospects. While we have already invested approximately 73.7 billion rubles in the development of the Elga coal deposit (out of which approximately 64.3 billion rubles was invested in the construction of the rail line), its further development requires a substantial amount of investment. Based on the expected financial capabilities of the group in view of the current and projected market conditions for our main products, we plan to invest in Elga from our own funds approximately 5.8 billion rubles in 2017-2019. In 2013 and 2014, our subsidiary Elgaugol and State Corporation Bank for Development and Foreign Economic Affairs (Vnesheconombank) (**Vnesheconombank**) signed a \$150.0 million bridge loan agreement and a \$2.5 billion main project financing loan agreements for the development of the Elga coal deposit. As of December 31, 2016, the principal amount outstanding under the loan agreements was \$167.3 million, with overdue principal in the amount of \$146.4 million and overdue interest in the amount of \$6.2 million. Disbursement under the main project financing loan agreements was subject to fulfillment of conditions precedent. Elgaugol has not fulfilled these conditions and Vnesheconombank has suspended the financing. We hold negotiations with Vnesheconombank with respect to restructuring of the bridge loan and possibility of further financing of the Elga project.

*Successful implementation of our strategy to expand our special steel long products sales and coal sales depends on our ability to increase our export sales of these products.*

Our strategy to expand our special steel long products sales is dependent on our ability to increase our exports of these products to other countries. Likewise, our strategy to increase our sales of coal, particularly high-grade coking coal and PCI, is substantially dependent on our ability to increase our production and exports of these products through ports in the Russian Far East to other countries, particularly Japan, China, South Korea and other Pacific Rim countries. We face a number of obstacles to this strategy, including oversupply and low demand, trade barriers and sales and distribution challenges, as well as restrictions imposed by antimonopoly legislation. See Antimonopoly regulation could lead to sanctions with respect to the subsidiaries we have acquired or established or our prices, sales volumes and business practices.

Currently, key ports in the Russian Far East have limited cargo-handling capacity, lack adequate port facilities and have old and worn-out equipment. In particular, the limited capacity of the railways connecting to these ports is a critical impediment to the further development of port infrastructure and the entire transportation system in the Russian Far East. Increasing the capacity of the ports in the Russian Far East is one of the key issues identified in the Transportation Strategy of the Russian Federation. Existing railway sections must be reconstructed, the logistics

structure improved and the actions of the cargo owners, the ports management and Russian Railways, an open joint-stock company wholly owned by the Russian government, must be better coordinated. In addition, the shortage of the locomotive fleet of Russian Railways due to its worn-out state and



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frequent breakdowns, as well as major track repairs by Russian Railways in the summer months result in restriction on cargo volumes and increase in delivery time. Slowdown in train movements in the winter months has a negative impact on the state of bulk cargo as freezing occurs due to low temperatures which further reduces the rate of discharge in ports and leads to congestion of railcars in the railway network.

In particular, the total current annual capacity of the Baikal-Amur Mainline to which our Elga deposit is connected by our private rail line, was increased to 23 million tonnes in 2016 and upon implementation of a set of actions set forth in the Federal Target Program Development of Transport System of Russia (2010-2020) is expected to increase up to 33 million tonnes per year by 2018. However, in order to comply with the general declared volumes for cargo transportation on the Baikal-Amur Mainline, its capacity will need to be further expanded to meet, among others, our needs when Elga Open Pit reaches its full planned annual production capacity of 28.2 million tonnes of saleable coal in 2027. In addition, Russian Railways increased the capacity of the Komsomolsk-on-Amur-to-Sovetskaya Gavan segment, which connects the Baikal-Amur Mainline to Port Vanino, to 42.3 million tonnes in 2016. However, this increase may not be sufficient as other cargo shippers may also substantially increase their cargo volumes on the Baikal-Amur and Trans-Siberian Mainlines and further in the direction from Komsomolsk-on-Amur to Sovetskaya Gavan transportation hub. We cannot guarantee that the development projects by Russian Railways will proceed according to current plans, particularly in light of international sanctions against Russian companies and individuals. In addition, there is acute competition among Russian coal exporters for existing port capacity. In light of this shortage, Russian coal producers have endeavored to acquire ports or separate terminals to ensure the export of their products.

Our ability to increase coking coal export volumes is also limited by requirements to first satisfy Russian domestic coal demand, pursuant to a FAS directive issued to us in August 2008. See Antimonopoly regulation could lead to sanctions with respect to the subsidiaries we have acquired or established or our prices, sales volumes and business practices. Failure to successfully manage the obstacles and tasks involved in the implementation of our export sales strategy could have a material adverse effect on our business, financial condition, results of operations and prospects.

*In the event the title to the shares of any company we acquired is successfully challenged, we risk losing our ownership interest in that company or its assets.*

Almost all of our Russian assets consist of companies formed during the course of Russian privatizations in the 1990s and early 2000s and generally we acquired shares in these companies from third parties after their respective privatizations. Given that Russian privatization legislation is vague, many privatizations are vulnerable to challenge. The Russian statute of limitations for challenging privatization transactions is generally three years since the date when performance of the transaction began. If a person presenting the claim was not a party to the transaction, the statute of limitations runs from the date when such person found out or should have found out that performance of the transaction was initiated. The statute of limitations generally cannot exceed 10 years from the commencement of performance of the transaction, although recent court practice suggests this limit does not apply if a claimant was not aware of a violation and if it is determined that, in accordance with general principles of justice, the statute of limitations concept cannot be otherwise relied on to allow the legalization of unlawfully acquired property. As noted above, most of our subsidiaries were privatized more than 10 years ago. In the event that any title to, or our ownership stakes in, any of the privatized companies acquired by us is subject to challenge as having been improperly privatized and we are unable to defeat this claim, we risk losing our ownership interest in the company or its assets, which could materially adversely affect our business, financial condition, results of operations and prospects.

In addition, under Russian law transactions in shares may be invalidated on many grounds, including a sale of shares by a person without the right to dispose of such shares, breach of interested party and/or major transaction rules and/or the terms of transaction approvals issued by governmental authorities, or failure to register the share transfer in the

securities register. As a result, defects in earlier transactions with shares of our subsidiaries (where such shares were acquired from third parties) may cause our title to such shares to be subject to challenge.

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*Our business could be adversely affected if we fail to obtain or extend necessary subsoil licenses and permits or fail to comply with the terms of our subsoil licenses and permits.*

Our business depends on the continuing validity of our subsoil licenses and the issuance of new and extended subsoil licenses and our compliance with the terms thereof. In particular, in estimating our reserves, we have assumed that we will be able to renew our Russian subsoil licenses as and when necessary in the ordinary course of business so that we will be able to exploit the resources under such licenses for the operational life of the relevant subsoil plot. See Item 4. Information on the Company Regulatory Matters Subsoil Licensing in Russia Extension of licenses and Mining Segment Mineral reserves. However, license extension is subject to the licensee being in compliance with the terms of the license. Our experience with license extensions and publicly available information about current market practice and available court practice suggest that regulatory authorities tend to focus on such terms of the license as production levels, operational milestones and license payments, which are considered to be material terms of the license. Nevertheless, there is no assurance that this approach will be consistently applied by the regulatory authorities and the courts and that there will be no changes to this approach in the future. Regulatory authorities exercise considerable discretion in the timing of license issuance, extension of licenses and monitoring licensees' compliance with license terms. Subsoil licenses and related agreements typically contain certain environmental, safety and production commitments. See Item 4. Information on the Company Regulatory Matters Subsoil Licensing in Russia Maintenance and termination of licenses. If regulatory authorities determine that we have violated the material terms of our licenses, it could lead to rejection in license extension or suspension or termination of our subsoil licenses, and to administrative and civil liability. In addition, requirements imposed by relevant authorities may be costly to implement and result in delays in production. Our subsoil licenses expire on dates falling in 2019 through 2037. See the tables setting forth expiry dates of our Russian subsoil licenses in Item 4. Information on the Company Mining Segment and reserves information. Accordingly, these factors may seriously impair our ability to operate our business and realize our reserves which could have a material adverse effect on our business, financial condition, results of operations and prospects.

We are currently in compliance with the material terms of our Russian subsoil licenses, except for the following. We failed to commence commercial coal production at the Raspadsk license area (part of Olzherassky Open Pit) in 2009 as required by the license due to unfavorable mine economics, but expect to commence such production in the fourth quarter of 2018 provided coal prices recover sufficiently. In addition, we commenced preparation for the commercial development of the Yerunakovsk-1, Yerunakovsk-2 and Yerunakovsk-3 license areas, but failed to commence commercial production at these license areas in 2011 as required by the licenses due to unfavorable mine economics. Moreover, we cannot fully develop the deposit at the Yerunakovsk-3 license area due to the presence of a third-party sludge pond in this area. Furthermore, we failed to commence commercial coal production at the Olzherassk license area (Olzherasskaya-Glubokaya Underground) due to unfavorable mine economics and the significant capital investments required to develop this license area. The Yerunakovsk-2, Yerunakovsk-3 and Olzherassk (Olzherasskaya-Glubokaya Underground) license areas are not counted for the purposes of our coal reserves.

*Increasing costs of electricity, natural gas and labor could materially adversely affect our operating margins.*

In 2016, our Russian operations purchased approximately 4.7 billion kilowatt-hours ( **kWh** ) of electricity at a total cost of 13.2 billion rubles, implying an average cost of 2.4 rubles per kWh. According to the Ministry of Economic Development of the Russian Federation, the average increase in market prices on the retail electricity market was 7.9% in 2016, and is expected to be 6.5% in 2017. Further price increases for electricity may also occur in the future due to the increase in fuel prices.

Our Russian operations also purchase significant amounts of natural gas, primarily for the production of power resources at our own co-generation facilities, from Novatek PAO ( **Novatek** ), Russia's largest independent producer of

natural gas, Rosneft Oil Company ( **Rosneft** ), the leader of Russia's petroleum industry, and Gazprom PAO ( **Gazprom** ), the government-controlled dominant gas producer and the owner of

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the unified gas supply system of Russia. Domestic natural gas prices are regulated by the Russian government. In 2016, we purchased approximately 1.8 billion cubic meters of gas at a total cost of approximately 6.9 billion rubles. Russian domestic natural gas prices are significantly below Western European levels, which provides us with a cost advantage over our competitors, an advantage which may diminish as Russian domestic gas prices approach Western European levels. Starting from July 1, 2015, the Russian Federal Tariff Service set wholesale prices of gas produced by Gazprom for domestic consumers on the territory of the Russian Federation, except for households, in the range of 2,395 rubles to 4,906 rubles as compared to prices set for the previous period which were set starting from January 1, 2014 in the range of 2,228 rubles to 4,675 rubles per thousand cubic meters, depending on the region of the Russian Federation where the gas is purchased. In 2016, gas prices were not increased and remained at the level of 2015.

Following raw materials used in the production process and energy-related costs, our labor costs are the next most significant operational cost. Labor costs in Russia have historically been significantly lower than those in the more developed market economies of North America and Western Europe for similarly skilled employees. According to Rosstat, after adjusting for inflation, the average wage in the Russian Federation has risen at the annual rate of 1.2% and 4.8% in 2014 and 2013, respectively. In 2015, the average wage has decreased by 9.0%, according to Rosstat. In 2016, the average wage has increased by 0.7%, according to Rosstat. Labor costs in Russia are indexed to and adjusted for inflation, which means that in the future labor costs may rise and our advantage with respect to our competitors with foreign operations that have historically had to pay higher average wages than those paid in Russia may be reduced.

Higher costs of electricity, natural gas and labor could negatively impact our operating margins, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

*A limited capacity of the railway infrastructure and an increase in railway tariffs expose us to uncertainties regarding transportation costs of raw materials and steel products.*

Railway transportation is our principal means of transporting raw materials and steel products to our facilities and to customers in Russia and abroad. The Russian rail system is controlled by Russian Railways, which is a state-sanctioned monopoly responsible for the management of all Russian railroads. The Russian government sets domestic rail freight prices and the terms of transportation, including the terms related to the type of rolling stock to be used for transportation of certain types of cargo and the estimated minimum tonnage for the purposes of determining the applicable tariff. These rail freight prices are subject to annual adjustment based on, among other factors, inflation and the funding requirements of Russian Railways' capital investment program, which is in turn affected by the acute need to upgrade track infrastructure and passenger- and cargo-handling facilities.

The most significant railcar owners are Freight One JSC, Federal Freight JSC, NefteTransService, Globaltrans and Freight Company Novotrans. Our cargoes are currently transported in the railcars owned by our subsidiary Mecheltrans or third party railcar owners, mainly to transport coal products and iron ore concentrate. Mecheltrans works with third party railcar owners to arrange for transportation and forwarding of cargoes with their railcars. In 2016, our freight volume transported by third party railcar owners amounted to 28.0 million tonnes, for which we paid 8.6 billion rubles.

In 2016, railway tariffs were indexed by 9.0%. Starting from January 1, 2017, railway tariffs have increased by an additional 6.08%. Along with the growth of tariff levels, a disruption in the transportation of our raw materials and products may occur. In 2016, due to the ban to increase the service life of railcars, the open car fleet of Russian Railways decreased sharply while traffic volumes remained unchanged. In the summer of 2016, the shortage of railcars increased as a result of scheduled track repairs. The shortage of the rolling stock led to a significant increase in prices of rolling stock operators' services and a reduction in volume of transported cargo, including our cargo. All of

the above factors may preserve in the future and negatively impact our operating margins, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

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*We face certain trade restrictions in the export of ferrosilicon to the European Union.*

In February 2008, an antidumping duty in the amount of 17.8% was imposed on exports to the European Union of ferrosilicon produced by our subsidiary Bratsk Ferroalloy Plant for a period of five years. In February 2013, the European Commission initiated an expiry review of the antidumping measures applicable to imports of ferrosilicon. In April 2014, the antidumping duty was extended for another five years. We may face additional antidumping duties and other trade restrictions in the European Union, the United States and other markets in the future. See Item 4. Information on the Company Steel Segment Trade restrictions.

*We benefit from Russia's tariffs and duties on imported steel, many of which have been reduced upon Russia's WTO membership and may be eliminated in the future.*

Russia has in place import tariffs with respect to certain imported steel products. These tariffs generally amount to 5-15% of the value of the imports. Almost all of our sales of steel products in Russia were protected by these import tariffs in 2016. The Republic of Belarus, the Republic of Kazakhstan and the Russian Federation entered into a Customs Union and implemented a Common Customs Tariff, which came into force on January 1, 2010, reducing import duties on stainless rolled products from 15% to 10%. Further, the Republic of Belarus, the Republic of Kazakhstan and the Russian Federation established the Eurasian Economic Union which was enlarged in 2015 to include the Republic of Armenia and the Kyrgyz Republic. Creation of the Customs Union, as well as other actions and decisions of Russian authorities in respect of tariffs and duties, can lead to further reduction of import duties.

On November 20, 2013, the Eurasian Economic Commission initiated an antidumping investigation against imports of steel bars originating in Ukraine. In March 2016, the investigation was completed resulting in the imposition of antidumping duties for a period of five years. Therefore, we benefit from protection of the Eurasian Economic Union's market from low-priced import of steel bars.

Upon Russia's entry into the World Trade Organization ( **WTO** ), the import tariffs and duties of Russia were reduced or eliminated, depending on the type of steel products. In particular, according to the WTO accession terms Russian import duties on most types of steel products have been reduced to 5%, causing increased competition in the Russian steel market from foreign producers and exporters.

*Our exports to the European Union are subject to REACH regulations.*

Chemical substances contained in some of our products, as well as by-products and waste, which we export to or produce in the European Union are subject to regulation (EC) No 1907/2006 on registration, evaluation, authorization and restrictions of use of chemicals ( **REACH** ). Under REACH, we must provide a registration dossier for such substances to the European Chemicals Agency ( **ECHA** ). In addition, we must provide the information about the registered substances usage and utilization to the competent authorities of the E.U. Member States and downstream users upon request. We believe that we are in compliance with current REACH requirements and we will have to maintain certain resources to ensure compliance with further developing REACH requirements.

REACH provides for a special authorization regime for substances of high concern, including those that are identified from scientific evidence as causing probable serious effects to humans or the environment on a case-by-case basis. To obtain authorization, a manufacturer of substances of high concern is generally required to demonstrate that the risk from the use of the substance is adequately controlled. All substances under the authorization regime are subject to restrictions with respect to manufacture, placing on the market or use. The European Commission may amend or withdraw the authorization, even one given for adequate control, if suitable substitutes have become available. Currently, none of our products contain substances which may be subject to the authorization regime. There is no

assurance that our products will not be subject to further restrictions or bans if any substance of high concern is detected in our products in excess of statutory thresholds, which could have a material adverse effect on our business, financial condition, results of operations and prospects.



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The European Commission has planned several revisions of the REACH regulation by 2019. Compliance with changes to the existing regulations may lead to increased costs, modifications in operating practices and/or further restrictions affecting our products. Any such changes and/or modifications could have a material adverse effect on our business, financial condition, results of operations and prospects.

*We are subject to mining risks.*

Our operations, like those of other mining companies, are subject to all of the hazards and risks normally associated with the exploration, development and production of natural resources, any of which could result in production shortfalls or damage to persons or property.

In particular, hazards associated with our open pit mining operations include, but are not limited to: (1) flooding of the open pit; (2) collapses of the open pit wall; (3) accidents associated with the operation of large open pit mining and rock transportation equipment; (4) accidents associated with the preparation and ignition of large-scale open pit blasting operations; (5) deterioration of production quality due to weather; and (6) hazards associated with the disposal of mineralized waste water, such as groundwater and waterway contamination.

Hazards associated with our underground mining operations include but are not limited to: (1) underground fires and explosions, including those caused by flammable gas; (2) cave-ins or ground falls; (3) emissions of gases and toxic chemicals; (4) flooding; (5) sinkhole formation and ground subsidence; and (6) other accidents and conditions resulting from drilling, blasting and removing and processing material from an underground mine, including due to human error.

We are at risk of experiencing any and all of these hazards. The occurrence of such hazards could delay production, increase production costs, result in injury to persons or death, and damage to property, as well as liability for us. For example, in 2008, there were two accidents at V.I. Lenina Underground which involved multiple casualties, and one of the accidents resulted in five fatalities. In 2010 through 2012, there were a number of occasions of self-heating and spontaneous ignition of coal as well as an increase of coal dust levels, each of which resulted in the temporary suspension of mining operations at the longwalls of Sibirginskaya Underground, V.I. Lenina Underground and Olzherasskaya-Novaya Underground. There were no casualties involved in any of these occasions. In 2013-2016, there were also a number of occasions which caused the temporary suspension of mining operations, but had no significant effect on our business. We implemented measures to cure the causes of these occasions and we are implementing measures aimed at preventing accidents and occasions in the future and we are cooperating with the competent governmental authorities, in particular, the Russian Federal Service for Ecological, Technological and Nuclear Supervision ( **Rostekhnadzor** ).

The risk of occurrence of these hazards is also exacerbated by the significant level of wear of the equipment of our mining enterprises. We are conducting a program of phased replacement and refurbishment of obsolete equipment in order to meet safety requirements at our most hazardous facilities.

*Abnormal weather conditions and natural hazards could negatively impact our business.*

Our production facilities are located in different climate and weather conditions, and abnormal weather changes and natural hazards could affect their operations. Interruptions in electricity supply and transport communication could lead to delays in deliveries of raw materials to our production facilities and finished products to consumers, as well as a suspension of production. For example, in 2016, a 50 meters long wash-out of railway track on the Ulak-Elga rail line occurred as a result of heavy rains. Coal transportation from the Elga deposit was interrupted for 4 days until the full restoration of the railway. In addition, the existence of abnormally low temperatures for a long period of time may

limit the work of the port infrastructure, crane equipment and mining-and-transport equipment. For example, in 2013, operations at our open pit mines in Russia were suspended for a period of 2 to 16 days. The negative impact of such abnormal or extreme climate and weather conditions may have an adverse effect on our business, financial condition, results of operations and prospects.

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*More stringent environmental laws and regulations or more stringent enforcement or findings that we have violated environmental laws and regulations could result in higher compliance costs and significant fines and penalties, cleanup costs and compensatory damages, or require significant capital investment, or even result in the suspension of our operations, which could have a material adverse effect on our business, financial condition, results of operations and prospects.*

Our operations and properties are subject to environmental laws and regulations in the jurisdictions in which we operate. For instance, our operations generate large amounts of pollutants and waste, some of which are hazardous, such as benzapiren, sulfur oxide, sulfuric acid, nitrogen ammonium, sulfates, nitrites and phenicols. Some of our operations result in the creation of sludges, including sludges containing base elements such as chromium, copper, nickel, mercury and zinc. The creation, storage and disposal of such hazardous waste is subject to environmental regulations, including the requirement to perform decontamination and reclamation, such as cleaning up highly hazardous waste oil and iron slag. In addition, pollution risks and related cleanup costs are often impossible to assess unless environmental audits have been performed and the extent of liability under environmental and civil laws is clearly determinable. Furthermore, new and more stringent regulations have been introduced in a number of countries in response to the impacts of climate change. See Increased regulations associated with climate change and greenhouse gas emissions may give rise to increased costs and may adversely impact our business and markets.

Generally, there is a greater awareness in Russia of damage caused to the environment by industry than existed during the Soviet era. At the same time, environmental legislation in Russia is generally weaker and less stringently enforced than in the European Union or the United States. However, recent Russian government initiatives indicate that Russia will introduce new water, air and soil quality standards and increase its monitoring and fines for non-compliance with environmental rules, and environmental concerns are increasingly being voiced at the local level. For example, Resolution No. 1029 of the Government of the Russian Federation dated September 28, 2015 On approval of criteria for attribution of objects having a negative impact on the environment to objects of I, II, III and IV category, sets criteria for the classification of objects that have a negative impact on the environment into the four categories. The first category includes objects that have a significant negative impact on the environment and relate to fields of application of the best available technology and the fourth category includes objects that have minimal environmental impact. Certain of our production facilities can be attributed to the first category of objects that have a negative impact on the environment.

Based on the current regulatory environment in Russia and elsewhere where we conduct our operations, as of December 31, 2016, we have not created any reserves for environmental liabilities and compliance costs, other than an accrual in the amount of RUB 3,678 million for rehabilitation provision. Any change in this regulatory environment could result in actual costs and liabilities for which we have not provided. We estimated the total amount of capital investments to address environmental concerns at our various subsidiaries at RUB 647 million as of December 31, 2016. These amounts are not accrued in the consolidated financial statements until actual capital investments are made. See note 28 to the consolidated financial statements.

In the course, or as a result, of an environmental investigation by Russian governmental authorities, courts can issue decisions requiring part or all of the production at a facility that has violated environmental standards to be halted for a period of up to 90 days. We have been cited in Russia for various violations of environmental regulations in the past and we have paid certain fines levied by regulatory authorities in connection with these infractions. In June 2013, the Russian Federal Service for the Supervision of Natural Resources ( **Rosprirodnadzor** ) claimed 398.6 million rubles from Beloretsk Metallurgical Plant as compensation for damages caused by discharging waste water into the river Belaya and Beloretsk storage reservoir. This claim was resolved by means of a settlement agreement approved by the arbitrazh court according to which Beloretsk Metallurgical Plant was obliged to reconstruct a waste treatment facilities system by December 31, 2016. In November 2016, Beloretsk Metallurgical Plant applied for a stay of

execution and the court ruled to complete the reconstruction in the period up to December 31, 2023. In February 2015, Rosprirodnadzor filed a similar claim in the amount of 195.3 million rubles against Beloretsk Metallurgical Plant. In accordance with the court's decision, Beloretsk Metallurgical Plant is obliged to perform a set of measures for equipment modernization until July 1,

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2017. See Item 8. Financial Information – Litigation – Environmental and safety. Though our production facilities have not been ordered to suspend operations due to environmental violations during the respective periods since we acquired or established them, there are no assurances that environmental protection authorities will not seek such suspensions in the future. In the event that production at any of our facilities is partially or wholly suspended due to this type of sanction, our business, financial condition, results of operations and prospects could be materially adversely affected.

*Increased regulations associated with climate change and greenhouse gas emissions may give rise to increased costs and may adversely impact our business and markets.*

Through our mining and power segments, we are a major producer of carbon-related products such as coal, coal concentrate and energy. Coal and coal-based energy are also significant inputs in many of the operations of our steel segment. A major by-product of the underground mining of coal is methane (CH<sub>4</sub>) and a major by-product of coal burning is carbon dioxide (CO<sub>2</sub>), both of which are considered to be greenhouse gases and generally a source of concern in connection with global warming and climate change.

The December 1997 Kyoto Protocol established a set of greenhouse gas emission targets for developed countries that have ratified the Kyoto Protocol. In order to give the countries a certain degree of flexibility in meeting their emission reduction targets, the Kyoto Protocol developed mechanisms allowing participating countries to earn and trade emissions credits by way of implementing projects aimed at meeting the Kyoto Protocol targets. The European Union has established greenhouse gas regulations and many other countries are in the process of doing so. The European Union Emissions Trading System ( EU ETS ) has had an impact on greenhouse gas and energy-intensive businesses based in the European Union. Our operations in Lithuania are currently subject to the EU ETS, as are our E.U. based customers.

The Russian Federation ratified the Kyoto Protocol in 2005 and since October 2009 Russia has established a legal procedure for implementing trading mechanisms provided under the Kyoto Protocol. However, in 2012, Russia refused to sign up for the second period of limits set to begin in 2013 and remain in effect until 2020.

In December 2015 at the Paris climate conference, 196 countries adopted the United Nations Framework Convention on Climate Change which is due to enter into force in 2020. The agreement sets out a global action plan to avoid climate change. As stated by Mr. Putin during his speech at the Paris conference, Russia expects to decrease greenhouse gas emissions to 70% of the 1990 level by 2030. Furthermore, the Russian Federation shall develop a long-term plan to reduce greenhouse gas emissions and shall establish a strategy on adaptation to climate change. In July 2015, Ministry of Natural Resources and Ecology of the Russian Federation has approved guidelines for the quantification of the amount of greenhouse gas emissions by organizations conducting business and other activities in Russia.

Further Russia's steps on implementation of the United Nations Framework Convention on Climate Change could restrict our operations and/or impose significant costs or obligations on us, including requiring additional capital expenditures, modifications in operating practices, and additional reporting obligations. These regulatory programs may also have a negative effect on our production levels, profit and cash flows and on our suppliers and customers, which could result in higher costs and lower sales. Finally, we note that even without further legislation or regulation of greenhouse gas emissions, increased awareness and any adverse publicity in the global marketplace about the greenhouse gasses emitted by companies in the steel manufacturing industry could harm our reputation and reduce customer demand for our products.

*Failure to comply with existing laws and regulations could result in substantial additional compliance costs or various sanctions which could materially adversely affect our business, financial condition, results of operations and prospects.*

Our operations and properties are subject to regulation by various government entities and agencies in connection with obtaining and renewing various licenses, permits, approvals and authorizations, as well as with

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ongoing compliance with existing laws, regulations and standards. See Item 4. Information on the Company Regulatory Matters Licensing of Operations in Russia. Governmental authorities in countries where we operate exercise considerable discretion in matters of enforcement and interpretation of applicable laws, regulations and standards, the issuance and renewal of licenses, permits, approvals and authorizations, and in monitoring licensees compliance with the terms thereof which may result in unexpected audits, criminal prosecutions, civil actions and expropriation of property. For example, in November 2015, the Ministry for Investment and Development of the Republic of Kazakhstan unilaterally terminated the contract for the silicate nickel ore production at the Shevchenko deposit in Kazakhstan's Kostanay region entered into in connection with the subsoil license for the Shevchenko deposit due to non-compliance with the terms of the contract. Governmental authorities have the right to, and frequently do, conduct periodic inspections of our operations and properties throughout the year.

Our failure to comply with existing laws and regulations or to obtain and comply with all approvals, authorizations and permits required for our operations or findings of governmental inspections may result in the imposition of fines or penalties or more severe sanctions including the suspension, amendment or termination of our licenses, permits, approvals and authorizations or in requirements that we cease certain of our business activities, or in criminal and administrative penalties applicable to our officers. Arbitrary government actions directed against other Russian companies (or the consequences of such actions) may generally impact on the Russian economy, including the securities market. Any such actions, decisions, requirements or sanctions could increase our costs and materially adversely affect our business, financial condition, results of operations and prospects.

*The concentration of our shares with our largest shareholders will limit your ability to influence corporate matters and transactions with largest shareholders may present conflicts of interest, potentially resulting in the conclusion of transactions on less favorable terms than could be obtained in arm's length transactions.*

Our Chairman, Igor Zyuzin may be deemed to be the beneficial owner of approximately 36.34% of our common shares. In addition, our Chairman's wife and children, Mrs. Irina Zyuzina and Ms. Ksenia Zyuzina and Mr. Kirill Zyuzin, together may be deemed to be the beneficial owners of approximately 18.70% of our common shares each separately. Therefore, Mr. Igor Zyuzin and Mrs. Irina Zyuzina together beneficially own 55.04% of our common shares. See Item 7. Major Shareholders and Related Party Transactions. Except in certain cases as provided by the Federal Law On Joint-Stock Companies, dated December 26, 1995, as amended (the **Joint-Stock Companies Law**), resolutions at a general shareholders' meeting are adopted by a majority of the voting stock at a meeting where shareholders holding more than half of the voting shares are present or represented. Accordingly, Mr. Zyuzin and his family members have the power to control the outcome of most matters to be decided by a majority of the voting stock present at a general shareholders' meeting and can control the appointment of the majority of directors and the removal of all of the elected directors if they act in concert. In addition, our largest shareholders are likely to be able to take actions, which require a three-quarters supermajority of the voting stock present at such a general shareholders' meeting, such as amendments to our charter, reorganization, significant sales of assets and other major transactions, if other shareholders do not participate in such meeting. Thus, our largest shareholders can take actions that you may not view as beneficial or prevent actions that you may view as beneficial, and as a result, the value of our common shares and ADSs could be materially adversely affected.

We have also engaged and will likely continue to engage in transactions with related parties, including our largest shareholder, which may present conflicts of interest, potentially resulting in the conclusion of transactions on less favorable terms than could be obtained in arm's length transactions. See Item 7. Major Shareholders and Related Party Transactions Related Party Transactions.

*Our competitive position and future prospects depend on our senior management team.*

Our ability to maintain our competitive position and to implement our business strategy is dependent on the performance of our senior management team and, in particular, Mr. Zyuzin, our Chairman and largest



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shareholder. Competition in Russia, and in the other countries where we operate, for senior management personnel with relevant expertise is intense due to the small number of qualified individuals. The loss or decline in the services of members of our senior management team or an inability to attract, retain and motivate qualified senior management personnel could have a material adverse effect on our business, financial condition, results of operations and prospects.

*Antimonopoly regulation could lead to sanctions with respect to the subsidiaries we have acquired or established or our prices, sales volumes and business practices.*

Our business has grown substantially through the acquisition and founding of companies, many of which required the prior approval or subsequent notification of the FAS or its predecessor agencies. Relevant legislation restricts the acquisition or founding of companies by legal entities or individuals acting alone or jointly with their group of persons without such approval or notification. This legislation is vague in certain parts and subject to varying interpretations. If the FAS were to conclude that a company was acquired or created in contravention of applicable legislation and that competition has been or could be limited as a result, it could seek redress, including invalidating the transactions that led to or could lead to the limitation of competition, obliging the acquirer or founder to perform activities to restore competition, and seeking the dissolution of the new company created as a result of reorganization. Any of these actions could materially adversely affect our business, financial condition, results of operations and prospects.

In 2008, the FAS issued a number of directives to our companies placing certain restrictions on our business practices. On May 13, 2008, the FAS issued a directive ordering Mechel and Southern Kuzbass Coal Company, as a group of companies holding a dominant position in the Russian coking coal market, to fulfill the following requirements:

to avoid the unjustified reduction of production volumes and product range at Southern Kuzbass Coal Company;

to provide, to the extent possible, equal supply terms to all customers without discrimination against companies not forming part of this group of companies;

not to restrict other companies from supplying coking coal to the same geographical area of operations; and

to notify the FAS prior to any increase in domestic prices of coking coal and coking coal concentrate, if such increase amounts to more than 10% of the relevant price used 180 days before the date such increase is planned to take place, with submission to the FAS of the financial and economic reasoning for the planned increase of prices.

In connection with the establishment of Mechel Mining, the subsidiary into which we consolidated certain of our mining assets, we received a directive from the FAS dated June 23, 2008, which contains requirements as to the activities of Mechel Mining and its subsidiaries Yakutugol and Southern Kuzbass Coal Company, as a group of companies holding a dominant position in the Russian coking coal market. The requirements are the same as those described above.

In August 2008, as a result of an antimonopoly investigation into the business of our subsidiaries Mechel Trading House, Southern Kuzbass Coal Company, Yakutugol and Mechel Trading, the FAS found them to have abused their

dominant position in the Russian market for certain grades of coking coal concentrate. The FAS issued a directive requiring these subsidiaries and their successors to, among others, refrain from taking any action in the Russian market for certain grades of coking coal concentrate which would or may preclude, limit or eliminate competition and/or violate third parties' interests, including fixing and maintaining a monopolistically high or low price, refusing or avoiding to enter into an agreement with certain buyers without good economic or technological reasons where the production or supply of the relevant grades of coking coal concentrate is possible and creating discriminatory conditions for buyers. Furthermore, material fines were imposed on Mechel Trading House, Southern Kuzbass Coal Company and Yakutugol.

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In the event of a breach of the terms of business conduct set forth by the FAS, the FAS may seek to impose fines for violations of antimonopoly and administrative legislation. Such fines may include an administrative fine of an amount from 300 thousand to one million rubles or, if such violation has led or may lead to the prevention, limitation or elimination of competition, an administrative fine of up to 15% of the proceeds of sale of all goods, works and services on the market where such violation was committed, but not more than 2% of gross proceeds of sale of all goods, works and services. Russian legislation also provides for criminal liability for violations of antimonopoly legislation in certain cases. Furthermore, for systematic violations, a court may order, pursuant to a suit filed by the FAS, a compulsory split-up or spin-off of the violating company, and no affiliation can be preserved between the new entities established as result of such a mandatory reorganization. The imposition of any such liability on us or our subsidiaries could materially adversely affect our business, financial condition, results of operations and prospects.

In 2016, the FAS conducted large-scale inspections of companies engaged in loading, unloading and storage of cargoes in ports of the Russian Federation concerning justification of applied tariffs for services. Based on the findings, proceedings for violation of antimonopoly legislation were initiated in respect of a number of companies. Our group companies which provide services of loading, unloading and storage of cargoes in ports were not subject to proceedings for violation of antimonopoly legislation, however the inspections are ongoing. The FAS is also considering repeated introduction of government regulation of tariffs for services of loading, unloading and storage of cargoes in ports which could have a material adverse effect on our business, financial condition, results of operations and prospects.

Negative publicity associated with any antimonopoly, administrative, criminal or other investigation or prosecution carried out with respect to our business practices, regardless of the outcome, could damage our reputation and result in a significant drop in the price of our shares and ADSs and could materially adversely affect our business, financial condition, results of operations and prospects.

*In the event that the minority shareholders of our subsidiaries were to successfully challenge past interested party transactions or do not approve interested party transactions in the future, we could be limited in our operational flexibility.*

We own less than 100% of the equity interests in some of our subsidiaries. In addition, certain of our wholly-owned subsidiaries have previously had other shareholders. We and our subsidiaries have carried out, and continue to carry out, transactions among our companies which may be deemed controlling or controlled entities in relation to each other, as well as transactions with other parties which may be considered to be interested party transactions under Russian law, requiring approval by disinterested directors, disinterested independent directors or disinterested shareholders depending on the nature and value of the transaction and the parties involved. The provisions of Russian law defining which transactions must be approved as interested party transactions are subject to different interpretations, and these transactions may not always have been properly approved, including by former shareholders. We cannot make any assurances that our and our subsidiaries' applications of these rules will not be subject to challenge by shareholders. Any such challenges, if successful, could result in the invalidation of transactions, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

In addition, Russian law requires a three-quarters majority of the voting stock present at a general shareholders meeting to approve certain matters, including, for example, charter amendments, reorganizations, major transactions involving property in excess of 50% of the balance sheet value of the company's assets, acquisition by the company of outstanding shares and certain share issuances. In some cases, minority shareholders may not approve interested party transactions requiring their approval or other matters requiring approval of minority shareholders or supermajority approval. In the event that these minority shareholders were to successfully challenge past interested party transactions, or do not approve interested party transactions or other matters in the future, we could be limited in our

operational flexibility and our business, financial condition, results of operations and prospects could be materially adversely affected.

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*Minority shareholder lawsuits, if resolved against our group companies, could have a material adverse effect on our financial condition and results of operations.*

Russian corporate law allows minority shareholders holding in aggregate at least 1% of the voting shares to have standing to bring claims against the company challenging decisions of its governing bodies. These features of Russian corporate law are often abused by minority shareholders, who can bring claims in local courts seeking injunctions and other relief for which, in some cases, we may not receive notice. Any such actions by minority shareholders, if resolved against our group companies, could have a material adverse effect on our business, financial condition, results of operations and prospects. See Item 8. Financial Information Litigation Securities litigation.

*A majority of our employees are represented by trade unions, and our operations depend on good labor relations.*

As of December 31, 2016, approximately 59% of all our employees were represented by trade unions. Although we have not experienced any business interruption at any of our companies as a result of labor disputes from the dates of their respective acquisition by us and we consider our relations with our employees to be good, under Russian law unions have the legal right to strike and other Russian companies with large union representation periodically face interruptions due to strikes, lockouts or delays in renegotiations of collective bargaining agreements. Our businesses could also be affected by similar events if our relationships with our labor force and trade unions worsen in the future. We have extended the industry agreements for coal and ore mining and smelting industries and have renegotiated most related collective bargaining agreements. If we are unable to prolong collective bargaining agreements on similar conditions in the future or our employees are dissatisfied with the terms of the collective bargaining agreements and undertake any industrial action, it could have material adverse effects on our business, financial condition, results of operations and prospects.

*We do not carry the types of insurance coverage customary in more economically developed countries for a business of our size and nature, and a significant adverse event could result in substantial property loss and inability to rebuild in a timely manner or at all.*

The insurance industry is still developing in Russia, and many forms of insurance protection common in more economically developed countries are not available in Russia on comparable terms, including coverage for business interruption. At present, most of our Russian production facilities are not insured, and we have no coverage for business interruption or for third-party liability, other than insurance required under Russian law, collective agreements, loan agreements or other undertakings. Some of our international production facilities are not covered by comprehensive insurance typical for such operations in Western countries. We cannot assure you that the insurance we have in place is adequate for the potential losses and the liability we may suffer.

Since most of our production facilities lack insurance covering their property, if a significant event were to affect one of our facilities, we could experience substantial financial and property losses, as well as significant disruptions in our production activity, for which we would not be compensated by business interruption insurance.

Since we do not maintain separate funds or otherwise set aside reserves for these types of events, in case of any such loss or third-party claim for damages we may be unable to seek any recovery for lost or damaged property or compensate losses due to disruption of production activity. Any such uninsured loss or event may have a material adverse effect on our business, financial condition, results of operations and prospects.

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*If transactions, corporate decisions or other actions of members of our group and their predecessors-in-interest were to be challenged on the basis of non-compliance with applicable legal requirements, the remedies in the event of any successful challenge could include the invalidation of such transactions, corporate decisions or other actions or the imposition of other liabilities on such group members.*

Businesses of our group, or their predecessors-in-interest at different times, have taken a variety of actions relating to the incorporation of entities, share issuances, share disposals and acquisitions, mandatory buy-out offers, acquisition and valuation of property, including land plots, interested party transactions, major transactions, decisions to transfer licenses, meetings of governing bodies, other corporate matters and antimonopoly issues that, if successfully challenged on the basis of non-compliance with applicable legal requirements by competent state authorities, counterparties in such transactions or shareholders of the relevant members of our group or their predecessors-in-interest, could result in the invalidation of such actions, transactions and corporate decisions, restrictions on voting rights or the imposition of other liabilities. As applicable laws of the jurisdictions where our group companies are located are subject to varying interpretations, we may not be able to defend successfully any challenge brought against such actions, decisions or transactions, and the invalidation of any such actions, transactions and corporate decisions or imposition of any restriction or liability could have a material adverse effect on our business, financial condition, results of operations and prospects.

*Terrorist attacks and threats, escalation of military activity, as well as massive cyber attacks or incidents, and government regulation in response to such attacks or acts of war may negatively affect our business, financial condition, results of operations and prospects.*

Terrorist attacks and threats, escalation of military activity, as well as massive cyber attacks or incidents, and an increase in government regulation in response to such attacks or acts of war may negatively affect our business. There could be delays or losses in transportation and deliveries of our products to our customers, increased government regulation and decreased sales due to disruptions in the businesses of our customers. It is possible that any such occurrences could have a material adverse effect on our business, financial condition, results of operations and prospects.

*We have used certain information in this document that has been sourced from third parties.*

We have sourced certain information contained in this document from independent third parties, including private companies, government agencies and other publicly available sources. We believe these sources of information are reliable and that the information fairly and reasonably characterizes the industry in countries where we operate. However, although we take responsibility for compiling and extracting the data, we have not independently verified this information. In addition, the official data published by Russian federal, regional and local governments may substantially differ from those of Western countries. Official statistics may also be produced on different bases than those used in Western countries.

### ***Risks Relating to Our Shares and the Trading Market***

*The price of our shares and ADSs could be volatile and could drop unexpectedly, making it difficult for investors to resell our shares or ADSs at or above the price paid.*

The price at which our shares and ADSs trade is influenced by a large number of factors, some of which are specific to us and our operations and some of which are related to the mining and steel industries and equity markets in general. As a result of these factors, investors may not be able to resell their shares or ADSs at or above the price paid for them. In particular, the following factors, in addition to other risk factors described in this section, may have a

material impact on the market price of our shares and ADSs:

investor perception of us as a company;

actual or anticipated fluctuations in our revenues or operating results;

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announcement of intended acquisitions, disposals or financings, or speculation about such acquisitions, disposals or financings;

changes in our dividend policy, which could result from changes in our cash flow and capital position;

sales of blocks of our common shares, common ADSs, preferred shares or preferred ADSs by significant shareholders, including the Justice persons;

price and timing of any refinancing of our indebtedness;

potential litigation involving us;

changes in financial estimates and recommendations by securities research analysts;

fluctuations in Russian and international capital markets, including those due to events in other emerging markets;

the performance of other companies operating in similar industries;

regulatory developments in the markets where we operate, especially Russia and the European Union;

international political and economic conditions, including the effects of fluctuations in foreign exchange rates, interest rates and oil prices and other events such as terrorist attacks, military operations, changes in governments and relations between countries, international sanctions, particular those currently in place against certain Russian companies and individuals, natural disasters and the uncertainty related to these developments;

news or analyst reports related to markets or industries in which we operate; and

general investor perception of investing in Russia.

As a result of deteriorating market conditions in 2014 for our main products, together with our high leverage, our shares and ADSs price dropped significantly in 2014, and ADSs started trading below one U.S. dollar and thus became non-compliant with the NYSE continuous listing standards. On February 27, 2015, the 30 trading-day average closing price of ADSs amounted to \$1.26 per ADS. As a result, we received official notice from the NYSE on March 2, 2015 that our ADSs came back into compliance with the listing standards.



On August 19, 2015, we received an official notice from the NYSE stating that the price for Mechel ADSs had fallen below the \$1.00 threshold and we were required to bring our share price and average share price back above one U.S. dollar within six months from the date of receipt of the notice. In order to regain compliance with the NYSE requirements, we changed the ratio of our ADSs from one ADS per one common share to one ADS per two common shares, which became effective on January 12, 2016. As a result, we received official notice from the NYSE on February 1, 2016 that our ADSs came back into compliance with the listing standards.

*Our ability to pay dividends depends primarily upon receipt of sufficient funds from our subsidiaries.*

Because we are a holding company, our ability to pay dividends depends primarily upon receipt of sufficient funds from our subsidiaries. Under Russian law, dividends may be declared and paid only out of net profits calculated under Russian accounting standards and as long as certain conditions have been met, including if the value of the net assets, calculated under Russian accounting standards, is not less (and would not become less as a result of the proposed dividend payment) than the sum of the charter capital, the reserve fund and the difference between the liquidation value and the par value of the issued and outstanding preferred shares. See Item 10. Additional Information Charter and Certain Requirements of Russian Legislation Description of Capital Stock Dividends. Currently, some of our subsidiaries do not meet this criteria and cannot approve payment of, or pay dividends. See Risks Relating to the Russian Federation One or more of our subsidiaries could be forced into liquidation on the basis of formal non-compliance with certain requirements of Russian law, which could materially adversely affect our business, financial condition, results of operations and prospects.

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Furthermore, the payment of dividends by our subsidiaries and/or our ability to repatriate such dividends may, in certain instances, be subject to taxes, statutory restrictions, retained earnings criteria, and covenants in our subsidiaries financing arrangements and are contingent upon the earnings and cash flow of those subsidiaries. See note 25 to the consolidated financial statements. In addition, loan agreements which we have restructured contain restrictions on the payment of dividends on our common and preferred shares. See Item 8. Financial Information Dividend Distribution Policy.

*Upon introduction of a new system of recording the depositary's rights to the shares underlying depositary receipts, the depositary is required to disclose information on ADS and GDS owners in order to exercise voting rights and receive dividends with respect to the shares underlying ADSs and GDSs.*

Effective January 1, 2013, a new system of recording the depositary's rights to the shares underlying depositary receipts was introduced by the Federal Law No. 415-FZ of December 7, 2011, as amended on December 29, 2012 ( **Federal Law No. 415-FZ** ). Pursuant to the new system, the underlying shares are no longer recorded at the depositary's owner's account opened with a Russian custodian holding a depo account of nominee holder with the issuer's shareholder register. Instead, the underlying shares are now recorded at a depo account of depositary programs opened with a Russian custodian which in its turn has a depo account of nominee holder opened with the central depositary. On November 6, 2012, the FFMS granted JSC National Settlement Depositary ( **NSD** ) the status of Russian central depositary. Starting from November 6, 2013, the depo accounts of depositary programs should be opened for depositaries, and shares represented by depositary receipts should be recorded in depo accounts of depositary programs.

In addition to the new recording system, the Federal Law No. 415-FZ also sets forth new obligations for a depositary to disclose information on depositary receipt owners in order to exercise voting rights with respect to the shares represented by depositary receipts. The CBR by its Directive No. 3680-U dated June 15, 2015 sets forth the requirements for the provision of information about the depositary receipt owners. Such information is provided to the issuer in the form of a list of persons who exercise the rights under the depositary receipts. The list is provided to the issuer by the foreign depositary which opens the depo account of depositary programs. The list is provided for the preparation and holding of a shareholders' meeting. Furthermore, any obligations of the depositary to disclose information on depositary receipt owners in order to receive dividends were abolished effective January 1, 2014 pursuant to the Federal Law No. 282-FZ of December 29, 2012, as amended ( **Federal Law No. 282-FZ** ). Under the Federal Law No. 282-FZ, the payment of dividends on the shares represented by depositary receipts is made to the foreign depositary which opens the depo account of depositary programs.

Currently, it is not clear whether the term "depositary receipt owner" means a holder registered on the records of the depositary, a securities intermediary or a beneficial owner of a depositary receipt. As a result, the scope of the above reporting obligations, which may affect the rights of our ADS and GDS holders, also remains uncertain. We cannot assure you that the Federal Law No. 415-FZ and the other regulations by the CBR, to which the powers of the FFMS were delegated, will be compatible with the way in which depositary receipt programs were customarily operated in the past or with foreign confidentiality regulations, or that the new requirements will not impose additional burdens upon the depositary, ADS and GDS holders or their respective securities intermediaries, any of which may cause investments in our ADSs to be seen as less attractive.

In addition, the Federal Law No. 282-FZ requires the foreign depositary to take all reasonable steps to provide information on depositary receipt owners to the issuer, state arbitrazh courts, the CBR and governmental investigative authorities upon their request, and depositary receipt owners may not refuse to provide such information in response to the depositary if so requested. The CBR is entitled to demand the depositary to cure any breach of such disclosure requirements, and if the depositary fails to cure, the CBR may suspend or limit any operations with depo accounts of

depository receipt program for up to six months with respect to the number of securities not exceeding the number of securities for which the obligation to provide information has not been fulfilled. It is unclear how the CBR will use these new regulatory powers. Any suspension of or limitation on our ADS or GDS programs could have a material adverse effect on the value of the ADSs.

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*The depositary may be required to take certain actions due to Russian law requirements which could adversely impact the liquidity and the value of the shares and ADSs.*

If at any time the depositary believes that the shares deposited with it against the issuance of ADSs represent (or, upon accepting any additional shares for deposit, would represent) a percentage of shares which exceeds any threshold or limit established by any applicable law, directive, regulation or permit, or satisfies any condition for making any filing, application, notification or registration or obtaining any approval, license or permit under any applicable law, directive or regulation, or taking any other action, the depositary may (1) close its books to deposits of additional shares in order to prevent such thresholds or limits being exceeded or conditions being satisfied or (2) take such steps as are, in its opinion, necessary or desirable to remedy the consequences of such thresholds or limits being exceeded or conditions being satisfied and to comply with any such law, directive or regulation, including, causing *pro rata* cancellation of ADSs and withdrawal of underlying shares from the depositary receipt program to the extent necessary or desirable to so comply. Any such circumstances may affect the liquidity and the value of the shares and ADSs.

*Voting rights with respect to the shares represented by our ADSs are limited by the terms of the relevant deposit agreement for the ADSs and relevant requirements of Russian law.*

ADS holders have no direct voting rights with respect to the shares represented by the ADSs. They can only exercise voting rights with respect to the shares represented by ADSs in accordance with the provisions of the deposit agreements relating to the ADSs and relevant requirements of Russian law. Therefore, there are practical limitations upon the ability of ADS holders to exercise their voting rights due to the additional procedural steps which are involved. Our charter require us to notify shareholders not less than 30 days prior to the date of any meeting of shareholders and at least 50 days prior to the date of an extraordinary meeting to elect our Board of Directors. Within specified time limits, the notification of the convocation of the general shareholders meeting shall be sent to each person entitled to participate in the general shareholders meeting by post or delivered to each of the above persons against signature in accordance with the procedure prescribed by our charter and published on our site [www.mechel.ru](http://www.mechel.ru) in the information and telecommunication network Internet, or in the newspaper *Rossiyskaya Gazeta* and on our site [www.mechel.ru](http://www.mechel.ru) in the information and telecommunication network Internet or on our site [www.mechel.ru](http://www.mechel.ru) in the information and telecommunication network Internet. Our common shareholders, as well as our preferred shareholders in cases when they have voting rights, are able to exercise their voting rights by either attending the meeting in person or voting by power of attorney.

For ADS holders, in accordance with the deposit agreements, we will provide the notice to the depositary. The depositary has in turn undertaken, as soon as practicable thereafter, to mail to ADS holders notice of any such meeting of shareholders, copies of voting materials (if and as received by the depositary from us) and a statement as to the manner in which instructions may be given by ADS holders. To exercise their voting rights, ADS holders must then timely instruct the depositary how to vote their shares. As a result of this extra procedural step involving the depositary, the process for exercising voting rights may take longer for ADS holders than for holders of shares. ADSs for which the depositary does not receive timely voting instructions will not be voted at any meeting.

In addition, although securities regulations expressly permit the depositary to split the votes with respect to shares underlying the ADSs in accordance with instructions from ADS holders, there is little court or regulatory guidance on the application of such regulations, and the depositary may choose to refrain from voting at all unless it receives instructions from all ADS holders to vote the shares in the same manner. Holders of ADSs may thus have significant difficulty in exercising voting rights with respect to the shares underlying the ADSs. There can be no assurance that holders and beneficial owners of ADSs will: (1) receive notice of shareholder meetings to enable the timely return of voting instructions to the depositary; (2) receive notice to enable the timely cancellation of ADSs in respect of shareholder actions; or (3) be given the benefit of dissenting or minority shareholders rights in respect of an event or

action in which the holder or beneficial owner has voted against, abstained from voting or not given voting instructions.

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*ADS holders may be unable to repatriate their earnings.*

Dividends that we may pay in the future on the shares represented by the ADSs will be declared and paid to the depositary in rubles. Such dividends will be converted into U.S. dollars by the depositary and distributed to holders of ADSs, net of the fees and charges of, and expenses incurred by, the depositary, together with taxes withheld and any other governmental charges. The ability to convert rubles into U.S. dollars is subject to the currency markets. Although there is an active market for the conversion of rubles into U.S. dollars, including the interbank currency exchange and over-the-counter and currency futures markets, the functioning of this market in the future is not guaranteed and, in particular may be negatively impacted by any future imposition of exchange controls imposed by the Russian authorities in an effort to stabilize the value of the ruble.

*ADS holders may not be able to benefit from the United States-Russia income tax treaty.*

Under Russian tax legislation, dividends paid to a non-resident holder of shares of a Russian company generally will be subject to a 15% withholding tax. This tax rate may potentially be reduced to 10% or 5% for U.S. holders of the shares that are legal entities and organizations and to 10% for U.S. holders of the shares that are individuals under the Convention between the United States of America and the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital (the **United States-Russia income tax treaty** ), provided a number of conditions are satisfied. In connection with the enactment of amendments to Russian tax legislation, effective from January 1, 2014, the reduced tax rate of 5% established in accordance with certain provisions of the United States-Russia income tax treaty does not apply on dividend payments under ADSs. The general rate of 10% which is established by the treaty and does not account for benefits applies, subject to the submission of certain information to the tax agent. If such information has not been submitted to the tax agent in the prescribed manner and in a certain period of time, a tax rate of 30% is applied. Thus, the tax agent may be obliged to withhold tax at higher non-treaty rates when paying out dividends, and U.S. ADS holders may be unable to benefit from the United States-Russia income tax treaty. ADS holders may apply for a refund of a portion of the tax withheld under an applicable tax treaty, however, this process may be time-consuming and no assurance can be given that the Russian tax authorities will grant a refund. See Item 10. Additional Information Taxation Russian Income and Withholding Tax Considerations for additional information.

*Capital gains from the sale of ADSs may be subject to Russian profit tax.*

Under Russian tax legislation, gains realized by foreign organizations from the disposition of Russian shares and securities, as well as financial instruments derived from such shares, with the exception of shares that are traded on an organized securities market, may be subject to Russian profit tax or income tax if more than 50% of our assets directly or indirectly consist of immovable property located in Russia. Gains arising from the sale on foreign exchanges (foreign market operators) of securities or derivatives circulated on such exchanges are not considered Russian source income.

However, no procedural mechanism currently exists to withhold and remit this tax with respect to sales made to persons other than Russian companies and foreign companies with a registered permanent establishment in Russia. Gains arising from the disposition on foreign stock exchanges of the foregoing types of securities listed on these exchanges are not subject to taxation in Russia.

Gains arising from the disposition of the foregoing types of securities and derivatives outside of Russia by U.S. holders who are individuals not resident in Russia for tax purposes will not be considered Russian source income and will not be taxable in Russia. Gains arising from disposition of the foregoing types of securities and derivatives in Russia by U.S. holders who are individuals not resident in Russia for tax purposes may be subject to a withholding tax

in Russia based on an annual tax return, which they may be required to submit with the Russian tax authorities.

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*Holders of ADSs may have limited recourse against us and our directors and executive officers because most of our operations are conducted outside the United States and all of our directors and executive officers reside outside the United States.*

Our presence outside the United States may limit ADS holders' legal recourse against us. Mechel is incorporated under the laws of the Russian Federation. Our directors and executive officers reside outside the United States, principally in Russia. A substantial portion of our assets and the assets of most of our directors and executive officers are located outside the United States. As a result, holders of our ADSs may be limited in their ability to effect service of process within the United States upon us or our directors and executive officers or to enforce in a U.S. court a judgment obtained against us or our directors and executive officers in jurisdictions outside the United States, including actions under the civil liability provisions of U.S. securities laws. In addition, it may be difficult for holders of ADSs to enforce, in original actions brought in courts in jurisdictions outside the United States, liabilities predicated upon U.S. securities laws.

There is no treaty between the United States and the Russian Federation providing for reciprocal recognition and enforcement of foreign court judgments in civil and commercial matters. These limitations may deprive investors of effective legal recourse for claims related to investments in the ADSs. The deposit agreements provide for actions brought by any party thereto against us to be settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association, provided that any action under the U.S. federal securities laws or the rules or regulations promulgated thereunder may, but need not, be submitted to arbitration. The Russian Federation is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards, but it may be difficult to enforce arbitral awards in the Russian Federation due to a number of factors, including the inexperience of Russian courts in international commercial transactions, official and unofficial political resistance to enforcement of awards against Russian companies in favor of foreign investors and Russian courts' inability to enforce such orders.

*We and the Justice persons may offer additional preferred shares and preferred ADSs in the future, and these and other sales may adversely affect the market price of the preferred shares and preferred ADSs.*

As of March 31, 2017, of the 138,756,915 issued preferred shares, 40% are held by our wholly-owned subsidiary Skyblock Limited, the remaining preferred shares are held by the public and may be held by James C. Justice II, James C. Justice III, James C. Justice Companies Inc. and Jillean L. Justice (collectively, the **Justice persons**). The Justice persons disposed or may dispose of all or part of the remaining preferred shares they held through one or more offerings or broker trades. It is also possible that we may decide to offer additional preferred shares and preferred ADSs through public offering or broker trades in the future, including preferred shares held by Skyblock Limited. Additional offerings or sales of preferred shares and preferred ADSs by us or the Justice persons, or the public perception that such offerings or sales may occur, could have an adverse effect on the market price of our preferred shares and preferred ADSs.

### ***Risks Relating to the Russian Federation***

*Emerging markets such as Russia are subject to greater risks than more developed markets, and financial turmoil in developed or other emerging markets could have a material adverse effect on our business and could cause the value of our shares and ADSs to fluctuate widely.*

Investors in emerging markets such as the Russian Federation should be aware that these markets are subject to greater risk than more developed markets, including in some cases significant legal, economic and political risks. Investors should also note that the value of securities of Russian companies is subject to rapid and wide fluctuations



due to various factors. The emergence of new tensions between Russia and other countries, imposed sanction by Russian Federation on some countries and vice versa may lead to outflow of the investors from the market, quick and huge sales of Russian assets which will result in reductions in the price of Russian securities. We cannot assure you that any such developments will not have a material adverse effect on our business, financial condition, results of operations and prospects, and the value of our shares and ADSs is expected to be highly volatile while tension between Russian and other countries remains unresolved and/or the Russian economy continues to deteriorate.

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Investors should also note that emerging markets such as the Russian Federation are subject to rapid change and that the information set forth in this document may become outdated relatively quickly. Moreover, financial turmoil in any emerging market country tends to affect adversely the value of investments in all emerging market countries as investors move their money to more stable, developed markets. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in the Russian Federation and adversely affect the Russian economy. In addition, during such times, companies that operate in emerging markets can face liquidity constraints as foreign funding sources become less available. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, their investment is appropriate. Generally, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved.

*Domestic, regional and international political and diplomatic conflicts could create an uncertain operating environment that could adversely affect our business and hinder our long-term planning ability.*

Russia has endured ethnic, religious, historical and other divisions, which have, on occasion, given rise to tensions and, in certain cases, diplomatic and military conflict, both internally and with other countries.

For example, the Russian Federation was involved in armed conflict with Georgia in August 2008, and differing views on the Georgia conflict have had an impact on the relationship between the Russian Federation, the European Union, the United States and certain former Soviet Union countries. In addition, the relationship between Ukraine and the Russian Federation has in the recent past been subject to significant strain for a number of reasons, including Ukraine's failure to pay and accumulation of payment arrears relating to the supply of energy resources, Ukraine's possible accession to NATO and the European Union. More recently, Russia's relations with Ukraine have reached an historic post-Soviet low point following renewed political instability in Ukraine that resulted in the departure from office of Mr. Yanukovich (Ukraine's former president), Russia's role in the subsequent accession of Crimea and Sevastopol to Russia, and widespread accusations that Russia is actively involved in or otherwise supporting insurgents in eastern Ukraine in their struggle against Ukraine's central authorities. This has resulted in a substantial deterioration in Russia's relations with the United States, the European Union and other countries such as Canada, Japan and Australia, and has led to the imposition of sanctions against certain Russian individuals and entities and has contributed to certain volatility in the Russian economy and a deterioration in Russia's macroeconomic condition and prospects. See **Risks Relating to the Russian Federation** The political and economic crisis in Ukraine as well as other politically related disagreements and allegations between Russia and other countries and sanctions imposed as a result thereof by the United States and the European Union may have a material adverse effect on our business, liquidity and financial condition, as well as the trading market for and value of our shares and ADSs. If such tensions intensify or new tensions emerge between the Russian Federation and Ukraine, Georgia, the European Union, the United States or any other countries, leading potentially to the imposition of further trade sanctions or embargoes, the Russian economy will likely experience further volatility and deterioration.

In September 2015, the Russian Federal Council approved the use of Russian forces in Syria, following a formal request from the Syrian government. Operations in Syria commenced in late September 2015 and are continuing as at the date hereof. Furthermore, in November 2015, the Turkish air force shot down a Russian strike aircraft over the territory of Syria, which resulted in tensions between Russia and Turkey and led to imposition of wide range of sanctions by Russia against Turkey, which were partially removed in the second half of 2016 and beginning of 2017. Russian involvement in the conflict in Syria could further lead to the escalation of geopolitical situation and the deterioration of relationship between the Russian Federation and other countries.

Many of the aforementioned events have adversely affected the Russian economy and the Russian financial and banking markets, increased capital outflows, as well as worsened general business and investment climate in Russia.

The Russian stock exchanges have experienced heightened volatility, Russia's credit markets have tightened, and the exchange rate of the ruble against the U.S. dollar and other currencies has depreciated

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significantly. See Risks Relating to Our Financial Condition and Financial Reporting Changes in the exchange rate of the ruble against the U.S. dollar and in interest rates may materially adversely affect our business, financial condition and results of operations.

In part as a result of political tensions, international sanctions, ruble volatility and drop in the oil price, in January 2015, Standard & Poor's lowered the long- and short-term Russian Federation's foreign currency rating to BB+/B from BBB-/A-3 and local currency rating to BBB-/A-3 from BBB/A-2, both with a negative outlook. In September 2016, Standard & Poor's confirmed the Russian Federation's ratings and revised the outlook from negative to stable. In March 2017, the Russian Federation's ratings were confirmed at previous levels (BB+/B for foreign currency and BBB-/A-3 for local currency) with outlook changed to positive. In January 2015, Moody's Investors Service lowered Russia's government bond rating to Baa3 from Baa2, further downgrading it in February 2015 to Ba1, with a negative outlook. In February 2017, Moody's confirmed Russia's Ba1 rating and revised the outlook from negative to stable. In January 2015, Fitch downgraded the Russian Federation's long-term foreign and local currency Issuer Default Rating to BBB- with a negative outlook. In October 2016, Fitch confirmed the Russian Federation's ratings and revised the outlook from negative to stable. In March 2017, the Russian Federation's ratings were confirmed at BBB- with a stable outlook.

The risks associated with these events or potential future events could materially and adversely affect the investment environment and overall consumer confidence in the Russian Federation, which in turn could have a material adverse effect on our business, financial condition, results of operations and prospects.

*The political and economic crisis in Ukraine as well as other politically related disagreements and allegations between Russia and other countries and sanctions imposed as a result thereof by the United States and the European Union may have a material adverse effect on our business, liquidity and financial condition, as well as the trading market for and value of our shares and ADSs.*

In connection with the ongoing events in Ukraine, the United States and the European Union (as well as certain other countries) have imposed sanctions on certain Russian and Ukrainian persons and entities. Furthermore, in December 2016, President Obama announced sanctions against Russia's intelligence and security services, the Main Intelligence Directorate (GRU) and the Federal Security Service (FSB), as well as other entities and individuals associated with the GRU in connection with certain allegations of tampering with the political process in the United States by those entities. Furthermore, the United States Senate proposed further legislation to impose sanctions on Russia, as of the date hereof the discussions are still ongoing.

No individual or entity within our group has been designated with sanctions. Additional designations may be made, or additional categories of sanctions may be created, at any time, and we can give no assurance that any member of our group, or individuals holding positions in our group, will not be affected by future sanctions designations. The U.S. regulations identify metals and mining as an example of a sector that may be identified for sectoral sanctions, however, at this time, no such identification has been made. U.S. law also provides that persons that have materially assisted, sponsored or provided financial, material or technological support for, or goods or services to or in support of any targeted person or activity may be designated for sanctions. Mechel, like a large number of Russian companies, has commercial relationships with entities that are subject to U.S. sanctions.

Furthermore, certain entities within our group are E.U. persons. These entities are therefore required to comply with the E.U. sanctions regime, including not conducting business with any sanctioned persons. Most of the group's entities, however, are neither U.S. persons nor E.U. persons, and therefore are restricted in dealings with sanctioned persons only to the extent those dealings are subject to U.S. and/or E.U. jurisdiction. However, the United States takes a broad view with respect to its sanctions jurisdiction, and there can be no assurance that compliance issues under applicable

U.S. and/or E.U. sanctions laws and regulations will not arise with respect to us or our personnel. In particular, sanctions against Russia and Russian subjects are very recent, their scope and

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consequences remain subject to interpretation by competent authorities and courts in the United States and the European Union, and no assurance can be given that a broader interpretation may not affect any of the group entities. Non-compliance with applicable sanctions could result in, among other things, the inability of the relevant group entities to contract with U.S. and/or E.U. governments or their agencies, civil or criminal liability of such entities and/or their personnel under U.S. and/or E.U. law, the imposition of significant fines, and negative publicity and reputational damage. In addition, should our dealings with sanctioned counterparties become material, our ability to transact with U.S. or E.U. persons could be affected. As a result, our ability to raise funding from international financial institutions or the international capital markets may be inhibited.

Further tensions between Russia and other countries and any escalation of related tensions between Russia and the United States and/or the European Union, the imposition of further sanctions, or continued uncertainty regarding the scope thereof, could have a prolonged adverse impact on the Russian economy, particularly levels of disposable income, consumer spending and consumer confidence, as well as the ability of Russian banks to sustain required liquidity levels and comply with their financial obligations. These impacts could be more severe than those experienced to date. In particular, should either the United States or the European Union expand their respective sanctions on our existing or future clients, suppliers or other counterparties, a large sector of the Russian economy or otherwise, such an expansion could result in our dealings with designated persons, if any, being materially adversely impacted, the suspension or potential curtailment of business operations between us and the designated persons could occur, and substantial legal and other compliance costs and risks on our business operations could emerge.

Moreover, if we become subject to U.S. or E.U. sanctions, we may become unable to deal with persons or entities bound by the relevant sanctions, including international financial institutions and rating agencies, transact in U.S. dollars, raise funds from international capital markets, acquire equipment from international suppliers, or access our assets held abroad. Should any sector in which we operate become subject to so-called sectoral sanctions, in either of the United States or the European Union, the relevant clearing systems, brokers and other market participants as well as the New York Stock Exchange ( **NYSE** ) may refuse to permit trading in or otherwise facilitate transfers of the ADSs. Furthermore, investors in our shares or ADSs may be restricted in their ability to sell, transfer or otherwise deal in or receive distributions with respect to our shares or ADSs, either because the investor or (in the case of ADSs) the depositary is subject to the jurisdiction of an applicable sanctions regime, which could make such shares or ADSs partially or completely illiquid and have a material adverse effect on their market value.

An expansion of sanctions as set forth above would likely have a material adverse impact on our business, financial condition, results of operations or prospects.

***Economic risks***

*Economic instability in Russia could adversely affect our business and the value of our shares and ADSs.*

The Russian economy has experienced various risks in the past, including high state debt, high interest rates, devaluation of the national currency and others, as well as positive trends, such as annual increases in the gross domestic product ( **GDP** ), a relatively stable ruble, strong domestic demand, rising real wages and reduced rates of inflation. However, the positive trends were interrupted by the global financial crisis in late 2008, which led to a substantial decrease in the GDP's growth rate, ruble depreciation and a decline in domestic demand. The Russian government took certain anti-crisis measures using the stabilization fund and hard currency reserves in order to soften the impact of the economic crisis on the Russian economy and support the value of the ruble. The emerging market economies, including Russia, began to experience a new economic slowdown in 2013, which together with political and other disturbances in emerging markets have introduced additional uncertainty in the overall outlook for growth of the global economy. Growth in the Russian economy has slowed down considerably, recording GDP growth of

0.6% in 2014 and further decline of 3.7% in 2015 and 0.2% in 2016, according to Rosstat. The deterioration of Russian economy in recent years is resulted from an array of factors,

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including negative investor sentiment arising from the disturbances in eastern Ukraine, international sanctions imposed on Russian companies and individuals, substantial depreciation of the ruble against major world currencies and the precipitous drop in oil prices. See **Risks Relating to the Russian Federation** The political and economic crisis in Ukraine as well as other politically related disagreements and allegations between Russia and other countries and sanctions imposed as a result thereof by the United States and the European Union may have a material adverse effect on our business, liquidity and financial condition, as well as the trading market for and value of our shares and ADSs. Further economic instability in Russia could have a material adverse effect on our business, financial condition, results of operations and prospects and the value of our shares and ADSs.

*The Russian banking system is still developing, and another banking crisis or international sanctions could place severe liquidity constraints on our business.*

A substantial portion of our loans are from Russian banks, including state-owned banks such as Sberbank, VTB Bank and Gazprombank, who in recent years have extended the maturity of our loans, waived breaches of financial covenants and reset our financial covenants to give us more flexibility to operate our business. Such banks may not exhibit the same degree of flexibility with respect to our financings as they have in the past due to the imposition of international sanctions against them. Moreover, we rely on the Russian banking system to complete various day-to-day fund transfers and other actions required to conduct our business with customers, suppliers, lenders and other counterparties.

Despite progress achieved in recent years, the Russian banking system suffers from international sanctions imposed against state-owned banks, weak depositor confidence, high concentration of exposure to certain borrowers and their affiliates, poor credit quality of borrowers and related party transactions. In response to ruble depreciation and decline in Russian economy the CBR progressively increased its key rate in 2014 from 5.5% to 17%, which resulted in substantial volatility and liquidity shortages on the domestic financial and interbank market. The CBR proceeded to gradually reduce its key rate to 9.75% throughout 2015-2017 and introduced other measures aimed at supporting Russian banking system. Although these measures resulted in partial stabilization of the banking system and assisted some Russian banks in withstanding the recent volatility on the currency and financial markets, the Russian banking system continues to experience financial difficulties and could continue to worsen in the near future due to the impact of international sanctions and general instability of global economy and domestic financial market.

A banking or liquidity crisis or the bankruptcy or insolvency of the banks which lend to us or in which we hold our funds or use for banking transactions could have a material adverse effect on our business, results of operations, financial condition and prospects.

*The infrastructure in Russia needs significant improvement and investment, which could disrupt normal business activity.*

The infrastructure in Russia largely dates back to the Soviet era and has not been adequately funded and maintained since the dissolution of the Soviet Union. Particularly affected are the rail and road networks, power generation and transmission systems, communication systems and building stock. The deterioration of the infrastructure in Russia harms the national economy, disrupts the transportation of goods and supplies, adds costs to doing business and can interrupt business operations. These factors could have a material adverse effect on our business, financial condition, results of operations and prospects.

*The Russian economy and the value of our shares and ADSs could be materially adversely affected by fluctuations in the global economy.*



The global economic crisis, social and political instability in some Middle East countries and in Ukraine, Chinese economic slowdown followed by Chinese market's crash and decline in demand and dramatic fall in oil prices and other negative developments in various countries have resulted in increased volatility in the capital

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markets in many countries, including Russia. As has happened in the past, financial problems in emerging market economies or an increase in the perceived risks associated with investing in emerging market economies could dampen foreign investment in Russia, and Russian businesses could face severe liquidity constraints, further materially adversely affecting the Russian economy. In addition, because Russia produces and exports large amounts of oil, the Russian economy is especially vulnerable to the price of oil on the world market and a decline in the price of oil or international sanctions against the Russian oil industry could slow or disrupt the Russian economy or undermine the value of the ruble against foreign currencies. During the period from December 15, 2014 to December 14, 2015, the average price for Urals crude oil in the Mediterranean and Rotterdam petroleum markets fell by 24.6%, from \$381.8 per tonne to \$287.7 per tonne, according to the Ministry of Economic Development of the Russian Federation. Although during the period from December 15, 2015 to December 14, 2016 the average price for Urals crude oil has risen by 47.3%, prices for petroleum feedstock remain highly volatile. The ruble's value against major world currencies has fallen significantly in 2015 and although ruble has recovered during 2016 and beginning of 2017 it still remains highly volatile. See Risks Relating to Our Financial Condition and Financial Reporting Changes in the exchange rate of the ruble against the U.S. dollar and in interest rates may materially adversely affect our business, financial condition and results of operations. Russia is also one of the world's largest producers and exporters of metal products and its economy is vulnerable to fluctuations in world commodity prices and the imposition of international sanctions, tariffs and/or antidumping measures by any of its principal export markets.

As many of the factors that affect the Russian and global economies affect our business and the business of many of our domestic and international customers, our business could be materially adversely affected by a downturn in the Russian economy or the global economy. In addition to a reduction in demand for our products, we may experience increases in overdue accounts receivable from our customers, some of whom may face liquidity problems and potential bankruptcy. Our suppliers may raise their prices, eliminate or reduce trade financing or reduce their output. A decline in product demand, a decrease in collectibility of accounts receivable or substantial changes in the terms of our suppliers' pricing policies or financing terms, or the potential bankruptcy of our customers or contract counterparties may have a material adverse effect on our business, financial condition, results of operations and prospects.

In June 2016, a majority of voters in the United Kingdom elected to withdraw from the E.U. in a national referendum. In early February 2017, the parliament of the United Kingdom voted in favor of advancing legislation that would give the Prime Minister the authority to initiate the formal process of leaving the E.U. On March 29, 2017, the Prime Minister of the United Kingdom signed the letter that gives an official notice to European Council in accordance with Article 50 of the Treaty on European Union of the United Kingdom's intention to withdraw from the European Union, beginning a legal process of leaving the E.U. As a result, there remains significant uncertainty about the future relationship between the United Kingdom and the E.U. In addition, the recent U.S. presidential election, as a result of which the Republican party nominee, Donald Trump, became the next president of the United States, may impact the financial markets and lead to greater uncertainty on the status of trade relations between the U.S. and some of its largest trade partners, including the U.S.'s existing trade agreements. These developments, or the perception that any of them could occur, have had and may continue to have a material adverse effect on global economic conditions and the stability of global financial markets, and may significantly reduce global market liquidity and restrict the ability of key market participants to fund their capital and liquidity requirements and operate in certain financial markets. Any of these factors could depress economic activity, commodities markets and restrict access to capital, which could result in the global economic conditions deterioration.

In addition, a deterioration in macroeconomic conditions could require us to reassess the value of goodwill on certain of our assets, recorded as the difference between the fair value of the net assets of business acquired and its purchase price. This goodwill is subject to impairment tests on an annual basis. The weakening macroeconomic conditions in the countries in which we operate and/or a significant difference between the performance of an acquired company

and the business case assumed at the time of acquisition could require us to write down the value of the goodwill or portion of such value. See note 18 to the consolidated financial statements.

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***Political and social risks***

*Political and governmental instability could materially adversely affect our business, financial condition, results of operations and prospects and the value of our shares and ADSs.*

Tensions in Russia's relations with other countries and world bodies or conflicts between the government and powerful business groups or among such business groups, as well as the continuation of and the development of international sanctions imposed on Russian institutions, organizations and individuals could disrupt or reverse political, economic and regulatory reforms and also lead to restrictions on our business and a negative impact on Russia's economy and investment climate. Any disruption or reversal of reform policies or economic downturn could lead to social, political or governmental instability or the occurrence of conflicts between various groups, which could have a material adverse effect on our business, financial condition, results of operations and prospects and the value of our shares and ADSs and impede our efforts to restructure our indebtedness, especially in relation to international lenders.

*Corruption and negative publicity could negatively impact our business and the value of our shares and ADSs.*

The local press and international press have reported high levels of corruption in Russia, including unlawful demands by government officials and the bribery of government officials for the purpose of initiating investigations by government agencies. Press reports have also described instances in which government officials engaged in selective investigations and prosecutions to further the commercial interests of certain government officials or certain companies or individuals. In addition, there are reports of the Russian media publishing disparaging articles in return for payment. From time to time, we are the subject of press reports that we believe contain false information about our business and financial condition as well as our largest shareholder. If we or our managers, largest shareholder or counterparties are accused of involvement in government corruption or are otherwise the subject of libelous reports in the press, the resulting negative publicity could disrupt our ability to conduct our business and impair our relationships with customers, suppliers, creditors and other parties, which could have a material adverse effect on our business, financial condition and results of operations and the value of our shares and ADSs and impede our efforts to restructure our indebtedness.

*Shortage of skilled Russian labor could materially adversely affect our business, financial condition, results of operations and prospects.*

Currently the Russian labor market suffers from a general shortage of skilled and trained workers, and we compete with other Russian companies to hire and retain such workers. In Russia, the working age population has declined due to a relatively low birth rate at the end of the 1980s and through the early 1990s. As of January 1, 2017, Rosstat estimated Russia's population at 146.8 million, a decline of 1.7 million from 1992. In recent years, declines in population levels slowed down as a result of an increase in migration and a reduction in the natural decline of the population; in 2014-2016, the population level in fact increased. However, the birth rate remains relatively low, which together with the aging and high mortality of the population, is the main problem of Russia's demographic development. Russia's working age population is estimated to decline by 10-13 million by 2025. A shortage of skilled Russian labor combined with restrictive immigration policies could materially adversely affect our business, financial condition, results of operations and prospects.

***Legal risks and uncertainties***

*Deficiencies in the legal framework relating to subsoil licensing subject our licenses to the risk of governmental challenges and, if our licenses are suspended or terminated, we may be unable to realize our reserves, which could materially adversely affect our business, financial condition, results of operations and prospects.*

Most of the existing subsoil licenses in Russia date from the Soviet era. The Russian government enacted the Procedure for Subsoil Use Licensing on July 15, 1992, which came into effect on August 20, 1992 (the **Licensing Regulation** ). As was common with legislation of this time, the Licensing Regulation was passed

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without adequate consideration of transition provisions and contained numerous gaps. In an effort to address the problems in the Licensing Regulation, the Ministry of Natural Resources (the **MNR**) issued ministerial acts and instructions that attempted to clarify and, in some cases, modify the Licensing Regulation. Many of these acts contradicted the law and were beyond the scope of the MNR's authority, but subsoil licensees had no option but to deal with the MNR in relation to subsoil issues and comply with its ministerial acts and instructions. Thus, it is possible that licenses applied for and/or issued in reliance on the MNR's acts and instructions could be challenged by the prosecutor general's office as being invalid. In particular, deficiencies of this nature subject subsoil licensees to selective and arbitrary governmental claims.

Legislation on subsoil rights still remains internally inconsistent and vague, and the regulator's acts and instructions are often arguably inconsistent with legislation. Subsoil licensees thus continue to face the situation where both failing to comply with the regulator's acts and instructions and choosing to comply with them places them at the risk of being subject to arbitrary governmental claims, whether by the regulator or the prosecutor general's office. Our competitors may also seek to deny our rights to develop certain natural resource deposits by challenging our compliance with tender rules and procedures or compliance with license terms.

An existing provision of the law that a license may be suspended or terminated if the licensee does not comply with the significant or material terms of a license is an example of such a deficiency in the legislation. The MNR (including its successor agency since May 13, 2008, the Ministry of Natural Resources and Ecology) has not issued any interpretive guidance on the meaning of these terms. Similarly, under Russia's civil law system, court decisions interpreting these terms do not have any precedential value for future cases and, in any event, court decisions in this regard have been inconsistent. These deficiencies result in the regulatory authorities, prosecutors and courts having significant discretion over enforcement and interpretation of the law, which may be used to challenge our subsoil rights selectively and arbitrarily.

Moreover, during the tumultuous period of the transformation of the Russian planned economy into a free market economy in the 1990s, documentation relating to subsoil licenses was not properly maintained in accordance with administrative requirements and, in many cases, was lost or destroyed. Thus, in many cases, although it may be clearly evident that a particular enterprise has mined a licensed subsoil area for decades, the historical documentation relating to its subsoil licenses may be incomplete. If, through governmental or other challenges, our licenses are suspended or terminated we would be unable to realize our reserves, which could materially adversely affect our business, financial condition, results of operations and prospects.

*Weaknesses relating to the Russian legal system and legislation create an uncertain investment climate.*

Russia is still developing the legal framework required to support a market economy. The following weaknesses relating to the Russian legal system create an uncertain investment climate and result in risks with respect to our legal and business decisions:

inconsistencies between and among the Constitution, federal laws, presidential decrees and governmental, ministerial and local orders, decisions, resolutions and other acts;

conflicting local, regional and federal rules and regulations;

rapid enactment of many laws and regulations resulting in their ambiguities and inconsistencies;

large-scale continuing reforms in almost all legal matters;

the lack of fully developed corporate and securities laws, significant changes in the regulatory framework;

substantial gaps in the regulatory structure due to the delay or absence of implementing legislation;

changes in the Russian court system, in particular, the merger of the Supreme Arbitrazh Court with the Russian Supreme Court;

the relative inexperience of judges in interpreting legislation and contradictory judicial interpretations of the law;

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the lack of full independence of the judicial system from commercial, political and nationalistic influences;

difficulty in enforcing court orders;

a high degree of discretion or arbitrariness on the part of governmental authorities; and

still-developing bankruptcy procedures that are subject to abuse. See **Risks Relating to Our Financial Condition and Financial Reporting** We may become subject to bankruptcy procedures, which may result in the inability of holders of our shares and ADSs to recover any of their investments.

All of these weaknesses could affect our ability to protect our rights under our licenses and under our contracts, or to defend ourselves against claims by others. We make no assurances that regulators, judicial authorities or third parties will not challenge our compliance with applicable laws, decrees and regulations.

*One or more of our subsidiaries could be forced into liquidation on the basis of formal non-compliance with certain requirements of Russian law, which could materially adversely affect our business, financial condition, results of operations and prospects.*

Certain provisions of Russian law may allow a court to order liquidation of a Russian legal entity on the basis of its formal non-compliance with certain requirements during formation, reorganization or during its operation. There have been cases in the past in which formal deficiencies in the establishment process of a Russian legal entity or non-compliance with provisions of Russian law have been used by Russian courts as a basis for liquidation of a legal entity. For example, under Russian corporate law, if a Russian company's net assets calculated on the basis of Russian accounting standards at the end of its third or any subsequent financial year, fall below its share capital, the company must decrease its share capital to the level of its net assets value or initiate a voluntary liquidation. In addition, if a Russian company's net assets calculated on the basis of Russian accounting standards at the end of its second or any subsequent financial year, fall below the minimum share capital required by law, the company must initiate voluntary liquidation not later than six months after the end of such financial year. If the company fails to comply with either of the requirements stated above within the prescribed time limits, the company's creditors may accelerate their claims and demand reimbursement of applicable damages, and governmental authorities may seek involuntary liquidation of the company. Certain Russian companies have negative net assets mainly due to very low historical asset values reflected on their balance sheets prepared in accordance with Russian accounting standards; however, their solvency, i.e., their ability to pay debts as they become due, is not otherwise adversely affected by such negative net assets. Currently, we have the following subsidiaries with total liabilities greater than total assets: Mechel Garant, Mechel-Steel Management, Mechel Trading House, Mecheltrans, Mechel Energo, Kaslinsky Architectural Art Casting Plant, Port Kambarka, VtorResource, Mechel Materials, Yakutugol, Metallurgshakhtspetsstroy, Southern Kuzbass Coal Company, Shakhtspetsstroy, Romantika, Port Mechel Vanino, Sky-Extra, Mechel-Remservice, Maritime Cargo Shipping, Mecheltrans Management, MecheltransVostok, Izhstal, Mecheltrans Auto and Mechel Vtormet.

If involuntary liquidation were to occur, then we may be forced to reorganize the operations we currently conduct through the affected subsidiaries. Any such liquidation could lead to additional costs, which could materially adversely affect our business, financial condition, results of operations and prospects.

*Selective government action could have a material adverse effect on the investment climate in Russia and on our business, financial condition, results of operations and prospects and the value of our shares and ADSs.*



Governmental authorities in Russia have a high degree of discretion. Press reports have cited instances of Russian companies and their major shareholders being subjected to government pressure through prosecutions of violations of regulations and legislation which are either politically motivated or triggered by competing business groups.

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In mid-2008, Mechel came under public criticism by the Russian government. Repeated statements were made accusing Mechel of using tax avoidance schemes and other improprieties. Ultimately the allegations regarding tax avoidance were not confirmed by the tax authorities, but the antimonopoly investigation resulted in imposition of a fine and issuance of a FAS directive regarding our business practices. See [Risks Relating to Our Business and Industry](#) Antimonopoly regulation could lead to sanctions with respect to the subsidiaries we have acquired or established or our prices, sales volumes and business practices.

Selective government action, if directed at us or our largest shareholder, could have a material adverse effect on our business, financial condition, results of operations and prospects and the value of our shares and ADSs.

*Due to still-developing law and practice related to minority shareholder protection in Russia, the ability of holders of our shares and ADSs to bring, or recover in, an action against us may be limited.*

In general, minority shareholder protection under Russian law derives from supermajority shareholder approval requirements for certain corporate actions, as well as from the ability of a shareholder to demand that the company purchase the shares held by that shareholder if that shareholder voted against or did not participate in voting on certain types of actions. Russian law does not expressly require obtaining prior consent for interested party transactions, unless persons specified by the law do not require it. See [Item 10. Additional Information](#) Description of Capital Stock Rights attaching to common shares. Disclosure and reporting requirements have also been enacted in Russia. Concepts similar to the fiduciary duties of directors and officers to their companies and shareholders are also expected to be further developed in Russian legislation; for example, amendments to the Russian Code of Administrative Offenses imposing administrative liability on members of a company's board of directors or management board for violations committed in the maintenance of shareholder registers and the convening of general shareholders' meetings. While these protections are similar to the types of protections available to minority shareholders in U.S. corporations, in practice, the enforcement of these and other protections has not been effective.

The supermajority shareholder approval requirement is met by a vote of 75% of all voting shares that are present at a general shareholders' meeting. Thus, controlling shareholders owning less than 75% of the outstanding shares of a company may hold 75% or more of the voting power if enough minority shareholders are not present at the meeting. In situations where controlling shareholders effectively have 75% or more of the voting power at a general shareholders' meeting, they are in a position to approve amendments to a company's charter, reorganizations, significant sales of assets and other major transactions, which could be prejudicial to the interests of minority shareholders. See [Risks Relating to Our Business and Industry](#) The concentration of our shares with our largest shareholders will limit your ability to influence corporate matters and transactions with largest shareholders may present conflicts of interest, potentially resulting in the conclusion of transactions on less favorable terms than could be obtained in arm's length transactions.

*Shareholder liability under Russian legislation could cause us to become liable for the obligations of our subsidiaries.*

The Civil Code and the Joint-Stock Companies Law generally provide that shareholders in a Russian joint-stock company are not liable for the obligations of the joint-stock company and bear only the risk of loss of their investment. This may not be the case, however, when one entity is capable of determining decisions made by another entity. The entity capable of determining such decisions is deemed an effective parent. The entity whose decisions are capable of being so determined is deemed an effective subsidiary. Under the Joint-Stock Companies Law, an effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if:

this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between such entities; and

the effective parent gives obligatory directions to the effective subsidiary based on the above-mentioned decision-making capability.

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In addition, an effective parent is secondarily liable for an effective subsidiary's debts if an effective subsidiary becomes insolvent or bankrupt due to the fault of an effective parent resulting from its action or inaction. This is the case no matter how the effective parent's ability to determine decisions of the effective subsidiary arises. For example, this liability could arise through ownership of voting securities or by contract. Other shareholders of the effective subsidiary may claim compensation for the effective subsidiary's losses from the effective parent which caused the effective subsidiary to take action or fail to take action knowing that such action or failure to take action would result in losses. Accordingly, we could be liable in some cases for the debts of our subsidiaries. This liability could have a material adverse effect on our business, financial condition, results of operations and prospects.

*Shareholder rights provisions under Russian law could result in significant additional obligations on us.*

As a general rule, Russian law provides that shareholders that vote against or do not participate in voting on certain matters have the right to request that the company redeem their shares at value determined in accordance with Russian law. The decisions of a general shareholders' meeting that trigger this right include:

decisions with respect to a reorganization;

consent or subsequent approval by shareholders of a major transaction, which involves property in excess of 50% of the balance sheet value of the company's assets calculated according to Russian accounting standards, regardless of whether the transaction is actually consummated (including those which are simultaneously interested party transactions), except for transactions undertaken in the ordinary course of business;

the amendment of the company's charter or approval of a new version of the company's charter that limits shareholder rights; and

the amendment of the public company's charter which eliminates indication that the company is public, simultaneously with the decision on applying to the CBR on release from obligation to disclose information under the laws of the Russian Federation on securities and the decision on applying for delisting of shares and securities convertible into shares.

Our and our Russian subsidiaries' obligation to purchase shares in these circumstances, which is limited to 10% of our or the subsidiary's net assets, respectively, calculated in accordance with Russian accounting standards at the time the matter at issue is voted upon, could have a material adverse effect on our business, financial condition, results of operations and prospects due to the need to expend cash on such obligatory share purchases.

*The lack of a central and rigorously regulated share registration system in Russia may result in improper record ownership of our shares and ADSs.*

Ownership of Russian joint-stock company shares (or, if the shares are held through a nominee or custodian, then the holding of such nominee or custodian) is determined by entries in a share register and is evidenced by extracts from that register. Currently, there is no single central registration system in Russia. Share registers can be maintained only by licensed registrars located throughout Russia. Regulations have been adopted regarding the licensing conditions for such registrars, as well as the procedures to be followed by licensed registrars when performing the functions of registrar. In practice, however, these regulations have not been strictly enforced, and registrars generally have

relatively low levels of capitalization and inadequate insurance coverage. Moreover, registrars are not necessarily subject to effective governmental supervision. Due to the lack of a central and rigorously regulated share registration system in Russia, transactions in respect of a company's shares could be improperly or inaccurately recorded, and share registration could be lost through fraud, negligence or oversight by registrars incapable of compensating shareholders for their misconduct. This creates risks of loss not normally associated with investments in other securities markets. Furthermore, the depositary, under the terms of the deposit agreements governing record keeping and custody of our ADSs, is not liable for the unavailability of

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shares or for the failure to make any distribution of cash or property with respect thereto due to the unavailability of the shares. See Item 10. Additional Information Description of Capital Stock Registration and transfer of shares.

*Characteristics of and changes in the Russian tax system could materially adversely affect our business, financial condition, results of operations and prospects and the value of our shares and ADSs.*

Generally, Russian companies are subject to numerous taxes. These taxes include, among others:

a profit tax;

a value-added tax ( **VAT** );

a mineral extraction tax; and

property and land taxes.

Laws related to these taxes have been in force for a short period relative to tax laws in more developed market economies and few precedents with regard to the interpretation of these laws have been established. Global tax reforms commenced in 1999 with the introduction of Part One of the Tax Code of the Russian Federation, as amended (the **Russian Tax Code** ), which sets general taxation guidelines. Since then, Russia has been in the process of replacing legislation regulating the application of major taxes such as the corporate profit tax, VAT and property tax with new chapters of the Russian Tax Code.

In practice, the Russian tax authorities generally interpret the tax laws in ways that rarely favor taxpayers, who often have to resort to court proceedings to defend their position against the tax authorities. Events within the Russian Federation suggest that the tax authorities may be taking a more assertive position in their interpretations of the legislation and assessments. Contradictory interpretations of tax regulations exist within government ministries and organizations at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Tax declarations and documentation such as customs declarations, are subject to review and investigation by relevant authorities, which may impose severe fines, penalties and interest charges. Generally, in a tax audit, taxpayers are subject to inspection with respect to the three calendar years which immediately preceded the year in which the audit is carried out. Previous audits do not completely exclude subsequent claims relating to the audited period because Russian tax law authorizes upper-level tax inspectorates to re-audit taxpayers which were audited by subordinate tax inspectorates. In addition, on July 14, 2005, the Russian Constitutional Court issued a decision that allows the statute of limitations for tax liabilities to be extended beyond the three-year term set forth in the tax laws if a court determines that a taxpayer has obstructed or hindered a tax audit. As a result of the fact that none of the relevant terms are defined, tax authorities may have broad discretion to argue that a taxpayer has obstructed or hindered a tax audit and ultimately seek back taxes and penalties beyond the three year term. In some instances, new tax regulations have been given retroactive effect.

Since May 2009, in connection with the proposal expressed by the Russian President in his Budget Message regarding the budget policy for 2010-2012, an overhaul of the anti-avoidance mechanism of double tax treaties has begun. In November 2014, Russian legislation was significantly revised in order to prevent unlawful use of low-tax jurisdictions for tax evasion in the Russian Federation. The amendments in the legislation set out the rules for the taxation of

income of a foreign organization that is deemed to be a controlled foreign company. A foreign organization is recognized as a controlled foreign company if it is not a tax resident of the Russian Federation and the participation interest of the controlling legal entities or individuals in the organization is more than 25%. The transition period provides for a gradual reduction in the size of non-taxable profit, in particular, 50 million rubles, 30 million rubles and 10 million rubles for 2015, 2016 and 2017 and thereafter, respectively. Starting from 2015, these changes in tax regulations could increase the tax burden on companies which are recognized to be controlling of foreign companies. In addition, Russian companies are required to disclose information about controlled foreign companies to the Russian tax authorities. All of these measures are intended

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to ensure the transparency of economic transactions, including foreign trade transactions. Disclosure of beneficial ownership, beneficial recipients of income and tax residence of legal entities at their actual place of business is, according to the new legislation, a prerequisite for the application of tax preferences, including reduced tax rates under international double tax treaties. In July 2015, the Convention on Mutual Administrative Assistance in Tax Matters became effective. The Convention provides for the potential exchange of tax information, including simultaneous tax inspections with Member States of the Council of Europe and member countries of the Organization for Economic Co-operation and Development (OECD), which signed the convention, as well as for assistance in the collection of taxes on their territories. Furthermore, starting from June 30, 2014, the Federal Law No. 173-FZ entered into force, which regulates the procedure of interaction of financial market entities with foreign tax authorities, primarily within the bounds of the U.S. law Foreign Account Tax Compliance Act (FATCA).

On November 16, 2011, the Russian President signed the Law on Amendment of Part One and Part Two of the Tax Code of the Russian Federation in Connection with the Formation of a Consolidated Group of Taxpayers. The main provisions of the law came into force on January 1, 2012. The law provides for formation of a consolidated group of taxpayers for the purposes of profit tax calculation and payment on the basis of the combined business performance of the members of such group. However, the law sets forth a number of requirements for the formation of a consolidated group of taxpayers. Starting from 2013, 16 companies of our group have formed a consolidated group of taxpayers, with Mechel being a responsible party. The formation of the consolidated group of taxpayers allowed us to determine the taxable income with profit and loss offset of all the companies included in the consolidated group of taxpayers and to pay profit tax from total aggregate income under the consolidated group of taxpayers, starting from January 1, 2013. In 2014, there have been some changes in the composition of the consolidated group of taxpayers as a result the number of members has increased to 20 companies. Due to changes in Russian tax legislation, starting in 2015 the consolidated tax base does not include any profit received from controlled foreign companies by a member of the consolidated group of taxpayers (such member being the controlling entity of such controlled foreign companies and the responsible party for paying profit tax in respect of the profits of controlled foreign companies irrespective of the profit tax of the consolidated group of taxpayers).

However, regardless of being a member of the consolidated group of taxpayers or not, Mechel and our Russian subsidiaries pay Russian taxes on dividends they receive from other companies in our group. The tax rate on dividend income amounts to 0% or 13% (depending on whether the recipient of dividends qualifies for Russian participation exemption rules) if being distributed to Russian companies, and 15% (or lower, subject to benefits provided by relevant double tax treaties) if being distributed to foreign companies which are not controlled foreign companies. Dividends from foreign companies to Russian companies are subject to a tax of 13%. Taxes paid in foreign countries by Russian companies may be offset against payment of these taxes in the Russian Federation up to the maximum amount of the Russian tax liability. In order to apply the offset, the company is required to confirm the payment of taxes in the foreign country. The confirmations must be authorized by the tax authority of the foreign country if taxes were paid by the company itself, and the confirmation must be authorized by the tax agent if taxes were withheld by the tax agent under foreign tax law or an international tax agreement.

In 2017, due to changes in the Russian tax legislation, the order of set-off of tax loss accumulated by Russian companies, including companies within the consolidated group of taxpayers significantly changed. Such changes may lead to an increase in the Mechel's tax burden. During the period from 2017 to 2020, the amount of recognized loss for previous tax periods cannot exceed 50% of the tax base of the current period. Since 2021, this limitation will cease to apply and the recognition of accumulated losses in full will be possible again. At the same time, the current 10-year limit on the transfer of losses is canceled.

The limitation in the amount of recognized loss is also applied to the members of the consolidated group of taxpayers with respect to current year loss of its members. Such limitation equals to 50% of the consolidated tax base of the



consolidated group of taxpayers for the current reporting (tax) period. The limitation in the amount of

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not more than 50% of the consolidated tax base for the current reporting (tax) period is also set on the amounts of loss, which were formed prior to January 1, 2017. This change in accounting the loss of the consolidated group of taxpayers in combination with a limited duration of the agreement for the consolidated group of taxpayers increase the tax burden on companies included in the consolidated group of taxpayers.

In addition, application of current Russian thin capitalization rules and the developing negative court practice on such disputes, especially at the level of the Presidium of the Supreme Arbitrazh Court of the Russian Federation and the Supreme Court of the Russian Federation, may require us to withhold dividend taxes in Russia upon payment of interest on loans. In particular, taking into account the requirements of Russian law and negative court practice on thin capitalization, part of the interest on borrowings of our subsidiaries which are either received from Mechel or received from independent banks and guaranteed by Mechel may be classified as dividends and may not be treated as expenses for tax purposes under certain conditions provided by thin capitalization rules. In February 2016, a law which significantly changes the current approach to thin capitalization rules application was adopted. We believe that thin capitalization rules are not applicable to Mechel's loans starting from May 2016. However, we cannot guarantee that in case of change of the existing thin capitalization rules and the applicable practice we will not be subject to the risks specified above.

In accordance with amendments to the Russian Tax Code which entered into force on November 30, 2016, the tax authorities are entitled to seek in court payment of taxes by the company's dependent persons, including dependent individuals, for example, the owners, founders or shareholders of such company, if these persons received cash or property from the company which has outstanding tax amounts within the amounts received by them.

The foregoing conditions create tax risks in Russia that are more significant than typically found in countries with more developed tax systems, imposing additional burdens and costs on our operations, including management resources. In addition to our tax burden, these risks and uncertainties complicate our tax planning and related business decisions, potentially exposing us to significant fines and penalties and enforcement measures despite our best efforts at compliance. See also Risks Relating to the Russian Federation Legal risks and uncertainties Selective government action could have a material adverse effect on the investment climate in Russia and on our business, financial condition, results of operations and prospects and the value of our shares and ADSs.

*Established practice in applying Russian transfer pricing rules only starts to develop and a small number of decisions pronounced in favor of taxpayers exposes our business to the risk of significant additional liabilities.*

The Russian transfer pricing rules entered into force on January 1, 2012 require taxpayers to notify the tax authorities on controlled transactions that are performed from January 1, 2012. Controlled transactions mean any transactions between related parties both domestic and cross-border as well as certain transactions between unrelated parties. The rules introduce specific pricing methods, and documentation requirements for proving market prices. Currently established practice in applying the rules only starts to develop and in some cases decisions are being pronounced not in favor of taxpayers, therefore we cannot predict what effect the transfer pricing rules will have on our business. If the tax authorities impose significant additional tax assessments as a result of changes in transfer pricing regulation and we are unable to successfully challenge them in court or make symmetrical adjustments provided by these rules, it could have a material adverse effect on our business, financial condition, results of operations and prospects.

*Expansion of limitations on foreign investment in strategic sectors could affect our ability to attract and/or retain foreign investments.*

On April 29, 2008, the Federal Law On the Procedure for Foreign Investment in Companies with Strategic Impact on the National Defense and Security of the Russian Federation was adopted. See Item 4. Information on the Company

Regulatory Matters The Strategic Industries Law.

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As our subsidiary Southern Urals Nickel Plant holds the subsoil license on land plots with nickel and cobalt ore deposits which are included in the official list of subsoil plots of federal importance published on March 5, 2009 in the Russian official newspaper *Rossiyskaya Gazeta* as amended (the **Strategic Subsoil List**), it qualifies as a Strategic Company and is subject to special regulation. Our subsidiaries Urals Stampings Plant and Port Posiet are included in the register of natural monopolies, and therefore are also Strategic Companies. Furthermore, entities producing and distributing industrial explosives are deemed to be Strategic Companies. Thus, our subsidiaries Yakutugol, Vzryvprom and Korshunov Mining Plant also qualify as Strategic Companies, as they hold licenses to carry out activities related to the handling of industrial explosives.

Therefore, any transfer, directly or indirectly, to a foreign investor or its group of entities (except for the transfer to a foreign investor controlled by the Russian Federation, the constituent entity of the Russian Federation and/or Russian nationals provided such Russian nationals are Russian tax residents and do not have other nationality) of a stake or certain rights in or fixed assets (equal to 25% or more of the balance sheet value of the relevant entity) of Southern Urals Nickel Plant, Yakutugol, Vzryvprom, Korshunov Mining Plant, Urals Stampings Plant and Port Posiet, which, according to the Strategic Industries Law, is deemed to transfer control, as described in Item 4. Information on the Company Regulatory Matters The Strategic Industries Law, will be subject to prior approval from the state authorities. Likewise, a sale to a foreign investor or its group of entities of a stake in Mechel which provides control (as defined in the Strategic Industries Law) over Southern Urals Nickel Plant, Yakutugol, Vzryvprom, Korshunov Mining Plant, Urals Stampings Plant and Port Posiet, will also be subject to prior approval in accordance with the Strategic Industries Law.

In addition, in case a foreign investor or its group of entities which is a holder of securities of Southern Urals Nickel Plant, Yakutugol, Vzryvprom, Korshunov Mining Plant, Urals Stampings Plant and Port Posiet, becomes a holder of voting shares in amount which is considered to give them direct or indirect control over these companies in accordance with the Strategic Industries Law due to the allocation of voting shares as a result of certain corporate procedures provided by Russian law (e.g., as a result of a buy-back by the relevant company of its shares, conversion of preferred shares into common shares, or holders of preferred shares becoming entitled to vote at a general shareholders meeting in cases provided under Russian law), such shareholders will have to apply for approval within three months after they acquired such control.

In this connection, there is a risk that the requirement to receive prior or subsequent approvals and the risk of not being granted such approvals might affect our ability to attract foreign investments, create joint ventures with foreign partners with respect to our companies that qualify as Strategic Companies or effect restructuring of our group which might, in turn, materially adversely affect our business, financial condition, results of operations and prospects.

*Land use rights regulation in Russia is subject to uncertainty and contradiction.*

The main law governing the title to land is the Land Code of the Russian Federation introduced by the Federal Law On Introduction of the Land Code, dated October 25, 2001, as amended (the **Land Code**), which establishes the principles of land legislation and determines relations governed by land legislation.

In March 2015, the Land Code was significantly amended in part concerning the procedure for allotment of land plots by public authorities to citizens and legal entities. Law enforcement practice, taking into account changes in the applicable legislation, is currently under development; therefore, risks associated with uncertainty of regulatory aspects of the allotment of land plots by public authorities exist.

In addition, there is a general risk of seizure of land plots for state needs for the implementation of governmental programs and projects, which means creation and construction of complexes within the framework of such federal

programs. Moreover, if the land plots owned or leased by us are found not to be in compliance with all applicable approvals, consents, registrations or other regulations, we may lose the use of such land plots.

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The ambiguous interpretation of land law and/or a potential seizure of our land plots for state needs or for other reasons may have a material adverse effect on our business, financial condition, results of operations and prospects.

### ***Item 4. Information on the Company***

#### **Overview**

We are a vertically integrated group with revenues of RUB 276,009 million in 2016, RUB 253,141 million in 2015 and RUB 243,992 million in 2014, with operations organized into three industrial segments: mining, steel and power, each of which has a management company that performs the functions of respective executive management bodies of the companies within the segment, as described below.

Our group includes a number of logistical and marketing companies that help us to deliver and market our products. We have freight seaports in Russia on the Sea of Japan (Port Posiet) and on the Sea of Azov (Port Temryuk) and a freight river port on the Kama River, a tributary of the Volga River in central Russia (Port Kambarka). We have a fleet of freight railcars, locomotives and long-haul trucks, and operate a rail line to our Elga coal deposit in the Sakha Republic.

We have a network of overseas subsidiaries, branches, warehouses, service centers and agents to market our products internationally, and we have a Russian domestic steel retail and service subsidiary with regional offices in 43 cities throughout Russia.

Mechel PAO is a public joint-stock company incorporated under the laws of the Russian Federation. From the date of our incorporation on March 19, 2003 until July 19, 2005, our corporate name was Mechel Steel Group OAO. We conduct our business through a number of subsidiaries. We are registered with the Federal Tax Service of the Russian Federation under main state registration number (OGRN) 1037703012896. Our principal executive offices are located at Krasnoarmeyskaya Street, 1, Moscow 125167, Russian Federation. Our telephone number is +7 495 221 8888. Our Internet addresses are [www.mechel.com](http://www.mechel.com) and [www.mechel.ru](http://www.mechel.ru). Information posted on our website is not a part of this document. We have appointed CT Corporation System, located at 111 Eighth Avenue, New York, New York 10011, as our authorized agent upon which process may be served for any suit or proceeding arising out of or relating to our shares, ADSs or the deposit agreements.

#### ***Mining Segment***

Our mining segment produces metallurgical coal (coking coal, PCI and anthracite), steam coal, iron ore and iron ore concentrate and coke.

The segment primarily consists of our coal, iron ore and coke production facilities in Russia. It also includes certain transportation and logistics facilities and engineering operations.

Our subsidiary Southern Kuzbass Coal Company and its subsidiaries operate coal mines located in the Kuznetsky basin, near Mezhdurechensk in Western Siberia. These mines include four open pit mines and three underground mines. Another of our subsidiaries, Yakutugol, operates coal mines located in the Sakha Republic in Eastern Siberia, consisting of three open pit mines. Yakutugol also holds subsoil licenses for three iron ore deposits, located in close proximity to its coal mining operations. In August 2013, we established Elgaugol which holds the subsoil license for the Elga coal deposit, located in the Sakha Republic in Eastern Siberia. Our mining segment also provides coal washing services to our coal mining subsidiaries.

Korshunov Mining Plant operates two open pit iron ore mines and a washing plant located near Zheleznogorsk-Ilimsky, a town in the Irkutsk region in Eastern Siberia.

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The mining segment also produces significant amounts of coke, both for use by our subsidiaries in the steel segment and for sales to third parties. We have the flexibility to supply our own steel mills with our mining products or to sell such mining products to third parties, depending on price differentials between local suppliers and foreign and domestic customers.

In April 2008, we established Mechel Mining, a wholly-owned subsidiary, in which we consolidated coal, iron ore and coke assets of our mining segment (Southern Kuzbass Coal Company, Korshunov Mining Plant, Yakutugol, Moscow Coke and Gas Plant and Mechel Coke and certain other companies).

Mechel Mining Management, a wholly-owned subsidiary of Mechel Mining, acts as the sole executive body of our subsidiaries in the mining segment.

### ***Steel Segment***

Our steel segment produces and sells semi-finished steel products, long products of a wide range of steel grades, carbon and stainless flat steel products and high value-added metal products, including wire products, stampings and forgings.

Our steel production facilities in Russia include one integrated steel mill, one steel-making mill, a wire products plant and forgings and stampings mill in the southern Ural Mountains and a wire products plant in northwestern Russia near the border with Finland. We also have a wire products plant in Lithuania.

In 2014, to further optimize the structure of our group, we transferred our ferrosilicon producing subsidiary Bratsk Ferroalloy Plant to the steel segment.

Mechel-Steel Management, a wholly-owned subsidiary of Mechel, acts as the sole executive body of our main subsidiaries in the steel segment.

Our steel segment also includes our distribution network in Russia and abroad, which consists of Mechel Service Global and its subsidiaries in Russia, the CIS and Europe.

### ***Power Segment***

The power segment was formed in April 2007, when we acquired a controlling interest in Southern Kuzbass Power Plant located in Kaltan in the Kemerovo region, which sells electricity and capacity to the wholesale market. In June 2007, we acquired a controlling interest in Kuzbass Power Sales Company, the largest power distribution company in the Kemerovo region. Our power segment enables us to market high value-added products, such as electricity and heat energy, and to increase the power self-sufficiency of our mining and steel segments. Mechel Energo acts as the sole executive body of Southern Kuzbass Power Plant in our power segment.



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**Competitive Strengths**

Our main competitive strengths are the following:

***Leading mining and metals group by production volume with strong positions in key businesses***

*We are the second largest coking coal producer and exporter by volume in Russia.*

In 2016, we were the second largest coking coal producer in Russia, with an approximately 18.5% share of total coking coal production by volume, according to the Central Dispatching Department of Fuel and Energy Complex ( **Central Dispatching Department** ), a Russian information agency reporting on the fuel and energy industry. In 2016, our export sales of coking coal concentrate were the second largest by volume among Russian companies, according to Metals & Mining Intelligence ( **MMI** ), a private information and research company.

*We have a large coal reserve base and a broad-range offering of high-quality metallurgical coals, as well as steam coals of various grades.*

Our total coal reserves amounted to 3,029.9 million tonnes as of December 31, 2016, as accounted pursuant to SEC Industry Guide 7.

Our coal reserves allow us to supply steel producers and coke makers globally with a wide range of coal grades to make quality metallurgical coke or to use in PCI-assisted and sintering-assisted steel manufacturing. In addition to metallurgical coals, we supply steam coals of various grades. In particular, Southern Kuzbass Coal Company produces semi-hard and semi-soft coking coal, PCI, anthracite and steam coal. Most of the coking coal grades of Southern Kuzbass Coal Company are sold in Russia, while PCI, steam coal and anthracite are generally exported. Yakutugol produces low-volatile hard coking coal used by customers both in the Asia-Pacific region and in Russia, as well as steam coal which is sold domestically to local municipal services and for export. Elgaugol produces high-quality hard coking coal of high-volatile content and steam coal which are primarily supplied for export. The ability to serve our customers with a broad range of metallurgical and steam coal grades gives us a competitive advantage in entering the new markets and establishing long-term relationships with the customers.

*By production volume we are Russia's second largest producer of long steel products and Russia's largest producer of wire products.*

According to Metal Expert, a source for global steel and raw materials market news and analytics, in 2016 by production volume we were Russia's second largest producer of long steel products (excluding square billets), second largest producer of reinforcement bars (rebar) and largest producer of wire rod. Our long steel products business has particularly benefited from the increased infrastructure and construction activity in Russia. Our share of Russia's total production volume of rebar in 2016 was approximately 19.2%, according to Metal Expert. According to Metal Expert and Chermet, a Russian ferrous metals industry association ( **Chermet** ), we are Russia's third largest producer of special steel by production volume, accounting for 11.8% of Russia's total special steel output in 2016. Our product range in special steel is broader and more comprehensive than other Russian producers, giving us an added advantage in our markets. According to Metal Expert, we are Russia's largest producer of wire products by production volume, accounting for 35.9% of Russia's total wire products output in 2016.

***High degree of vertical integration***

*Our steel segment is able to source most of its raw materials from our group companies, which provides a hedge against supply interruptions and market volatility.*

We believe that our internal supplies of coke, iron ore concentrate and ferrosilicon give us advantages over other steel producers, such as higher stability of operations, better quality control of end products, reduced production costs, improved flexibility and planning latitude in the production of our steel and value-added steel

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products and the ability to respond quickly to market demands and cycles. In 2016, we were fully self-sufficient with respect to coke and ferrosilicon; we were approximately 72% self-sufficient with respect to iron ore concentrate; and we satisfied approximately 26% of our electricity needs internally. We believe that the level of our self-sufficiency in raw materials gives our steel business a competitive advantage.

We view our ability to source most of our inputs internally not only as a hedge against potential supply interruptions, but as a hedge against market volatility. From an operational perspective, since our mining and power assets produce the same type of inputs that our manufacturing facilities use, we are less dependent on third party vendors and less susceptible to supply bottlenecks. From a financial perspective, this also means that if the market prices of our steel segment's inputs rise, putting pressure on steel segment margins, the margins of our mining segment will tend to increase. Similarly, while decreases in commodity prices tend to reduce revenues in our mining segment, they also create an opportunity for increased margins in our steel business.

Furthermore, we work on improving the quality of our steel products and reducing the costs for raw materials. Depending on prevailing market conditions, we evaluate the efficiency of use of our own raw materials and the raw materials purchased from third parties to be able to generate additional income.

The ability to internally source our materials also gives us better market insight when we negotiate with our outside suppliers, and improves our ability to manage our raw materials costs.

*Our logistics capability allows us to better manage infrastructure bottlenecks, to market our products to a broader range of customers and to reduce our reliance on trade intermediaries.*

We are committed to maximum efficiency in delivering goods to consumers and have been actively developing our own logistics network. Using our own transportation capacity enables us to save costs as we are less exposed to market fluctuations in transportation prices and are able to establish flexible delivery schedules that are convenient for our customers. Our logistics capacities are currently comprised of two seaports (Port Posiet and Port Temryuk) and a river port (Port Kambarka), as well as freight forwarding companies (Mecheltrans, MecheltransVostok and Mecheltrans Auto) which manage rail and motor transportation of our products and carry out the overall coordination of our sea, rail and motor transportation logistics. These companies not only transport our products but also provide transportation services to third parties.

We own two seaports and a river port and we have our own rail rolling stock. Port Posiet in the Russian Far East, on the Sea of Japan, gives us easy access to the Asia-Pacific seaborne market and provides a delivery terminal for the coal mined by our subsidiaries Yakutugol and Elgaugol in Yakutia. We are in the process of the Port Posiet's modernization, which enabled us to expand the cargo-handling capacity of the port up to 7.0 million tonnes per annum. Port Temryuk on the Sea of Azov, an inlet of the Black Sea basin, is primarily used for coal and metal transshipment and provides us access to the emerging market economies of the Black Sea and Mediterranean basins. Port Kambarka on the Kama River in the Republic of Udmurtia (a Russian administrative region also known as Udmurtia) is connected to the Volga River basin and the Caspian Sea, by canal to the Don River and the Sea of Azov, as well as by the Volga-Baltic Route to the Baltic Sea. As of December 31, 2016, our subsidiaries Mecheltrans and Mecheltrans Auto owned and leased 11,478 freight transportation units, including 11,433 railcars and 45 long-haul trucks that we use to ship our products.

In June 2008, pursuant to the terms of our subsoil license for the Elga coal deposit we began construction of a private rail line, which we own and control subject to applicable regulation. In December 2011, we finished laying track for the rail line in accordance with the terms of the license. The 321 kilometer-long rail line is now in operation and we are able to use it for transportation of coal currently produced at the Elga deposit. The rail line connects the Elga coal

deposit with the Baikal-Amur Mainline (at the Ulak railway station), which, in turn, provides access to the Russian rail network, in general, and Pacific Ocean ports, in particular. We will further develop the rail line to increase its capacity in line with our coal production plans. We anticipate that the Elga rail line will not only provide an avenue for delivery of coal produced at the Elga coal deposit, but will eventually serve as the transport route for coal, iron ore and other raw materials mined in the adjacent deposits.

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**Table of Contents*****One of the lowest-cost metallurgical coal producers***

According to CRU International Limited ( **CRU** ), our hard coking coal operations are in the first quartile of the global business cost curve (CFR basis). In 2016, approximately 93% of our coking coal production was mined from open pit mines, which we believe is one of the highest rates among our Russian competitors. Open pit coal mining is generally considered safer, cheaper and faster than the underground method of mining. Most of our mines and processing facilities have long and established operating histories. We view strict cost management and increases in productivity as fundamental aspects of our day-to-day operations, and continually reassess and improve the efficiency of our mining operations.

***Strategically positioned to supply key growth markets***

*Our mining and logistical assets are well-positioned to expand sales to the Asia-Pacific seaborne market.*

Eastern Siberian coal mines of Yakutugol and Elga coal deposit, which are part of our mining segment, are strategically located and will enable us to expand exports of our products to key Asian markets. Yakutugol and Elgaugol are located within the shortest distance among Russian coking coal producers to Port Posiet and Port Vanino in the Russian Far East. We view the proximity of these mining and logistical assets to the Asian economies as one of the key competitive advantages which allow us to diversify our sales, provides us with additional growth opportunities and acts as a hedge in the event of a decrease in demand from customers in Russia. Moreover, due to our integration, experience and location in Russia, which has some of the largest deposits of coal and iron ore in the world, we are better positioned than many of our international peers to secure future production growth.

*Our steel mills are well-positioned to supply Russian infrastructure projects.*

Russia is our core steel market and we have significant domestic market shares in main types of carbon and special steel long products. We believe we have established a strong reputation and brand image for Mechel within Russia, just as we have with our international customers. The location of a number of our core steel segment assets in the southern Urals positions us advantageously, from a geographical and logistical perspective, to serve the areas in the west of the Urals as this region is a large consumer of long steel products in Russia, according to Metal Expert. The construction industry has been a major source of our revenue and we have captured a large portion of the market. According to Metal Expert, our share of Russia's total production volume of rebar in 2016 was approximately 19.2%.

***Established distribution and sales platform***

We have a non-retail sales and distribution network represented by our Swiss subsidiaries Mechel Trading and Mechel Carbon with representative offices in various countries. This network facilitated sales constituting 23.9% of our total sales in 2016.

We also have Mechel Service Global's distribution network which conducts sales of our steel products in Russia, the CIS and Europe. Through our distribution network in Russia and the CIS we sell a whole range of steel products manufactured by our plants. In case of sales to the European Union, we focus on sales of high value-added products, primarily high-quality rolled steel products and forgings produced by our Urals plants, through Mechel Service Belgium. Our companies in Germany, Austria and the Czech Republic provide customers with a wide range of services for metal processing. Mechel Service Global sales accounted for 50.7% of our steel segment sales and 29.7% of our total sales in 2016. Approximately 91.2% of Mechel Service Global sales were sold domestically. Sales to companies within our group accounted for 1.6% of total sales of Mechel Service Global (including intra-group sales) in 2016.

Our direct access to end customers allows us to obtain real-time market intelligence and improve production planning at our steel facilities, which in turn allows us to improve the efficiency of our existing operations through the optimization of our sales structure.

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### ***Strong and focused management team***

Our current management team has significant experience in all aspects of our businesses. Mr. Zyuzin, one of the founders of our group and our Chairman and largest shareholder, has led our successful transformation from a small coal trading operation to a large integrated mining and metals group. Mr. Zyuzin has over 30 years of experience in the coal mining industry and holds a Ph.D. in technical sciences in the coal mining field. Our divisional management also has long-tenured experience in the mining and metals industry. See Item 6. Directors, Senior Management and Employees Directors and Executive Officers.

### **Business Strategy**

Our goal is to become one of the largest producers of metallurgical coal and steel products by realizing potential of the vertical integration and maximizing synergies between our performing assets underlying our business model.

Our strategy aimed at extracting the maximum value from our mining and steel assets. We intend to concentrate on efficiency improvements and modernization of the business lines, which we expect will increase the business overall profitability.

In the mining segment, we will continue to develop our existing coal reserves, particularly in order to sell more high-quality metallurgical coal and coal products to third parties. We intend to prioritize the development of the Elga coal deposit, one of the largest global metallurgical coal reserves. Our coking coal and iron ore production form a solid platform for our steel business. Steam coal can be used to feed our power generating business which enables us to market high value-added products, such as electricity and heat energy, and to increase the power self-sufficiency of our mining and steel segments. However, even as we develop our internal sourcing capability, we intend to adhere to our long-standing approach of purchasing inputs from third party suppliers and selling products, including raw materials, to domestic and international customers in a way that we believe creates the most advantageous profit opportunities for our group.

In the steel segment, we plan to focus on the Russian rail, engineering and construction markets. The launch of the universal rail and structural rolling mill at Chelyabinsk Metallurgical Plant allowed us to widen our portfolio of high value-added products such as structural shapes and rails, as well as significantly improve our competitive advantage as a full product range supplier to the construction sector and as an important supplier to Russian Railways. In 2015, we successfully went through the certification of rail products resulting in obtainment of three certificates of conformity of the Customs Union. The increase in sales volume of the universal rolling mill products will occur along with the development and certification of new types of products and will enable us to realize the import substitution strategy. We intend to increase our group's output and improve the quality of high value-added steel products in order to preserve our leadership in special and stainless steels and wire products in Russia. For some of these products, we hold a unique market niche, which serves as the basis for further improvement of our market share and growth of our customer base.

Our distribution network provides us with a strong platform for further development of our sales. In the current economic situation, we are capable to quickly respond to changing market conditions and if necessary redirect deliveries of our products not only in Russia but abroad, thereby allowing us to obtain additional profit.

Another strategic priority is development of our logistics capabilities. Our own railcar fleet is to ensure the balance between transportation security and cost efficiency. Development of the cargo-handling capacity of Port Posiet is crucial for continuous shipments of our coal products in the Asia-Pacific region. Growing production of export-oriented coal in our mining segment will require further expansion of port capacities on our main export routes.



With focus on efficiency improvements of our main businesses, we may also consider selective disposal of assets in order to minimize possible costs, as well as attract financial or strategic investors to our key assets in order to reduce the debt burden and contribute to business development.

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**Table of Contents****Our History and Development**

We trace our beginnings to a small coal trading operation in Mezhdurechensk in the southwestern part of Siberia in the early 1990s. See Item 5. Operating and Financial Review and Prospects History of Incorporation. Since that time, through strategic acquisitions in Russia and abroad, Mechel has developed into one of the world's leading mining and metals companies, comprising producers of coal, iron ore, coke, steel, rolled products, ferrosilicon, heat energy and electricity, with operations and assets in Russia, the CIS and Europe. We intend to retain a controlling voting interest in each of our subsidiary holding companies as we continue to build upon our business model of vertical integration among our assets.

**Mining Segment**

Our mining segment produces coking coal and other types of metallurgical coal (anthracite and coal for pulverized, or finely crushed, coal injection (PCI)), steam coal, middlings, coking coal and steam coal concentrates, as well as coke and chemical products, iron ore and iron ore concentrate. Our mining segment also includes certain transportation and logistics facilities and engineering operations. Our coal operations consist of Southern Kuzbass Coal Company, Yakutugol and Elgaugol, which together produced 14.2 million tonnes of raw coking coal, 6.1 million tonnes of raw steam coal and 2.4 million tonnes of raw anthracite in 2016. Our coke operations consist of Moscow Coke and Gas Plant and Mechel Coke, which together produced 3.0 million tonnes of coke in 2016. Our iron ore operations consist of Korshunov Mining Plant which produced 8.2 million tonnes of iron ore and 2.7 million tonnes of iron ore concentrate in 2016.

***Description of key products***

*Coking coal and metallurgical coal.* Southern Kuzbass Coal Company produces high-quality bituminous coal, which is washed to reduce the ash content. The premier product is a high-quality, low phosphorous, low sulfur semi-soft to semi-hard coking coal used to produce coke for the iron and steel industry. Other products produced by Southern Kuzbass Coal Company include PCI and anthracite. Yakutugol produces hard coking coal of low-volatile content. Elgaugol produces high-quality hard coking coal of high-volatile content.

*Steam coal.* Southern Kuzbass Coal Company, Yakutugol and Elgaugol produce high-energy steam coal as part of their product mix. Steam coal is primarily used for the generation of electricity in coal-fired power stations.

*Coke.* Coke is used in the blast furnace as a main source of heat, a reducing agent for iron and a raising agent for charging material in the smelting process. It is a product prepared by pyrolysis (heating in the absence of oxygen) of low-ash, low-phosphorus and low-sulfur coal charging material. We offer customers coke from our Moscow Coke and Gas Plant and Mechel Coke.

*Chemical products.* Chemical products are hydrocarbon products obtained as a by-product of the production of coke. We produce chemical products in our subsidiaries Moscow Coke and Gas Plant and Mechel Coke. We offer our customers coal tar, naphthalene and other compounds. Worldwide, coal tar is used in diverse applications, including in the production of electrode pitch, pitch coke, coal-tar oils, naphthalene, as well as boiler fuel. Naphthalene, a product of the distillation of coal tar, is used by the chemical industry to produce chemical compounds used in synthetic dyes, solvents, plasticizers and other products.

*Iron ore concentrate.* From our Korshunov Mining Plant we offer iron ore concentrate with a standard iron content of 62%. Yakutugol holds subsoil licenses for three iron ore deposits located in Yakutia. These deposits contain high-quality iron ore, which will allow to produce iron ore concentrate with 65% iron content.

***Mining process***

*Coal.* At our Russian mines, coal is mined using open pit or underground mining methods. Following a drilling and blasting stage, a combination of shovels and draglines is used for moving coal and waste at our open

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pit mines. Production at the underground mines is predominantly from longwall mining, a form of underground coal mining where a long wall of coal in a seam is mined in a single slice. After mining, depending upon the amount of impurities in the coal, the coal is processed in a washing plant, where it is crushed and impurities are removed by gravity methods. Coking coal concentrate is then transported to coking plants for conversion to coke for use in pig iron smelting at steel plants. Steam coal is shipped to power utilities which use it in furnaces for steam generation to produce electricity. Among the advantages of our mining business are the high quality of our coking coal and the low level of volatile matter in our steam coal.

*Iron ore.* At our Korshunov Mining Plant, ore is mined using the open pit mining method. Following a drilling and blasting stage, ore is hauled by dump trucks and dumping cars to the washing plant. At the washing plant, the ore is crushed and ground to a fine particle size, then separated into an iron ore concentrate slurry and a waste stream using wet magnetic separators. The iron ore is upgraded to a concentrate that contains about 62% elemental iron. Tailings are pumped to a tailings dam facility located adjacent to the washing plant. The concentrate is sent to disk vacuum filters which remove the water from the concentrate to reduce the moisture level, enabling shipment to customers by rail during warmer months; in colder periods the concentrate must be dried further to prevent freezing in railcars. Korshunov Mining Plant operates its own drying facility with a dry concentrate production capacity of up to 16,000 tonnes per day. In 2011-2012, Yakutugol obtained subsoil licenses for the Pionerskoye iron ore deposit, the Sutamskaya iron ore area and the Sivaglinskoye iron ore deposit in Yakutia. We plan to develop all new iron ore deposits with the open pit mining method, using excavators and dump trucks.

***Coal production***

Our coal production consists of the following mines in Russia:

| <b>Subsidiary (Location)</b>                       | <b>Surface</b>   | <b>Underground</b>   |
|--|--|--|
| Yakutugol (Sakha Republic, Russia)                 | Neryungrinsky Open Pit<br>Kangalassky Open Pit<br>Dzhebariki-Khaya Open Pit                              |  |
| Elgaugol (Sakha Republic, Russia)                  | Elga Open Pit  |  |
| Southern Kuzbass Coal Company<br>(Kuzbass, Russia) | Sibirginsky Open Pit<br><br>Tomusinsky Open Pit<br><br>Olzherassky Open Pit<br><br>Krasnogorsky Open Pit | V.I. Lenina Underground<br>Sibirginskaya Underground<br>Olzherasskaya-<br>Novaya Underground |

Our coal mines are primarily located in the Kuznetsky basin, a major Russian coal-producing region, and in the Sakha Republic in Eastern Siberia.

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The table below summarizes our run-of-mine (ROM) coal production by type of coal and location of mines for the periods indicated.

|                               | 2016                                   |                 | 2015        |                 | 2014        |                 |
|-------------------------------|--|-----------------|-------------|-----------------|-------------|-----------------|
|                               | Tonnes                                 | % of Production | Tonnes      | % of Production | Tonnes      | % of Production |
|                               | (In millions of tonnes) <sup>(1)</sup> |                 |             |                 |             |                 |
| <b>Coking Coal</b>            |  |                 |             |                 |             |                 |
| Yakutugol                     | 8.9                                    |                 | 7.8         |                 | 8.9         |                 |
| Elgaugol                      | 2.8                                    |                 | 2.6         |                 | 0.7         |                 |
| Southern Kuzbass Coal Company | 2.5                                    |                 | 3.4         |                 | 4.3         |                 |
| Bluestone <sup>(2)</sup>      |  |                 |             |                 | 0           |                 |
| <b>Total Coking Coal</b>      | <b>14.2</b>                            | <b>62.7%</b>    | <b>13.8</b> | <b>59.5%</b>    | <b>13.9</b> | <b>61.5%</b>    |
| <b>Steam Coal</b>             |  |                 |             |                 |             |                 |
| Yakutugol                     | 1.0                                    |                 | 1.4         |                 | 0.5         |                 |
| Elgaugol                      | 0.9                                    |                 | 1.3         |                 | 0.5         |                 |
| Southern Kuzbass Coal Company | 4.2                                    |                 | 4.2         |                 | 5.4         |                 |
| Bluestone <sup>(2)</sup>      |  |                 |             |                 | 0           |                 |
| <b>Total Steam Coal</b>       | <b>6.1</b>                             | <b>26.8%</b>    | <b>6.9</b>  | <b>29.7%</b>    | <b>6.4</b>  | <b>28.3%</b>    |
| <b>Anthracite</b>             |  |                 |             |                 |             |                 |
| Yakutugol                     |  |                 |             |                 |             |                 |
| Elgaugol                      |  |                 |             |                 |             |                 |
| Southern Kuzbass Coal Company | 2.4                                    |                 | 2.5         |                 | 2.3         |                 |
| Bluestone <sup>(2)</sup>      |  |                 |             |                 |             |                 |
| <b>Total Anthracite</b>       | <b>2.4</b>                             | <b>10.5%</b>    | <b>2.5</b>  | <b>10.8%</b>    | <b>2.3</b>  | <b>10.2%</b>    |
| <b>Total Coal</b>             | <b>22.7</b>                            | <b>100%</b>     | <b>23.2</b> | <b>100%</b>     | <b>22.6</b> | <b>100%</b>     |

(1) Volumes are reported on a wet basis.

(2) In January-February 2014, we temporarily suspended works at our Bluestone mines due to adverse market conditions. In February 2015, we disposed of Bluestone mining business.

The coking coal produced by our Russian mines is predominately low-sulfur (0.3%) bituminous coal. Heating values for coking coal range from 6,861 to 8,488 kcal/kg on a moisture- and ash-free basis. Heating values for steam coal range from 6,627 to 8,286 kcal/kg on a moisture- and ash-free basis.

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The table below summarizes our saleable coal production by type of coal and location of mines for the periods indicated.

|                               | 2016                    |                 | 2015        |                 | 2014        |                 |
|-------------------------------|-------------------------|-----------------|-------------|-----------------|-------------|-----------------|
|                               | Tonnes                  | % of Production | Tonnes      | % of Production | Tonnes      | % of Production |
|                               | (In millions of tonnes) |                 |             |                 |             |                 |
| <b>Coking Coal</b>            |                         |                 |             |                 |             |                 |
| Yakutugol                     | 5.9                     | 30%             | 5.1         | 25%             | 5.7         | 26%             |
| Elgaugol                      | 1.6                     | 8%              | 1.6         | 8%              | 0.2         | 1%              |
| Southern Kuzbass Coal Company | 3.1                     | 16%             | 2.7         | 13%             | 4.0         | 19%             |
| Bluestone <sup>(1)</sup>      |                         |                 |             |                 | 0           | 0%              |
| <b>Total Coking Coal</b>      | <b>10.6</b>             | <b>54%</b>      | <b>9.4</b>  | <b>46%</b>      | <b>9.9</b>  | <b>46%</b>      |
| <b>PCI</b>                    |                         |                 |             |                 |             |                 |
| Yakutugol                     |                         |                 |             |                 |             |                 |
| Elgaugol                      |                         |                 |             |                 |             |                 |
| Southern Kuzbass Coal Company | 1.4                     | 7%              | 2.0         | 9%              | 2.6         | 12%             |
| Bluestone <sup>(1)</sup>      |                         |                 |             |                 |             |                 |
| <b>Total PCI</b>              | <b>1.4</b>              | <b>7%</b>       | <b>2.0</b>  | <b>9%</b>       | <b>2.6</b>  | <b>12%</b>      |
| <b>Anthracite</b>             |                         |                 |             |                 |             |                 |
| Yakutugol                     |                         |                 |             |                 |             |                 |
| Elgaugol                      |                         |                 |             |                 |             |                 |
| Southern Kuzbass Coal Company | 1.8                     | 9%              | 2.1         | 10%             | 1.5         | 7%              |
| Bluestone <sup>(1)</sup>      |                         |                 |             |                 |             |                 |
| <b>Total Anthracite</b>       | <b>1.8</b>              | <b>9%</b>       | <b>2.1</b>  | <b>10%</b>      | <b>1.5</b>  | <b>7%</b>       |
| <b>Steam Coal</b>             |                         |                 |             |                 |             |                 |
| Yakutugol                     | 3.2                     | 17%             | 3.5         | 17%             | 2.9         | 14%             |
| Elgaugol                      | 1.3                     | 7%              | 1.6         | 8%              | 0.5         | 2%              |
| Southern Kuzbass Coal Company | 1.2                     | 6%              | 2.0         | 10%             | 4.2         | 19%             |
| Bluestone <sup>(1)</sup>      |                         |                 |             |                 | 0           | 0%              |
| <b>Total Steam Coal</b>       | <b>5.7</b>              | <b>30%</b>      | <b>7.1</b>  | <b>35%</b>      | <b>7.6</b>  | <b>35%</b>      |
| <b>Total Coal</b>             | <b>19.5</b>             | <b>100%</b>     | <b>20.6</b> | <b>100%</b>     | <b>21.6</b> | <b>100%</b>     |

(1) In January-February 2014, we temporarily suspended works at our Bluestone mines due to adverse market conditions. In February 2015, we disposed of Bluestone mining business.

*Yakutugol mines*

Our Yakutugol coal mines are located in the Sakha Republic. The Sakha Republic is located in Eastern Siberia and covers an area of 3.1 million square kilometers. It has a population of fewer than one million inhabitants. Its capital,

Yakutsk, is located on the Lena River in south central Yakutia.

Our Yakutugol mines include three open pit mines: Neryungrinsky Open Pit, Kangalassky Open Pit and Dzhebariki-Khaya Open Pit. Neryungrinsky Open Pit is located in the South-Yakutsky basin which covers an area of 25,000 square kilometers and lies near the southern border of Yakutia. Neryungrinsky Open Pit is located near the town of Neryungri, one of the main industrial centers of Yakutia and its second largest city. Kangalassky Open Pit and Dzhebariki-Khaya Open Pit are located in the Lensky basin which covers an area of 750,000 square kilometers and lies near Yakutsk.

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The table below sets forth certain information regarding the subsoil licenses for our Yakutugol coal mines.

| Mine  | License (plot)              | Area (sq. km) | Mining Method | Life of Mine | License Expiry Date | Status <sup>(1)</sup> | Year Production Commenced | Surface Land Use Rights |
|---|-----------------------------|---------------|---------------|--------------|---------------------|-----------------------|---------------------------|-------------------------|
| Neryungrinsky Open Pit                      | 12336<br>(Moshchny seam)    | 15.3          | Open pit      | 2029         | Dec 2024            | In production         | 1979                      | Ownership               |
| Kangalassky Open Pit                        | 15017<br>(Kangalassk)       | 7.7           | Open pit      | 2100         | Dec 2027            | In production         | 1962                      | Ownership               |
| Dzhebariki-Khaya Underground <sup>(2)</sup> | 15061<br>(Dzhebariki-Khaya) | 14.8          | Underground   | 2036         | Dec 2023            | Conservation          | 1972                      | Ownership               |
| Dzhebariki-Khaya Open Pit                   | 15061<br>(Dzhebariki-Khaya) | 14.8          | Open pit      | 2036         | Dec 2023            | In production         | 2017                      | Ownership               |

(1) In production refers to sites that are currently producing coal. Conservation refers to sites where no mining activity is conducted, but measures for mine conservation are being taken.

(2) In August 2016, the underground mining operations were discontinued.

The earliest production at our Yakutugol mines was in 1962, although we acquired these mines and license areas in October 2007. Neryungrinsky Open Pit produces low-volatile hard coking coal and steam coal which are sold primarily in the Asia-Pacific region and domestically. Neryungrinsky Open Pit has a railway spur connected to the Russian rail system, which is controlled by Russian Railways. Kangalassky Open Pit produces steam coal that is sold as fuel for boiler plants in Yakutia. It is accessible through an all-weather road from Kangalassy and through a highway from Yakutsk. Dzhebariki-Khaya Open Pit will produce steam coal, most of which will be sold to state housing and municipal services. Dzhebariki-Khaya Open Pit is accessible only by means of the Aldan River.

The table below summarizes ROM coal production of our Yakutugol mines by mine and type of coal for the periods indicated.

| Mine                   | 2016   |                       | 2015   |                       | 2014   |                       |
|------------------------|--------|-----------------------|--------|-----------------------|--------|-----------------------|
|                        | Tonnes | % of Total Production | Tonnes | % of Total Production | Tonnes | % of Total Production |
| <b>Coking Coal</b>     |        |                       |        |                       |        |                       |
| Neryungrinsky Open Pit | 8.9    |                       | 7.8    |                       | 8.9    |                       |
| Total Coking Coal      | 8.9    | 89.9%                 | 7.8    | 84.9%                 | 8.9    | 94.7%                 |
| <b>Steam Coal</b>      |        |                       |        |                       |        |                       |
| Neryungrinsky Open Pit | 0.4    |                       | 0.7    |                       | 0.1    |                       |



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|                              |            |             |            |             |            |             |
|------------------------------|------------|-------------|------------|-------------|------------|-------------|
| Dzhebariki-Khaya Underground | 0.4        |             | 0.5        |             | 0.3        |             |
| Kangalassky Open Pit         | 0.2        |             | 0.2        |             | 0.1        |             |
| Total Steam Coal             | 1.0        | 10.1%       | 1.4        | 15.1%       | 0.5        | 5.3%        |
| <b>Total Coal</b>            | <b>9.9</b> | <b>100%</b> | <b>9.2</b> | <b>100%</b> | <b>9.4</b> | <b>100%</b> |

(1) Volumes are reported on a wet basis.

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The table below sets forth coal sales volumes of our Yakutugol mines by type of coal and destinations for the periods indicated.

| Coal Type    | Region | 2016                     | 2015           | 2014           |
|--------------|--------|--------------------------|----------------|----------------|
|              |        | (In thousands of tonnes) |                |                |
| Coking coal  | Asia   | 3,942.6                  | 3,609.7        | 5,268.1        |
|              | Russia | 1,136.1                  | 894.5          | 11.6           |
|              | CIS    | 22.3                     | 9.8            | 60.1           |
|              | Europe | 19.1                     | 0.5            | 0.0            |
| <b>Total</b> |        | <b>5,120.1</b>           | <b>4,514.5</b> | <b>5,339.8</b> |
| Steam coal   | Russia | 703.2                    | 776.8          | 630.4          |
|              | Asia   | 622.5                    | 124.7          | 0.0            |
| <b>Total</b> |        | <b>1,325.7</b>           | <b>901.5</b>   | <b>630.4</b>   |
| Middlings    | Russia | 1,758.9                  | 1,647.9        | 1,705.2        |
|              | Asia   | 459.4                    | 476.1          | 662.7          |
| <b>Total</b> |        | <b>2,218.3</b>           | <b>2,124.0</b> | <b>2,367.9</b> |
| <b>Total</b> |        | <b>8,664.1</b>           | <b>7,540.0</b> | <b>8,338.1</b> |

*Elgaugol mine*

Our Elga Open Pit is located in the South-Yakutsky basin of the Toko Coal-Bearing region in the Sakha Republic. This coal region was first discovered and explored in 1952 with the first geological surveys being conducted in 1954 through 1956. The closest inhabited localities are Verkhnezeysk village, located 320 kilometers south of the deposit, and the town of Neryungri, located 415 kilometers to the west. Since 1998, there have been several studies on the Elga coal deposit, including geology and resources, mine planning and feasibility studies. Overburden removal at the Elga deposit commenced in November 2010. Coal mining at Elga Open Pit commenced in August 2011.

Our subsidiary Elgaugol was established on August 14, 2013 under the laws of the Russian Federation with Yakutugol and Mechel Mining as participants for raising project financing from Vnesheconombank. In September 2013, Vnesheconombank's Supervisory Board approved project financing for the construction of the first stage of the Elga coal complex and the relevant loan agreements were signed in October 2013 and March 2014. Elgaugol has not fulfilled conditions precedent under the loan agreements and Vnesheconombank has suspended the financing. We hold negotiations with Vnesheconombank with respect to possibility of further financing of the Elga project.

In August 2013, the board of directors of Yakutugol decided to transfer the subsoil license for the Elga coal deposit to Elgaugol. In January 2014, Elgaugol obtained the respective subsoil license.

The table below sets forth certain information regarding the subsoil license for our Elgaugol mine.

| Mine | License (plot) | Status <sup>(1)</sup> |
|------|----------------|-----------------------|
|------|----------------|-----------------------|

|               |       |        | <b>Area<br/>(sq. km)</b> | <b>Mining<br/>Method</b> | <b>Life<br/>of<br/>Mine</b> | <b>License<br/>Expiry<br/>Date</b> |               | <b>Year<br/>Production<br/>Commenced</b> | <b>Surface<br/>Land Use<br/>Rights</b> |
|---------------|-------|--------|--------------------------|--------------------------|-----------------------------|------------------------------------|---------------|--|--|
| Elga Open Pit | 03730 | (Elga) | 144.1                    | Open pit                 | 2100                        | Dec 2033                           | In production | 2011                                     | Lease                                  |

(1) In production refers to sites that are currently producing coal.

Elga Open Pit produces two types of coal: high-quality hard coking coal (high-volatile) and steam coal. It also produces middlings (by-product of the coking coal washing process). Coking coal, steam coal and middlings are sold primarily in the Asia-Pacific market with transshipment in ports of the Russian Far East.

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The table below summarizes ROM coal production of our Elgaugol mine by type of coal for the periods indicated.

| Mine               | 2016       |                       | 2015       |                       | 2014       |                       |
|--------------------|------------|-----------------------|------------|-----------------------|------------|-----------------------|
|                    | Tonnes     | % of Total Production | Tonnes     | % of Total Production | Tonnes     | % of Total Production |
| <b>Coking Coal</b> |            |                       |            |                       |            |                       |
| Elga Open Pit      | 2.8        |                       | 2.6        |                       | 0.7        |                       |
| Total Coking Coal  | 2.8        | 75.7%                 | 2.6        | 66.7%                 | 0.7        | 58.3%                 |
| <b>Steam Coal</b>  |            |                       |            |                       |            |                       |
| Elga Open Pit      | 0.9        |                       | 1.3        |                       | 0.5        |                       |
| Total Steam Coal   | 0.9        | 24.3%                 | 1.3        | 33.3%                 | 0.5        | 41.7%                 |
| <b>Total Coal</b>  | <b>3.7</b> | <b>100%</b>           | <b>3.9</b> | <b>100%</b>           | <b>1.2</b> | <b>100%</b>           |

(1) Volumes are reported on a wet basis.

The table below sets forth coal sales volumes of our Elgaugol mine by type of coal and destinations for the periods indicated.

| Coal Type    | Region | 2016                     | 2015           | 2014         |
|--------------|--------|--------------------------|----------------|--------------|
|              |        | (In thousands of tonnes) |                |              |
| Coking coal  | Asia   | 242.6                    | 11.8           | 34.6         |
| Total        |        | 242.6                    | 11.8           | 34.6         |
| Steam coal   | Asia   | 1,429.2                  | 1,201.5        | 319.9        |
|              | Russia | 1.2                      | 209.0          | 149.1        |
| Total        |        | 1,430.4                  | 1,410.5        | 469.0        |
| Middlings    | Asia   | 0.0                      | 152.8          | 164.7        |
| Total        |        | 0.0                      | 152.8          | 164.7        |
| <b>Total</b> |        | <b>1,673.0</b>           | <b>1,575.1</b> | <b>668.3</b> |

In 2009, the general scheme of the Elga coal complex development and the plan for initial mine block development were prepared. The plan for initial mine block development was subsequently approved by governmental authorities. In 2011, the project documentation of the first stage of the Elga coal complex construction was prepared and subsequently approved by governmental authorities.

In December 2011, we finished laying track for the rail line to the Elga deposit. The 321 kilometer-long rail line is now in operation and we are able to use it for transportation of coal produced at Elga Open Pit. The rail line connects Elga Open Pit with the Baikal-Amur Mainline (at the Ulak railway station), which, in turn, provides access to the Russian rail network, in general, and Pacific Ocean ports, in particular. We will further develop the rail line to increase its capacity in line with our production plans. In March 2016, we contributed the Ulak-Elga rail line to the registered capital of the newly established company Elga-road OOO.

In October 2012, we launched a pilot seasonal washing plant for Elga Open Pit, which operated in the warmer months of April to October only, with a seasonal capacity of 2.0 million tonnes per annum. In late 2014, we completed the transfer of the pilot seasonal washing plant to year-round operation with a designed capacity of up to 2.7 million tonnes per annum.

Currently, Elga has an electricity substation with diesel power generators with a total installed capacity of 9 megawatts ( **MW** ). Federal Grid Company, the state-owned operator of the unified national electric grid, is

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installing high-voltage transmission lines to deliver electricity from the Zeysky hydro power plant located 270 kilometers from the site, and we are constructing electricity-receiving infrastructure capable of receiving of up to 134 MW. We expect to start receiving electricity from this power plant in the fourth quarter of 2017.

In accordance with the order of the Federal Agency for Subsoil Use ( **Rosnedra** ) No. 177 dated February 27, 2015 On the conducting of a one-time updating of subsoil licenses, we filed an application with the Department for Subsoil Use for the Sakha Republic (Yakutia) regarding conduct of an update procedure relating to the terms of the subsoil license for the Elga coal deposit. In December 2015, the Department for Subsoil Use for the Sakha Republic (Yakutia) made a decision to update the existing terms and issued an amendment to the subsoil license. The amendments provide that the level of coal extraction and deadlines of reaching the design capacity are determined by the deposit development technical plan. In September 2016, based on the decision of Rosnedra the subsoil license for the Elga coal deposit was extended until December 31, 2033.

In the event of significant deviations from the design solutions, we can prepare and duly approve the adjustment of the current technical plan in order to avoid violation of the terms of subsoil use. Thus, the amended license terms allow us to manage licensing risks by adjusting the project documentation which significantly reduces the risk of suspension of the subsoil license in the event of a deviation from the design solutions. See also Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry The development of the Elga coal deposit is subject to certain risks due to the substantial amount of capital costs involved in developing the required infrastructure.

*Southern Kuzbass mines*

The Kuznetsky basin, or Kuzbass, is located in the southeastern part of Western Siberia and is one of the largest coal mining areas in the world, covering an area of around 70,000 square kilometers. Coal-bearing seams extend over an area of 26,700 square kilometers and reach a depth of up to 1,800 meters. Coal was discovered in 1721, and systematic mining started in 1851. During the Soviet era, Kuzbass was the second largest regional coal producer. According to the Central Dispatching Department, Kuzbass (Kemerovo region) now accounts for about 59% of Russia's total coal production.

All of our Southern Kuzbass mines are located in southeast Kuzbass around the town of Mezhdurechensk in the Kemerovo region, with the exception of the Yerunakovskaya mine area, which is located about 100 kilometers northwest of Mezhdurechensk.

The earliest production at our Southern Kuzbass mines was in 1953, although we acquired these mines and license areas starting in the 1990s. The Southern Kuzbass mines include four open pit mines, three underground mines and one underground mine under development: Sibirginsky Open Pit, Tomusinsky Open Pit, Olzherassky Open Pit, Krasnogorsky Open Pit, V.I. Lenina Underground, Sibirginskaya Underground, Olzherasskaya-Novaya Underground and Yerunakovskaya-1 Underground (project).

Our Southern Kuzbass mines and the related washing plants produce semi-soft and semi-hard coking coal, anthracite, PCI and steam coal. Our Kuzbass operations are connected by rail to the Trans-Siberian Mainline and substantially all products are shipped by rail. Products are generally shipped by rail to Russian customers, to Baltic ports for European customers, to Port Posiet and Port Vanino for export to Asia and to Port Temryuk for customers in the Black Sea and Mediterranean basins.

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The table below sets forth certain information regarding the subsoil licenses for our coal mines in Kuzbass, all of which are held by our subsidiary Southern Kuzbass Coal Company, unless otherwise noted.

| Mine                             | License (plot)                             | Area (sq. km) | Mining Method | Life of Mine | License     |                             | Year Surface Production Commenced | Surface Use Rights |
|----------------------------------|--|---------------|---------------|--------------|-------------|-----------------------------|-----------------------------------|--------------------|
|                                  |  |               |               |              | Expiry Date | Status <sup>(1)</sup>       |                                   |                    |
| Krasnogorsky Open Pit            | 14016 (Tomsk, Sibirginsk)                  | 22.4          | Open pit      | 2055         | Jan 2021    | In production               | 1954                              | Lease              |
|                                  | 13367 (Sorokinsk, Tomsk, Sibirginsk)       | 2.8           |               |              | Nov 2025    | In production               | 2012                              | Lease              |
| Olzherassky Open Pit             | 01374 (Raspadsk, Berezovsk, Sosnovsk)      | 9.3           | Open pit      | 2050         | Dec 2029    | In production               | 1980                              | Lease              |
|                                  | 12939 (Raspadsk) <sup>(2)</sup>            | 3.5           |               |              | Dec 2024    | Development                 | n/a                               | Lease              |
|                                  | 12940 (Berezovsk-2, Berezovsk, Olzherassk) | 4.8           |               |              | Dec 2024    | In production               | 2007                              | Lease              |
|                                  | 01917 (Berezovsk Gluboky)                  | 7.4           |               |              | Aug 2035    | Exploration and development | n/a                               | Lease              |
| Tomusinsky Open Pit              | 13312 (Tomsk) <sup>(3)</sup>               | 6.7           | Open pit      | 2028         | Dec 2020    | In production               | 1959                              | Lease              |
| Sibirginsky Open Pit             | 13639 (Sibirginsk, Kureinsk, Uregolsk)     | 17.7          | Open pit      | 2055         | Dec 2032    | In production               | 1970                              | Lease              |
|                                  | 01557 (New-Uregolsk)                       | 2.4           |               |              | Apr 2031    | In production               | 2011                              | Lease              |
| Sibirginskaya Underground        | 12917 (Sibirginsk, Tomsk)                  | 5.9           | Underground   | 2058         | Dec 2024    | In production               | 2002                              | Lease              |
|                                  | 15463 (Sibirginsk-2, Sibirginsk, Kureinsk) | 0.9           |               |              | Dec 2032    | In production               | 2014                              | Lease              |
|                                  | 01914 (Sibirginsk-3)                       | 7.6           |               |              | Aug 2035    | Exploration and development | n/a                               |                    |
| V.I. Lenina Underground          | 14060 (Olzherassk)                         | 10.0          | Underground   | 2050         | Dec 2032    | In production               | 1953                              | Lease              |
|                                  | 01701 (Granichny, Olzherassk)              | 1.2           |               |              | Feb 2033    | Exploration and development | n/a                               |                    |
| Olzherasskaya-Novaya Underground | 14199 (Raspadsk)                           | 1.2           | Underground   | 2035         | Dec 2021    | In production               | 2008                              | Lease              |
|                                  | 01471 (Olzherassk-2, Raspadsk)             | 0.03          |               |              | Jan 2030    | In production               | 2010                              | Lease              |
|                                  | 13366                                      | 14.6          |               |              | Nov 2025    | In production               | 2010                              | Lease              |

|  |  |              |      |             |      |          |              |           |
|--|--|--------------|------|-------------|------|----------|--------------|-----------|
|  | (Razvedochny, Rospadsk)                        |              |      |             |      |          |              |           |
| Yerunakovskaya-1 Underground (project)         | 13237  |              | 8.4  | Underground | 2033 | Jun 2025 | Development  | n/a Lease |
|  | (Yerunakovsk-1, Yerunakovsk) <sup>(4)</sup>    |              |      |             |      |          |              |           |
| Yerunakovskaya-3 Underground (prospect)        | 13238  |              | 7.1  | Underground | 2115 | Jun 2025 | Development  | n/a       |
|  | (Yerunakovsk-3, Yerunakovsk) <sup>(4)</sup>    |              |      |             |      |          |              |           |
| Yerunakovskaya-2 Underground (prospect)        | 13271  |              | 7.3  | Underground | 2051 | Jul 2025 | Development  | n/a       |
|  | (Yerunakovsk-2, Yerunakovsk) <sup>(4)(5)</sup> |              |      |             |      |          |              |           |
| Olzherasskaya-Glubokaya Underground (prospect) | 13365  | (Olzherassk) | 19.2 | Underground | 2211 | Nov 2025 | Development  | n/a       |
| Usinskaya Underground (prospect)               | 14093  | (Olzherassk) | 3.6  | Underground | 2071 | Dec 2033 | Conservation | n/a       |



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- (1) In production refers to sites that are currently producing coal. Development refers to sites where preliminary work is being carried out. Exploration refers to sites where drilling for calculation of mineral reserves is being carried out. Exploration and development refers to sites where preliminary work and drilling for calculation of mineral reserves are being carried out. Conservation refers to sites where no mining activity is conducted, but measures for mine conservation are being taken.
- (2) We failed to commence commercial production in 2009 as required by the subsoil license due to unfavorable mine economics. We expect to commence production at the Raspadsk license area in the fourth quarter of 2018 provided coal prices recover sufficiently.
- (3) License held by Tomusinsky Open Pit, a subsidiary of Southern Kuzbass Coal Company.
- (4) We failed to commence commercial production in 2011 as required by the subsoil license due to unfavorable mine economics.
- (5) License held by Resurs-Ugol OOO, a subsidiary of Southern Kuzbass Coal Company.

The table below summarizes ROM coal production of our Southern Kuzbass mines by mine and type of coal for the periods indicated.

| Mine                             | 2016       |                       | 2015       |                       | 2014       |                       |
|----------------------------------|------------|-----------------------|------------|-----------------------|------------|-----------------------|
|                                  | Tonnes     | % of Total Production | Tonnes     | % of Total Production | Tonnes     | % of Total Production |
| <b>Coking Coal</b>               |            |                       |            |                       |            |                       |
| Sibirginsky Open Pit             | 0.2        |                       | 0.5        |                       | 1.2        |                       |
| Tomusinsky Open Pit              | 0.8        |                       | 0.8        |                       | 0.9        |                       |
| V.I. Lenina Underground          | 0.8        |                       | 0.4        |                       | 0.7        |                       |
| Sibirginskaya Underground        | 0.2        |                       | 1.1        |                       | 1.0        |                       |
| Olzherassky Open Pit             | 0.5        |                       | 0.6        |                       | 0.5        |                       |
| <b>Total Coking Coal</b>         | <b>2.5</b> | <b>27.5%</b>          | <b>3.4</b> | <b>33.7%</b>          | <b>4.3</b> | <b>35.8%</b>          |
| <b>Steam Coal</b>                |            |                       |            |                       |            |                       |
| Krasnogorsky Open Pit            | 1.8        |                       | 2.7        |                       | 2.8        |                       |
| Sibirginsky Open Pit             | 0.3        |                       | 0.5        |                       | 0.8        |                       |
| Olzherassky Open Pit             | 0.0        |                       | 0.0        |                       | 0.1        |                       |
| Olzherasskaya-Novaya Underground | 1.5        |                       | 0.3        |                       | 0.8        |                       |
| Tomusinsky Open Pit              | 0.6        |                       | 0.7        |                       | 0.9        |                       |
| <b>Total Steam Coal</b>          | <b>4.2</b> | <b>46.1%</b>          | <b>4.2</b> | <b>41.6%</b>          | <b>5.4</b> | <b>45.0%</b>          |
| <b>Anthracite</b>                |            |                       |            |                       |            |                       |
| Krasnogorsky Open Pit            | 2.4        |                       | 2.5        |                       | 2.3        |                       |
| Sibirginsky Open Pit             |            |                       |            |                       |            |                       |
| Olzherassky Open Pit             |            |                       |            |                       |            |                       |
| Olzherasskaya-Novaya Underground |            |                       |            |                       |            |                       |
| Tomusinsky Open Pit              |            |                       |            |                       |            |                       |

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|                   |     |       |      |       |      |       |
|-------------------|-----|-------|------|-------|------|-------|
| Total Anthracite  | 2.4 | 26.4% | 2.5  | 24.7% | 2.3  | 19.2% |
| <b>Total Coal</b> | 9.1 | 100%  | 10.1 | 100%  | 12.0 | 100%  |

(1) Volumes are reported on a wet basis.

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The table below sets forth Southern Kuzbass mines' coal sales volumes by type of coal and destinations for the periods indicated.

| Coal Type   | Region                     | 2016                     | 2015    | 2014    |
|-------------|----------------------------|--------------------------|---------|---------|
|             |                            | (In thousands of tonnes) |         |         |
| Coking coal | Russia                     | 242.0                    | 492.2   | 1,407.2 |
|             | Asia                       | 179.3                    | 227.4   | 955.7   |
|             | CIS                        | 0.0                      | 0.0     | 40.1    |
| Total       |                            | 421.3                    | 719.6   | 2,403.0 |
| Anthracite  | Europe                     | 892.6                    | 1,241.2 | 1,200.5 |
|             | Other                      | 255.9                    | 73.4    | 76.2    |
|             | Asia                       | 224.9                    | 321.7   | 336.5   |
|             | CIS                        | 108.6                    | 68.2    | 183.3   |
|             | Russia                     | 32.6                     | 42.3    | 36.3    |
|             | Middle East <sup>(1)</sup> | 0.0                      | 14.9    | 24.5    |
| Total       |                            | 1,514.6                  | 1,761.7 | 1,857.3 |
| PCI         | Asia                       | 1,571.9                  | 1,684.3 | 1,870.8 |
|             | Europe                     | 37.8                     | 473.5   | 837.8   |
|             | Middle East <sup>(1)</sup> | 10.4                     | 91.5    | 338.5   |
|             | CIS                        | 0.0                      | 0.0     | 4.1     |
|             | Russia                     | 0.0                      | 4.7     | 0.0     |
| Total       |                            | 1,620.1                  | 2,254.0 | 3,051.2 |
| Steam coal  | Asia                       | 845.6                    | 122.2   | 26.2    |
|             | Middle East <sup>(1)</sup> | 44.9                     | 96.7    | 152.2   |
|             | Russia                     | 12.7                     | 30.4    | 38.6    |
|             | Europe                     | 4.6                      | 11.6    | 13.9    |
|             | CIS                        | 0.0                      | 15.5    | 392.8   |
| Total       |                            | 907.8                    | 276.4   | 623.7   |
| Middlings   | Asia                       | 0.0                      | 0.0     | 94.0    |
| Total       |                            | 0.0                      | 0.0     | 94.0    |
| Total       |                            | 4,463.8                  | 5,011.7 | 8,029.2 |

(1) Includes Turkey only.

**Coal washing plants**

We operate six coal washing plants and one processing unit in Russia: four coal washing plants and one processing unit located near our coal mines in Southern Kuzbass, one coal washing plant located near Neryungrinsky Open Pit and one coal washing plant at Elga Open Pit.

Our four coal washing plants and one processing unit located near our coal mines in Southern Kuzbass have an aggregate annual capacity of approximately 17.0 million tonnes of ROM coal. These are Krasnogorskaya Washing Plant, Sibir Washing Plant, Tomusinskaya Washing Plant, Kuzbasskaya Washing Plant and Sibirginskaya Processing Unit. These washing plants have aggregate storage capacity for saleable products of 201,000 tonnes, including 81,500 tonnes of additional capacity, of which 29% is covered storage.

Neryungrinskaya Washing Plant located near Neryungrinsky Open Pit has an annual capacity of 9.0 million tonnes. The plant produces coking coal concentrate and middlings.

In October 2012, we launched a pilot seasonal washing plant for Elga Open Pit, which operated in the warmer months of April to October only, with a seasonal capacity of 2.0 million tonnes per annum. In late 2014, we completed the transfer of the pilot seasonal washing plant to year-round operation with a designed capacity of up to 2.7 million tonnes per annum.

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All of the coal feedstock enriched by our washing plants in 2016 (19.9 million tonnes) was supplied by our own mining operations.

***Coke and chemical products production***

The following table lists the various types and grades of coke and chemical products we produce and sell. We also produce and sell coke gas.

| <b>Plant</b>              | <b>Products</b>   |
|---------------------------|---|
| Moscow Coke and Gas Plant | Coke +40 mm, Coke 25-40 mm, Coke nut 10-25 mm, Coke breeze 0-10 mm, Coal benzene, Coal tar, Coke gas                                |
| Mechel Coke               | Coke +40 mm, Coke +25 mm, Coke 25-40 mm, Coke nut 10-25 mm, Coke breeze 0-10 mm, Coal benzene, Coal tar, Ammonium sulfate, Coke gas |

We have two coke plants, one of which is located in the city of Chelyabinsk and the other in the Moscow region. Coke is prepared by pyrolysis (heating in the absence of oxygen) of low-ash, low-phosphorus and low-sulfur coal. Coke is used in the blast furnace as a main source of heat, a reducing agent for iron and a raising agent for charging material in the smelting process.

In addition, we produce coke nut, which is smaller in size than metallurgical coke and is principally used as a reducing agent in ferroalloys production and for other purposes, and coke breeze, which is even smaller in size and is principally used for sintering iron ore concentrate prior to its use in blast furnaces or as fuel. Coke production and sales volumes figures presented herein include, among others, coke nut and coke breeze. Additional chemical products, such as coal benzene, coal tar and ammonium sulfate, are obtained as by-products in the coke production process.

The table below summarizes our production of coke, chemical products and coke gas for the periods indicated.

|                                  | <b>2016</b>                                   | <b>2015</b> | <b>2014</b> |
|----------------------------------|---|-------------|-------------|
|                                  | <b>(Coke and chemical products in</b>         |             |             |
|                                  | <b>thousands of tonnes)</b>                   |             |             |
|                                  | <b>(Coke gas in millions of cubic meters)</b> |             |             |
| <b>Mechel Coke</b>               |   |             |             |
| Coke (6% moisture)               | 2,244   | 2,313       | 2,586       |
| Chemical products                | 110   | 112         | 119         |
| Coke gas                         | 824   | 851         | 835         |
| <b>Moscow Coke and Gas Plant</b> |   |             |             |
| Coke (6% moisture)               | 742   | 723         | 799         |
| Chemical products                | 38  | 38          | 41          |
| Coke gas                         | 328   | 319         | 367         |
| <b>Total</b>                     |   |             |             |
| Coke (6% moisture)               | 2,986   | 3,036       | 3,385       |

|                   |       |       |       |
|-------------------|-------|-------|-------|
| Chemical products | 148   | 150   | 160   |
| Coke gas          | 1,152 | 1,170 | 1,202 |

The table below summarizes our sales volumes of coke and chemical products for the periods indicated.

|                   | <b>2016</b>                     | <b>2015</b> | <b>2014</b> |
|-------------------|---------------------------------|-------------|-------------|
|                   | <b>(In thousands of tonnes)</b> |             |             |
| Coke              | 894                             | 985         | 1,262       |
| Chemical products | 146                             | 155         | 173         |

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The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for Moscow Coke and Gas Plant's principal production area.

| <b>Production Area</b> | <b>Capacity in 2016</b> | <b>Capacity Utilization Rate in 2016</b> | <b>Planned Increase (2017-2019)</b> |
|------------------------|-------------------------|--|-------------------------------------|
|                        |                         | <b>(In thousands of tonnes)</b>          |                                     |
| Coke (6% moisture)     | 867                     | 85.6%                                    |                                     |

The following table sets forth the capacity, the capacity utilization rate and the planned decrease in capacity for Mechel Coke's principal production area.

| <b>Production Area</b> | <b>Capacity in 2016</b> | <b>Capacity Utilization Rate in 2016</b> | <b>Planned Decrease (2017-2019)</b> |
|------------------------|-------------------------|--|-------------------------------------|
|                        |                         | <b>(In thousands of tonnes)</b>          |                                     |
| Coke (6% moisture)     | 2,961                   | 75.8%                                    | 401                                 |

Our own production facilities purchase a substantial majority of our coke production. For the years ended December 31, 2016, 2015 and 2014, purchases of our coke by our own production facilities amounted to 1.9 million tonnes, 1.9 million tonnes and 2.0 million tonnes, respectively, which represented 68%, 66% and 61% of our total coke sales volumes (including intra-group sales) for those periods.

We purchase some coking coal from other producers in order to produce coke. The need to purchase coking coal from third parties for coke production varies from period to period, depending on customer demand for particular products and the availability of suitable coal grades from our own mines.

***Iron ore and concentrate production***

Our iron ore operations consist of Korshunov Mining Plant which operates Korshunovsky Open Pit, Rudnogorsky Open Pit and Korshunovskaya Washing Plant, and three subsoil licenses held by Yakutugol for the Pionerskoye iron ore deposit, the Sivaglinskoye iron ore deposit and the Sutamskaya iron ore area in Yakutia.

Korshunovskaya Washing Plant is located outside of the town of Zheleznogorsk-Ilimsky, 120 kilometers east of Bratsk in the Irkutsk region. Korshunovsky Open Pit is located near the washing plant and Rudnogorsky Open Pit is located about 85 kilometers to the northwest of the washing plant. We have operated these iron ore mines and the washing plant since 2003 when we acquired Korshunov Mining Plant. Both mines produce a magnetite ore (Fe<sub>3</sub>O<sub>4</sub>) and the washing plant produces iron ore concentrate with a standard iron content of 62%. Product is shipped by rail to domestic customers as well as for export sales. All of the sites are served by regional public highways and a nearby federal motorway. The area is served by the Baikal-Amur Mainline, which connects the Trans-Siberian Mainline with China and Yakutia.

The table below sets forth certain information regarding the subsoil licenses for our iron ore mines, all of which are held by our subsidiary Korshunov Mining Plant.

| <b>Mine</b> | <b>License (plot)</b> | <b>Status<sup>(1)</sup></b> |
|-------------|-----------------------|-----------------------------|
|-------------|-----------------------|-----------------------------|

|                       |                        | <b>Area<br/>(sq. km)</b> | <b>Mining<br/>Method</b> | <b>License<br/>Expiry<br/>Date</b> |               | <b>Year<br/>Production<br/>Commenced</b> | <b>Surface<br/>Land Use<br/>Rights</b> |
|-----------------------|------------------------|--------------------------|--------------------------|------------------------------------|---------------|--|--|
| Korshunovsky Open Pit | 03333<br>(Korshunovsk) | 4.3                      | Open pit                 | Apr 2019                           | In production | 1965                                     | Lease                                  |
| Rudnogorsky Open Pit  | 03334<br>(Rudnogorsk)  | 5.3                      | Open pit                 | Jan 2028                           | In production | 1984                                     | Ownership                              |

(1) In production refers to sites that are currently producing iron ore.



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The table below summarizes our ROM iron ore and iron ore concentrate production for the periods indicated.

| Mine                            | 2016                                   |                 | 2015   |                 | 2014   |                 |
|---------------------------------|--|-----------------|--------|-----------------|--------|-----------------|
|                                 | Tonnes                                 | Grade<br>(% Fe) | Tonnes | Grade<br>(% Fe) | Tonnes | Grade<br>(% Fe) |
|                                 | (In millions of tonnes) <sup>(1)</sup> |                 |        |                 |        |                 |
| Korshunovsky Open Pit           | 4.1                                    | 23.6%           | 3.3    | 24.2%           | 4.8    | 23.5%           |
| Rudnogorsky Open Pit            | 4.1                                    | 27.9%           | 4.5    | 30.6%           | 4.4    | 29.6%           |
| Total ore production            | 8.2                                    | 25.8%           | 7.8    | 27.9%           | 9.2    | 26.4%           |
| Iron ore concentrate production | 2.7                                    | 62.8%           | 2.7    | 63.2%           | 3.2    | 63.2%           |

(1) Volumes are reported on a wet basis.

In 2011-2012, we obtained subsoil licenses for three iron ore deposits: the Pionerskoye deposit, the Sivaglinskoye deposit and the Sutamskaya area which are held by Yakutugol. The Pionerskoye deposit is located in Yakutia about 127 kilometers from the town of Neryungri. The area is well connected to the regional transportation network with a federal motorway located 5 kilometers to the east of the deposit. The Sivaglinskoye deposit is 120 kilometers away from Neryungri and located close to the Pionerskoye deposit. The Sutamskaya area is located 210 kilometers south-east of Neryungri. These deposits contain high-quality iron ore, which will allow to produce iron ore concentrate with 65% iron content.

The table below sets forth certain information regarding the subsoil licenses for our iron ore deposits, all of which are held by our subsidiary Yakutugol.

| Deposit         | License (plot)             | Area<br>(sq. km) | Mining<br>Method | License<br>Expiry<br>Date | Status <sup>(1)</sup> | Year                    | Surface            |
|-----------------|----------------------------|------------------|------------------|---------------------------|-----------------------|-------------------------|--------------------|
|                 |                            |                  |                  |                           |                       | Production<br>Commenced | Land Use<br>Rights |
| Pionerskoye     | 03034 (Pionersk)           | 9.95             | Open pit         | Aug 2031                  | Exploration           | n/a                     | Lease              |
| Sivaglinskoye   | 03153 (Sivaglinsk)         | 2.23             | Open pit         | Mar 2022                  | Exploration           | n/a                     | Lease              |
| Sutamskaya area | 03158<br>(Sutamskaya area) | 731.32           | Open pit         | Mar 2037                  | No activity           | n/a                     |                    |

(1) Exploration refers to sites where drilling for calculation of mineral reserves is being carried out.

**Sales of mining segment products**

The following table sets forth sales of mining segment products (by volume) and as a percentage of total sales of these products (including intra-group sales) for the periods indicated.

| <b>Product</b>           | <b>2016</b>                                   | <b>2015</b> | <b>2014</b> | <b>2016</b>  | <b>2015</b> | <b>2014</b> |
|--------------------------|---|-------------|-------------|--|-------------|-------------|
|                          | <b>(In thousands of tonnes)<sup>(1)</sup></b> |             |             | <b>(% of total sales,<br/>including intra-group)</b> |             |             |
| Coking coal concentrate  | 5,784.0                                       | 5,246.0     | 7,777.4     | 66.8%  | 63.9%       | 77.1%       |
| Steam coal and middlings | 5,927.2                                       | 4,880.3     | 4,375.6     | 84.7%  | 74.4%       | 74.6%       |
| PCI and Anthracite       | 3,139.0                                       | 4,066.7     | 4,996.1     | 92.6%  | 94.0%       | 96.6%       |
| Iron ore concentrate     | 26.3  | 488.9       | 1,168.7     | 1.0%   | 17.4%       | 37.5%       |
| Coke                     | 893.5   | 984.8       | 1,262.0     | 31.5%  | 33.8%       | 39.0%       |
| Chemical products        | 146.3   | 154.7       | 173.0       | 96.4%  | 98.8%       | 99.7%       |

(1) Includes resale of mining segment products purchased from third parties.

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The following table sets forth revenues by product, as further divided between domestic sales and exports (including as a percentage of total mining segment revenues) for the periods indicated. We define exports as sales by our Russian and foreign subsidiaries to customers located outside their respective countries. We define domestic sales as sales by our Russian and foreign subsidiaries to customers located within their respective countries. See note 27 to the consolidated financial statements.

| Product   | 2016            |               | 2015            |               | 2014            |               |
|---|-----------------|---------------|-----------------|---------------|-----------------|---------------|
|   | Amount          | % of Revenues | Amount          | % of Revenues | Amount          | % of Revenues |
| (In millions of Russian rubles, except for percentages) |                 |               |                 |               |                 |               |
| Coking coal concentrate                                 | 38,743.9        | 43.2%         | 27,209.6        | 33.7%         | 30,645.3        | 38.5%         |
| Domestic Sales  | 21.6%           |               | 28.0%           |               | 17.5%           |               |
| Export  | 78.4%           |               | 72.0%           |               | 82.5%           |               |
| Steam coal  | 12,587.3        | 14.1%         | 7,236.0         | 9.0%          | 4,337.1         | 5.5%          |
| Domestic Sales  | 17.1%           |               | 30.0%           |               | 37.6%           |               |
| Export  | 82.9%           |               | 70.0%           |               | 62.4%           |               |
| PCI and Anthracite                                      | 18,737.1        | 20.9%         | 24,989.9        | 31.0%         | 22,411.6        | 28.2%         |
| Domestic Sales  | 1.3%            |               | 1.3%            |               | 0.8%            |               |
| Export  | 98.7%           |               | 98.7%           |               | 99.2%           |               |
| Middlings   | 5,189.8         | 5.8%          | 4,750.5         | 5.9%          | 4,990.6         | 6.3%          |
| Domestic Sales  | 68.0%           |               | 55.2%           |               | 46.9%           |               |
| Export  | 32.0%           |               | 44.8%           |               | 53.1%           |               |
| Coke  | 9,341.5         | 10.4%         | 9,428.9         | 11.7%         | 8,427.0         | 10.6%         |
| Domestic Sales  | 64.1%           |               | 53.9%           |               | 62.0%           |               |
| Export  | 35.9%           |               | 46.1%           |               | 38.0%           |               |
| Chemical products                                       | 1,988.0         | 2.2%          | 2,327.4         | 2.9%          | 2,421.9         | 3.0%          |
| Domestic Sales  | 54.8%           |               | 55.4%           |               | 84.5%           |               |
| Export  | 45.2%           |               | 44.6%           |               | 15.5%           |               |
| Iron ore concentrate                                    | 125.9           | 0.1%          | 1,844.0         | 2.3%          | 4,010.7         | 5.0%          |
| Domestic Sales  | 100.0%          |               | 7.6%            |               | 52.9%           |               |
| Export  | 0.0%            |               | 92.4%           |               | 47.1%           |               |
| Other <sup>(1)</sup>                                    | 2,934.6         | 3.3%          | 2,846.0         | 3.5%          | 2,264.4         | 2.9%          |
| <b>Total</b>  | <b>89,648.1</b> | <b>100.0%</b> | <b>80,632.3</b> | <b>100.0%</b> | <b>79,508.6</b> | <b>100.0%</b> |
| Domestic Sales  | 25.4%           |               | 25.9%           |               | 26.1%           |               |
| Export  | 74.6%           |               | 74.1%           |               | 73.9%           |               |

(1) Includes revenues from transportation, distribution, construction and other miscellaneous services provided to local customers.

**Marketing and distribution**

In 2016, our Russian domestic sales were conducted directly by our own production facilities and our export sales were conducted by Mechel Carbon, based in Baar, Switzerland. We generally do not involve traders in the sales and distribution of our mining products and we have had long-standing relationships with end users of our mining

products.

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The following table sets forth percentage of sales by the regions in which our mining segment products were sold for the periods indicated.

| <b>Region<sup>(1)</sup></b> | <b>2016</b> | <b>2015</b> | <b>2014</b> |
|-----------------------------|-------------|-------------|-------------|
| Asia                        | 58.2%       | 47.5%       | 49.4%       |
| Russia                      | 25.4%       | 25.9%       | 26.1%       |
| Europe                      | 11.3%       | 19.6%       | 15.1%       |
| CIS                         | 2.1%        | 2.7%        | 5.5%        |
| Middle East <sup>(2)</sup>  | 0.8%        | 3.2%        | 2.9%        |
| United States               | 0.3%        | 0.3%        | 0.1%        |
| Other                       | 1.9%        | 0.8%        | 0.9%        |
| Total                       | 100.0%      | 100.0%      | 100.0%      |

(1) The regional breakdown of sales is based on the geographic location of our customers, and not on the location of the end users of our products, as our customers are often distributors that resell and, in some cases, further export our products.

(2) Includes Turkey, the United Arab Emirates and Saudi Arabia.

The following table sets forth information about the five largest customers of our mining segment, which together accounted for 35.7% of our total mining segment sales in 2016.

| <b>Customer</b>      | <b>% of Total Mining Segment Sales</b> | <b>Product</b>          | <b>% of Total Products Sales</b> |
|----------------------|--|-------------------------|----------------------------------|
| POSCO                | 11.1%                                  | Coking coal concentrate | 15.5%                            |
|                      |  | PCI and Anthracite      | 21.1%                            |
| Batek Resources      | 7.5%                                   | Steam coal              | 44.8%                            |
|                      |  | Middlings               | 20.8%                            |
|                      |  | Coking coal concentrate | 0.01%                            |
| ArcelorMittal        | 5.9%                                   | PCI and Anthracite      | 28.4%                            |
| Shunshun Development | 5.7%                                   | Coking coal concentrate | 13.2%                            |
| Sojitz Corporation   | 5.5%                                   | Coking coal concentrate | 9.6%                             |
|                      |  | PCI and Anthracite      | 5.6%                             |
|                      |  | Steam coal              | 1.2%                             |

*Domestic sales*

We ship our coking coal concentrate from our coal washing facilities, located near our coal mines, by railway directly to our customers, including steel producers. In 2016, our largest domestic customer for our coking coal concentrate was Severstal, accounting for 7.7% of our total coking coal concentrate sales and 3.3% of our total mining segment sales.

We sell coking coal concentrate domestically on the basis of annual framework contracts with monthly or quarterly adjustments to price and quantity.

We ship our steam coal from our warehouses by railway directly to our customers, which are predominantly electric power stations. Our supply contracts for steam coal are generally concluded with customers on a long-term basis with quantities and prices either fixed for the whole term or adjusted monthly. Some of our steam coal is consumed within our group; for example, sales of steam coal and middlings from our Southern Kuzbass Coal Company to our Southern Kuzbass Power Plant were 853.7 million rubles in 2016. In total, 364.9 thousand tonnes of steam coal was sold within our group in 2016. SUE HCS Sakha Republic (Yakutia) is our largest domestic customer of steam coal, accounting for 10.8% of our total steam coal sales and 1.5% of our total mining segment sales in 2016.

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Iron ore concentrate is shipped via railway directly from our Korshunov Mining Plant to customers. In 2016, iron ore concentrate was sold primarily within our group. We set our prices on a monthly basis which is in line with the current practice in the Russian market of iron ore feed.

The majority of coke is sold domestically to our subsidiaries Chelyabinsk Metallurgical Plant and Bratsk Ferroalloy Plant, which accounted for 68.2% of our total coke sales (including intra-group sales) by volume in 2016. Major third party customers include pig iron, steel and ferroalloy producers located in the Central Region and in the Urals of Russia. Sales in Russia are conducted pursuant to framework agreements with monthly adjustments of quantities and prices.

Our subsidiary Mecheltrans is a railway freight forwarding company, which owns its own rail rolling stock, consisting of 2,130 open cars and 57 pellet cars, and leases 3,924 open cars, 135 hopper pellet cars and 203 dumpcars under operating leases and 4,984 open cars under finance leases. In 2016, Mecheltrans transported domestically approximately 27.4 million tonnes of our cargo, approximately 68.1% of which was comprised of coal and iron ore concentrate.

*Export sales*

We export coking coal concentrate, PCI and anthracite, coke and steam coal.

In 2016, the largest foreign customer of our mining segment was POSCO, accounting for 11.1% of our total mining segment sales. POSCO purchases consisted of PCI and coking coal concentrate.

We were Russia's second largest exporter of coking coal concentrate in 2016, according to MMI. Our exports of coking coal concentrate are primarily to China, Japan and South Korea. In 2016, POSCO, Shunshun Development (Hongkong) Co. Ltd., Baosteel Group Corporation, Sojitz Corporation and JFE Steel Corporation were our largest foreign customers of coking coal concentrate, accounting for 52.6% of our total coking coal concentrate sales and 22.7% of our total mining segment sales. Shipments are made by rail to seaports and further by sea, except for shipments to Poland and northeast China that are made only by rail.

Our exports of PCI and anthracite are primarily to Europe, South Korea, Japan and China, which together accounted for 81.6% of our total PCI and anthracite sales and 17.0% of our total mining segment sales in 2016. In 2016, our largest foreign customers of PCI and anthracite were ArcelorMittal, POSCO, Sumitomo Corporation, Sojitz Corporation and International Coke and Ferro-Alloys Company.

Our exports of steam coal are primarily to China, South Korea and Japan, which together accounted for 79.9% of our total steam coal sales and 11.2% of our total mining segment sales in 2016. In 2016, our largest foreign customers of steam coal were Batek Resources Limited, Rizhao Shenghe Trading Co., Ltd., Shandong Huanxin Products, LG International and LS Networks Co., Ltd.

PCI, anthracite and steam coal are shipped to customers from our warehouses by railway and further by sea from Russian and Baltic ports.

In 2016, we used annual contracts for export sales of coal. Coal not shipped under annual contracts was sold on the spot market primarily to Chinese customers.

We export coke, including coke breeze, primarily to Europe, which accounted for 22.7% of our total coke sales and 2.4% of our total mining segment sales in 2016.

From Port Posiet we ship primarily coking coal concentrate, steam coal and PCI to Japan, South Korea and China. In 2016, our Port Posiet processed 7.1 million tonnes of coal; its warehousing capacity is limited to 200 thousand tonnes per month for one-time storage of no more than four grades of coal. In order to expand the



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cargo-handling capacity of the port we constructed a modern transshipment complex and put into operation a mechanized coal loosening complex. The first stage of the Port Posiet's modernization enabled us to expand the cargo-handling capacity of the port up to 7.0 million tonnes per annum in 2016. Further modernization envisages the construction of deepwater berth and approach channel, as well as shiploader. The port's proximity to roads and rail links to key product destinations and transshipment points in China and Russia make it a cost-effective link in the logistical chain for bringing our coal products to the market.

In 2016, Mecheltrans transported for export approximately 13.7 million tonnes of our cargo, approximately 85.5% of which was comprised of coal.

**Market share and competition***Coal*

According to the Central Dispatching Department, in 2016, the Russian coal mining industry was represented by 181 companies, which operated 66 underground mines and 115 open pit mines. As a result of the privatization of 1990s and subsequent mergers and acquisitions, the Russian coal mining industry has become more concentrated. Based on the Central Dispatching Department's data and our estimates, the ten largest coal mining companies in Russia produced approximately 74.4% of the overall coal production volume in 2016.

According to data from the Central Dispatching Department, companies' websites and our estimates, in 2016, we were the second largest coking coal producer in Russia, with an approximately 18.5% share of total production by volume, and we had a 5.9% market share with respect to overall Russian coal production by volume. The following table lists the main Russian coking coal producers in 2016, the industrial groups to which they belong, their coking coal production volumes and their share of total Russian production volume.

| <b>Group</b>       | <b>Company</b>                    | <b>Coking Coal Production (Thousands of Tonnes)</b> | <b>% of Coking Coal Production by Volume</b> |
|--------------------|-----------------------------------|---|--|
| EVRAZ plc          | Yuzhkuzbassugol Coal Company OAO  | 11,183  | 13.2%  |
|                    | Raspadskaya PAO                   | 10,512  | 12.4%  |
|                    | EVRAZ Total                       | 21,695  | 25.6%  |
| Mechel PAO         | Yakutugol JSHC                    | 8,899   | 10.5%  |
|                    | Southern Kuzbass Coal Company PAO | 3,887   | 4.6%   |
|                    | Elgaugol OOO                      | 2,849   | 3.4%   |
|                    | Mechel Total                      | 15,635  | 18.5%  |
| Severstal PAO      | Vorkutaugol AO                    | 9,455   | 11.2%  |
| SUEK AO            | SUEK-Kuzbass AO                   | 7,086   | 8.4%   |
|                    | Arcticheskie razrabotki OOO       | 96  | 0.1%   |
|                    | SUEK Total                        | 7,182   | 8.5%   |
| Sibuglemet Holding | Mezhdurechye AO                   | 4,289   | 5.1%   |
|                    | Bolshevik Mine AO                 | 1,561   | 1.8%   |
|                    | Antonovskaya Mine AO              | 852   | 1.0%   |

|       |                  |        |        |
|-------|------------------|--------|--------|
|       | Sibuglemet Total | 6,702  | 7.9%   |
| Other |                  | 23,899 | 28.3%  |
| Total |                  | 84,568 | 100.0% |

Source: Central Dispatching Department, companies' websites and our estimates.

According to Metal Expert, in 2016, we were the eighth largest steam coal producer in Russia, with a 1.9% share of total production by volume. The main Russian steam coal producers that occupy a substantial share in

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the Russian steam coal industry include SUEK, UMMC (Kuzbassrazrezugol Coal Company) and SDS-Coal, accounting for 58.6% of total steam coal production in 2016, according to Metal Expert.

In the domestic coal market, we compete primarily on the basis of price, as well as on the basis of the quality of coal, which in turn depends upon the quality of our production assets and the quality of our mineral reserves. Competition in the steam coal market is also affected by the fact that most steam power stations were built near specific steam coal sources and had their equipment customized to utilize the particular type of coal produced at the relevant local source. Outside of Russia, competition in the steam coal market is largely driven by coal quality, including volatile matter and calorie content.

*Iron ore*

The Russian iron ore market is generally characterized by high demand and limited sources of supply, with product quality as the main factor driving prices. According to Metal Expert, the market is dominated by relatively few producers, with the top three mining groups being Metalloinvest, Severstal and NLMK, representing 70.3% of total production of iron ore concentrate. We were sixth in production volume in 2016 with 2.7 million tonnes of iron ore concentrate, representing 2.7% of total production of iron ore concentrate in Russia.

*Mineral reserves*

Our coal and iron ore reserves are based on exploration drilling and geological data, and are that part of a mineral deposit which could be economically and legally extracted or produced at the time of the reserve determination. Each year we update our reserve calculations based on actual production and other factors, including economic viability and any new exploration data. Our coal and iron ore reserves are presented in accordance with the criteria for internationally recognized reserve and resource categories of the Australasian Code for Reporting Mineral Resources and Ore Reserves (as amended) published by the Joint Ore Reserves Committee ( **JORC** ) of the Australasian Institute of Mining and Metallurgy, Australian Institute of Geoscientists and the Minerals Council of Australia (the **JORC Code** ), and meet the standards set by the SEC in its Industry Guide 7. Information on our mineral reserves has been prepared by our internal mining engineers as of December 31, 2016. To prepare this information our internal mining engineers used resource and reserve estimates, actual and forecast production, operating costs, capital costs, geological plan maps, geological cross sections, mine advance maps in plan and cross section and price projections.

Our coal and iron ore reserve estimates contained herein inherently include a degree of uncertainty and depend to some extent on geological assumptions and statistical inferences which may ultimately prove to have been unreliable. Consequently, reserve estimates should be regularly revised based on actual production experience or new information and should therefore be expected to change. Notably, should we encounter mineralization or formations different from those predicted by past drilling, sampling and similar examinations, reserve estimates may have to be adjusted and mining plans may have to be altered in a way that might adversely affect our operations. Moreover, if the price of metallurgical coal, steam coal or iron ore declines, or stabilizes at a price lower than recent levels, or if production costs increase or recovery rates decrease, it may become uneconomical to recover reserves containing relatively lower grades of mineralization and consequently our reserves may decrease. Conversely, should the price of metallurgical coal, steam coal or iron ore stabilize at a materially higher price than currently assumed, or if production costs decrease or recovery rates increase, it may become economical to recover material at lower grades than that assumed here and consequently our reserves may increase.

The calculation of our reserves in Russia is based on the expected operational life of each deposit based on life-of-mine plans, which in many cases exceed the relevant license period for the deposit. Russian subsoil licenses are issued for defined boundaries and specific periods, generally about 20 years. Our declared reserves are contained

within the current license boundary. Our Russian subsoil licenses expire on dates falling in 2019

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through 2037. However, in many cases, the life of the deposit is well beyond the license term. Based on Russian law and practice, as evidenced by our experience and publicly available information, including a number of court cases, it is reasonably likely that an incumbent subsoil user will be granted license extension through the end of the expected operational life of the deposit, provided that the licensee is not in violation of the material terms of the license. The cost for the license extension is not substantial. See [Regulatory Matters Subsoil Licensing in Russia Extension of licenses](#). We have received extension of certain of our subsoil licenses which expired and we intend to extend the licenses for all deposits expected to remain productive subsequent to their license expiry dates. However, license extension is not guaranteed and is to a certain extent subject to the discretion of regulatory authorities. See [Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry](#) Our business could be adversely affected if we fail to obtain or extend necessary subsoil licenses and permits or fail to comply with the terms of our subsoil licenses and permits, [Item 3. Key Information Risk Factors Risks Relating to the Russian Federation Legal risks and uncertainties](#) Deficiencies in the legal framework relating to subsoil licensing subject our licenses to the risk of governmental challenges and, if our licenses are suspended or terminated, we may be unable to realize our reserves, which could materially adversely affect our business, financial condition, results of operations and prospects and [Regulatory Matters Subsoil Licensing in Russia](#).

As of December 31, 2016, we had coal reserves totaling 3,029.9 million tonnes, of which approximately 75% was coking coal. The table below summarizes our coal reserves as of December 31, 2016.

| Company                       | Proved Reserves <sup>(1)</sup> | Probable Reserves <sup>(1)</sup> | Total     | % in Open Pit |
|-------------------------------|--------------------------------|----------------------------------|-----------|---------------|
|                               | (In thousands of tonnes)       |                                  |           |               |
| Yakutugol                     | 197,537                        | 555                              | 198,092   | 100.0%        |
| Elgaugol                      | 1,736,051                      | 503,461                          | 2,239,512 | 100.0%        |
| Southern Kuzbass Coal Company | 566,405                        | 25,849                           | 592,254   | 74.1%         |
| Total                         | 2,499,993                      | 529,865                          | 3,029,858 | 94.9%         |

(1) Reserves include adjustments for loss and dilution modifying factors.

The table below summarizes our reserves by coal type as of December 31, 2016.

| Company   | Category | Coking Coal              | Steam Coal | Anthracite | Lignite | Total <sup>(1)</sup> |
|-----------|----------|--------------------------|------------|------------|---------|----------------------|
|           |          | (In thousands of tonnes) |            |            |         |                      |
|           | Proved   | 105,133                  | 9,293      | 0          | 83,111  | 197,537              |
|           | Probable | 263                      | 292        | 0          | 0       | 555                  |
| Yakutugol | Total    | 105,396                  | 9,585      | 0          | 83,111  | 198,092              |
|           | Proved   | 1,475,278                | 260,773    | 0          | 0       | 1,736,051            |
|           | Probable | 462,257                  | 41,204     | 0          | 0       | 503,461              |
| Elgaugol  | Total    | 1,937,535                | 301,977    | 0          | 0       | 2,239,512            |
|           | Proved   | 209,551                  | 242,275    | 114,579    | 0       | 566,405              |
|           | Probable | 18,529                   | 7,217      | 103        | 0       | 25,849               |

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|                               |          |           |         |         |        |           |
|-------------------------------|----------|-----------|---------|---------|--------|-----------|
| Southern Kuzbass Coal Company | Total    | 228,080   | 249,492 | 114,682 | 0      | 592,254   |
|                               | Proved   | 1,789,962 | 512,341 | 114,579 | 83,111 | 2,499,993 |
|                               | Probable | 481,049   | 48,713  | 103     | 0      | 529,865   |
| Total                         |          | 2,271,011 | 561,054 | 114,682 | 83,111 | 3,029,858 |

(1) Reserves include adjustments for loss and dilution modifying factors.

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The table below sets forth reserves attributable to our Yakutugol mines as of December 31, 2016.

| Mine   | Proved Reserves          | Probable Reserves | Total <sup>(1)(2)</sup> | Heat Value <sup>(3)</sup> | % Sulfur    |
|--|--------------------------|-------------------|-------------------------|---------------------------|-------------|
|  | (In thousands of tonnes) |                   |                         | (In kcal/kg)              |             |
| Neryungrinsky Open Pit <sup>(4)(5)</sup>       | 111,610                  | 555               | 112,165                 | 8,794                     | 0.11 - 0.30 |
| Kangalassky Open Pit <sup>(6)</sup>            | 83,111                   | 0                 | 83,111                  | 6,834                     | 0.40        |
| Dzhebariki-Khaya Underground <sup>(6)(7)</sup> | 0                        | 0                 | 0                       |                           |             |
| Dzhebariki-Khaya Open Pit <sup>(8)</sup>       | 2,816                    | 0                 | 2,816                   | 7,470                     | 0.22        |
| <b>Total</b>                                   | <b>197,537</b>           | <b>555</b>        | <b>198,092</b>          |                           |             |

- (1) Reserves reported on a wet in-situ basis and include adjustments for loss and dilution modifying factors.
- (2) In estimating the reserves, we used the following average prices: \$69 per tonne (FCA basis) for coking coal concentrate and \$38 per tonne (FCA basis) for raw steam coal.
- (3) Heat value is reported on a moisture- and ash-free basis.
- (4) In 2016, revised estimation of reserves under Russian standards was conducted which led to the increase in reserves by 8,243 thousand tonnes.
- (5) Mined coking coal is processed at Neryungrinskaya Washing Plant with a weighted average yield of coking coal concentrate of 63%.
- (6) Coal is sold as ROM without processing.
- (7) Coal mining by underground methods was completed due to economic unviability.
- (8) Reserves for open pit mining operations were re-estimated under Russian standards.

The table below sets forth reserves attributable to our Elgaugol mine as of December 31, 2016.

| Mine                         | Proved Reserves          | Probable Reserves | Total <sup>(1)(2)</sup> | Heat Value <sup>(3)</sup> | % Sulfur |
|------------------------------|--------------------------|-------------------|-------------------------|---------------------------|----------|
|                              | (In thousands of tonnes) |                   |                         | (In kcal/kg)              |          |
| Elga Open Pit <sup>(4)</sup> | 1,736,051                | 503,461           | 2,239,512               | 7,000-8,600               | 0.25     |
| <b>Total</b>                 | <b>1,736,051</b>         | <b>503,461</b>    | <b>2,239,512</b>        |                           |          |

- (1) Reserves reported on a wet in-situ basis and include adjustments for loss and dilution modifying factors.
- (2) In estimating the reserves, we used the following average prices: \$78 per tonne (FCA basis) for coking coal concentrate and \$19 per tonne (FCA basis) for raw steam coal.
- (3) Heat value is reported on a moisture- and ash-free basis.
- (4) Mined coking coal is processed at Elginskaya Washing Plant and Sibir Washing Plant with a weighted average yield of coking coal concentrate of 42% and 56%, respectively.

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The table below sets forth reserves attributable to our Southern Kuzbass mines as of December 31, 2016.

| Mine  | Proved         | Probable      | Total <sup>(1)(2)(3)(4)</sup> | Heat                 | % Sulfur |
|---|----------------|---------------|-------------------------------|----------------------|----------|
|   | Reserves       | Reserves      |                               | Value <sup>(5)</sup> |          |
|   |                |               | (In thousands of tonnes)      | (In kcal/kg)         |          |
| Krasnogorsky Open Pit   | 198,352        | 194           | 198,546                       | 8,100                | 0.33     |
| Olzherassky Open Pit  | 54,595         | 5,963         | 60,558                        | 8,363                | 0.30     |
| Tomusinsky Open Pit   | 7,556          | 4,400         | 11,956                        | 8,390                | 0.30     |
| Sibirginsky Open Pit  | 167,856        | 45            | 167,901                       | 8,530                | 0.30     |
| Sibirginskaya Underground                                     | 38,918         | 4,024         | 42,942                        | 8,477                | 0.28     |
| V.I. Lenina Underground                                       | 28,096         | 11,223        | 39,319                        | 8,436                | 0.35     |
| Olzherasskaya-Novaya Underground                              | 34,049         | 0             | 34,049                        | 7,912                | 0.20     |
| Yerunakovskaya-1 Underground (project)                        | 36,983         | 0             | 36,983                        | 8,150                | 0.50     |
| Yerunakovskaya-3 Underground (prospect) <sup>(6)</sup>        |                |               |                               |                      |          |
| Yerunakovskaya-2 Underground (prospect) <sup>(6)</sup>        |                |               |                               |                      |          |
| Olzherasskaya-Glubokaya Underground (prospect) <sup>(6)</sup> |                |               |                               |                      |          |
| Usinskaya Underground (prospect) <sup>(6)</sup>               |                |               |                               |                      |          |
| <b>Total</b>  | <b>566,405</b> | <b>25,849</b> | <b>592,254</b>                |                      |          |

- (1) Reserves reported on a wet in-situ basis and include adjustments for loss and dilution modifying factors.
- (2) In estimating the reserves, we used the following average prices (FCA basis): \$60 per tonne for coking coal concentrate, \$62 per tonne for anthracite, \$36 per tonne for PCI and \$16 per tonne for raw steam coal.
- (3) Reserves are presented on an assumed 100% basis.
- (4) Mined coal is processed at Sibir Washing Plant, Kuzbasskaya Washing Plant, Tomusinskaya Washing Plant, Sibirginskaya Processing Unit and Krasnogorskaya Washing Plant with a weighted average yield of concentrate of 68%, 72%, 60%, 24% and 52%, respectively.
- (5) Heat value is reported on a moisture- and ash-free basis.
- (6) Not considered in the review because these prospects presently do not have mine plans.

As of December 31, 2016, we had iron ore reserves (proved and probable) totaling 154.6 million tonnes at an average iron grade of 26.4%. The table below summarizes iron ore reserves by mine as of December 31, 2016.

| Mine                  | Proved        | Probable      | Total <sup>(1)(2)(3)</sup> | Grade (Fe %) <sup>(4)</sup> |
|-----------------------|---------------|---------------|----------------------------|-----------------------------|
|                       | Reserves      | Reserves      |                            |                             |
|                       |               |               | (In thousands of tonnes)   |                             |
| Korshunovsky Open Pit | 53,636        | 35,233        | 88,869                     | 23.7                        |
| Rudnogorsky Open Pit  | 38,279        | 27,472        | 65,751                     | 30.7                        |
| <b>Total</b>          | <b>91,915</b> | <b>62,705</b> | <b>154,620</b>             | <b>26.4</b>                 |



- (1) Reserves reported on a wet in-situ basis and include adjustments for loss and dilution modifying factors.
- (2) In estimating the reserves, we used the average price of \$35 per tonne (FCA basis) for iron ore concentrate.
- (3) Reserves are presented on an assumed 100% basis.
- (4) Mined iron ore is processed at Korshunovskaya Washing Plant with a weighted average yield of iron ore concentrate within the range of 32-35%.

**Steel Segment**

Our steel segment comprises the production and sale of semi-finished steel products, long products of a wide range of steel grades, carbon and stainless flat steel products and high value-added metal products, including wire products, stampings and forgings, structural shapes, beams and rails. Within these product groups, we are further able to tailor various steel grades to meet specific end-user requirements. Our steel segment is supported by our mining segment, which includes coke and iron ore concentrate.

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Our steel segment has production facilities in Russia and Lithuania. Our total steel output was 4.3 million tonnes in 2016, 4.3 million tonnes in 2015 and 4.3 million tonnes in 2014.

In 2014, we transferred our ferrosilicon producing subsidiary Bratsk Ferroalloy Plant to the steel segment. Bratsk Ferroalloy Plant's ferrosilicon production amounted to 88.5 thousand tonnes in 2016, 92.9 thousand tonnes in 2015 and 90.8 thousand tonnes in 2014.

***Description of key products***

*Pig iron.* Pig iron is an iron alloy with usual carbon content of above 2% which is produced from smelting iron ore feed (sinter, pellets and other ore materials) in the blast furnace. Liquid pig iron is used as an intermediate product in the manufacturing of steel. Pig iron in molten state and cold pig iron can be used as charging material for steel manufacturing in basic oxygen furnaces, electric arc furnaces and in the manufacturing of cast iron in cupolas. Cold pig iron is brittle. We sell small volumes of pig iron from our Chelyabinsk Metallurgical Plant to third parties.

*Semi-finished products.* Semi-finished products typically require further milling before they are useful to end consumers. We offer semi-finished billets, blooms and slabs. Billets and blooms are precursors to long products and have a square cross section. The difference between billets and blooms is that blooms have a larger cross-section which is more than eight inches and is broken down in the mill to produce rails, I-beams, H-beams and sheet piling. Slabs are precursors to flat products and have a rectangular cross section. Such types of products can be produced both by continuous casting of liquid steel and by casting of liquid steel in casting forms with subsequent drafting on blooming mills. We offer our customers billets and blooms produced by Izhstal and Chelyabinsk Metallurgical Plant, as well as slabs produced by Chelyabinsk Metallurgical Plant.

*Long steel products.* Long steel products are rolled products used in many industrial sectors, particularly in the construction and engineering industries. They include various types of products, for example, rebar, calibrated long steel products and wire rod, which could be supplied both in bars and coils in a wide range of sizes. Our long steel products are manufactured at Chelyabinsk Metallurgical Plant, Izhstal and Beloretsk Metallurgical Plant.

We offer our customers a wide selection of long products produced from various steel grades, including rebar, calibrated long steel products, steel angles, round products, surface-conditioned steel products, wire rod and others.

*Flat steel products.* Flat steel products are manufactured by multiple drafting slabs in forming rolls with subsequent coiling or cutting into sheets. Plates are shipped after hot rolling or heat treatment. Coiled stock can be subject to cutting lengthwise into slit coils or crosswise into sheets. Stainless steel is used to manufacture plates and cold-rolled sheets in coils and flat sheets. Hot-rolled plates and carbon and alloyed coiled rolled products are manufactured at Chelyabinsk Metallurgical Plant.

*Stampings and forgings.* Stampings are special parts stamped from metal billets. Forgings are special products made through the application of localized compressive forces to metal. Forged metal is stronger than cast or machined metal. Our forgings and stampings are offered on a made-to-order basis according to minimum batches depending on the products' sizes. Our product offerings include rollers and axles used in vehicle manufacturing; gears and wheels; bars; and others. Our stampings and forgings are produced at Urals Stampings Plant, including its branch in Chelyabinsk.

*Wire products.* Wire products are the result of processing of wire rod which are ready for use in manufacturing and consumer applications. Our wire products are manufactured at Beloretsk Metallurgical Plant, Vyartsilya Metal Products Plant and Izhstal in Russia and Mechel Nemunas in Lithuania. Our wide-ranging wire products line includes

spring wire; rope wire; bearing wire; microwire; precision alloy wire; high and low carbon

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concrete reinforcing wire; galvanized wire; copper-coated and bright welding wire; strand of various application; various types of nails; steel wire ropes specially engineered for the shipping, aerospace, oil and gas and construction industries; steel wire ropes for passenger and freight elevators; general-purpose wire; steel straps and clips; chain link fences; welded (reinforcing) meshes; and others.

*Ferrosilicon.* Ferrosilicon is used in ferrous metallurgy as a deoxidizer or as an alloying element for production of electrotechnical, spring wire, corrosion-resistant and heat resistant steel grades, or as a pig iron modifier. In nonferrous metallurgy, ferrosilicon is used as a reducing agent for production of nonferrous metals and alloys. We produce two types of ferrosilicon: with 65% and 75% silicon content in the alloy. We offer our customers ferrosilicon produced by Bratsk Ferroalloy Plant.

The following table sets out our production volumes by primary steel product categories and main products within these categories.

| <b>Product</b>                                | <b>2016</b>                     | <b>2015</b> | <b>2014</b> |
|---|---------------------------------|-------------|-------------|
|   | <b>(In thousands of tonnes)</b> |             |             |
| Pig Iron                                      | 4,053                           | 4,065       | 3,946       |
| Semi-Finished Steel Products, including:      | 936                             | 1,098       | 970         |
| Carbon and Low-Alloyed Semi-Finished Products | 926                             | 1,081       | 966         |
| Long Steel Products, including:               | 2,768                           | 2,463       | 2,721       |
| Stainless Long Products                       | 12                              | 12          | 14          |
| Alloyed Long Products                         | 127                             | 121         | 278         |
| Rebar   | 1,509                           | 1,543       | 1,575       |
| Wire Rod                                      | 249                             | 230         | 402         |
| Low-Alloyed Engineering Steel                 | 353                             | 557         | 452         |
| Flat Steel Products, including:               | 464                             | 481         | 435         |
| Stainless Flat Products                       | 6                               | 10          | 18          |
| Carbon and Low-Alloyed Flat Products          | 457                             | 471         | 417         |
| Forgings, including:                          | 41                              | 49          | 61          |
| Stainless Forgings                            | 3                               | 3           | 5           |
| Alloyed Forgings                              | 26                              | 34          | 39          |
| Carbon and Low-Alloyed Forgings               | 11                              | 11          | 17          |
| Stampings                                     | 75                              | 69          | 84          |
| Wire Products, including:                     | 602                             | 628         | 695         |
| Wire  | 549                             | 580         | 603         |
| Ropes   | 43                              | 37          | 45          |

***Steel manufacturing process and types of steel***

The most common steel manufacturing processes are production in a basic oxygen furnace ( **BOF** ) and production in an electric arc furnace ( **EAF** ).

In BOF steel manufacturing, steel is produced with less than 2% carbon content. The principal raw materials used to produce steel are liquid pig iron and scrap metal. The molten steel, depending on the products in which it will be used, undergoes additional refining and is mixed with manganese, nickel, chrome, titanium and other components to give it special properties. Approximately 72% of the world's steel output is made in BOFs, according to CRU.

In EAF steel manufacturing, steel is generally produced from remelted scrap metal. Heat to melt the scrap metal is supplied from high-voltage electricity that arcs within the furnace between graphite electrodes and the scrap metal. This process is suitable for producing almost all steel grades, including stainless steel; however, it is limited in its use for production of high-purity carbon steel. Approximately 28% of the world's steel output is made in EAFs, according to CRU.

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Steel products are broadly subdivided into two categories – flat and long products. Flat products are hot-rolled or cold-rolled coils and sheets that are used in the engineering, pipe and manufacturing industries, as well as in the white goods and automotive industries. Long products are used for construction-type applications (beams, rebar) and the engineering industry. To create flat and long products, molten steel is cast in continuous-casting machines or casting forms (molds). The molten steel crystallizes and turns into semi-finished products in the form of blooms, slabs or ingots. Ingots and blooms have a square cross-section and are used for further processing into long products. Slabs have a rectangular cross-section and are used to make flat products. All semi-finished products are rolled at high temperatures, a process known as hot rolling. They are drawn and flattened through rollers to give the metal the desired dimensions and strength properties. Some flat steel products go through an additional step of rolling without heating, a process known as cold rolling and is used to obtain certain mechanical properties of the steel. After cold rolling, annealing in reheating furnaces with cooling that stress-relieves the metal is periodically required. Oil may be applied to the metal surface for protection from rust.

The properties of steel (strength, solidity, plasticity, magnetization, corrosion-resistance) may be modified to render it suitable for its intended future use by the addition by smelting of small amounts of other metals into the structure of the steel, varying the steel's chemical composition. For example, the carbon content of steel can be varied in order to change its plasticity, or chrome and nickel can be added to produce stainless steel. Resistance to corrosion can be achieved through application of special coatings (including polymeric coatings), galvanization, copper coating or tinning, painting and other treatments.

***Ferrosilicon manufacturing process***

Ferrosilicon is produced in EAFs in a continuous ore smelting process. Silicon is reduced from quartzite with coke and coal carbon and alloyed with steel cutting iron. Ferrosilicon is discharged from the furnace periodically. After cooling, metal ingots are split and sorted into various commercial fractions.

***Steel segment production facilities***

Most of our metallurgical plants have obtained a certificate of quality under ISO international standards. For example, the main manufacturing processes at Chelyabinsk Metallurgical Plant, Izhstal, Beloretsk Metallurgical Plant and Urals Stampings Plant are ISO 9001:2008 certified.

***Chelyabinsk Metallurgical Plant***

Chelyabinsk Metallurgical Plant is an integrated steel mill which produces flat and long carbon and stainless steel products, rail and beam sections and semi-finished products. Semi-finished products are used for further processing in Russia or our internal needs. Chelyabinsk Metallurgical Plant also produces pig iron which is used in the manufacturing of steel. The plant sources all of its metallurgical coke needs from Mechel Coke and most of its iron ore concentrate needs from Korshunov Mining Plant. Its customer base is largely comprised of companies from the construction and railways construction and repair industries, as well as ferrous metallurgy. We acquired Chelyabinsk Metallurgical Plant in 2001.

Chelyabinsk Metallurgical Plant's principal production lines include a BOF workshop equipped with three converters; two EAF workshops equipped with EAFs of 100 and 125 tonnes, respectively; five concasting machines; a blooming mill for 200-320 millimeter billets; five long products rolling mills for 6.5-190 millimeter round bars and 75-156 millimeter square bars, wire rod, rebar steel, bands and long products; a universal rail and structural rolling mill for structural shapes of different types and sizes and rail products; a hot-rolled flat products workshop with a thick sheet continuous rolling mill for hot-rolled sheets of up to 1,800 millimeters wide and up to 20 millimeters thick; a

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semi-continuous rolling mill for up to 1,500 millimeters wide and up to 6 millimeters thick hot-rolled coils; a cold-rolled product workshop for 0.3-4 millimeter cold-rolled stainless sheet. In addition, we have at our Chelyabinsk Metallurgical Plant four sintering machines and three blast furnaces. The following

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table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for each of Chelyabinsk Metallurgical Plant's principal production areas.

| <b>Production Area</b> | <b>Capacity<br/>in 2016<br/>(In thousands of tonnes, except for percentages)</b> | <b>Capacity<br/>Utilization<br/>Rate in 2016</b> | <b>Planned<br/>Increase<br/>(2017-2019)</b> |
|------------------------|--|--|---|
| Sintering              | 5,252  | 94.2%  |   |
| Pig iron               | 4,300  | 94.3%  |   |
| Steel-making           | 5,177  | 76.6%  |   |
| Rolling                | 4,751  | 79.8%  |   |

Chelyabinsk Metallurgical Plant produced approximately 4.0 million tonnes of raw steel and 3.8 million tonnes of rolled products in 2016.

In 2008, we initiated construction of a universal rail and structural rolling mill at the Chelyabinsk Metallurgical Plant. The project is aimed at producing new types of large section structural shapes (including beams, angles, rails, channels and special sections) with total output 1.1 million tonnes per annum. Italian Danieli & C. Officine Meccaniche S.p.A. ( **Danieli** ) is the equipment supplier and Chinese Minmetals Engineering Co. Ltd. ( **Minmetals** ) is the general contractor. Investments will amount to 23.1 billion rubles. In July 2013, the universal rail and structural rolling mill was launched. At present, we are developing production of both guarantee products and new products, as well as certification of products for the Russian and European markets is being carried out. Three certificates of conformity of the Customs Union were obtained on certain types of rails; preparatory work for certification of rails for the European Union is in progress.

The main target customers for the universal rolling mill products are Russian Railways, construction industry and different manufacturing companies. On November 13, 2008, Chelyabinsk Metallurgical Plant and Russian Railways signed an agreement for the supply of rails for the period until 2030. The annual supply volume is fixed at up to 400 thousand tonnes of rails. The increase in sales volume of the universal rolling mill products will occur along with the development and certification of new types of products.

In December 2010, Mechel Materials started assembling the main manufacturing equipment of the grinding-mixing complex for Portland blast-furnace slag cement production with 1.6 million tonnes capacity per annum in the territory of Chelyabinsk Metallurgical Plant. The main raw material is blast furnace slag produced by Chelyabinsk Metallurgical Plant. This complex is the first Russian facility to produce high-quality Portland blast-furnace slag cement of certain grades (CEMIII/A, CEMIII/B, CEMIII/C). Portland blast-furnace slag cement is widely used in the construction industry for the production of reinforced concrete structures. The general contractor is Austrian FMW GmbH. Investments amount to 5,084 million rubles. In 2013, construction and assembly and commissioning works on the basic process equipment were completed and production in the mode of experimental-industrial testing commenced. In 2014-2016, we mastered production of Portland blast-furnace slag cement, ground granulated blast-furnace slag and Portland cement. In April 2016, Mechel Materials obtained a quality management system certificate ISO 9001:2008. In late 2016, main technological equipment was commissioned.

*Izhstal*

Izhstal is a special steel producer located in the western Urals city of Izhevsk, in the Republic of Udmurtia, a Russian administrative region also known as Udmurtia. Its customer base is largely comprised of companies from the aircraft,



defense, engineering, metal-processing and automotive industries. We acquired Izhstal in 2004.

Izhstal's principal production facilities include two EAFs of 25 and 40 tonnes; two ladle furnaces and a ladle vacuum oxygen decarburizer; a concasting machine; a blooming mill for 100-220 millimeter billets; two medium-sized long products rolling mills for 30-120 millimeter round bars, 30-90 millimeter square bars, bands

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and hexagonal bars; and one continuous small sort wire mill for 5.5-29 millimeter round, 12-28 millimeter square and 12-27 millimeter hexagonal light sections, reinforced steel and bands. In June 2011, wire products production, which includes various drawing machines, a pickling line, bell furnaces and patenting lines, was spun-off into a branch of Beloretsk Metallurgical Plant. The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for each of Izhstal's principal production areas.

| <b>Production Area</b> | <b>Capacity<br/>in 2016</b>                             | <b>Capacity<br/>Utilization<br/>Rate in 2016</b> | <b>Planned<br/>Increase<br/>(2017-2019)</b> |
|------------------------|---|--|---|
|                        | <b>(In thousands of tonnes, except for percentages)</b> |  |   |
| Steel-making           | 351   | 72.7%  |   |
| Rolling                | 420   | 89.3%  |   |
| Wire products          | 6   | 6.1%   |   |

Izhstal produced approximately 255.1 thousand tonnes of raw steel, 375.0 thousand tonnes of rolled products and approximately 0.4 thousand tonnes of wire products in 2016.

*Beloretsk Metallurgical Plant*

Beloretsk Metallurgical Plant is a wire products plant in Beloretsk, in the southern part of Ural Mountains, which produces wire rod and a broad range of wire products from semi-finished products supplied by Chelyabinsk Metallurgical Plant and third party suppliers. Its customers are largely from the construction, mining, engineering and other industries. We acquired Beloretsk Metallurgical Plant in 2002.

Beloretsk Metallurgical Plant's principal production lines include a rolling workshop equipped with a wire mill for production of 5.5-13.5 millimeter wire rod; a number of wire products workshops equipped with drawing, rewinding, wire stranding, cabling, grinding equipment and heat treatment furnaces, wire annealing and galvanizing, patenting and galvanizing lines; low relaxation prestressed concrete wire and rope lines; cold-worked rebar line and cold strand and section rolling mills. In June 2011, wire products production facilities were transferred to Beloretsk Metallurgical Plant from Izhstal. In September 2014, in order to optimize costs these production facilities were moved to Beloretsk Metallurgical Plant. The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for each of Beloretsk Metallurgical Plant's principal production areas.

| <b>Production Area</b> | <b>Capacity<br/>in 2016</b>                             | <b>Capacity<br/>Utilization<br/>Rate in 2016</b> | <b>Planned<br/>Increase<br/>(2017-2019)</b> |
|------------------------|---|--|---|
|                        | <b>(In thousands of tonnes, except for percentages)</b> |  |   |
| Rolling                | 630   | 79.9%  |   |
| Wire products          | 600   | 75.4%  |   |

Beloretsk Metallurgical Plant produced a total of 452.1 thousand tonnes of wire products in 2016. Rolled products production in 2016 amounted to a total of 503.2 thousand tonnes, of which 436.0 thousand tonnes were further processed into wire products and 67.2 thousand tonnes constituted the output volume of wire rod for third party customers.

*Vyartsilya Metal Products Plant*

Vyartsilya Metal Products Plant is a wire products plant in the Republic of Karelia, an administrative region in the northwest of Russia near the Finnish border that produces low carbon welding, general-purpose and structural wire, nails and steel bright and polymeric-coated chain link fences. The plant uses wire rod supplied by Chelyabinsk Metallurgical Plant and Beloretsk Metallurgical Plant. The plant's customers are largely from the construction industry and ferrous metallurgy. We acquired Vyartsilya Metal Products Plant in 2002.

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Vyartsilya Metal Products Plant's principal production facilities include drawing machines, annealing furnaces, chain linking machines, nail-making presses and cutting machines. The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for Vyartsilya Metal Products Plant's principal production area.

| <b>Production Area</b> | <b>Capacity<br/>in 2016</b> | <b>Capacity<br/>Utilization<br/>Rate in 2016</b> | <b>Planned<br/>Increase<br/>(2017-2019)</b> |
|------------------------|-----------------------------|--|---|
| Wire products          | 123                         | 62.8%  |   |

Vyartsilya Metal Products Plant produced 77.3 thousand tonnes of wire products in 2016.

*Urals Stampings Plant*

Urals Stampings Plant produces stampings and forgings from special steels and heat-resistant and titanium alloys for the aerospace, oil and gas, heavy engineering, power and other industries. Urals Stampings Plant sources its special steel needs from Chelyabinsk Metallurgical Plant. We acquired Urals Stampings Plant in 2003.

Principal production facilities of Urals Stampings Plant and its branch in Chelyabinsk include 1.5-25 tonne swages and hydraulic presses. The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for Urals Stampings Plant's principal production area.

| <b>Production Area</b> | <b>Capacity<br/>in 2016</b> | <b>Capacity<br/>Utilization<br/>Rate in 2016</b> | <b>Planned<br/>Increase<br/>(2017-2019)</b> |
|------------------------|-----------------------------|--|---|
| Stampings and forgings | 100                         | 75.4%  |   |

Urals Stampings Plant produced 75.4 thousand tonnes of special steel stampings and forgings in 2016.

*Mechel Nemunas*

Mechel Nemunas is a Lithuanian wire products plant located in Kaunas that produces hard-drawn, annealed, electrode and concrete reinforcement wire, nails, steel wire fiber and chain link fences. Its customers are primarily from the construction industry of Europe and Baltic countries. We acquired Mechel Nemunas in 2003.

Mechel Nemunas's principal production facilities include drawing machines, nail-making presses, equipment for fiber production, chain linking machines and bell furnaces. The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for Mechel Nemunas's principal production area.

| <b>Production Area</b> | <b>Capacity<br/>in 2016</b> | <b>Capacity<br/>Utilization<br/>Rate in 2016</b> | <b>Planned<br/>Increase<br/>(2017-2019)</b> |
|------------------------|-----------------------------|--|---|
|                        |                             |  |   |

|               |    |       |
|---------------|----|-------|
| Wire products | 90 | 80.3% |
|---------------|----|-------|

Mechel Nemunas produced 72.1 thousand tonnes of wire products in 2016.

*Bratsk Ferroalloy Plant*

Bratsk Ferroalloy Plant is the largest enterprise in Eastern Siberia producing high-grade ferrosilicon. Ferrosilicon is used in the steel-making industry as a deoxidizer for manufacturing of most steel grades,

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including carbon and stainless steel grades; or as an alloying element for the production of insulating, acid-proof and heatproof steel grades; or as a pig iron modifier; and as a reducing agent for the production of nonferrous metals and alloys. Approximately 5-6 kg of ferrosilicon is used in every tonne of steel produced. We acquired Bratsk Ferroalloy Plant in 2007.

The main production facilities of the plant include three ore-thermal furnaces with a capacity of 25 megavolt-amperes ( MVA ) and one ore-thermal furnace with a capacity of 33 MVA. In October 2010, we signed contracts with Siberian Plant of Electrothermal Equipment (Sibelectrotherm JSC, Novosibirsk) for the supply of four ore-thermal furnaces with a capacity of 33 MVA each to replace the existing furnaces. We commenced commercial operations of the first new furnace in the second quarter of 2013. Currently, the second furnace assemblage is suspended. The launch of this furnace is expected in 2017. Following the commissioning of the second new furnace, Bratsk Ferroalloy Plant's production capacity is expected to increase by 15%.

The following table sets forth the capacity, the capacity utilization rate and the planned increase in capacity for Bratsk Ferroalloy Plant's principal production area.

| <b>Production Area</b> | <b>Capacity<br/>in 2016</b> | <b>Capacity<br/>Utilization<br/>Rate in 2016</b> | <b>Planned<br/>Increase<br/>(2017-2019)</b> |
|------------------------|-----------------------------|--|---|
| Ferrosilicon           | 90.0                        | 98.4%  |   |

Bratsk Ferroalloy Plant produced 88.5 thousand tonnes of ferrosilicon in 2016.

**Table of Contents****Sales of steel segment products**

The following table sets forth our revenues by primary steel segment product categories and our main products within these categories (including as a percentage of total steel segment revenues) for the periods indicated.

| Product   | 2016             |               | 2015             |               | 2014             |               |
|---|------------------|---------------|------------------|---------------|------------------|---------------|
|   | Amount           | % of Revenues | Amount           | % of Revenues | Amount           | % of Revenues |
| (In millions of Russian rubles, except for percentages) |                  |               |                  |               |                  |               |
| Pig Iron  | 679.2            | 0.4%          | 1,287.4          | 0.9%          | 3,251.5          | 2.3%          |
| Semi-Finished Steel Products, including:                | 3,433.5          | 2.1%          | 5,027.2          | 3.4%          | 2,834.5          | 2.0%          |
| Carbon and Low-Alloyed Semi-Finished Products           | 2,730.4          | 1.7%          | 4,139.8          | 2.8%          | 2,281.7          | 1.6%          |
| Long Steel Products, including:                         | 89,575.0         | 55.5%         | 73,853.0         | 50.6%         | 71,063.7         | 51.3%         |
| Stainless Long Products                                 | 2,055.2          | 1.3%          | 1,711.9          | 1.2%          | 1,053.0          | 0.8%          |
| Other Long Products                                     | 39,098.9         | 24.2%         | 28,151.8         | 19.3%         | 26,316.3         | 19.0%         |
| Rebar   | 45,204.1         | 28.0%         | 39,980.2         | 27.4%         | 39,537.9         | 28.5%         |
| Wire Rod  | 3,216.8          | 2.0%          | 4,009.1          | 2.7%          | 4,156.5          | 3.0%          |
| Flat Steel Products, including:                         | 18,230.2         | 11.2%         | 17,490.1         | 12.0%         | 14,646.0         | 10.6%         |
| Stainless Flat Products                                 | 1,507.7          | 0.9%          | 2,564.6          | 1.8%          | 3,502.0          | 2.6%          |
| Carbon and Low-Alloyed Flat Products                    | 16,722.5         | 10.3%         | 14,925.5         | 10.2%         | 11,144.0         | 8.0%          |
| Forgings, including:                                    | 4,416.9          | 2.8%          | 5,248.6          | 3.6%          | 4,421.8          | 3.2%          |
| Stainless Forgings                                      | 1,385.2          | 0.9%          | 1,368.4          | 0.9%          | 1,145.2          | 0.8%          |
| Other Forgings  | 3,031.7          | 1.9%          | 3,880.2          | 2.7%          | 3,276.6          | 2.4%          |
| Stampings   | 7,235.1          | 4.5%          | 6,917.6          | 4.7%          | 7,421.2          | 5.3%          |
| Wire Products, including:                               | 24,579.8         | 15.2%         | 23,442.6         | 16.0%         | 22,396.5         | 16.2%         |
| Wire  | 15,530.4         | 9.6%          | 15,560.9         | 10.7%         | 14,968.3         | 10.8%         |
| Ropes   | 3,075.7          | 1.9%          | 2,254.9          | 1.5%          | 2,069.0          | 1.5%          |
| Other Wire Products                                     | 5,973.7          | 3.7%          | 5,626.8          | 3.8%          | 5,359.2          | 3.9%          |
| Steel Pipes   | 3,286.2          | 2.0%          | 3,308.3          | 2.3%          | 3,390.7          | 2.4%          |
| Ferrosilicon  | 3,367.5          | 2.1%          | 3,527.7          | 2.4%          | 2,712.6          | 2.0%          |
| Other   | 6,835.3          | 4.2%          | 5,929.4          | 4.1%          | 6,521.3          | 4.7%          |
| <b>Total</b>  | <b>161,638.7</b> | <b>100.0%</b> | <b>146,031.9</b> | <b>100.0%</b> | <b>138,659.8</b> | <b>100.0%</b> |

The following table sets forth percentage of sales by the regions in which our steel segment products were sold for the periods indicated.

| Region <sup>(1)</sup> | 2016  | 2015  | 2014 <sup>(2)</sup> |
|-----------------------|-------|-------|---------------------|
| Russia                | 72.3% | 68.1% | 68.2%               |
| Europe                | 14.8% | 15.9% | 16.0%               |
| CIS                   | 10.4% | 12.4% | 12.6%               |

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|                            |        |        |        |
|----------------------------|--------|--------|--------|
| Asia                       | 1.2%   | 1.3%   | 1.4%   |
| Middle East <sup>(3)</sup> | 0.5%   | 1.1%   | 0.9%   |
| Other                      | 0.5%   | 1.0%   | 0.5%   |
| United States              | 0.3%   | 0.2%   | 0.4%   |
| Total                      | 100.0% | 100.0% | 100.0% |

- (1) The regional breakdown of sales is based on the geographic location of our customers, and not on the location of the end users of our products, as our customers are often distributors that resell and, in some cases, further export our products.
- (2) The data was presented in accordance with IFRS.



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(3) Our steel segment sales to Middle East primarily go to Turkey, which accounted for 64.8% of the total steel segment sales to Middle East in 2016. We did not have any direct sales to Iran, Syria and Sudan in 2016, and we have no plans to make such direct sales in the future.

In 2016, the five largest customers of our steel products were Russian Railways (long steel products, flat steel products, wire products and pig iron), EVRAZ (flat steel products, long steel products and wire products), Guryevsk Metallurgical Plant (long steel products, pig iron, semi-finished products, flat steel products, forgings, pipes and wire products), Steel Industrial Company AO (long steel products, wire products, flat steel products, pipes and forgings) and Tikhvin Machine Engineering Plant AO (long steel products, wire products and stampings), which together accounted for 11.7% of our total steel segment sales.

In 2016, the five largest customers of ferrosilicon were Mitsui & Co., MMK, Severstal, Globalalloy Technologies Co., Ltd and ACTS Trading Corporation, which together accounted for 1.6% of our total steel segment sales.

The majority of our steel segment export sales are made to end users in non-sanctioned countries on a CFR and CPT basis. The remainder of our steel products is exported to independent distributors and traders on an FOB basis. We refer to such sales as indirect sales. Contracts with distributors and traders generally specify certain ports to which we must deliver our products. The distributors and traders take delivery of our products at these locations, and further on-sell the products to other distributors or end users. When these distributors take delivery of our products, we are provided in certain instances with documentation showing the further destination of our products. In case of indirect sales, we do not have control over the final destination of our products, contractually or otherwise.

Based on such documentation, we are aware that certain of our products are sold into and can be re-sold to countries that are subject to international trade restrictions or economic embargoes that prohibit and/or materially restrict certain persons (for instance, U.S. incorporated entities and U.S. citizens or residents) from engaging in commercial, financial or trade transactions with such countries, including Iran, Syria, Sudan and Belarus (the **Sanctioned Countries**). We estimate that approximately 0.5% of our total sales in 2016 were sold in Belarus, of which 0.2% were indirect sales by independent distributors and traders to other distributors or end users and 0.3% were direct sales to end users.

We are aware of governmental initiatives in the United States and elsewhere to adopt laws, regulations or policies prohibiting or materially restricting transactions with or investment in, or requiring divestment from, entities doing business with the Sanctioned Countries. We recognize that acts prohibiting or restricting the foregoing can sometimes be applied to our company and that dealings with the Sanctioned Countries can have an adverse effect on our business reputation.

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The following table sets forth information on our domestic and export sales of our primary steel segment product categories for the periods indicated. We define exports as sales by our Russian and foreign subsidiaries to customers located outside their respective countries. We define domestic sales as sales by our Russian and foreign subsidiaries to customers located within their respective countries. See note 27 to the consolidated financial statements.

| <b>Product</b>               | <b>2016</b>  | <b>2015</b>      | <b>2014</b>      |
|------------------------------|--|------------------|------------------|
|                              | <b>(In millions of Russian rubles, except for percentages)</b> |                  |                  |
| Pig Iron                     | 679.2  | 1,287.4          | 3,251.5          |
| Domestic Sales               | 82.7%  | 35.6%            | 51.2%            |
| Export                       | 17.3%  | 64.4%            | 48.8%            |
| Semi-Finished Steel Products | 3,433.5  | 5,027.2          | 2,834.5          |
| Domestic Sales               | 63.7%  | 63.0%            | 53.4%            |
| Export                       | 36.3%  | 37.0%            | 46.6%            |
| Long Steel Products          | 89,575.0   | 73,853.0         | 71,063.7         |
| Domestic Sales               | 88.6%  | 83.1%            | 82.4%            |
| Export                       | 11.4%  | 16.9%            | 17.6%            |
| Flat Steel Products          | 18,230.2   | 17,490.1         | 14,646.0         |
| Domestic Sales               | 88.5%  | 88.9%            | 86.8%            |
| Export                       | 11.5%  | 11.1%            | 13.2%            |
| Forgings                     | 4,416.9  | 5,248.6          | 4,421.8          |
| Domestic Sales               | 72.0%  | 63.3%            | 75.1%            |
| Export                       | 28.0%  | 36.7%            | 24.9%            |
| Stampings                    | 7,235.1  | 6,917.6          | 7,421.2          |
| Domestic Sales               | 95.4%  | 92.2%            | 93.5%            |
| Export                       | 4.6%   | 7.8%             | 6.5%             |
| Wire Products                | 24,579.8   | 23,442.6         | 22,396.5         |
| Domestic Sales               | 84.0%  | 84.4%            | 84.8%            |
| Export                       | 16.0%  | 15.6%            | 15.2%            |
| Steel Pipes                  | 3,286.2  | 3,308.3          | 3,390.7          |
| Domestic Sales               | 90.2%  | 90.5%            | 91.5%            |
| Export                       | 9.8%   | 9.5%             | 8.5%             |
| Ferrosilicon                 | 3,367.5  | 3,527.7          | 2,712.6          |
| Domestic Sales               | 47.2%  | 57.1%            | 56.3%            |
| Export                       | 52.8%  | 42.9%            | 43.7%            |
| Other                        | 6,835.3  | 5,929.4          | 6,521.3          |
| Domestic Sales               | 81.2%  | 86.4%            | 87.0%            |
| Export                       | 18.8%  | 13.6%            | 13.0%            |
| <b>Total</b>                 | <b>161,638.7</b>   | <b>146,031.9</b> | <b>138,659.8</b> |
| Domestic Sales               | 86.0%  | 82.3%            | 82.2%            |
| Export                       | 14.0%  | 17.7%            | 17.8%            |

The end users of our steel products vary. Our rebar is principally used in the construction industry. The main end users of our wire rod are construction companies and wire products producers. Our other long steel products are used in various moving parts manufactured by the automotive industry, as well as the engineering, pipe, construction and

railway construction industries. Our flat steel products are used in the construction (covers, floor plates) and pipe industries. Our forgings and stampings are primarily used in the engineering and pipe industries. The main end users of our wire products are the construction, mining, engineering and other industries.

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The following table describes, in percentage terms, Russian domestic shipment volumes of our steel products further broken down by industry sector.

| <b>Use by Industry</b>       | <b>Construction</b> | <b>Metals<br/>Trading</b> | <b>Ferrous<br/>Metallurgy</b> | <b>Engineering<br/>and<br/>Metalworking</b> | <b>Vehicles<br/>Manufacturing</b> | <b>Railways<br/>Construction<br/>and<br/>Repair</b> | <b>Other<br/>Industries<sup>(1)</sup></b> |
|------------------------------|---------------------|---------------------------|-------------------------------|---|-----------------------------------|---|---|
| Semi-Finished Steel Products | 0.0%                | 0.3%                      | 97.8%                         | 0.1%  | 0.0%                              | 0.0%  | 1.8%                                      |
| Forgings                     | 0.0%                | 53.4%                     | 20.4%                         | 22.8%                                       | 3.3%                              | 0.0%  | 0.1%                                      |
| Wire Products                | 18.3%               | 42.7%                     | 11.2%                         | 6.2%  | 3.0%                              | 3.5%  | 15.1%                                     |
| Flat Steel Products          | 13.2%               | 39.9%                     | 18.9%                         | 5.0%  | 1.6%                              | 0.0%  | 21.4%                                     |
| Long Steel Products          | 29.4%               | 32.2%                     | 8.3%                          | 2.5%  | 3.3%                              | 12.3%   | 12.0%                                     |
| Steel Pipes                  | 5.4%                | 80.5%                     | 4.6%                          | 0.2%  | 0.0%                              | 0.0%  | 9.3%                                      |
| Stampings                    | 0.0%                | 6.4%                      | 0.0%                          | 8.0%  | 85.6%                             | 0.0%  | 0.0%                                      |

(1) Including mining and power industries and consumer goods sector.

**Marketing and distribution**

We use flexible sales strategies that are tailored to our customers and the markets we serve. Our overall sales strategy is to develop long-term close partnership with the end users of our products. As part of our end-user strategy, we research sales to distributors to identify the end user and directly market our steel capabilities and products to these customers. With respect to our largest end users, we have established working committees, composed of our manufacturing engineers and customer personnel. These committees meet quarterly to monitor the performance of our products and ensure that our customers' specifications and quality requirements are consistently met. These committees also provide customers with the opportunity to discuss their future needs with us. Our sales force also regularly follows up with these and many of our other customers. We attend industry conferences and advertise in industry periodicals to market our products and capabilities. Through these efforts, we have established a strong brand identity for Mechel in Russia, the CIS, Central Europe, South-East Asia and the Middle East.

Mechel Service Global, through its subsidiaries, provides end users in Russia, the CIS and Europe with our steel products. Mechel Service Global's subsidiaries help us to develop and service our long-standing customer relationships by providing highly specialized technical sales and service to our customers.

In 2016, most of our production facilities handled their domestic sales independently, and our export sales were marketed through Mechel Trading and Mechel Service Global, as well as conducted directly by our production facilities.

**Domestic sales**

Our Russian steel production facilities Chelyabinsk Metallurgical Plant, Izhstal and Urals Stampings Plant are located in large industrial areas and have long-standing relationships with local wholesale customers. Mechel Service, a Russian subsidiary of Mechel Service Global, has 59 storage sites in 43 cities throughout Russia to serve our end users, which helps us to establish long-standing customer relationships by virtue of proximity to both production and customers.

Ferrosilicon sales are conducted directly by our Bratsk Ferroalloy Plant. We supply ferrosilicon on the Russian market under annual contracts with monthly adjustment of prices and volumes, as well as on the spot market (under monthly tenders).

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**Table of Contents***Export sales*

Most of the exports in our steel segment are made to end users in non-sanctioned countries, with the rest sold to independent distributors and traders, which then resell our products to end users. In 2016, our export sales were carried out by Mechel Trading, directly by our own production facilities and through Mechel Service Global's distribution network.

Our production facilities supply high-quality rolled steel products to the subsidiaries of Mechel Service Global in Western Europe either directly, or through the logistics center in the Port of Antwerp. Our logistics center in the Port of Antwerp also allows us to sell high-quality rolled steel products to manufacturing and service companies on a walk-in basis.

In 2016, ferrosilicon sales outside of Russia were principally to Japan. Deliveries to Japanese customers were carried out on CIF delivery terms (including transportation by railway, handling in ports of Nakhodka, Vladivostok and Vostochny and use major container lines to major Japanese ports and insurance). We sell ferrosilicon based both on long-term contracts and on a spot basis.

*Distribution*

Rail transportation is used for most shipments from our production facilities and warehouses to our end customers, wholesale warehouses or seaports.

*Market share and competition*

In our core export markets, we primarily compete with other Russian producers, as well as producers from China, Ukraine, Belarus, Turkey and Kazakhstan. The leading global steel manufacturers have been increasingly focused on value-added and higher-priced products. The principal competitive factors include price, distribution, product quality, product range and customer service.

In the Russian market, we compete on the basis of price and quality of steel products, their added value, product range and service, technological innovation and proximity to customers. The Russian steel industry is characterized by a relatively high concentration of production, with the six largest integrated steel producers, including ourselves, accounting for 84.5% of overall domestic crude steel output in 2016, according to Metal Expert.

The following is a brief description of Russia's five largest steel producers excluding ourselves:

*Novolipetsk Steel PAO ( NLMK )* is Russia's largest steel manufacturer by volume, accounting for 21.8% of the volume of Russian commodity steel production in 2016. NLMK produces flat products (hot-rolled and cold-rolled), galvanized products and slabs, as well as long products. The company's production facilities are located in Lipetsk (NLMK), in the Sverdlovsk region (long products producer NLMK-Ural and wire products producer NLMK-Metalware) and in the Kaluga region (long products producer NLMK-Kaluga). NLMK exported 64.4% of its steel products in 2016. Domestically, NLMK's largest customers are in the construction and oil and gas industries, followed by companies in the automotive sector. NLMK also controls iron ore producer Stoilensky GOK and coke producer Altai-Koks.

*Magnitogorsk Iron & Steel Works OAO* ( **MMK** ) is Russia's second largest steel manufacturer by volume, accounting for 17.0% of the volume of Russian commodity steel products output (including long products, flat products and semi-finished products) in 2016. MMK's product mix is comprised mostly of flat products, which accounted for 84.5% of its commercial steel products output (including semis) in 2016. Domestically, MMK controls a significant portion of the supplies to the oil and gas and automotive sectors. MMK exported 37.0% of its output in 2016. Its production facilities are located in Magnitogorsk in the southern Urals. MMK also controls coking coal producer Belon OAO.

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*Severstal PAO* ( **Severstal** ) is Russia's third largest steel manufacturer by volume on a consolidated basis, accounting for 16.3% of the volume of Russian commodity steel products output in 2016. The company specializes in flat products which constitute a significant part of its production. Severstal is the second-leading producer of flat products, accounting for 29.2% of Russia's total flat products output in 2016. Domestic sales of flat products accounted for 64.1% of Severstal's output in 2016, with the oil and gas industry and automotive sector as its leading customers. Severstal controls coal producer Vorkutaugol and iron ore producers Karelsky Okatysh and Olenegorsky GOK, which satisfy a portion of Severstal's coking coal and iron ore requirements.

*EVRAZ plc* ( **EVRAZ** ), which includes Russian steel producers EVRAZ NTMK and EVRAZ ZSMK, had a 15.4% share by volume of Russian commodity steel products output in 2016. EVRAZ focuses on the production of long products, including rebar, wire rod and profiled rolled products (such as rails, beams, channels and angles). EVRAZ exported 59.3% of its output in 2016. EVRAZ also controls iron ore producers EVRAZ KGOK, Evrazruda and EVRAZ Sukha Balka, as well as coking coal producers Yuzhkuzbassugol Coal Company, Rapsadskaya PAO and Mezhegeyugol.

*Metalloinvest Holding Company AO* ( **Metalloinvest** ), whose Russian assets consist of Oskol Electrometallurgical Plant AO ( **OEMK** ) and Ural Steel AO, had a 6.3% share by volume of Russian commodity steel products output in 2016. OEMK produces long products only, and Ural Steel produces both long and flat products. Metalloinvest exported 67.1% of its commodity steel production in 2016. The company's production facilities are located in the Central and Urals Federal Districts of Russia. Metalloinvest also controls Russia's largest iron ore and pellets production facilities Lebedinsky GOK and Mikhailovsky GOK.

Source: Companies' websites; Metal Expert.

These six companies, including ourselves, can be divided into two groups by product type. MMK, Severstal and NLMK focus mainly on flat products, while we, EVRAZ and Metalloinvest produce primarily long products. Mechel is the third largest and most comprehensive producer of special steel and alloys in Russia, accounting for 11.8% of total Russian special steel output by volume in 2016, according to Chermet and Metal Expert. We are also the second largest producer of long steel products (excluding square billets) in Russia by volume, with significant market shares in both regular long steel products and special steel long products, according to Metal Expert.

In the Russian non-special steel long products category, our primary products and our market position by production volume in 2016 were as follows, according to Metal Expert:

*Reinforcement bars ( rebar )* In rebar, we compete in the 6-40 millimeters range. In 2016, the largest domestic rebar producers were NLMK (22.0%), Mechel (19.2%), EVRAZ (16.4%), Severstal (15.6%) and MMK (5.9%).

*Wire rod* There were five major producers of wire rod in Russia in 2016: Mechel (26.1%), MMK (16.6%), NLMK (16.2%), EVRAZ (14.8%) and Severstal (13.8%).



OEMK, an EAF steel mill specializing in carbon and special steel long products and our nearest special steel competitor, is located in the southwest of Russia and serves customers in the pipe, engineering and ball-bearing industries.

According to Metal Expert and Chermet, we were one of the leading producers in Russia of special steel long products (bearing, tool, high-speed and stainless long steel) in 2016, producing 9.9% of the total Russian output by volume, and we held significant shares of Russian production volumes in 2016 of stainless long products (20.9%), tool steel (23.6%) and high-speed steel (34.3%).

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The following tables set forth additional information regarding our 2016 market share in Russia for various categories of steel products.

*All long products (excluding square billets)*

| <b>Manufacturer</b> | <b>Production</b><br><b>(In thousands of tonnes, except for percentages)</b> | <b>Market Share<br/>by Production<br/>Volume</b> |
|---------------------|--|--|
| EVRAZ               | 4,896  | 27.0%  |
| Mechel              | 3,194  | 17.6%  |
| NLMK                | 2,170  | 12.0%  |
| Severstal           | 1,778  | 9.8%   |
| MMK                 | 1,713  | 9.4%   |
| Metalloinvest       | 1,145  | 6.3%   |
| Other               | 3,261  | 17.9%  |
| Total               | 18,157   | 100.0%   |

Source: Metal Expert.

*Long products Wire rod<sup>(1)</sup>*

| <b>Manufacturer</b> | <b>Production</b><br><b>(In thousands of tonnes, except for percentages)</b> | <b>Market Share<br/>by Production<br/>Volume</b> |
|---------------------|--|--|
| Mechel              | 745  | 26.1%  |
| MMK                 | 473  | 16.6%  |
| NLMK                | 461  | 16.2%  |
| EVRAZ               | 423  | 14.8%  |
| Severstal           | 393  | 13.8%  |
| Other               | 355  | 12.5%  |
| Total               | 2,850  | 100.0%   |

Source: Metal Expert.

(1) Including wire rod further processed into wire and other products within the same holding company.  
*Long products Rebar*

| <b>Manufacturer</b> | <b>Production</b>                                       | <b>Market Share<br/>by Production<br/>Volume</b> |
|---------------------|---|--|
|                     | <b>(In thousands of tonnes, except for percentages)</b> |  |
| NLMK                | 1,684   | 22.0%  |
| Mechel              | 1,475   | 19.2%  |
| EVRAZ               | 1,260   | 16.4%  |
| Severstal           | 1,195   | 15.6%  |
| MMK                 | 450   | 5.9%   |
| Other               | 1,601   | 20.9%  |
| <b>Total</b>        | <b>7,665</b>  | <b>100.0%</b>                                    |

Source: Metal Expert.

**Table of Contents***Flat stainless steel*

| <b>Manufacturer</b> | <b>Production</b><br><b>(In thousands of tonnes, except for percentages)</b> | <b>Market Share<br/>by Production<br/>Volume</b> |
|---------------------|--|--|
| VMZ Red October     | 17.6   | 64.3%  |
| Mechel              | 6.2  | 22.5%  |
| Other               | 3.6  | 13.2%  |
| Total               | 27.4   | 100.0%   |

Source: Metal Expert.

*Wire products*

| <b>Manufacturer</b> | <b>Production</b><br><b>(In thousands of tonnes, except for percentages)</b> | <b>Market Share<br/>by Production<br/>Volume</b> |
|---------------------|--|--|
| Mechel              | 481.2  | 35.9%  |
| MMK-Metiz           | 368.6  | 27.6%  |
| NLMK-Metalware      | 259.6  | 19.4%  |
| EVRAZ               | 210.5  | 15.7%  |
| Severstal-Metiz     | 18.9   | 1.4%   |
| Total               | 1,338.8  | 100.0%   |

Source: Metal Expert.

*Wire products High-tensile wire*

| <b>Manufacturer</b> | <b>Production</b><br><b>(In thousands of tonnes, except for percentages)</b> | <b>Market Share<br/>by Production<br/>Volume</b> |
|---------------------|--|--|
| Severstal-Metiz     | 42.4   | 47.6%  |
| Mechel              | 38.7   | 43.5%  |

|           |      |        |
|-----------|------|--------|
| MMK-Metiz | 7.9  | 8.9%   |
| Total     | 89.0 | 100.0% |

Source: Metal Expert.

According to Metal Expert, Mechel is the third largest Russian producer of ferrosilicon by volume. In 2016, we had a 14.4% market share by volume of Russian ferrosilicon production.

Following is a brief description of Russia's other largest ferrosilicon producers, according to Metal Expert and the companies' data:

*Kuznetsk Ferroalloys AO* ( **Kuznetsk Ferroalloys** ) is the largest Russian ferrosilicon producer, with a 39.8% market share by production volume in 2016. Kuznetsk Ferroalloys produces microsilica and quartzite. It is primarily export-oriented, having exported 97.6% of its ferrosilicon production volume in 2016.

*Chelyabinsk Electrometallurgical Plant AO* ( **ChEMK** ) is the second largest Russian ferrosilicon producer, with a 26.8% market share by production volume in 2016. In addition it produces ferrochrome, silicomanganese and silicocalcium. ChEMK exports most of its production. In 2016, it exported 62.3% by volume of its ferrosilicon production.

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The following table sets forth additional information regarding our 2016 ferrosilicon market share in Russia.

| <b>Manufacturer</b>        | <b>Region</b>   | <b>Production</b> | <b>Market Share<br/>by Production<br/>Volume</b> |
|----------------------------|---|-------------------|--|
|                            | <b>(In thousands of tonnes, except for percentages)</b> |                   |  |
| Kuznetsk Ferroalloys       | Kemerovo  | 227.0             | 39.8%  |
| ChEMK                      | Chelyabinsk   | 153.2             | 26.8%  |
| Bratsk Ferroalloy Plant    | Irkutsk   | 82.2              | 14.4%  |
| Yurginsk Ferroalloys Plant | Kemerovo  | 79.2              | 13.9%  |
| NLMK                       | Lipetsk   | 25.8              | 4.5%   |
| Serov Ferroalloys Plant    | Sverdlovsk  | 3.6               | 0.6%   |
| <b>Total</b>               |   | <b>571.0</b>      | <b>100.0%</b>                                    |

Source: Metal Expert.

**Raw materials**

The principal raw materials we use in pig iron production are iron ore products (sinter of our own production and purchased oxidized pellets), coke and limestone. Pig iron is made in blast furnaces. For sinter production we use iron ore concentrate. Iron ore concentrate is converted into sinter at Chelyabinsk Metallurgical Plant. In 2016, our steel-making operations used 6.3 million tonnes of iron ore feed, approximately 20% in the form of pellets and 71% in the form of sinter, and we internally sourced approximately 43% of our total iron ore feed requirements. In 2016, Korshunov Mining Plant supplied our steel segment with 2.7 million tonnes of iron ore concentrate. In 2016, we purchased most of the remaining part of our iron ore feed from Russian suppliers such as Kachkanarsky GOK, Kovdorsky GOK, Vysokogorsky GOK, Mikhailovsky GOK and Bakalskoye Rudoupravlenie under monthly, quarterly and annual contracts on market terms.

We process coking coal concentrate into coke at Mechel Coke and Moscow Coke and Gas Plant. In 2016, our production facilities used 3.8 million tonnes of coking coal concentrate (including 2.9 million tonnes used by Mechel Coke and 0.9 million tonnes used by Moscow Coke and Gas Plant), and 77% of total usage was sourced internally. Coke is used both in pig iron production at Chelyabinsk Metallurgical Plant and in ferrosilicon production at Bratsk Ferroalloy Plant. In 2016, we produced and internally used approximately 2.1 million tonnes of coke as well as produced for sale to third parties another approximately 0.9 million tonnes of coke.

We are capable of internally sourcing all of the limestone requirements from our Pugachevsky Open Pit. In 2016, we supplied approximately 961.4 thousand tonnes of limestone to our steel production facilities. In 2016, approximately 55.7% of the limestone produced at Pugachevsky Open Pit was used internally as auxiliary, with 53.5% shipped to Chelyabinsk Metallurgical Plant and 2.2% to other our group companies; approximately 11.2% was sold to third parties; and approximately 33.1% remained in the warehouse and partly was used for internal needs of the quarry.

We produce 88.5% of steel in basic oxygen furnaces. In steel-making, scrap is used in the composition of feedstock, and we are approximately 65.9% self-sufficient in this raw material, which amounts to 497.3 thousand tonnes of scrap,

sourcing the balance from various scrap traders.

In 2016, our production facilities used 27.8 thousand tonnes of ferrosilicon (including 23.3 thousand tonnes at Chelyabinsk Metallurgical Plant, 2.3 thousand tonnes at the Chelyabinsk branch of Urals Stampings Plant and 2.2 thousand tonnes at Izhstal), all of which was supplied by Bratsk Ferroalloy Plant.

Steel-making requires significant amounts of electricity to power EAFs, ladle furnaces and rolling mills and to produce sinter. In 2016, our steel segment operations consumed approximately 3.3 billion kWh of electricity.

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Chelyabinsk Metallurgical Plant, Moscow Coke and Gas Plant and Urals Stampings Plant have power co-generation facilities, which are operated by Mechel Energo. In 2016, these facilities produced 1.2 billion kWh of electricity, yielding approximately 26% self-sufficiency overall for our group, which consumed 4.7 billion kWh of electricity in 2016. The balance was purchased in the wholesale and retail electricity markets. Aside from Southern Kuzbass Power Plant, which ran on steam coal in 2016, our power generating facilities work on blast furnace and coke gas, which are by-products of our steel-making operations, and natural gas, which we purchase from Novatek, Rosneft and Gazprom. In 2016, we consumed 2.0 billion cubic meters of blast furnace gas, 558.9 million cubic meters of coke gas and 892.6 million cubic meters of natural gas. In 2016, Southern Kuzbass Power Plant consumed 1.3 million tonnes of steam coal sourced mostly from our own coal mining assets.

Large amounts of water are also required in the production of steel. Water serves as a re-solvent, accelerator and washing agent. Water is used to cool equipment components, to carry away waste, to help produce and distribute heat and power and to dilute liquids. One of the principal sources of water is rivers, and many of our production facilities recirculate a portion of water used for their production needs. For example, Chelyabinsk Metallurgical Plant sources 89.4% of its water needs from recirculated water and the rest from a local river. Izhtal sources 81.5% of its water needs from recirculated water, 8.3% from recycled water and the rest from a storage reservoir. Beloretsk Metallurgical Plant sources 72.3% of its water needs from recirculated and recycled water and the rest from a storage reservoir and a local river.

Transportation costs are a significant component of our production costs and a factor in our price-competitiveness in export markets. Rail transportation is our principal means of transporting raw materials from our mines to processing facilities and products to domestic customers and to ports for shipment overseas. For a description of our railway freight and forwarding subsidiary, see [Mining Segment Marketing and distribution](#) above.

For a description of how seasonal factors impact our use and reserve levels of raw materials, see [Item 5. Operating and Financial Review and Prospects Trend Information](#).

***Trade restrictions***

Trade restrictions in the form of tariffs and duties are widespread in the steel industry. However, we are less exposed than most other Russian steel producers to these trade restrictions as restrictions on Russian exports have mainly been directed against flat products, whereas most of our exports consist of long products and semi-finished products. In addition, the abolition by the Russian government of steel export duties in 2002 has also effectively improved exports of Russian steel. In the future the Russian government may restore export duties on steel products and may also impose export duties on some raw materials, such as coal and iron ore concentrate.

In February 2008, an antidumping duty in the amount of 17.8% was imposed on exports to the European Union of ferrosilicon produced by our subsidiary Bratsk Ferroalloy Plant for a period of five years. In February 2013, the European Commission initiated an expiry review of the antidumping measures applicable to imports of ferrosilicon. In April 2014, the antidumping duty was extended for another five years.

**Quartzite Production**

We hold the subsoil license for the Uvatskoye deposit of quartzite and quartzite sandstones, a raw material used for ferrosilicon production. The deposit is accessible by unpaved road and located 20 kilometers southwest of Nizhneudinsk in the Irkutsk region. In 2011, we conducted successful technological tests of an experimental batch of quartzite for smelting of ferrosilicon. We completed the exploration of the alluvial part of the southern area of the Uvatskoye deposit and applied to the Department for Subsoil Use for the Irkutsk region ( **Irkutsknedra** ) with a plan



for the pilot commercial development of the alluvial part of the southern area. Irkutsknedra agreed the plan and recommended further geologic exploration within the entire license area of the Uvatskoye deposit. In 2012, drilling and sampling activities were conducted. Since 2013, we have been carrying

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out the pilot commercial development of the alluvial part of the southern area of the Uvatskoye deposit, with a view to develop the processing methods and technical and economic parameters of the deposit. Currently, in order to determine the qualitative characteristics of the mineral, laboratory studies of selected cores of the bedrock of the deposit are being conducted. We also continue the exploration of the other two areas of the Uvatskoye deposit. In light of the above, we are not able to state the amount of proved reserves for the Uvatskoye quartzite deposit.

The table below sets forth certain information regarding the subsoil license for our quartzite and quartzite sandstones deposit.

| License Area | License Holder          | License Expiry Date | Status <sup>(1)</sup>       | Year      | Surface    |
|--------------|-------------------------|---------------------|-----------------------------|-----------|------------|
|              |                         |                     |                             | Commenced | Use Rights |
| Uvatskoye    | Bratsk Ferroalloy Plant | July 2033           | Exploration and development | 18.21     | n/a Lease  |

(1) Exploration and development refers to sites where preliminary work and drilling for calculation of mineral reserves are being carried out.

**Power Segment**

Our power segment generates and supplies electricity, heat energy and other power resources to our group companies and to external consumers. It enables us to market high value-added products made from our steam coal, such as electricity and heat energy, and to increase the electric power self-sufficiency of the mining and steel segments of our business. Our power segment consists of a power generating plant Southern Kuzbass Power Plant with installed capacity of 554 MW, power co-generation facilities at Chelyabinsk Metallurgical Plant, Moscow Coke and Gas Plant and Urals Stampings Plant with installed capacity of 229 MW, 24.7 MW and 3.5 MW, respectively, and a power distribution company Kuzbass Power Sales Company.

The following table sets out total volumes of electricity production by our power segment.

|                                     | 2016             | 2015    | 2014    |
|-------------------------------------|------------------|---------|---------|
|                                     | (In million kWh) |         |         |
| Electricity                         | 3,378.2          | 4,137.4 | 3,682.1 |
| <i>Southern Kuzbass Power Plant</i> |                  |         |         |

Southern Kuzbass Power Plant is located in Kaltan in the Kemerovo region, which is in the southern part of Russia's coal-rich Kuzbass district. It has a total installed capacity of 554 MW and installed heat capacity of 506 Gcal/h. In 2016, the plant generated 1,809.9 million kWh of electricity and 729.2 thousand Gcal of heat energy. We acquired Southern Kuzbass Power Plant in 2007.

Southern Kuzbass Power Plant uses steam coal as fuel, which is supplied to it from local sources, including our Southern Kuzbass Coal Company. In 2016, it consumed 1.0 million tonnes of steam coal sourced from Southern Kuzbass Coal Company.



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The generation facilities of Southern Kuzbass Power Plant are listed below:

| Generation Unit No. | Year of Manufacture | Month and Year of Commissioning at |  | Installed Capacity (MW) | Electricity Production in 2016 (million kWh) |
|---------------------|---------------------|------------------------------------|--|-------------------------|--|
|                     |                     | Southern Kuzbass Power Plant       |  |                         |  |
| VK-50-2 LMZ         | 1950                | April 1951                         |  | 53                      | 49.1   |
| VK-50-2 LMZ         | 1950                | November 1951                      |  | 53                      | 56.2   |
| VK-50-2 LMZ         | 1950                | August 1952                        |  | 53                      | 139.9  |
| VK-50-2 LMZ         | 1952                | February 1953                      |  | 53                      | 341.6  |
| T-115-8,8 LMZ       | 1996                | December 2003                      |  | 113                     | 625.6  |
| T-88/106-90 LMZ     | 1953                | July 1954                          |  | 88                      | 199.4  |
| VK-50-2 LMZ         | 1954                | December 1954                      |  | 53                      | 312.7  |
| T-88/106-90 LMZ     | 1953                | September 1956                     |  | 88                      | 85.4   |
| Total               |                     |                                    |  | 554                     | 1,809.9                                      |

The plant sells electricity and capacity on the wholesale market only, as well as heat energy directly to consumers. In Russia it is common for thermal power plants to produce and sell heat energy, sometimes in the form of industrial steam and sometimes in the form of hot water, for business and residential heating and household use, which is distributed in towns and cities by a network of hot water distribution pipes. Southern Kuzbass Power Plant's heat energy is distributed at regulated prices in the form of hot water in the cities of Kaltan, Osinniki and Mezhdurechensk.

***Kuzbass Power Sales Company***

Kuzbass Power Sales Company is the largest power distribution company in the Kemerovo region. Its marketed power volume in 2016 amounted to approximately 9.4 billion kWh. We acquired Kuzbass Power Sales Company in 2007. The addition of Kuzbass Power Sales Company, along with Southern Kuzbass Power Plant, allows us to increase revenues in our power segment.

Kuzbass Power Sales Company sells electricity on the retail and wholesale markets. The company sells electricity to households, social infrastructure companies, housing and public utilities and large industrial companies. Due to its area of operation, its primary industrial consumers are in the mining and processing industries. It supplies electricity to end consumers directly and also through one regional agent.

The company is included in the Register of Guaranteeing Suppliers of the Kemerovo region. For a discussion of guaranteeing suppliers, see [Regulatory Matters](#) [Regulation of Russian Electricity Market](#) [Sales of electricity](#) [Retail electricity market](#).

***Mechel Energo***

Mechel Energo's core activity is the supply of electricity, heat energy in the form of hot water and steam, compressed air, oxygen, nitrogen, liquid nitrogen and liquid oxygen. In addition, it coordinates the supply of energy to our production facilities. The company has a separate business unit in Izhevsk, as well as branches in Chelyabinsk (including production department in Chebarkul), Beloretsk and Vidnoye. Mechel Energo also performs the functions

of the sole executive body of its subsidiary Southern Kuzbass Power Plant.

Mechel Energo supplies heat energy (in the form of hot water and steam) at regulated prices to its consumers, including residential consumers and commercial customers, in the cities of Vidnoye, Chelyabinsk, Chebarkul, Beloretsk and Izhevsk.

Mechel Energo has generation facilities and operates using mainly blast furnace gas and coke gas, which are a by-product of steel-making, and natural gas, which we purchase from Novatek, Rosneft and Gazprom.

Mechel Energo's sales amounted to approximately 3.5 billion kWh of electricity purchased in the wholesale and retail electricity markets and 3.8 million Gcal of heat energy in 2016.

**Table of Contents****Capital Investment Program**

We continually review our capital investment program in light of our cash flow, liquidity position, results of operations and market conditions. In light of the above factors, we may adjust our capital investment program. Our planned capital expenditures for 2017 are increased by approximately 174% as compared to 2016. See Item 3. Key Information Risk Factors Risks Relating to Our Financial Condition and Financial Reporting We will require a significant amount of cash to fund our capital investment program.

Our capital investment program includes capital spending of up to 35.7 billion rubles for 2017-2019. Our capital investment program is primarily targeted at expanding the mining segment and increasing the efficiency of the steel segment and includes, among others, investments of approximately 21.1 billion rubles in mining and approximately 11.7 billion rubles in steel. However, our ability to fully realize our capital investment program is constrained by our ability to generate cash flow, obtain additional financing and refinance or restructure existing indebtedness. We may be limited in our ability to obtain financing on a project finance basis which may impose further restrictions on the operations of the project or require the economic returns of the project to be shared with investors or lenders.

In the mining segment, we expect to direct approximately 5.7 billion rubles to the development of the Elga coal deposit in 2017-2019. We will invest approximately 1.7 billion rubles in 2017-2019 for increasing coal production at Sibirginskaya Underground which is part of Southern Kuzbass Coal Company.

The steel segment projects are targeted at expanding the share of high value-added products which we produce, while maintaining existing output, and are mainly focused on Chelyabinsk Metallurgical Plant. The main project, initiated in 2008, is the construction of a universal rail and structural rolling mill with a capacity of 1.1 million tonnes, which allows us to reduce the proportion of lower-value semi-finished products sales by increasing the production of high-quality rolled steel products and rails. The universal rail and structural rolling mill was launched in July 2013.

The table below sets forth the major items of our capital expenditures by segment and facility for 2017-2019 (including cumulatively the expenditures made since the launch of the relevant project):

|   | <b>Planned Increase in Capacity<br/>and/or Other Improvement<br/>(In millions of Russian rubles)</b>  | <b>Approximate<br/>Total Planned<br/>Expenditures<sup>(1)</sup></b> | <b>Year<br/>of<br/>Project<br/>Launch</b> | <b>Estimated<br/>Year of<br/>Completion</b> |
|---|---|---|---|---|
| <b>Mining Segment</b>                             |   |   |   |   |
| Maintenance expenditures                          | Maintaining current coal and iron ore mining and coal and iron ore concentrate production             | 11,197  | 2017                                      | 2019  |
| <b>Elgaugol</b>                                   |   |   |   |   |
| Construction of the Elga coal complex facilities  | Development of the coal deposit with increase of production capacity to 11.7 million tonnes per annum | 15,163  | 2009                                      | 2019  |
| <b>Elga-road</b>                                  |   |   |   |   |
| Construction of the rail line to the Elga deposit | Providing access to the coal deposit  | 64,421  | 2009                                      | 2017  |

***Southern Kuzbass Coal  
Company***

|  |   |       |      |      |
|--|---|-------|------|------|
| Increase of coal production at Sibirginskaya Underground | Increase of production output to 2.4 million tonnes per annum | 5,958 | 2009 | 2019 |
|--|---|-------|------|------|

**Steel Segment**

|                          |                                     |       |      |      |
|--------------------------|-------------------------------------|-------|------|------|
| Maintenance expenditures | Maintaining current output capacity | 3,824 | 2017 | 2019 |
|--------------------------|-------------------------------------|-------|------|------|

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|   | <b>Planned Increase in Capacity<br/>and/or Other Improvement<br/>(In millions of Russian rubles)</b>                      | <b>Approximate<br/>Total Planned<br/>Expenditures<sup>(1)</sup></b> | <b>Year<br/>of<br/>Project<br/>Launch</b> | <b>Estimated<br/>Year of<br/>Completion</b> |
|---|---|---|---|---|
| <b><i>Chelyabinsk Metallurgical Plant</i></b>           |   |   |   |   |
| Construction of rolling facilities in blooming building | Introducing new types of rolled products for construction industry with a design capacity of 1.1 million tonnes per annum | 23,104  | 2009                                      | 2019  |
| Reconstruction of oxygen-converter production           | Increase of cast weight to 152 tonnes   | 5,522   | 2009                                      | 2019  |
| <b>Power segment</b>                                    |   |   |   |   |
| Maintenance expenditures                                | Maintaining current output capacity   | 1,065   | 2017                                      | 2019  |
| <b>Transport division</b>                               |   |   |   |   |
| Maintenance expenditures                                | Maintaining current output capacity   | 1,317   | 2017                                      | 2019  |
| <b><i>Port Posiet</i></b>                               |   |   |   |   |
| Technical modernization of Port Posiet                  | Increase of cargo-handling capacity to 9.0 million tonnes per annum   | 4,148   | 2009                                      | 2017  |

(1) We estimate that approximately 1,812 million rubles of planned expenditures were spent on the aforementioned projects in 2016. In 2016, we spent 4,570 million rubles in total on capital expenditures.

**Research and Development**

We maintain research programs at the corporate level and at certain of our business units to carry out research and applied technology development activities. At the corporate level, we have a Department of Technology Development at Mechel-Steel Management (two employees) and a Production and Technical Department at Mechel Mining Management (11 employees). In December 2008, we established Mechel Engineering with a headcount of 294 employees to carry out design and engineering works to increase the efficiency of our mining business. Mechel Engineering has a head office in Novosibirsk and two offices in Russia's regions. Geological services provided by Mechel Engineering include: (1) geological survey work related to prospecting and developing minerals and coal deposits; (2) hydrogeological survey work; (3) monitoring of geological environment; (4) preparation of geological materials for feasibility studies and preparation of geological reports with reserves estimation; (5) test drilling (methane drainage borehole); and (6) computer simulation of coal and ore deposits.

In the course of our research and development we also contract with third party consultants and Russian research institutions.

In addition to these activities performed at our corporate level, each of Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant and Urals Stampings Plant have specialized research divisions with a total of 157 employees involved in the improvement of existing technologies and products.

Our research and development expenses in the years ended December 31, 2016, 2015 and 2014 were not significant.



**Insurance**

Most of our Russian production facilities have no comprehensive insurance coverage against the risks associated with the business in which we operate, other than insurance required under Russian law, existing collective agreements, loan agreements or other undertakings. Our Russian facilities have a number of compulsory insurance policies: liability of the owner of a hazardous facility for injury in an accident at a hazardous facility, third-party liability motor vehicle insurance and other forms of insurance. Some of our facilities provide their workers with medical insurance and accident and health insurance in accordance with

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existing collective bargaining agreements. In addition, most of our Russian facilities have voluntary motor vehicle insurance, and some of our facilities have cargo insurance, property insurance (real property and machinery) and certain types of third-party liability insurance.

Some of our international production facilities are not covered by comprehensive insurance typical for such operations in Western countries. However, they all have the compulsory insurance coverage required under the law of their respective jurisdictions: motor vehicle liability insurance, pollution liability insurance, employer liability, etc. Furthermore, some of our international facilities carry insurance coverage for their property (real property and machinery, inventory, motor vehicle), liability (third-party liability, professional and product liability), cargo (including freight insurance), accounts receivable, financial losses related to the abuse of the employees, as well as medical insurance, litigation insurance and accident insurance for their workers.

## **Environmental Protection**

Similar to other companies operating in the industries in which we operate, our activities may have an adverse impact on the environment due to emission of coal and coke dust and other pollutants and hazardous materials into the atmosphere, discharge of polluted waste water into the environment and generation of waste and hazardous materials that need to be disposed of or reused without serious damage to the environment.

Our environmental policy has the following key components:

- implement formal environmental management systems that are aligned with applicable international standards;

- identify, assess, monitor, control and manage significant environmental risks;

- establish clear and meaningful environmental objectives and targets aimed at continuous improvement;

- implement, maintain and regularly test emergency response plans;

- identify potential environmental emergencies; and

comply with all applicable laws and regulations and when practicable, strive to exceed those requirements. We have been developing and implementing environmental programs at all of our mining, steel and power subsidiaries. Such programs include measures to enforce our adherence to the requirements and limits imposed on air and water pollution, as well as disposal of industrial waste, introduction of environmentally friendly industrial technologies, the construction of purification and filtering facilities, the repair and reconstruction of industrial water supply systems, the installation of metering systems, reforestation and the recycling of water and industrial waste.

## **Regulatory Matters**

## **Licensing of Operations in Russia**

We are required to obtain numerous licenses, authorizations and permits from Russian governmental authorities for our operations. Some of our companies need to obtain licenses, authorizations and permits to carry out their activities, including, among other things, for:

the use of subsoil, which is described in more detail in [Subsoil Licensing in Russia](#) below;

the use of water resources;

the emission and discharge of pollutants into the environment;

the handling of waste of a I-IV hazard class;

the handling of industrial explosives;

operation of explosive and fire and chemically hazardous production facilities of a I-III hazard class;

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fire control and security;

medical operations;

mine surveying;

loading and unloading operations;

transportation activities;

collection, processing, storage and sale of ferrous and non-ferrous scrap;

works with information classified as state secret;

manufacturing of equipment for nuclear facility; and

operation of radiation source.

In addition, the Government of the Russian Federation has developed a draft law according to which starting from July 1, 2017 power sales activities should be conducted only on the basis of a license issued by an authorized authority. Currently, the draft law is under review by the State Duma.

The Federal Law On Licensing of Certain Types of Activities, dated May 4, 2011, as amended (the **Licensing Law**), as well as other laws and regulations, sets forth the activities subject to licensing and establish procedures for issuing licenses.

Under the Licensing Law, generally, licenses may be issued for an indefinite term. Licenses for the use of natural resources may be issued for various periods. Upon the expiration of a license, it may be extended upon application by the licensee, provided the licensee is not in violation of the terms and conditions of the license and the relevant regulations.

Regulatory authorities maintain considerable discretion in the timing of issuing licenses and permits. The requirements imposed by these authorities may be costly, time-consuming and may result in delays in the commencement or continuation of exploration or extraction operations. Further, private individuals and the public at large possess rights to comment on and otherwise participate in the licensing process, including through challenges in the courts. For example, individuals and public organizations may make claims or applications to Rosnedra regarding subsoil abuse, damage to the subsoil and general environmental issues. Rosnedra is required by law to review such claims and applications and to respond to those who file them. The agency can initiate further investigation in the course of reviewing claims and applications, and such investigations can lead to suspension of the subsoil license if the legal grounds for such suspension are identified in the course of the investigation. In addition, citizens may make claims in court against state authorities for failing to enforce environmental requirements (for example, if a breach by

the licensee of its license terms caused damage to an individual's health, legal interests or rights), and pursuant to such a claim the court may order state authorities to suspend the subsoil license. Accordingly, the licenses we need may not be issued, or if issued, may not be issued in a timely fashion, or may impose requirements which restrict our ability to conduct our operations or to do so profitably.

As part of their obligations under licensing regulations and the terms of our licenses and permits, some of our companies must comply with numerous industrial standards, employ qualified personnel, maintain certain equipment and a system of quality controls, monitor operations, maintain and make appropriate filings and, upon request, submit specified information to the licensing authorities that control and inspect their activities.

### **Subsoil Licensing in Russia**

In Russia, mining minerals requires a subsoil license from Rosnedra with respect to an identified mineral deposit. In addition to a subsoil license, a subsoil user needs to obtain rights (through ownership, lease or other right) to use a land plot covering the surface of the area where such licensed mineral deposit is located. In addition, as discussed above, operating permits are required with respect to specific mining activities.

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The primary law regulating subsoil licensing is the Federal Law On Subsoil, dated February 21, 1992, as amended (the **Subsoil Law**), which sets out the regime for granting licenses for the exploration and extraction of mineral resources. The Procedure for Subsoil Use Licensing, adopted by Resolution of the Supreme Soviet of the Russian Federation on July 15, 1992, as amended (the **Licensing Regulation**), also regulates the licensing of exploration and extraction of mineral resources. According to both the Subsoil Law and the Licensing Regulation, subsurface mineral resources are subject to the jurisdiction of the federal authorities.

Among different licenses required for mining minerals in Russia, the two major types of licenses are: (1) an exploration license, which is a non-exclusive license granting the right of geological exploration and assessment within the license area, and (2) an extraction license, which grants the licensee an exclusive right to produce minerals from the license area. In practice, many of the licenses are issued as combined licenses, which grant the right to explore and produce minerals from the license area. A subsoil license defines the license area in terms of latitude, longitude and depth. The subsoil user has the right to develop and use, including sell, mineral resources extracted from the license area for a specified period. The Russian Federation, however, retains ultimate state ownership of all subsoil mineral resources.

There are three major types of payments with respect to the extraction of minerals: (1) a lump-sum payment for granting the right to use subsoil; (2) periodic payments for the use of subsoil under the Subsoil Law; and (3) the mineral extraction tax under the Russian Tax Code. Failure to make these payments could result in refusal to grant the right to use subsoil or the suspension or termination of the subsoil license. The Subsoil Law-mandated payments are not material to our mining segment's results of operations. For coal, the basic rate of the mineral extraction tax ranges from 11 to 57 rubles per tonne depending on the type of coal. At the same time, the actual rate of tax in respect of extracted coal is subject to indexation on a quarterly basis taking into account deflator coefficients adopted by the Ministry of Economic Development of the Russian Federation. For iron ore, the mineral extraction tax is 4.8%. In 2016, mineral extraction taxes amounted to 964 million rubles, which are included in the consolidated statement of profit (loss) and other comprehensive income (loss) as extraction related overheads.

Currently, extraction licenses and combined licenses are awarded by tender or auction conducted by special auction commissions of Rosnedra. While such tender or auction may involve a representative of the relevant region, the separate consent of regional authorities is generally not required in order to issue subsoil licenses. The winning bidder in a tender is selected on the basis of the submission of the most technically competent, financially attractive and environmentally sound proposal that meets published tender terms and conditions. At an auction, the success of a bid is determined by the attractiveness of the financial proposal. In limited circumstances, extraction licenses may also be issued without holding an auction or tender, for instance to holders of exploration licenses who discover mineral resource deposits through exploration work conducted at their own expense. Regional authorities may issue extraction licenses for common mineral resources, such as clay, sand or limestone.

Pursuant to the Subsoil Law, a subsoil plot is provided to a subsoil user as a mining allotment, i.e. a geometric block of subsoil. Preliminary mining allotment boundaries are determined at the time the license is issued. Following the development and approval of a technical plan in accordance with established procedure, documents defining the adjusted mining allotment boundaries are incorporated as an integral part into the license. Pursuant to Resolution No. 118 of the Government of the Russian Federation dated March 3, 2010, as amended, a special commission comprised of representatives from the Ministry of Natural Resources and Ecology, Rosnedra, Rosprirodnadzor, Rostekhnadzor and relevant local authorities approve development plans and other project documentation relating to the use of subsoil plots.

The term of the license is set forth in the license. Under the Subsoil Law, exploration licenses are generally issued for a term of up to five years and up to 10 years for geological surveys of internal sea waters, territorial sea waters or the

continental shelf of the Russian Federation. In accordance with amendments to the Subsoil Law that entered into force in January 2014, exploration licenses with respect to subsoil plots partially or fully located

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in certain constituent entities of the Russian Federation can be issued for a term of up to seven years. Extraction licenses are issued for the term of the expected operational life of the field based on a feasibility study that provides for rational use and protection of the subsoil. In the event that a prior license with respect to a particular field is terminated early (for example, when a license is withdrawn due to non-usage of the licensed subsoil), an extraction license may have a one year term until a new licensee is determined, but is generally granted to another user for the term of the expected operational life of the field based on a feasibility study. Licensees are also allowed to apply for extensions of such licenses for the purposes of completing the exploration and development of the field, or remediation activities in the absence of violations of the terms and conditions of the license. The term of a subsoil license runs from the date the license is registered with Rosnedra.

### ***Issuance of licenses***

Subsoil licenses are issued by Rosnedra. Most of the currently existing extraction licenses owned by companies derive from: (1) pre-existing rights granted during the Soviet era and up to the enactment of the Subsoil Law to state-owned enterprises that were subsequently reorganized in the course of post-Soviet privatizations; or (2) tender or auction procedures held in the post-Soviet period. The Civil Code, the Subsoil Law and the Licensing Regulation contain the major requirements relating to tenders and auctions. The Subsoil Law allows extraction licenses to be issued without a tender or auction procedure only in limited circumstances, such as instances when a mineral deposit is discovered by the holder of an exploration license at its own expense during the exploration phase.

### ***Extension of licenses***

The Subsoil Law permits a subsoil licensee to request an extension of an extraction license for the term of the expected operational life of the subsoil plot in order to complete the extraction from the subsoil plot covered by the license or the procedures necessary to vacate the land once the use of the subsoil is complete, provided the user is not in violation of the terms and conditions of the license and the relevant regulations.

In order to extend the period of a subsoil license, a company must file an application with territorial authorities of Rosnedra to amend the license. In addition, as we have seen in practice, a subsoil licensee may be required to prepare and provide to the authority amended technical documentation and development plan of the deposit under the license justifying the requested extension. The costs associated with the license extension are generally not substantial and mainly relate to preparing amendments to the technical documentation and development plan of the subsoil plot. Application to extend the period of subsoil license is typically made six months before its expiration.

To the best of our knowledge, derived from publicly available information, the relevant governmental authorities when determining whether to approve an amendment (including an extension) of a license consider the following: (1) the grounds for the amendments, with specific information as to how the amendments may impact payments by the licensee to the federal and local budgets; (2) compliance of the licensee with the conditions of the license; and (3) the technical expertise and financial capabilities that would be required to implement the conditions of the amended license. We have successfully extended certain of our subsoil licenses which were due to expire for the entire term of the expected operational life of the subsoil plots. The terms of the licenses were extended in accordance with the amendments we made to the development plans of the subsoil plots. Furthermore, as evidenced by a number of court cases during the past several years, license extensions are being rejected predominantly on the grounds of subsoil users being in violation of the material terms of the licenses. Though current regulation does not specify what license terms are material, current practice suggest that regulatory authorities tend to treat as material terms of the license the terms related to license payments, production levels and operational milestones.



The factors that may, in practice, affect a company's ability to obtain the approval of license amendments (including extensions) include: (1) its compliance with the license terms and conditions; (2) its management's

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experience and expertise relating to subsoil issues; and (3) the relationship of its management with federal and/or local governmental authorities, as well as local governments. For a description of additional factors that may affect Russian companies' ability to extend their licenses, see Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry. Our business could be adversely affected if we fail to obtain or extend necessary subsoil licenses and permits or fail to comply with the terms of our subsoil licenses and permits. See also Item 3. Key Information Risk Factors Risks Relating to the Russian Federation Legal risks and uncertainties Deficiencies in the legal framework relating to subsoil licensing subject our licenses to the risk of governmental challenges and, if our licenses are suspended or terminated, we may be unable to realize our reserves, which could materially adversely affect our business, financial condition, results of operations and prospects and Item 3. Key Information Risk Factors Risks Relating to the Russian Federation Legal risks and uncertainties Weaknesses relating to the Russian legal system and legislation create an uncertain investment climate.

***Transfer of licenses***

Licenses may be transferred only under certain limited circumstances that are set forth in the Subsoil Law, including the reorganization or merger of the licensee or in the event that an initial licensee transfers its license to a newly established legal entity in which it has at least a 50% ownership interest, provided that the transferee possesses the equipment and authorizations necessary to conduct the exploration or extraction activity covered by the transferred license.

***Maintenance and termination of licenses***

A license granted under the Subsoil Law is accompanied by a licensing agreement. The law provides that there will be two parties to any subsoil licensing agreement: the relevant state authorities and the licensee. The licensing agreement sets out the terms and conditions for the use of the subsoil.

Under a licensing agreement, the licensee makes certain environmental, safety and extraction commitments. For example, the licensee makes an extraction commitment to bring the field into extraction by a certain date and to extract an agreed-upon volume of natural resources each year. The licensing agreement may also contain commitments with respect to the social and economic development of the region. When the license expires, the licensee must return the land to a condition which is adequate for future use. Although most of the conditions set out in a license are based on mandatory rules contained in Russian law, certain provisions in a licensing agreement are left to the discretion of the licensing authorities and are often negotiated between the parties. However, commitments relating to safety and the environment are generally not negotiated.

The fulfillment of a licensee's conditions is a major factor in the good standing of the license. If the subsoil licensee fails to fulfill the licensee's conditions, upon notice, the license may be terminated or the subsoil user's rights may be restricted by the licensing authorities. However, if a subsoil licensee cannot meet certain deadlines or achieve certain volumes of exploration work or extraction output as set forth in a license, it may apply to amend the relevant license conditions, though such amendments may be denied.

The Subsoil Law and other Russian legislation contain extensive provisions for license termination. A licensee can be fined or the license can be suspended or terminated for repeated breaches of the law, upon the occurrence of a direct threat to the lives or health of people working or residing in the local area, or upon the occurrence of certain emergency situations. A license may also be terminated for violations of material license terms. Although the Subsoil Law does not specify which terms are material, failure to pay subsoil taxes and failure to commence operations in a timely manner have been common grounds for limitation or termination of licenses. Consistent underproduction and failure to meet obligations to finance a project would also be likely to constitute violations of material license terms.

In addition, certain licenses provide that the violation by a subsoil licensee of any of its obligations may constitute grounds for terminating the license.

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Rosprirodnadzor routinely conducts scheduled and unscheduled inspections for compliance by subsoil users with the terms of their licenses and reports violations to Rosnedra. Rosnedra examines Rosprirodnadzor's reports and, if it finds that these violations constitute sufficient grounds for terminating the license, the Commission for Termination of Subsoil Licenses considers the nature of these violations and recommends that Rosnedra either (i) revoke the license; (ii) notify the subsoil user about the identified violations and potential termination of the license if the subsoil user fails to rectify the identified violations within a prescribed period of time; or (iii) consider that the actions described in (i) and (ii) above are unreasonable and accept the information provided by the subsoil user.

If the licensee does not agree with a decision of the licensing authorities, including a decision relating to the termination of a license or the refusal to change an existing license, the licensee may appeal the decision through administrative or judicial proceedings. In certain cases prior to termination, the licensee has the right to attempt to cure the violation within three months of its receipt of notice of the violation. If the issue has been resolved within such a three month period, no termination or other action may be taken.

## **Land Use Rights in Russia**

Russian legislation prohibits the carrying out of any commercial activity, including mineral extraction, on a land plot without appropriate surface land use rights. Land use rights are needed and obtained for only the portions of the license area actually being used, including the plot being mined, access areas and areas where other mining-related activity is occurring.

Under the Land Code, companies generally have ownership or lease rights with regard to land in the Russian Federation.

A majority of land plots in the Russian Federation is owned by federal, regional or municipal authorities who, through bidding (carried out in the form of an auction) or without bidding, can sell, lease or grant other use rights to the land to third parties.

Our mining subsidiaries generally have entered into long-term lease agreements for their surface land within the specified license mining area. Under Russian law, a lessee generally has a right to enter into a new land lease agreement with a lessor upon the expiration of a land lease. In order to renew a land lease agreement, the lessee must apply to the lessor (usually state or municipal authorities) for a renewal prior to the expiration of the agreement. Any land lease agreement for a term of one year or more must be registered with the relevant state authorities.

## **Environmental Legislation in Russia**

We are subject to laws, regulations and other legal requirements relating to the protection of the environment, including those governing the emission and discharge of substances into the air and water, the formation, distribution and disposal of hazardous substances and waste, the cleanup of contaminated sites, flora and fauna protection and wildlife protection. Issues of environmental protection in Russia are regulated primarily by the Federal Law On Environmental Protection, dated January 10, 2002, as amended (the **Environmental Protection Law**), as well as by a number of other federal, regional and local legal acts.

Since 2008, the Ministry of Natural Resources and Ecology has been working on significant amendments to the Environmental Protection Law and other regulations. These amendments were codified in the Federal Law No. 219-FZ, dated July 21, 2014, the Federal Law No. 458-FZ, dated December 29, 2014 and the Federal Law No. 404-FZ, dated December 29, 2015, which have already come into force or are gradually coming into force. The purpose of the amendments is to strengthen liability for companies' non-compliance with environmental laws and

regulations, as well as to improve the distribution of functions among state environmental agencies at both the federal and regional levels.

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The amendments, in particular, divide objects that have a negative impact on the environment into four categories depending on the degree of impact on the environment. The environmental protection requirements that apply differ depending on the relevant impact category and include environmental impact charges, permission documents and control procedures. The first category includes objects that have a significant negative impact on the environment (to which, therefore, the strictest environmental protection requirements apply) and the fourth category includes objects that have minimal environment impact. Among other things, the adopted amendments contemplate that starting from 2020 charges for environmental impact exceeding regulatory thresholds will increase. Furthermore, the liability for certain environmental violations has been enhanced recently, and the fines for certain environmental offenses, for example, in connection with violations of water use requirements, increased by 15 times the current amounts. See

Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry More stringent environmental laws and regulations or more stringent enforcement or findings that we have violated environmental laws and regulations could result in higher compliance costs and significant fines and penalties, cleanup costs and compensatory damages, or require significant capital investment, or even result in the suspension of our operations, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

***Pay-to-pollute***

The Environmental Protection Law and other Russian environmental protection legislation establish a pay-to-pollute regime administered by federal and local authorities. Pay-to-pollute (or payments for environmental pollution) is a form of mandatory reimbursement to the Russian government for damage caused to the environment.

The Russian government has established standards relating to the permissible impact on the environment and, in particular, standards of permissible emissions and discharges and waste disposal limits. In case of non-compliance with the statutory standards a company may obtain temporary approved limits on emissions and discharges on the basis of permits valid only during the period of implementation of environmental measures. The establishment of limits is allowed only upon the availability of a plan for emissions and discharges reduction agreed with Rosprirodnadzor. The emissions and discharges reduction plan is required to be implemented within a specific period with an annual submission of a report on its implementation to Rosprirodnadzor. Rosprirodnadzor may revoke the limits, if the company fails to implement measures to reduce emissions and discharges in a timely manner. If, by the end of that period, the company's emissions and discharges are still in excess of the statutory standards, a new plan must be submitted to Rosprirodnadzor for review and approval in order to receive new limits.

Fees for the emission/discharge per tonne of each contaminant into air and water and fees for waste disposal are established by governmental authorities. These fees are determined on a sliding scale for both the statutory standards and individually approved limits on emissions and discharges, as well as for pollution in excess of these limits: the lowest fees are imposed for pollution within the statutory standards, intermediate fees are imposed for pollution within the individually approved temporary limits (within limit fees; exceed the fees within the statutory standards by 5 times) and the highest fees are imposed for pollution exceeding such limits (above-limit fees; exceed the fees within the individually approved temporary limits by 5 times). Thus, above-limit fees exceed the fees within the statutory standards by 25 times. In accordance with recent amendments to the Environmental Protection Law, starting from 2020, environmental impact charges exceeding regulatory thresholds in certain cases will be increased by up to 100 times current fees as statutorily prescribed. Payment of above-limit fees does not relieve the company from the responsibility as provided by Russian law, as well as the development and implementation of environmental measures aimed at reducing the negative impact on the environment. In 2016, we incurred above-limit fees and penalties in Russia in the amount of approximately 61.9 million rubles.



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### ***Environmental expert review***

According to the Federal Law *On Environmental Expert Review* dated November 23, 1995, as amended (the **EER Law**), environmental expert review is a process of verifying compliance of business or operational documentation with environmental standards and technical regulations for the purpose of preventing a negative environmental impact of such business or operations. The EER Law provides for the main principles for conducting environmental expert review and for the type of documentation which is subject to such review.

In relation to our operating companies, all documentation underlying the issuance of some of our licenses is subject to environmental expert review.

Review of documentation related to capital construction is regulated under the Urban Development Code, dated December 29, 2004, as amended (the **Urban Development Code**). The Urban Development Code provides for governmental inspection to verify the compliance of project documentation with relevant technical regulations, including sanitary-epidemiological and environmental regulations, requirements for the protection of objects of cultural heritage, as well as fire, industrial, nuclear and other kinds of safety requirements, and compliance with the results of engineering surveys with relevant technical regulations.

### ***Environmental enforcement authorities***

Currently state environmental regulation is administered by several federal services and agencies and their regional subdivisions, in particular, Rosprirodnadzor, the Federal Service for Hydrometrology and Environmental Monitoring, Rosnedra, the Federal Agency for Forestry, the Federal Agency for Water Resources and some others. Included in these agencies' sphere of responsibility are environmental preservation and control, enforcement and observance of environmental legislation, drafting and approving regulations and filing court claims to recover environmental damages. The statute of limitations for such claims is 20 years.

The Russian federal government and the Ministry of Natural Resources and Ecology are responsible for coordinating the work of the federal services and agencies engaged in state environmental regulation.

The structure of environmental enforcement authorities described above was established in 2004. This structure was subjected to certain changes in 2008 and 2010. In particular, the Ministry of Natural Resources was transformed into the Ministry of Natural Resources and Ecology. In late 2010, this structure was further changed and the powers previously held by Rostekhnadzor in the field of environmental protection regarding the limitation of negative industrial impact, waste treatment and state environmental impact assessments were transferred to Rosprirodnadzor which is coordinated by the Ministry of Natural Resources and Ecology.

### ***Environmental liability***

If the operations of a company violate environmental requirements or cause harm to the environment or any individual or legal entity, a court action may be brought to limit or ban these operations and require the company to remedy the effects of the violation. Any company or employees that fail to comply with environmental regulations may be subject to administrative and/or civil liability, and individuals may be held criminally liable. Courts may also impose cleanup obligations on violators in lieu of or in addition to imposing fines or other penalties to compensate for damages.

Subsoil licenses generally require certain environmental commitments. Although these commitments can be substantial, the penalties for failing to comply and the reclamation requirements are generally low; however, failure to comply with reclamation requirements can result in a suspension of mining operations.



***Reclamation***

We conduct our reclamation activities for land damaged by production in accordance with the Basic Regulation on Land Reclamation, Removal, Preservation, and Rational Use of the Fertile Soil Layer, approved

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by Order No. 525/67 of December 22, 1995, of the Ministry of Natural Resources. In general, our reclamation activities involve both a technical stage and a biological stage. In the technical stage, we backfill the pits, grade and terrace mound slopes, level the surface of the mounds, and add clay rock on top for greater adaptability of young plants. In the biological stage, we plant conifers (pine, larch, cedar) on horizontal and gently sloping surfaces and shrubs and bushes to reinforce inclines. Russian environmental regulations do not require mines to achieve the approximate original contour of the property as is required, for example, in the United States. In 2016, we incurred reclamation costs in Russia of approximately 256 million rubles.

***Kyoto Protocol and the United Nations Framework Convention on Climate Change***

In December 1997, in Kyoto, Japan, the signatories to the United Nations Convention on Climate Change established individual, legally binding targets to limit or reduce greenhouse gas emissions by developed nations. This international agreement, known as the Kyoto Protocol, came into force on February 16, 2005. At the Doha 2012 United Nations Climate Change Conference Russia, Japan and some other countries announced suspension of their participation in the Kyoto Protocol.

In December 2015 at the Paris climate conference, 196 countries adopted the United Nations Framework Convention on Climate Change which is due to enter into force in 2020. The agreement sets out a global action plan to avoid climate change. The Russian Federation shall develop a long-term plan to reduce greenhouse gas emissions and shall establish a strategy on adaptation to climate change. In July 2015, Ministry of Natural Resources and Ecology of the Russian Federation has approved guidelines for the quantification of the amount of greenhouse gas emissions by organizations conducting business and other activities in Russia. Further Russia's steps on implementation of the United Nations Framework Convention on Climate Change could restrict our operations and/or impose significant costs or obligations on us, including requiring additional capital expenditures, modifications in operating practices, and additional reporting obligations.

**Technical Regulations**

We are subject to various technical regulations and standards which apply to industrial manufacturing businesses. The Federal Law No. 184-FZ On Technical Regulation dated December 27, 2002, as amended (the **Technical Regulation Law**) has introduced a new regime for the development, enactment, application and enforcement of mandatory rules applicable to production, manufacturing, storage, transportation, sales and certain other operations and processes, as well as new regulations relating to the quality of products and processes, including technical regulations, standards and certification. It was expected that these rules or technical regulations would replace the previously adopted state standards (the so-called GOSTs). However, most technical regulations have not been implemented yet, and, in the absence of such technical regulations, the existing federal laws and regulations, including GOSTs, that prescribe rules for different products and processes remain in force to the extent that they protect health, property, the environment and/or consumers. In addition, the federal standardization authority has declared GOSTs and interstate standards adopted before July 1, 2003 to be the applicable national standards.

In certain circumstances, companies are required to obtain certification of compliance with applicable technical regulations, standards and terms of contracts. A number of our products must be certified. Where certification is not mandatory, a company may elect voluntary certification by applying for a compliance certificate from the relevant authorities. Following the issuance of such certificate, the applicant has the right to use the relevant compliance mark on its products.

**Health and Safety Regulations in Russia**

Due to the nature of our business, much of our activity is conducted at industrial sites with a large number of workers, and industrial safety and workplace safety issues are of significant importance to the operation of these sites.

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The principal law regulating industrial safety is the Federal Law On Industrial Safety of Hazardous Production Facilities, dated July 21, 1997, as amended (the **Safety Law**). The Safety Law applies, in particular, to production facilities and sites where certain activities are conducted, including sites where load-lifting machines are used, where melts of ferrous and nonferrous metals are produced, used, stored and transported, where hazardous substances are stored and used (including allowed concentrations) and where certain types of mining is done. There are also regulations that address safety rules for coal mines, the production and processing of ore, the blast-furnace industry, steel smelting, alloy production and nickel production. Additional safety rules also apply to certain industries, including metallurgical and coke chemical enterprises and the foundry industry.

The Safety Law provides for hazardous production facilities of four classes from class IV to class I, with class IV being less hazardous and class I being the most hazardous. The safety and compliance requirements set up by the Safety Law apply to each facility depending on their class of hazard. Each existing hazardous production facility was to be re-registered with the state register by January 1, 2014 and be assigned with a hazard class. We re-registered hazardous production facilities at our operations in accordance with the applicable law.

Any construction, reconstruction, liquidation or other activities in relation to regulated industrial sites is subject to a state industrial safety review. Any deviation from project documentation in the process of construction, reconstruction or liquidation of industrial sites is prohibited unless reviewed by a licensed expert organization and approved by Rostekhnadzor.

In addition, the Safety Law establishes an alternative form of industrial safety regulation that is based on risk assessment rather than prescriptions of obligatory requirements and standards imposed by Rostekhnadzor. A company that operates a hazardous production facility may develop a safety case, a document which describes that the facility has been designed and operated in a way to limit any risks of major accident. The Safety Law considers that in drafting the safety case, the relevant companies will be able to refer to specific safety arrangements and safety analyses as confirmation of having certain safety measures in place. To make these arrangements fully operational further changes will need to be introduced into relevant laws and regulations.

Companies that operate such production facilities and sites have a wide range of obligations under the Safety Law and the Labor Code of Russia of December 30, 2001, as amended (the **Labor Code**). In particular, they must limit access to such sites to qualified specialists, maintain industrial safety controls and carry insurance for third-party liability for injuries caused in the course of operating industrial sites. Russian regulations require these companies to enter into contracts with professional emergency response units or create their own emergency response services in certain cases, conduct personnel trainings and drills, create systems to cope with and notify the authorities of accidents and maintain these systems in good working order. Effective from January 1, 2014, companies that operate industrial sites of hazard classes I and II must implement industrial safety management systems to prevent accidents and incidents at hazardous production facilities and develop certain emergency response plans.

Companies that operate production sites of hazard classes I and II and handle hazardous substances in quantities set by the law must also prepare declarations of industrial safety which summarize the risks associated with operating a particular production site and measures the company has taken and will take to mitigate such risks and use the site in accordance with applicable industrial safety requirements. Such declarations must be adopted by the chief executive officer of the company, who is personally responsible for the completeness and accuracy of the data contained therein. The industrial safety declaration as well as a state industrial safety review are required for the issuance of a license permitting the operation of a hazardous production facility.

Rostekhnadzor has broad authority in the field of control and management of industrial safety. In case of an accident, a special commission led by a representative of Rostekhnadzor conducts a technical investigation of the cause. The

company operating the hazardous production facility where the accident took place bears all costs of

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an investigation. Rostekhnadzor officials have the right to access production sites and may inspect documents to ensure a company's compliance with safety rules. Rostekhnadzor may suspend for up to 90 days or initiate a court decision to terminate operations of companies and/or impose administrative liability on officers of such companies.

Any company or individual violating industrial safety rules may incur administrative and/or civil liability, and individuals may also incur criminal liability. A company that violates safety rules in a way that negatively impacts the health of an individual may also be obligated to compensate the individual for lost earnings, as well as health-related damages.

**Russian Antimonopoly Regulation**

The Federal Law "On Protection of Competition," dated July 26, 2006, as amended (the **Competition Law**), provides for a mandatory pre-approval by the FAS of the following actions:

other than in respect to financial organizations, such as banks, an acquisition by a person (or its group) of more than 25% of the voting shares of a Russian joint-stock company (or one-third of the interests in a Russian limited liability company), except upon incorporation, and the subsequent increase of these stakes to more than 50% of the total number of the voting shares and more than 75% of the voting shares (one-half and two-thirds of the interests in a Russian limited liability company), or acquisition by a person (or its group) of ownership or rights of use with respect to the core production assets (other than land and non-industrial buildings, constructions, premises and parts thereof or constructions in progress) and/or intangible assets of an entity which are located in Russia if the balance sheet value of such assets exceeds 20% of the total balance sheet value of the core production and intangible assets of such entity, or obtaining rights to determine the conditions of business activity of a Russian entity or to exercise the powers of its executive body by a person (or its group), or an acquisition by a person (or its group) of more than 50% of the voting shares (interests) of a foreign entity, which has supplied goods, works and/or services to Russia in an amount exceeding 1 billion rubles in the preceding year, or other rights to determine the conditions of business activity of such entity or to exercise the powers of its executive body, if, in any of the above cases, the aggregate asset value of an acquirer and its group together with a target and its group (excluding the asset value of the seller and its group, if as a result of the acquisition the seller and its group cease to determine the conditions of business activity of the target) exceeds 7 billion rubles and at the same time the total asset value of the target and its group exceeds 400 million rubles, or the total annual revenues of such acquirer and its group, and the target and its group for the preceding calendar year exceed 10 billion rubles and at the same time the total asset value of the target and its group exceeds 400 million rubles;

mergers and consolidations of entities, other than financial organizations, if their aggregate asset value (the aggregate asset value of the groups of persons to which they belong) exceeds 7 billion rubles, or total annual revenues of such entities (or groups of persons to which they belong) for the preceding calendar year exceed 10 billion rubles;

founding of a business entity, if its charter capital is paid by the shares (or limited liability company interests) and/or the assets (other than cash) of another business entity (other than financial organization) or the newly founded business entity acquires shares (or limited liability company interests) and/or the assets (other than cash) of another business entity based on a transfer act or a separation balance sheet and rights in

respect of such shares (or limited liability company interests) and/or assets (excluding monetary funds) as specified above, at the same time provided that the aggregate asset value of the founders (or group of persons to which they belong) and the business entities (or groups of persons to which they belong) which shares (or limited liability company interests) and/or assets (other than cash) are contributed to the charter capital of the newly founded business entity exceeds 7 billion rubles, or total annual revenues of the founders (or group of persons to which they belong) and the business entities (or groups of persons to which they belong) which shares

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(or limited liability company interests) and/or assets are contributed to the charter capital of the newly founded business entity for the preceding calendar year exceed 10 billion rubles; and

entering into joint venture agreements between competitors, if their aggregate asset value (the aggregate asset value of the groups of persons to which they belong) exceeds 7 billion rubles, or total annual revenues of such entities (or groups of persons to which they belong) for the preceding calendar year exceed 10 billion rubles.

The above requirements for a mandatory pre-approval by the FAS will not apply if the transactions are performed by members of the same group, if the information about such a group of persons was disclosed to the antimonopoly authority and there were no changes within one month prior to the date of the transaction within that group of persons. In such cases, the FAS must be notified of the transactions subsequently in accordance with Russian anti-monopoly legislation. Furthermore, the requirement for a mandatory approval of transactions/actions described above will not apply if the transactions/actions are performed by members of the same group where a company and individual or an entity, if such an individual or an entity holds (either due to its participation in this company or based on the authorities received from other persons) more than 50% of the total amount of votes in the equity (share) capital of this company.

A transaction entered into in violation of the above requirements may be invalidated by a court decision pursuant to a claim brought by the FAS if the FAS proves to the court that the transaction leads or could lead to the limitation of competition in the relevant Russian market. The FAS may also issue binding orders to companies that have violated the applicable antimonopoly requirements and bring court claims seeking liquidation, split-up or spin-off of business entities if a violation of antimonopoly laws was committed by such business entities. In addition, a company may be subject to the administrative fine of an amount from 150 to 250 thousand rubles for the failure to file a FAS post-transactional notification and from 300 to 500 thousand rubles for the failure to file an application for FAS pre-approval of the transaction.

Under the Competition Law, a company with a dominant position in the relevant market is prohibited from misusing its dominant position. Specifically, such company is prohibited from:

establishing and maintaining monopolistically high or monopolistically low prices of goods;

withdrawing goods from circulation, if the result of such withdrawal is an increase in the price of goods;

imposing contractual terms upon a counterparty which are unprofitable for the counterparty or not related to with the subject matter of agreement (i.e., terms that are economically or technologically unjustified);

reducing or terminating, without economical or technological justification, production of goods if there is a demand for the goods or orders for their delivery have been placed and it is possible to produce them profitably;



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refusing or evading, without economical or technological justification, to enter into a contract with customers in cases when the production or delivery of the relevant goods is possible;

establishing without economical, technological or other justification different prices for the same goods;

establishing unjustifiably high or unjustifiably low price of a financial service by a financial organization;

creating discriminatory conditions;

creating barriers to entry into the market for the relevant goods or forcing other companies to leave the market;

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violating pricing procedures established by law; and

manipulating prices in the wholesale and/or retail electricity (capacity) markets.

In 2016, as a result of amendments to the Competition Law, the register of entities with a market share exceeding 35% in the relevant market was abolished. Inclusion of a company in the register implied that it might be subject to additional FAS oversight, but at the same time provided the company with information on the occupied market share. The abolition of the register creates additional antimonopoly risks to the company.

In order to prevent the creation of discriminatory conditions, the Government of the Russian Federation can establish rules for non-discriminatory access to goods that are produced and/or sold by a business entity holding a dominant position and not included into the register of natural monopolies whose share exceeds 70% in the relevant market. Such rules may be established in case a decision of the antimonopoly authority on the fact of abuse of a dominant position by such business entity entered into force.

In the event of breach of any terms of business conduct required by the FAS, the FAS may initiate proceedings to investigate a breach of antimonopoly laws. If a breach of the antimonopoly laws is identified, the FAS may initiate administrative proceedings which may result in the imposition of a fine calculated on the basis of the annual revenues received by the company in the market where such breach was committed. Such fines may include an administrative fine of an amount from 300 thousand to one million rubles or, if such violation has led or may lead to the prevention, limitation or elimination of competition, an administrative fine of up to 15% of the proceeds of sales of all goods, works and services in the market where such violation was committed, but not more than 2% of gross proceeds of sale of all goods, works and services for the year preceding the year of the violation. Russian legislation also provides for criminal liability of company managers for violations of certain provisions of antimonopoly legislation. Furthermore, for systematic violations, a court may order, pursuant to a suit filed by the FAS, a compulsory split-up or spin-off of the violating company, and no affiliation can be preserved between the new entities established as result of such a mandatory reorganization.

The FAS has determined certain of our companies to have a dominant position in certain markets and these companies are subject to directive issued by the FAS which impose certain restrictions on their commercial activities. See Risk Factors Risks Relating to Our Business and Industry Antimonopoly regulation could lead to sanctions with respect to the subsidiaries we have acquired or established or our prices, sales volumes and business practices.

### **The Strategic Industries Law**

The Strategic Industries Law, dated April 29, 2008, as amended, regulates foreign investments in companies with strategic importance for the national defense and security of the Russian Federation ( **Strategic Companies** ). The Strategic Industries Law provides an exhaustive list of strategic activities, engagement in which makes a company subject to restrictions. Among others, the list of such activities includes exploration and/or production of natural resources on subsoil plots of federal importance. Subsoil plots of federal importance include plots with deposits of uranium, diamonds, high-purity quartz ore, nickel, cobalt, niobium, lithium, beryllium, tantalum, yttrium-group rare-earth metals and platinoid metals. They also include deposits of oil, gas, vein gold and copper which are above certain size limits specified in the Subsoil Law, as well as subsoil plots of the internal sea, territorial sea and continental shelf; and subsoil plots, the use of which requires the use of land plots included in the category of national defense and security land. The Strategic Subsoil List was first officially published in *Rossiyskaya Gazeta* on March 5, 2009. Services rendered by business entities included into the register of natural monopolies pursuant to the Federal Law On Natural Monopolies, dated August 17, 1995, as amended, with certain exceptions, are also considered to constitute strategic activity. Furthermore, the activity of a business entity which is deemed to occupy a dominant

position in the production and sale of metals and alloys with special features which are used in production of weapons and military equipment is also deemed to be a strategic activity. The production and distribution of industrial explosives is also deemed to be activity of strategic importance for national defense and homeland security.

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Investments resulting in a foreign investor or a group of entities obtaining control over a Strategic Company, or acquiring fixed assets of a Strategic Company representing 25% or more of its balance sheet value, require prior approval from state authorities. The procedure for issuing such consent will involve a special governmental commission on the control of foreign investments (the **Governmental Commission**), which was established by a government resolution dated July 6, 2008 as the body responsible for granting such consents, and the FAS, which is authorized to process applications for consent from foreign investors and to issue such consents based on the decisions of the Governmental Commission. **Control** for these purposes means an ability to determine, directly or indirectly, decisions taken by a Strategic Company, whether through voting at the general shareholders (or limited liability company interest-holders) meeting of the Strategic Company, participating in the board of directors or management bodies of the Strategic Company, or acting as the external management organization of the Strategic Company or otherwise. Thus, generally, control will be deemed to exist if any foreign investor or a group of entities acquires more than 50% of the shares (or limited liability interests) of a Strategic Company, or if by virtue of a contract or ownership of securities with voting rights it is able to appoint more than 50% of the members of the board of directors or of the management board of a Strategic Company. However, there are special provisions for Strategic Companies involved in the exploration or extraction of natural resources on plots of federal importance (**Subsoil Strategic Companies**): a foreign investor or group of entities is considered to have control over a Subsoil Strategic Company when such foreign investor or group of entities holds directly or indirectly 25% or more of the voting shares of the Subsoil Strategic Company or holds the right to appoint its sole executive officer and/or 25% or more of its management board or has the unconditional right to elect 25% or more of its board of directors.

Furthermore, in case a foreign investor or its group of entities which is a holder of securities of a Strategic Company, Subsoil Strategic Company or other entity which exercises control over these companies becomes a direct or indirect holder of voting shares in amount which is considered to give them direct or indirect control over these companies in accordance with the Strategic Industries Law due to a change in the allocation of votes resulting from the procedures provided by Russian law (e.g. as a result of a buy-back by the relevant company of its shares, conversion of preferred shares into common shares or holders of preferred shares becoming entitled to vote at a general shareholders meeting in cases provided by Russian law), such shareholders will have to apply for state approval of their control within three months of receiving such control. If the Governmental Commission refuses to grant the approval the shareholders shall sell the relevant part of their respective shares or participatory interest, and if they do not comply with this requirement, a Russian court can deprive such foreign investor or its group of entities of the voting rights in such Strategic Company upon a claim of the competent authority. In such cases, the shares of the foreign investor are not counted for the purposes of establishing a quorum and reaching the required voting threshold at the general shareholders meeting of the Strategic Company.

Any transfers of a stake, or certain rights, in a Strategic Company or in a Subsoil Strategic Company to foreign investors that are (i) companies controlled by the Russian Federation, the constituent entity of the Russian Federation or (ii) companies controlled by Russian nationals, provided that such Russian nationals are Russian tax residents and do not have other nationality, will not require prior approval from the state authorities.

If a foreign investor or its group of entities obtains control over a Strategic Company in violation of the Strategic Industries Law, the relevant transaction is void, and in certain cases a Russian court can deprive such foreign investor or group of entities of the voting rights in such Strategic Company upon a claim by the competent authority. In addition, resolutions of the general shareholders meetings or other management bodies of a Strategic Company adopted after a foreign investor or group of entities obtained control over the Strategic Company in violation of the Strategic Industries Law, as well as transactions entered into by the Strategic Company after obtaining such control, may be held invalid by a court upon a claim by the competent authority. See Item 3. Key Information Risk Factors Risks Relating to the Russian Federation Legal risks and uncertainties Expansion of limitations on foreign investment in strategic sectors could affect our ability to attract and/or retain foreign investments.



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**Employment and Labor Regulations in Russia**

Labor matters in Russia are governed primarily by the Labor Code. In addition to this core legislation, relationships between employers and employees are regulated by federal laws, such as the Law On Employment in the Russian Federation, dated April 19, 1991, as amended, and the Law On Compulsory Social Insurance Against Industrial Accidents and Occupational Diseases, dated July 24, 1998, as amended; legal acts of executive authorities; and local government acts related to labor issues.

***Employment contracts***

As a general rule, employment contracts for an indefinite term are entered into with all employees. Russian labor legislation generally disfavors fixed-term employment contracts. However, an employment contract may be entered into for a fixed term of up to five years in certain cases where labor relations may not be established for an indefinite term due to the nature of the duties or the conditions of the performance of such duties, as well as in other cases expressly identified by the Labor Code or other federal law. In some cases it is also possible to enter into an employment contract for the employee to perform specified tasks. All terms and conditions of employment contracts are regulated by the Labor Code.

Under Russian law, employment may be terminated by mutual agreement between the employer and the employee at the end of the term of a fixed-term employment contract or on the grounds set out in the Labor Code as described below. An employee has the right to terminate his or her employment contract with a minimum of two weeks' notice (or one month's notice for a company's chief executive officer), unless the employment contract is terminated before the notice period ends by mutual agreement between employer and employee.

An employer may terminate an employment contract only on the basis of the specific grounds enumerated in the Labor Code, including, inter alia:

liquidation of the enterprise or downsizing of staff;

failure of the employee to comply with the position's requirements due to incompetence, as confirmed by the results of an attestation;

repeated failure of the employee to fulfill his or her work duties without valid reason, provided that the employee has been disciplined previously;

entering the workplace under the influence of alcohol, narcotics or other intoxicating substances;

a single gross breach by an employee of his or her work duties, including truancy;

disclosure of state secrets or other confidential information, which an employee has come to know during fulfillment of his professional duties;

embezzlement, willful damage or destruction of assets, and misappropriation as confirmed by a court decision or a decision by another competent governmental authority;

failure to comply with safety requirements in the workplace if such failure to comply caused injuries, casualties or catastrophe; and

provision by the employee of false documents upon entry into the employment contract.

An employee dismissed from an enterprise due to downsizing or liquidation is entitled to receive compensation and salary payments for a certain period of time, depending on the circumstances.

The Labor Code also provides protections for specified categories of employees. For example, except in cases of liquidation of an enterprise and other events specified in the Labor Code, an employer cannot dismiss minors, pregnant women, mothers with a child under the age of three, single mothers with a child under the age of 14 or other persons caring for a child under the age of 14 without a mother.

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Any termination by an employer that is inconsistent with the Labor Code requirements may be invalidated by a court, and the employee may be reinstated. Lawsuits resulting in the reinstatement of illegally dismissed employees and the payment of damages for wrongful dismissal are increasingly frequent, and Russian courts tend to support employees rights in most cases. Where an employee is reinstated by a court, the employer must compensate the employee for unpaid salary for the period between the wrongful termination and reinstatement, as well as for mental distress.

### ***Work time***

The Labor Code generally sets the regular working week at 40 hours. Any time worked beyond 40 hours per week, as well as work on public holidays and weekends, must be compensated at a higher rate.

For employees working in hazardous or harmful conditions, the regular working week is decreased by four hours. Some of our production employees qualify for this reduced working week.

Annual paid vacation leave under the law is 28 calendar days. Our employees who work in mines and pits or work in harmful conditions may be entitled to additional paid vacation ranging from 7 to 42 business days.

The retirement age in the Russian Federation is 60 years for males and 55 years for females. However, employees who work in underground and open pit mines or do other work in potentially harmful conditions have the right to retire at an earlier age. Early retirement ages are established by the applicable legislation.

### ***Salary***

The minimum salary in Russia, as established by federal law, is 7,500 rubles. Although the law requires that the minimum wage be at or above a minimum subsistence level, the current minimum wage is generally considered to be less than a minimum subsistence level.

### ***Strikes***

The Labor Code defines a strike as the temporary and voluntary refusal of workers to fulfill their work duties with the intention of settling a collective labor dispute. Russian legislation contains several requirements for legal strikes. Participation in a legal strike may not be considered by an employer as grounds for terminating an employment contract, although employers are generally not required to pay wages to striking employees for the duration of the strike. Participation in an illegal strike may be adequate grounds for termination of employment.

### ***Trade unions***

Although Russian labor regulations have decreased the authority of trade unions compared with the past, they retain influence over employees and, as such, may affect the operations of large industrial companies in Russia, such as Mechel. In this regard, our management routinely interacts with trade unions in order to ensure the appropriate treatment of our employees and the stability of our business.

The activities of trade unions are generally governed by the Federal Law On Trade Unions, Their Rights and Guarantees of Their Activity, dated January 12, 1996, as amended (the **Trade Union Law**). Other applicable legal acts include the Labor Code, which provides for more detailed regulations relating to activities of trade unions.

The Trade Union Law defines a trade union as a voluntary union of individuals with common professional and other interests that is incorporated for the purposes of representing and protecting the rights and interests of its members.



National trade union associations, which coordinate activities of trade unions throughout Russia, are also permitted.

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As part of their activities, trade unions may:

negotiate collective contracts and agreements such as those between the trade unions and employers, federal, regional and local governmental authorities and other entities;

monitor compliance with labor laws, collective contracts and other agreements;

access work sites and offices, and request information relating to labor issues from the management of companies and state and municipal authorities;

represent their members and other employees in individual and collective labor disputes with management;

organize and participate in strikes; and

monitor redundancy of employees and seek action by municipal authorities to delay or suspend mass layoffs. Russian laws require that companies cooperate with trade unions and do not interfere with their activities. Trade unions and their officers enjoy certain guarantees as well, such as:

legal restrictions as to rendering redundant employees elected or appointed to the management of trade unions;

protection from disciplinary punishment or dismissal on the initiative of the employer without prior consent of the management of the trade union and, in certain circumstances, the consent of the relevant trade union association;

retention of job positions for those employees who stop working due to their election to the management of trade unions;

protection from dismissal for employees who previously served in the management of a trade union for two years after the termination of the office term, except where a company is liquidated or the employer is otherwise entitled to dismiss the employee; and

provision of necessary equipment, premises and vehicles by the employer for use by the trade union free of charge, if provided for by a collective contract or other agreement.

If a trade union discovers any violation of work condition requirements, notification is sent to the employer with a request to cure the violation and to suspend work if there is an immediate threat to the lives or health of employees. The trade union may also apply to state authorities and labor inspectors and prosecutors to ensure that an employer does not violate Russian labor laws. Trade unions may also initiate collective labor disputes, which may lead to strikes.

To initiate a collective labor dispute, trade unions present their demands to the employer. The employer is then obliged to consider the demands and notify the trade union of its decision. If the dispute remains unresolved, a reconciliation commission attempts to end the dispute. If this proves unsuccessful, collective labor disputes are generally referred to mediation or labor arbitration. Although the Trade Union Law provides that those who violate the rights and guarantees provided to trade unions and their officers may be subject to disciplinary, administrative and criminal liability, no specific consequences for such violations are set out in Russian legislation.

## **Regulation of Russian Electricity Market**

### ***Industry background***

The functioning of the energy system of the Russian Federation is based on a combination of technological and commercial infrastructure which operates under state control, on the one hand, and organizations engaged in the generation and sale of electricity which interact with each other in a competitive environment, on the other hand.

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Pursuant to the Federal Law On the Electric Power Industry No. 35-FZ dated March 26, 2003, the electric power industry entities are organizations engaged in the production of electricity, heat energy and capacity, purchase and sale of electricity and capacity, power supply of consumers, rendering services in electricity transmission, operational-dispatching management in the electric power industry, sales of electric energy (capacity), organizing of purchase and sale of electric energy and capacity.

Generating companies carry out generation and sale of electricity in the wholesale or retail markets to sales organizations or end consumers. Sales organizations purchase electricity in the wholesale and retail markets and sell it to end consumers.

Electricity consumers are natural and legal persons who purchase electricity for their own household and/or production needs. Large consumers may purchase electricity directly on the wholesale market provided that they fulfill the requirements for participants of the wholesale electricity and capacity market. Other categories of consumers purchase electricity from power sales companies, including guaranteeing suppliers, as well as may purchase electricity from electricity producers who are not participants of the wholesale electricity and capacity market.

System Operator (SO UPS JSC), which is wholly-owned by the state, performs operational-dispatching management in the Unified Energy System of Russia. The main function of the System Operator is to control of the compliance of technological parameters of the energy system operation. The System Operator participates in the maintenance of the wholesale electricity and capacity market.

Grid operators transmit electricity through electric grids and carry out technological connection of power receiving devices of electricity consumers, power facilities of generating companies and power grid facilities of other owners to electric grids. Activities of grid operators are a natural monopoly and are regulated by the state.

Organizations of commercial infrastructure include Trading System Administrator JSC, Financial Settling Center JSC and Association Nonprofit Partnership Market Council. Association Nonprofit Partnership Market Council was established in order to balance the interests of the electricity market participants and to ensure the unity of the commercial infrastructure operation. Activities of infrastructure organizations, including pricing and conditions of interaction with contractors, are subject to state regulation and control.

### ***Sales of electricity***

The Russian electricity market consists of wholesale and retail electricity and capacity markets. The wholesale electricity and capacity market encompasses European territory of the Russian Federation, the Urals and Siberia and is divided into two pricing zones. The first pricing zone includes the European territory of the Russian Federation and the Urals and the second pricing zone includes Siberia. In addition, there are so-called non-pricing zones, namely the regions of the Far East, the Arkhangelsk region, the Kaliningrad region and the Komi Republic. Competition in these areas for various technical reasons is not possible yet. In non-pricing zones sale of electricity in the retail electricity and capacity market is made at regulated prices. The wholesale market provides a framework for large-scale, often interregional, energy trades. The retail electricity market operates within all Russian regional territories and provides a framework for mid-scale and end-consumer energy trades. This market is regulated by the respective Regional Energy Committees.

### ***Wholesale electricity market***

The wholesale electricity and capacity market is a sphere of distribution of electric energy and capacity within the Unified Energy System of Russia. The wholesale market participants include large producers and consumers of electricity and capacity, as well as other entities that earned the status of an entity of the wholesale market and act on the basis of applicable rules.

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Trading on the wholesale electricity and capacity market is conducted in accordance with the agreement on accession to the trading system and wholesale market regulations which are developed and adopted by Association Nonprofit Partnership Market Council.

Electricity trading on the wholesale electricity and capacity market is carried out by means of the classical model of supply and demand balance or through bilateral contracts of purchase and sale of electric energy.

Currently electricity is traded on the basis of the following trading mechanisms:

### **Regulated bilateral contracts**

Regulated contracts are effectively take-or-pay obligations at regulated prices defined by the FAS for electricity and capacity volumes. The volumes of electricity to be traded by the generators under regulated contracts are set up by the FAS annually based on percentages of the volumes of electricity generated in the previous year. The volumes of electricity traded under regulated contracts have gradually declined for the wholesale market when it became fully liberalized in 2011. Starting from January 1, 2011, electricity is traded at non-regulated prices, except for electricity intended for supply to households.

A generator may provide the volumes of electricity it must sell under regulated contracts either through own generation or through the purchase of electricity on the spot market at market prices. Similarly, its consumers receive electricity at regulated prices in the volumes agreed under the regulated contracts, regardless of their actual needs, and can freely trade the imbalance on the spot market at market prices (either by purchasing additional volumes, if needed, or selling the excess electricity volumes).

### **Non-regulated bilateral contracts**

Electricity supply volumes which are not agreed upon under regulated contracts, as well as all new generation capacity commissioned after January 1, 2007, can be traded by participants of the wholesale market under non-regulated contracts, on the one-day-ahead spot market or on the balancing market. All terms of electricity supply under non-regulated contracts are subject to free negotiation between sellers and purchasers.

### ***Retail electricity market***

The retail market participants include consumers, power supply companies, guaranteeing suppliers, power grid companies and electricity producers which do not supply electricity to the wholesale market.

The retail electricity market operates on the following main principles: (1) end consumers are free to choose between sales companies; (2) end consumers purchase at free prices set on the market, except for contracts with guaranteeing suppliers; and (3) guaranteeing suppliers cannot refuse to enter into a contract with an end consumer.

Guaranteeing suppliers sell electricity under prices that take account of: (1) the prices on the wholesale electricity market; (2) the sales premium of the particular guaranteeing supplier set by respective regional authorities; and (3) the prices for electricity transmission and distribution through electricity networks.

### ***Heat market***

Heat markets are regional retail markets and heat prices are regulated and set within the general guidelines provided by the FAS and by regional authorities. Minimum and maximum prices for heat energy traded on the retail markets

are set by the FAS separately for each administrative region of Russia for a period of at least one year. Regional authorities establish the prices for relevant territories within the range set by the FAS and subject to the types and prices of fuel used to produce the heat and the volumes of heat purchased on the relevant territory.

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Our Southern Kuzbass Power Plant delivers heat energy (in the form of hot water) at regulated prices to residential and commercial customers in the cities of Kaltan, Osinniki and Mezhdurechensk. Mechel Energo delivers heat energy (in the form of hot water and steam) at regulated prices to residential and commercial customers in the cities of Vidnoye, Chelyabinsk, Chebarkul, Beloretsk and Izhevsk.

## **E.U. REACH**

On June 1, 2007, the European Union enacted regulations on registration, evaluation, authorization and restrictions of use of chemicals, known as REACH. The purpose of REACH is to ensure a high level of protection of human health and the environment, including the promotion of alternative methods of assessment of hazards of chemical substances.

REACH requires foreign manufacturers importing their chemical substances into the European Union, as well as E.U. manufacturers producing such substances in quantities of one tonne or more per year, to register these substances with the ECHA and provide the information about the registered substances usage and utilization to the competent authorities of the E.U. Member States and downstream users upon request. To comply with REACH requirements, we have created dedicated internal working groups, procured external consultants' advice and budgeted for REACH procedures expenses. Prior to December 1, 2008, we pre-registered with the ECHA substantially all of the substances that we intended to export to or produce in the European Union. As a next step, we successfully registered with the ECHA the substances that we export to or produce in the European Union in an amount over 1,000 tonnes per year, and which are subject to REACH registration, namely: ferroalloys, coke-chemicals and pig iron exported to the European Union. This registration was completed prior to December 1, 2010 in compliance with the REACH implementation schedule.

## **Item 4A. *Unresolved Staff Comments***

None.

## **Item 5. *Operating and Financial Review and Prospects***

*The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes and other information in this document. This Item 5 contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in forward-looking statements as a result of various factors, including the risks described in Item 3. Key Information Risk Factors and under the caption Cautionary Note Regarding Forward-Looking Statements.*

In this Item 5, the term "domestic" describes sales by a subsidiary within the country where its operations are located. The term "export" describes cross-border sales by a subsidiary regardless of its location. See note 27 to the consolidated financial statements.

## **History of Incorporation**

Mechel PAO was incorporated on March 19, 2003, as a joint-stock company holding shares and interests in the charter capitals of various mining and steel companies owned by Igor Zyuzin, Vladimir Iorich and companies controlled by them. These individuals acted in concert from 1995 until December 2006 pursuant to an agreement which required them to vote in the same way. During the period from March through December 2006, Mr. Iorich disposed of his entire interest in Mechel PAO to Mr. Zyuzin, and the agreement terminated on December 21, 2006.





**Table of Contents****Business Structure****Segments**

We have organized our businesses into three segments:

the mining segment, comprising production and sale of coal (metallurgical and steam), coke and chemical products and iron ore, which supplies raw materials to our steel and power segments and also sells substantial amounts of raw materials to third parties, and includes logistical assets, such as our seaports on the Sea of Japan and on the Sea of Azov and our railway transportation assets;

the steel segment, comprising production and sale of semi-finished steel products, long products of a wide range of steel grades, carbon and stainless flat products, high value-added metal products, including wire products, forgings and stampings, as well as ferrosilicon, and our river port on the Kama River, a tributary of the Volga River; and

the power segment, comprising generation and sale of electricity and heat energy, which supplies electricity and heat energy to our mining and steel segments and also sells a portion of electricity and heat energy to third parties.

The table below sets forth by segments our key mining, steel and power subsidiaries, presented in chronological order by date of acquisition.

| <b>Name</b>                     | <b>Location of Assets</b> | <b>Product/Business</b>   | <b>Date Control Acquired</b> | <b>Voting Interest<sup>(1)</sup>%</b> |
|---------------------------------|---------------------------|---|------------------------------|---------------------------------------|
| <b><i>Mining Segment</i></b>    |                           |   |                              |                                       |
| Southern Kuzbass Coal Company   | Russia                    | Coking coal, steam coal, anthracite and PCI                                     | January 1999                 | 96.6%                                 |
| Korshunov Mining Plant          | Russia                    | Iron ore concentrate  | October 2003                 | 90.0%                                 |
| Port Posiet                     | Russia                    | Seaport: coal warehousing and transshipment                                     | February 2004                | 97.6%                                 |
| Mechel Coke                     | Russia                    | Coke and chemical products  | June 2006                    | 100.0%                                |
| Moscow Coke and Gas Plant       | Russia                    | Coke and chemical products  | October 2006                 | 99.5%                                 |
| Yakutugol                       | Russia                    | Coking coal, steam coal   | October 2007                 | 100.0%                                |
| Port Temryuk                    | Russia                    | Seaport: coal and metal transshipment   | March 2008                   | 100.0%                                |
| Elgaugol                        | Russia                    | Coking coal, steam coal   | August 2013                  | 51.0%                                 |
| Elga-road                       | Russia                    | Railroad transportation   | January 2016                 | 51.0%                                 |
| <b><i>Steel Segment</i></b>     |                           |   |                              |                                       |
| Chelyabinsk Metallurgical Plant | Russia                    | Semi-finished steel products, carbon and stainless long and flat steel products | December 2001                | 94.2%                                 |

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|                                 |           |  |               |        |
|---------------------------------|-----------|--|---------------|--------|
| Vyartsilya Metal Products Plant | Russia    | Wire products  | May 2002      | 93.3%  |
| Beloretsk Metallurgical Plant   | Russia    | Long steel products, wire products                       | June 2002     | 94.8%  |
| Urals Stampings Plant           | Russia    | Stampings and forgings                                   | April 2003    | 93.8%  |
| Mechel Nemunas                  | Lithuania | Wire products  | October 2003  | 100.0% |
| Izhstal                         | Russia    | Carbon and special steel long products and wire products | May 2004      | 90.0%  |
| Port Kambarka                   | Russia    | River port   | April 2005    | 90.4%  |
| Bratsk Ferroalloy Plant         | Russia    | Ferrosilicon   | August 2007   | 100.0% |
| <b><i>Power Segment</i></b>     |           |  |               |        |
| Mechel Energo                   | Russia    | Power generation and sale                                | February 2004 | 100.0% |
| Southern Kuzbass Power Plant    | Russia    | Power generation   | April 2007    | 98.3%  |
| Kuzbass Power Sales Company     | Russia    | Electricity distribution                                 | June 2007     | 72.1%  |

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- (1) The percentages provided in this table are as of December 31, 2016. Some of our Russian subsidiaries have preferred shares outstanding that have voting rights similar to the common shares rights if dividends on those shares have not been paid. We have calculated voting interests by including these preferred shares for subsidiaries where dividends have not been paid.

***Intersegment sales***

We are an integrated group with operations organized into mining, steel and power segments. Our group companies supply materials to other companies in the same reporting segment or different reporting segments. For example, for the year ended December 31, 2016:

The mining segment supplied approximately 43% of the steel segment's iron ore feed requirements, 100% of the steel segment's coke requirements and 82% of the power segment's coal requirements;

The steel segment supplies wires, ropes, wire products and other metal products to the mining segment for use in its day-to-day operations; and

The power segment supplied approximately 26% of our group's overall electricity requirements. The prices at which we record these transfers are based on market prices, and these transactions are eliminated as intercompany transactions for the purposes of our consolidated financial statements. For the period-on-period discussion of the results of operations by segments, such transfers are included in segment revenues and cost of goods sold.

***Recent acquisitions and disposals***

Set out below is our key disposal during 2014-2016. There were no significant acquisitions during 2014-2016. For more detail see notes 6 and 16 to the consolidated financial statements. The financial and sales information for the periods presented herein may not be directly comparable from period to period due to disposals.

*Bluestone.* In February 2015, we disposed of 100% of shares in Mechel Bluestone Inc., the holding company of our coal assets in the United States, to a company owned by the Justice family. The total consideration consisted of: (1) an immediate cash payment of \$5 million (RUB 330.3 million as of February 12, 2015); (2) future royalty payments on coal mined and sold in the amount of \$3.00 (RUB 198.2 as of February 12, 2015) per short ton, capped at \$150 million (RUB 9,908.8 million as of February 12, 2015); (3) a portion of a sale price in case of any future sale of Bluestone and/or its assets, amounting to 12.5% or 10% of the total consideration if the sale transaction closes within five or from five to ten years, respectively, of the sale to the Justice family. Following disposal of certain Bluestone assets by the Justice family, in February 2017, we received \$7.9 million (RUB 466.0 million as of February 6, 2017) as a portion of its sale price under relevant transaction documents. The results of operations of Bluestone companies are included in the consolidated financial statements as discontinued operations. See note 16 to the consolidated financial statements.

**Factors Affecting Our Results of Operations and Financial Condition**

***Change in reporting currency***

Beginning with the period commencing on January 1, 2014, the presentation currency of our consolidated financial statements is the Russian ruble. Before transition to IFRS, U.S. dollar was the presentation currency of our consolidated financial statements prepared under U.S. GAAP. The reason of adopting the Russian ruble as the presentation currency in the consolidated statements under IFRS is to allow a greater transparency of our financial and operating performance as it more closely reflects the profile of our revenue and operating income that are mostly generated in Russian rubles.

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**Table of Contents*****Cyclical nature of business and impact of macroeconomic factors***

Our mining business sells significant amounts of coal to third parties and our revenues depend significantly on these sales. Cyclical and other changes in the world market prices for coal and iron ore affect the results of our mining operations. The changes in these prices result from factors which are beyond our control, such as market supply and demand. The global coal and iron ore supply and demand balance is strongly influenced by interdependent global economic and industrial demand cycles, as well as supply chain-related constraints such as shipping capacity, availability of rolling stock, transportation bottlenecks, production disruptions and natural disasters. Prices for the products of our mining business have varied significantly in the past and could vary significantly in the future. See

Price trends for products below. See also Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry We operate in cyclical industries, and any local or global downturn, whether or not primarily affecting the mining and/or steel industries, may have an adverse effect on our business, financial condition, results of operations and prospects.

The steel industry is highly cyclical in nature because the industries in which steel customers operate are cyclical and sensitive to changes in general economic conditions. The demand for steel products thus generally correlates to macroeconomic fluctuations in the economies in which we sell our products, as well as in the global economy. The prices of our steel products are influenced by many factors, including demand, worldwide production capacity, capacity utilization rates, raw materials costs, exchange rates, trade barriers and improvements in steel-making processes. Steel prices also typically follow trends in raw materials prices and increases in market prices for steel may lag behind increases in production costs, including raw materials.

Demand for steel, particularly long steel products in which we believe we are one of the most competitive producers in the Russian market, is closely tied to the construction industry in the markets in which we sell our products. The construction business in Russia, the principal market for our products, was severely impacted by the global financial crisis and the sharp economic slowdown in Russia. As a result of the critical role of steel in infrastructural and overall economic development, the steel industry tends to track macroeconomic factors such as GDP and industrial output.

Global real GDP grew by 2.6% in 2014, 2.4% in 2015 and 2.3% in 2016, according to the World Bank. According to Rosstat, Russia recorded GDP growth of 0.6% in 2014 and further decline of 3.7% in 2015 and 0.2% in 2016. In 2014, world markets continued their slowdown amid slowing economic growth in China, the European debt crisis and geopolitical tensions. In 2015, the global economy was under pressure due to slowing growth in China, geopolitical tensions and high levels of over-production of hydrocarbon raw materials and as a result of low oil prices. In 2016, there was a slight recovery of the world economy, the reduction of geopolitical tensions and the decline in oversupply reserves of crude oil which in turn helped to restore in commodity prices. Prices for our products fluctuated depending on the level of demand in key consuming industries and supply and demand balance in our key markets. See Price trends for products.

***Trade and competition***

Mining products and many types of steel products are considered commodities and treated as fungible in the world markets. As such, we compete with steel producers and mining companies with operations in different countries. The main competitive advantages that steel producers can secure are based on quality and production costs. Generally, steel producers in economically developed regions compete primarily based on quality of steel, while we and other steel producers in developing countries compete in the international market based primarily on price. With respect to our mining products, such as coal and iron ore, quality, production costs and transportation capabilities are key areas where companies seek a competitive advantage.

We benefit from import tariffs that Russia has in place for certain steel products. See Risk Factors Risks Relating to Our Business and Industry We benefit from Russia's tariffs and duties on imported steel, many of which have been reduced upon Russia's WTO membership and may be eliminated in the future.

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**Table of Contents*****Consolidation trends in the mining and steel industries***

The mining industry has been severely impacted by the decline in coal prices since the end of 2011. Prices have fallen by nearly four times in 2011-2016. Profitability of coal producers has dramatically declined. Many coal companies around the globe suspended their operations or even had filed for bankruptcy. Major mining companies were scaling back acquisitions and looking to divest non-core and underperforming assets, some of which were acquired just several years ago. Diversified mining companies have corrected their strategy to focus on profitable operations and reduce their exposure to coal. A sudden increase in coal prices in the second half of 2016 is deemed to be a result of temporary factors (limiting the number of working days of the coal enterprises in China and adverse weather conditions in Australia). The rise in coal prices at the end of 2016 has not transformed into a steady trend of market consolidation.

As global economies show signs of stabilization and metal prices begin to recover, we expect a continued positive trend in steel industry M&A activity. The majority of M&A transactions in the steel industry continue to occur within the country due to the high cost of transportation of heavy metal products. Over the past three years, 77% of deal activity has occurred locally.

We, along with other Russian steel producers, tend to focus on vertical integration which ensures access to a stable supply of raw materials, particularly coking coal and iron ore. Our vertical integration helps us to better manage the effects of raw materials supply constraints and also provides us with an opportunity to capture higher margins in sales of our mining segment products to third parties.

***Price trends for products******Coking coal and steam coal***

Throughout 2014, the price for metallurgical coal declined driven by lower demand from Chinese consumers, as well as an increase in low-cost supply from the Australian coking coal producers. As a result, contract prices fell from \$143 per tonne (FOB Australia) in the first quarter of 2014 to \$119 per tonne (FOB Australia) in the fourth quarter of 2014, according to CRU. During 2015, global metallurgical coal prices were under pressure as demand continued to decline and oversupply remained. According to CRU, quarterly contract price dropped from \$117 per tonne (FOB Australia) in the first quarter of 2015 to \$89 per tonne (FOB Australia) in the fourth quarter of 2015. Spot prices declined from \$106 per tonne (FOB Australia) in the first quarter of 2015 to \$78 per tonne (FOB Australia) in the fourth quarter of 2015, according to CRU. The average contract price in 2015 was \$102 per tonne, 18% below the average price in 2014. The average spot price in 2015 was \$90 per tonne (FOB Australia), 21% below the average price in 2014. In this low-price environment, many producers were operating at a loss. In 2016, metallurgical coal prices were extremely volatile, especially in the second half of the year. According to CRU, in 2016, the premium hard coking coal spot price increased four times from the beginning of the year and reached \$310 per tonne (FOB Australia) in November. According to CRU, quarterly contract price rose from \$81 per tonne (FOB Australia) in the first quarter of 2016 to \$200 per tonne (FOB Australia) in the fourth quarter of 2016. The Chinese government's actions to reduce coal supply were the primary driver of the metallurgical coal price rally in 2016. By the end of the year, the spot price had fallen by 25% from its peak level in November 2016 and amounted to \$230 per tonne due to a reversal in Chinese coal supply policy. The government was attempting to inject supply into the market since October 2016 and this led to an improvement in the availability of domestic metallurgical coal, according to CRU. The average contract price in 2016 was \$114 per tonne, 12% higher than the average contract price in 2015, according to CRU. The average spot price in 2016 was \$140 per tonne (FOB Australia), 55% higher than the average spot price in 2015, according to CRU.



At the beginning of 2014, the spot price for steam coal was \$83 per tonne (CIF Amsterdam/Rotterdam/Antwerp); by the end of the year it dropped to \$70 per tonne, according to Platts. Among the factors which had led to lower prices in the world market for steam coal were the decline in demand from the Chinese and European economies, as well as the growth in supply from Australian producers. The reduction of prices in the

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steam coal market was also due to a general decline in energy prices in 2014. In 2015, steam coal market was still in oversupply, despite producers' efforts to cut production. Chinese power generation and consumption growth has slowed significantly in 2015. According to Platts, in 2015 the spot price for steam coal was \$58 per tonne (CIF Amsterdam/Rotterdam/Antwerp) in January; by the end of the year it declined to \$48 per tonne. The average price in 2015 was \$56 per tonne (CIF Amsterdam/Rotterdam/Antwerp), 25% lower than the average price in 2014, according to Platts. In the first five months of 2016, the spot price for steam coal was generally stable fluctuating around \$46 per tonne (CIF Amsterdam/Rotterdam/Antwerp) (the lowest level since 2003), but starting from June steam coal price began to rise sharply due to the Chinese government's coal supply policy, according to Platts. As a result of decreased coal production in China steam coal price rose from \$53 per tonne in June 2016 to \$87 per tonne in December 2016. The average price in 2016 was \$60 per tonne (CIF Amsterdam/Rotterdam/Antwerp), 7% higher than the average price in 2015, according to Platts.

*Iron ore*

During 2014, the iron ore spot price decreased from a high of \$129 per dry metric tonne (62% Fe, CFR China) in January to a low of \$69 per dry metric tonne in December, according to MMI. The price decrease was due to sharp increase in low-cost supply from the Australian and Brazilian producers. In 2015, this trend continued: a lot of new iron ore capacity came on stream which together with a reduction of steel production in China has led to lower prices. Iron ore spot price declined from \$68 per dry metric tonne (62% Fe, CFR China) in January 2015 to \$40 per dry metric tonne in December 2015, according to MMI. The average spot price in 2015 was \$56 per dry metric tonne which was 42% lower than the average price in 2014, according to MMI. Starting from January 2016, there was a reversal in iron ore spot price trend. During 2016, iron ore spot prices were generally rising with minor downward corrections in May-June and September. The iron ore spot price increased from a low of \$42 per dry metric tonne (62% Fe, CFR China) in January to a high of \$80 per dry metric tonne in December, according to MMI. Strong Chinese demand for imported iron ore which hit an all-time high in 2016 was the main reason of the price increase. The average spot price in 2016 was \$58 per dry metric tonne which was 4% higher than the average price in 2015, according to MMI.

*Coke*

In 2014, world market prices for coke were under pressure due to negative trends in the global steel and raw materials market, which resulted in a decrease in prices from \$238 per tonne (FOB China basis) in the first quarter of the year to \$183 per tonne (FOB China basis) at the end of the year, according to CRU. Domestic coke prices managed to stay at the level of 2013, namely 6,983 rubles per tonne (including VAT, FCA basis), according to Metal-Courier. By the end of the year, however, domestic coke prices fluctuated around 7,600-8,800 rubles per tonne (including VAT, FCA basis), according to Metal-Courier. The increase in domestic coke prices was due to an increase in demand from Ukrainian consumers and to devaluation of the ruble. In 2015, coke production continued to overshoot demand, Chinese export volume has increased, exacerbating oversupply and displacing market share of other coke producing countries in international markets, thus pressuring prices further. As a result coke prices declined from \$177 per tonne (FOB China basis) in the first quarter to \$123 per tonne (FOB China basis) in the fourth quarter, according to CRU. Average domestic coke price in 2015 was 10,892 rubles per tonne (including VAT, FCA basis), 56% higher than the average price in 2014, according to Metal-Courier. Price growth in the domestic coke market was due to depreciation of Russian ruble, higher coking coal prices and strong demand from Ukraine. In 2016, the world coke price showed almost the same dynamics as coking coal prices. According to CRU, coke prices increased from \$113 per tonne (FOB China basis) in the first quarter of the year to \$307 per tonne (FOB China basis) in the fourth quarter of the year. According to CRU, such sharp rise of the coke price was driven largely by panic buying by steel producers globally. Initially, tightness in the market was created following implementation of the 276 working days' policy at Chinese coal mines that reduced coal production. Domestic coke price in 2016 was 12,022 rubles per tonne (including VAT, FCA

basis), 10% higher than the average price in 2015, according to Metal-Courier. Price growth in the domestic coke market was due to sharp rise of coking coal prices in the second half of the year in Russia which led to costs increase of coke producers and increased coke prices on export markets.

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In 2014, the Russian domestic price for rebar increased to 23,948 rubles (+6% year-on-year) per tonne and the average export price for square billets declined to \$481 (-5.9% year-on-year) per tonne, according to Metal-Courier. In 2015, the Russian domestic price for rebar increased to 25,038 rubles (+4.6% year-on-year) per tonne mostly as a result of the growth in the exchange rate. The average export price for square billets declined to \$328 (-31.8% year-on-year) per tonne as a result of decreased oil and scrap prices, low demand and increased competition on the background of China's exports growth, according to Metal-Courier. In 2016, the Russian domestic price for rebar increased to 30,177 rubles (+20.5% year-on-year) per tonne due to further ruble devaluation, strong export markets and limited supply in the second and fourth quarters. The average export price for square billets remained almost unchanged at \$328 (+0.1% year-on-year) per tonne, according to Metal-Courier.

*Ferrosilicon*

In 2014, ferrosilicon prices decreased throughout the year. In January 2014, the average price level for Chinese ferrosilicon was \$1,475 per tonne (75% Si, CIF Japan). By the end of the year, ferrosilicon prices fell to \$1,341 per tonne (75% Si, CIF Japan), according to TEX. In the beginning of 2015, the price of ferrosilicon continued to fall. In May 2015, the price decline has stopped at \$1,242 per tonne (75% Si, CIF Japan), according to TEX. After a relatively stable position in June-August, ferrosilicon prices resumed falling. In December 2015, prices dropped to \$1,156 per tonne (75% Si, CIF Japan), according to TEX. The average price for ferrosilicon in 2015 was \$1,239 per tonne (75% Si, CIF Japan), a decrease of 11% compared to 2014, according to TEX. In 2016, from January to September, the average price for ferrosilicon had not been subject to significant fluctuations and was within the range of \$1,155-1,195 per tonne (75% Si, CIF Japan). In October and November, the average price for ferrosilicon showed a sharp increase and amounted to \$1,285 per tonne (75% Si, CIF Japan). Quotations in the Japanese market increased as the price rose in China. In December, the price stopped rising and amounted to \$1,260 per tonne (75% Si, CIF Japan). The average price for ferrosilicon in 2016 was \$1,193 per tonne (75% Si, CIF Japan), a decrease of 4% compared to 2015, according to TEX.

*Freight costs*

During 2016, ocean freight rates improved after reaching record lows in the first quarter of 2016. For the entirety of the year, the volatility of the global dry bulk freight market was driven by the volatility of the global oil price. The record lows of January and February coincided with a lowest Brent Crude price of USD 27.88 and a lowest Singapore bunker fuel price of USD 154. Freight rates improved for the remainder of the year as the 2016 average improved to USD 45.01 for Brent Crude and USD 239.71 for Singapore Bunkers. After the Baltic Dry Index (BDI) reached an all-time-low of \$290 on February 10, it improved steadily throughout the year to peak in mid-November at \$1,261. The largest decrease in the dry bulk sector came from the Capesize sector, where the average time charter rate decreased from \$8,127 per day in 2015 to \$7,388 per day in 2016. The average Panamax rate was \$5,562 per day in 2016 compared to \$5,560 per day in 2015. The average rate for Supramax vessels in 2016 was \$6,236 per day compared to \$6,695 per day in 2015. The average rate for Handysize vessels in 2016 was \$5,214 per day compared to \$5,381 per day in 2015.

*Exchange rates*

Our products are typically priced in rubles for Russian and the CIS sales and in U.S. dollars or euros for international sales. Our direct costs, including raw materials, labor and transportation costs are largely incurred in rubles and other local currencies, while other costs, such as interest expenses, are incurred in rubles, euros and U.S. dollars. The mix of our revenues and costs is such that a depreciation in real terms of the ruble against the U.S. dollar tends to result in a

decrease in our costs relative to our revenues, while an appreciation of the ruble against the U.S. dollar in real terms tends to result in an increase in our costs relative to our revenues.

**Table of Contents****Results of Operations**

The following table sets forth our consolidated statement of profit data for the years ended December 31, 2016, 2015 and 2014.

|  | <b>Year Ended December 31,</b> |                          |               |                          |               |                          |
|--|--------------------------------|--------------------------|---------------|--------------------------|---------------|--------------------------|
|  | <b>2016</b>                    |                          | <b>2015</b>   |                          | <b>2014</b>   |                          |
|  | <b>Amount</b>                  | <b>% of<br/>Revenues</b> | <b>Amount</b> | <b>% of<br/>Revenues</b> | <b>Amount</b> | <b>% of<br/>Revenues</b> |
| <b>(In millions of Russian rubles, except for percentages)</b>         |                                |                          |               |                          |               |                          |
| Revenue  | 276,009                        | 100.0%                   | 253,141       | 100.0%                   | 243,992       | 100.0%                   |
| Cost of goods sold   | (146,322)                      | (53.0%)                  | (151,334)     | (59.8%)                  | (153,057)     | (62.7%)                  |
| Gross profit   | 129,687                        | 47.0%                    | 101,807       | 40.2%                    | 90,935        | 37.3%                    |
| Total selling, distribution and operating income and (expenses), net   | (86,997)                       | (31.5%)                  | (77,555)      | (30.6%)                  | (90,028)      | (36.9%)                  |
| Operating profit   | 42,690                         | 15.5%                    | 24,252        | 9.6%                     | 907           | 0.4%                     |
| Total other income and (expense), net                                  | (28,539)                       | (10.3%)                  | (131,380)     | (51.9%)                  | (131,994)     | (54.1%)                  |
| Profit (loss) before tax from continuing operations                    | 14,151                         | 5.1%                     | (107,128)     | (42.3%)                  | (131,087)     | (53.7%)                  |
| Income tax (expense) benefit   | (4,893)                        | (1.8%)                   | (8,322)       | (3.3%)                   | 8,822         | 3.6%                     |
| Profit (loss) for the year from continuing operations                  | 9,258                          | 3.4%                     | (115,450)     | (45.6%)                  | (122,265)     | (50.1%)                  |
| (Loss) profit after tax for the year from discontinued operations, net | (426)                          | (0.2%)                   | 822           | 0.3%                     | (11,702)      | (4.8%)                   |
| Profit (loss) for the year   | 8,832                          | 3.2%                     | (114,628)     | (45.3%)                  | (133,967)     | (54.9%)                  |
| Less: profit (loss) attributable to non-controlling interests          | 1,706                          | 0.6%                     | 535           | 0.2%                     | (1,263)       | (0.5%)                   |
| Profit (loss) attributable to equity shareholders of Mechel PAO        | 7,126                          | 2.6%                     | (115,163)     | (45.5%)                  | (132,704)     | (54.4%)                  |

***Year ended December 31, 2016 compared to year ended December 31, 2015******Revenues***

Consolidated revenues increased by RUB 22,868 million, or 9.0%, to RUB 276,009 million in the year ended December 31, 2016 from RUB 253,141 million in the year ended December 31, 2015.

The sales increase was due to an increase in sales prices across our major segments.

The following table sets forth our net revenues by segment, including a breakdown by sales to third parties and other segments.

| Revenues by Segment   | Year Ended December 31,                                 |                |
|-----------------------|---|----------------|
|                       | 2016  | 2015           |
|                       | (In millions of Russian rubles, except for percentages) |                |
| <b>Mining segment</b> |   |                |
| To third parties      | 89,647  | 80,632         |
| To power segment      | 1,370   | 1,800          |
| To steel segment      | 30,537  | 26,291         |
| <b>Total</b>          | <b>121,554</b>  | <b>108,723</b> |

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| Revenues by Segment   | Year Ended December 31,                                 |         |
|-----------------------|---|---------|
|                       | 2016  | 2015    |
|                       | (In millions of Russian rubles, except for percentages) |         |
| <b>Steel segment</b>  |   |         |
| To third parties      | 161,639   | 146,032 |
| To power segment      | 5,693   | 5,475   |
| To mining segment     | 1,562   | 1,497   |
| Total                 | 168,893   | 153,004 |
| <b>Power segment</b>  |   |         |
| To third parties      | 24,723  | 26,477  |
| To steel segment      | 11,709  | 11,131  |
| To mining segment     | 4,193   | 3,858   |
| Total                 | 40,626  | 41,467  |
| Eliminations          | 55,064  | 50,052  |
| Consolidated revenues | 276,009   | 253,141 |
| % from mining segment | 32.5%   | 31.9%   |
| % from steel segment  | 58.5%   | 57.7%   |
| % from power segment  | 9.0%  | 10.5%   |
| <b>Mining segment</b> |   |         |

Our total mining segment sales increased by RUB 12,831 million, or 11.8%, to RUB 121,554 million in the year ended December 31, 2016 from RUB 108,723 million in the year ended December 31, 2015.

Coking coal concentrate sales to third parties increased by RUB 11,534 million, or 42.4%, to RUB 38,744 million in the year ended December 31, 2016 from RUB 27,210 million in the year ended December 31, 2015, as a result of an increase in sales volumes of RUB 2,790 million and an increase in sales prices of RUB 8,744 million. The Chinese government's actions to reduce coal supply were the primary driver of the coal price rally in 2016. According to CRU, in 2016, the premium hard coking coal spot price increased four times from the beginning of the year and reached \$310 per tonne (FOB Australia) in November. The average contract price in 2016 was \$114 per tonne, 12% higher than the average contract price in 2015, according to CRU. The average spot price in 2016 was \$140 per tonne (FOB Australia), 55% higher than the average spot price in 2015, according to CRU.

The volume of coking coal concentrate sold to third parties increased by 538 thousand tonnes, or 10.3%, to 5,784 thousand tonnes in the year ended December 31, 2016 from 5,246 thousand tonnes in the year ended December 31, 2015. The increase in sales volumes of coking coal in 2016 was mainly caused by the increased demand for coking coal.

The volume of coking coal sold to third parties increased at Yakutugol and decreased at Southern Kuzbass Coal Company. Yakutugol's coking coal sales volumes increased by 605 thousand tonnes, or 13.4%, to 5,120 thousand tonnes in the year ended December 31, 2016 from 4,515 thousand tonnes in the year ended December 31, 2015 due to higher coking coal output as a result of favorable geological conditions. Southern Kuzbass Coal Company's coking



coal sales volumes decreased by 289 thousand tonnes, or 40.7%, to 421 thousand tonnes in the year ended December 31, 2016 from 710 thousand tonnes in the year ended December 31, 2015 due to decrease in production as a result of equipment breakdown.

Coke sales to third parties decreased by RUB 87 million, or 0.9%, to RUB 9,342 million in the year ended December 31, 2016 from RUB 9,429 million in the year ended December 31, 2015, as a result of a decrease in

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sales volumes of RUB 874 million that was offset by an increase in sales prices of RUB 787 million. In 2016, the world coke price showed almost the same dynamics as coking coal prices. According to CRU, coke prices increased from \$113 per tonne (FOB China basis) in the first quarter of the year to \$307 per tonne (FOB China basis) in the fourth quarter of the year. Domestic coke price in 2016 was 12,022 rubles per tonne (including VAT, FCA basis), 10% higher than the average price in 2015, according to Metal-Courier. Price growth in the domestic coke market was due to sharp rise of coking coal prices in the second half of the year in Russia which led to costs increase of coke producers and increased coke prices on export markets.

Coke supplied to the steel segment increased by RUB 1,852 million, or 9.6%, to RUB 21,086 million in the year ended December 31, 2016 from RUB 19,234 million in the year ended December 31, 2015. The increase was due to an increase in sales prices of RUB 1,691 million that was enforced by an increase in sales volumes of RUB 161 million. Coke sales volumes from Mechel Coke to Chelyabinsk Metallurgical Plant increased by 14 thousand tonnes, or 0.7%, to 1,921 thousand tonnes in the year ended December 31, 2016 from 1,907 thousand tonnes in the year ended December 31, 2015.

Chemical products sales to third parties decreased by RUB 339 million, or 14.6%, to RUB 1,988 million in the year ended December 31, 2016 from RUB 2,327 million in the year ended December 31, 2015, mainly as a result of a decrease in both sales volumes and sales prices.

Anthracite and PCI sales to third parties decreased by RUB 6,253 million, or 25.0%, to RUB 18,737 million in the year ended December 31, 2016 from RUB 24,990 million in the year ended December 31, 2015, as a result of a decrease in sales prices of RUB 552 million and a decrease in sales volumes of RUB 5,701 million. The decrease in sales volumes of anthracite and PCI was due to drop in coal extraction at Krasnogorsky Open Pit as a result of logistical problems.

Steam coal sales to third parties increased by RUB 5,351 million, or 73.9%, to RUB 12,587 million in the year ended December 31, 2016 from RUB 7,236 million in the year ended December 31, 2015, as a result of an increase in sales volumes of RUB 3,071 million and an increase in sales prices of RUB 2,280 million. In 2016, starting from June steam coal price began to rise sharply due to the Chinese government's coal supply policy, according to Platts. As a result of decreased coal production in China steam coal price rose from \$53 per tonne in June to \$87 per tonne in December. The average price in 2016 was \$60 per tonne (CIF Amsterdam/Rotterdam/Antwerp), 7% higher than the average price in 2015, according to Platts.

Steam coal supplied to the power segment decreased by RUB 129 million, or 26.9%, to RUB 350 million in the year ended December 31, 2016 from RUB 479 million in the year ended December 31, 2015, as a result of a decrease in sales volumes. Sales of steam coal to the power segment companies decreased by 220 thousand tonnes, or 37.8%, to 362 thousand tonnes in the year ended December 31, 2016 from 582 thousand tonnes in the year ended December 31, 2015 due to power production decrease.

Sales of iron ore to third parties decreased by RUB 1,718 million, or 93.2%, to RUB 126 million in the year ended December 31, 2016 from RUB 1,844 million in the year ended December 31, 2015, as a result of a decrease in sales volumes of RUB 1,745 million that was partially offset by an increase in sales prices of RUB 27 million. During 2016, iron ore spot prices were generally rising with minor downward corrections in May-June and September. The iron ore spot price increased from a low of \$42 per dry metric tonne (62% Fe, CFR China) in January to a high of \$80 per dry metric tonne in December, according to MMI. The average spot price in 2016 was \$58 per dry metric tonne which was 4% higher than the average price in 2015, according to MMI.

Supplies of iron ore to the steel segment increased by RUB 2,601 million, or 44.5%, to RUB 8,444 million in the year ended December 31, 2016 from RUB 5,843 million in the year ended December 31, 2015, as a result of a RUB 1,010 million increase in sales volumes and a RUB 1,590 million increase in sales prices. Sales volumes increased due to the continued group strategy of redirection of iron ore sales volumes from third parties

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to group iron ore consumers. The share of iron ore consumed at Chelyabinsk Metallurgical Plant and produced by Korshunov Mining Plant increased from 52.5% in the year ended December 31, 2015 to 67.4% in the year ended December 31, 2016.

Excluding intersegment sales, export sales were stable at 74.6% of mining segment sales in the year ended December 31, 2016, compared to 74.1% in the year ended December 31, 2015.

***Steel segment***

Our steel segment revenues increased by RUB 15,889 million, or 10.4%, to RUB 168,893 million in the year ended December 31, 2016 from RUB 153,004 million in the year ended December 31, 2015, due to an increase in sales prices and volumes. The increase in third-party sales volumes was due to the strong domestic demand and growth in production and sales volumes of high value-added products of the universal rolling mill, including the commencement of rails supply to Russian Railways.

Semi-finished products sales decreased by RUB 1,593 million, or 31.7%, to RUB 3,434 million in the year ended December 31, 2016 from RUB 5,027 million in the year ended December 31, 2015, as a result of a decrease of RUB 78 million in sales prices and a decrease of RUB 1,516 million in sales volumes. In 2016, the annual average price for billets (including VAT, FCA basis) was 18,812 rubles per tonne, 3.0% lower than the average price in 2015. The decrease in third-party sales volumes was due to increase in consumption within our steel segment and decrease in production volumes as a result of temporary suspension of equipment and its repair.

Other long products sales increased by RUB 10,947 million, or 38.9%, to RUB 39,099 million in the year ended December 31, 2016 from RUB 28,152 million in the year ended December 31, 2015, as a result of an increase of RUB 1,455 million in sales prices and an increase of RUB 9,492 million in sales volumes. The increase in sales prices was mainly due to increase in prices for steel-making raw materials (iron ore, coke, coking coal, etc.). Sales volumes increased due to strengthening demand in the Russian market and increase in the range of the universal rolling mill's products.

Other flat products sales increased by RUB 1,797 million, or 12.0%, to RUB 16,723 million in the year ended December 31, 2016 from RUB 14,926 million in the year ended December 31, 2015, as a result of an increase of RUB 1,066 million in sales prices and an increase of RUB 731 million in sales volumes. In 2016, the annual average price for flat steel products (including VAT, FCA basis) was 35,989 rubles per tonne, 0.3% higher than the average price in 2015. The annual average price for hot-rolled coil (Russia exports, FOB Black Sea) in U.S. dollars increased by 11.5% to \$387 per tonne in the year ended December 31, 2016 from \$347 per tonne in the year ended December 31, 2015, according to Metal Expert. The sales volume increased due to the growth in market share and strengthening of consumer demand in the European market.

Wire sales decreased by RUB 31 million, or 0.2%, to RUB 15,530 million in the year ended December 31, 2016 from RUB 15,561 million in the year ended December 31, 2015, as a result of a decrease of RUB 826 million in sales volumes that was offset by an increase of RUB 795 million in sales prices. The increase in sales prices was driven by the increase in the prices of wire rod used as the main input for wire production. Sales volumes decreased due to the weakened demand in Russia and Europe.

Rebar sales increased by RUB 5,224 million, or 13.1%, to RUB 45,204 million in the year ended December 31, 2016 from RUB 39,980 million in the year ended December 31, 2015, as a result of an increase of RUB 5,170 million in sales prices and an increase of RUB 54 million in sales volumes. In 2016, the Russian domestic price for rebar increased due to favorable market conditions. Sales volumes increased due to recovery of demand in construction

sector.

Steel pipes sales decreased by RUB 22 million, or 0.7%, to RUB 3,286 million in the year ended December 31, 2016 from RUB 3,308 million in the year ended December 31, 2015, as a result of a decrease of

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RUB 389 million in sales volumes that was offset by an increase of RUB 367 million in sales prices. The price increased mainly due to increase in purchase prices for raw materials. The sales volume decreased due to lower demand in the Russian market.

Pig iron sales decreased by RUB 608 million, or 47.2%, to RUB 679 million in the year ended December 31, 2016 from RUB 1,287 million in the year ended December 31, 2015, as a result of a decrease of RUB 127 million in sales prices and a decrease of RUB 481 million in sales volumes. The decrease in third-party sales volumes was due to the increase in consumption within our steel segment.

Stampings sales increased by RUB 317 million, or 4.6%, to RUB 7,235 million in the year ended December 31, 2016 from RUB 6,918 million in the year ended December 31, 2015, as a result of a decrease of RUB 522 million in sales prices that was offset by an increase of RUB 839 million in sales volumes. The decrease in sales prices was driven by the decrease in domestic and export prices during 2016. The increase in sales volumes was due to recovery of demand from the key consuming industries (engineering and transport industries).

Ferrosilicon sales decreased by RUB 160 million, or 4.5%, to RUB 3,368 million in the year ended December 31, 2016 from RUB 3,528 million in the year ended December 31, 2015, as a result of a decrease of RUB 262 million in sales prices that was partially offset by an increase of RUB 101 million in sales volumes. The decrease in sales prices was driven by depreciation of the average rate of the ruble against the U.S. dollar by 10% as compared to the average rate of the ruble against the U.S. dollar in 2015. The decrease in domestic sales volumes was due to decrease in ferrosilicon consumption in Russia. The overall increase in sales volumes was due to increase in export sales as a result of favorable market conditions in Japan.

Sales of non-core products and services increased by RUB 906 million, or 15.3%, to RUB 6,835 million in the year ended December 31, 2016 from RUB 5,929 million in the year ended December 31, 2015, due to overall revival of domestic market.

Excluding intersegment sales, export sales were 14.0% of steel segment sales in the year ended December 31, 2016, compared to 17.7% in the year ended December 31, 2015.

***Power segment***

Our power segment revenues decreased by RUB 842 million, or 2.0%, to RUB 40,625 million in the year ended December 31, 2016 from RUB 41,467 million in the year ended December 31, 2015.

Electricity sales to third parties decreased by RUB 1,997 million, or 8.0%, to RUB 22,527 million in the year ended December 31, 2016 from RUB 24,524 million in the year ended December 31, 2015, as a result of a decrease of RUB 5,550 million in sales volumes that was partially offset by an increase of RUB 3,553 million in sales prices.

Other revenue, which consists mostly of heat energy and capacity, increased by RUB 244 million, or 12.5%, to RUB 2,196 million in the year ended December 31, 2016 from RUB 1,952 million in the year ended December 31, 2015, due to the increase in sales volumes of Kuzbass Power Sales Company.

Intersegment sales increased by RUB 913 million, or 6.1%, to RUB 15,903 million in the year ended December 31, 2016 from RUB 14,990 million in the year ended December 31, 2015, mainly as a result of an increase in electricity tariffs.

***Cost of goods sold and gross profit***

The consolidated cost of goods sold was 53.0% of consolidated revenues in the year ended December 31, 2016, as compared to 59.8% of consolidated revenues in the year ended December 31, 2015, resulting in an

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increase in consolidated gross profit to 47.0% in the year ended December 31, 2016 from 40.2% for the year ended December 31, 2015. Cost of goods sold primarily consists of costs relating to raw materials (including products purchased for resale), direct payroll, depreciation and energy. The table below sets forth cost of goods sold and gross profit by segment for the years ended December 31, 2016 and 2015, including as a percentage of segment revenues.

| <b>Cost of Goods Sold and Gross Profit by Segment</b>          | <b>Year Ended<br/>December 31, 2016</b> |                                  | <b>Year Ended<br/>December 31, 2015</b> |                                  |
|--|---|----------------------------------|---|----------------------------------|
|  | <b>Amount</b>                           | <b>% of Segment<br/>Revenues</b> | <b>Amount</b>                           | <b>% of Segment<br/>Revenues</b> |
| <b>(In millions of Russian rubles, except for percentages)</b> |   |                                  |   |                                  |
| <b>Mining segment</b>  |   |                                  |   |                                  |
| Cost of goods sold   | 45,040                                  | 37.1%                            | 51,280                                  | 47.2%                            |
| Gross profit   | 76,515                                  | 62.9%                            | 57,442                                  | 52.8%                            |
| <b>Steel segment</b>   |   |                                  |   |                                  |
| Cost of goods sold   | 126,745                                 | 75.0%                            | 119,610                                 | 78.2%                            |
| Gross profit   | 42,148                                  | 25.0%                            | 33,394                                  | 21.8%                            |
| <b>Power segment</b>   |   |                                  |   |                                  |
| Cost of goods sold   | 29,047                                  | 71.5%                            | 30,178                                  | 72.8%                            |
| Gross profit   | 11,578                                  | 28.5%                            | 11,289                                  | 27.2%                            |

**Mining segment**

Mining segment cost of goods sold decreased by RUB 6,240 million, or 12.2%, to RUB 45,040 million in the year ended December 31, 2016 from RUB 51,280 million in the year ended December 31, 2015. The gross profit percentage increased to 62.9% in the year ended December 31, 2016 compared to 52.8% in the year ended December 31, 2015, mainly due to the increase in selling prices caused by the global coal prices rally.

Coal production cash costs per tonne (see Cash Costs per Tonne Measure ) at Southern Kuzbass Coal Company increased by RUB 255 per tonne, or 17.5%, from RUB 1,460 in the year ended December 31, 2015 to RUB 1,715 in the year ended December 31, 2016, mainly due to the increase in fixed costs share per tonne stimulated by production volumes decrease.

Production cash costs of coal at Yakutugol decreased by RUB 34 per tonne, or 4.1%, from RUB 860 in the year ended December 31, 2015 to RUB 825 in the year ended December 31, 2016, mainly due to the decrease in fixed costs share per tonne stimulated by production volumes increase.

Coke production cash costs increased by 14.7% at Moscow Coke and Gas Plant following the increase in coking coal concentrate purchase prices caused by the global coal prices rally.

Production cash costs of iron ore were stable, decreased only by 2.3%.

**Steel segment**

Steel segment cost of goods sold increased by RUB 7,135 million, or 6.0%, to RUB 126,745 million in the year ended December 31, 2016 from RUB 119,610 million in the year ended December 31, 2015. Steel segment cost of goods sold was 75.0% of the segment's revenues in the year ended December 31, 2016, as compared to 78.2% in the year



ended December 31, 2015. The increase in gross profit from 21.8% to 25.0% is mainly explained by the increase in sales prices caused by the recovery of demand.

***Power segment***

Power segment cost of goods sold decreased by RUB 1,131 million, or 3.8%, to RUB 29,047 million in the year ended December 31, 2016 from RUB 30,178 million in the year ended December 31, 2015, due to decrease in sales volumes. The power segment gross profit percentage increased to 28.5% in the year ended December 31, 2016 from 27.2% in the year ended December 31, 2015 due to sales price increase.

**Table of Contents****Cash Costs per Tonne Measure**

In this document, we present cash costs per tonne for coal, coke and iron ore production for each significant production facility of our mining segment. Cash costs per tonne is a performance indicator that is not defined according to IFRS or U.S. GAAP. Cash costs per tonne includes various production costs, such as raw materials, auxiliary materials, wages and social taxes of production personnel, electricity, gas and fuel costs, repairs and maintenance of production equipment, costs of mining works, mineral extraction tax and royalty payments, but excludes non-cash items such as depreciation, depletion and write-down of inventories to their net realizable value. We use this indicator to evaluate the performance of individual production subsidiaries and their respective ability to generate cash. Cash costs per tonne is a widely used performance indicator in the mining industry to evaluate the cost-effectiveness of mining operations. We believe that investors use this indicator in addition to the financial information prepared in accordance with IFRS to evaluate the performance of our companies. Consequently, this information must be considered supplementary and should not be regarded as a substitute for the performance indicators prepared in accordance with IFRS.

The reconciliation of mining segment production cash costs per tonne for the year ended December 31, 2016 is presented below:

|  | In thousands of<br>tonnes | Cash cost,<br>in thousands of<br>Russian rubles<br>per tonne | In millions<br>of Russian<br>rubles |
|--|---------------------------|--|-------------------------------------|
| Coal Southern Kuzbass Coal Company sales to third parties  | 4,464                     | 1.7  | 7,655                               |
| Coal Southern Kuzbass Coal Company intersegment sales  | 1,021                     | 1.7  | 1,751                               |
| Coal Yakutugol sales to third parties  | 8,664                     | 0.8  | 7,152                               |
| Coal Yakutugol intersegment sales  |                           | 0.8  |                                     |
| Coal Elgaugol sales to third parties   | 1,673                     | 0.9  | 1,529                               |
| Coal Elgaugol intersegment sales   | 44                        | 0.9  | 41                                  |
| Iron ore Korshunov Mining Plant sales to third parties   | 26                        | 2.0  | 52                                  |
| Iron ore Korshunov Mining Plant intersegment sales   | 2,684                     | 2.0  | 5,272                               |
| Coke Moscow Coke and Gas Plant sales to third parties  | 682                       | 8.5  | 5,769                               |
| Coke Moscow Coke and Gas Plant intersegment sales  | 5                         | 8.5  | 40                                  |
| Coke Mechel Coke sales to third parties  | 211                       | 5.9  | 1,244                               |
| Coke Mechel Coke intersegment sales  | 1,938                     | 5.9  | 11,405                              |
| Depreciation   |                           |  | 5,265                               |
| Depletion  |                           |  | 1,716                               |
| Write-down of inventory to their net realizable value  |                           |  | 23                                  |
| Cost of coal produced by third companies and re-sold by our trading subsidiaries, including intersegment sales   |                           |  | 170                                 |
| Stockholding year to year movements, costs of other products and services (coking products, washing services) and costs of other subsidiaries <sup>(3)</sup> |                           |  | (4,043)                             |
| Total mining segment cost of sales   |                           |  | 45,040                              |

- (1) Cash costs per tonne for coke were reduced by by-products credits. The amount of by-products credits in the total cash costs per tonne was RUB 343, or 4%, at Moscow Coke and Gas Plant in the year ended December 31, 2016.
- (2) Cash costs per tonne for coke were reduced by by-products credits. The amount of by-products credits in the total cash costs per tonne was RUB 755, or 13%, at Mechel Coke in the year ended December 31, 2016.
- (3) Line Costs of other products and services was increased by the amount of by-products credits of RUB 831 million in the year ended December 31, 2016.

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The reconciliation of mining segment production cash costs per tonne for the year ended December 31, 2015 is presented below:

|  | In thousands of<br>tonnes | Cash cost,<br>in thousands of<br>Russian rubles<br>per tonne | In millions<br>of<br>Russian<br>rubles |
|--|---------------------------|--|--|
| Coal Southern Kuzbass Coal Company sales to third parties  | 5,012                     | 1.5  | 7,317                                  |
| Coal Southern Kuzbass Coal Company intersegment sales  | 1,674                     | 1.5  | 2,444                                  |
| Coal Yakutugol sales to third parties  | 7,540                     | 0.9  | 6,483                                  |
| Coal Yakutugol intersegment sales  |                           | 0.9  |  |
| Coal Elgaugol sales to third parties   | 1,575                     | 0.8  | 1,280                                  |
| Coal Elgaugol intersegment sales   | 6                         | 0.8  | 5                                      |
| Iron ore Korshunov Mining Plant sales to third parties   | 489                       | 2.0  | 983                                    |
| Iron ore Korshunov Mining Plant intersegment sales   | 2,288                     | 2.0  | 4,598                                  |
| Coke Moscow Coke and Gas Plant sales to third parties  | 715                       | 7.4  | 5,268                                  |
| Coke Moscow Coke and Gas Plant intersegment sales  | 3                         | 7.4  | 20                                     |
| Coke Mechel Coke sales to third parties  | 270                       | 6.0  | 1,612                                  |
| Coke Mechel Coke intersegment sales  | 1,924                     | 6.0  | 11,499                                 |
| Depreciation   |                           |  | 6,532                                  |
| Depletion  |                           |  | 1,685                                  |
| Write-down of inventory to their net realizable value  |                           |  | 6                                      |
| Cost of coal produced by third companies and re-sold by our trading subsidiaries, including intersegment sales   |                           |  | 346                                    |
| Stockholding year to year movements, costs of other products and services (coking products, washing services) and costs of other subsidiaries <sup>(3)</sup> |                           |  | 1,200                                  |
| <b>Total mining segment cost of sales</b>  |                           |  | <b>51,280</b>                          |

- (1) Cash costs per tonne for coke were reduced by by-products credits. The amount of by-products credits in the total cash costs per tonne was RUB 283, or 4%, at Moscow Coke and Gas Plant in the year ended December 31, 2015.
- (2) Cash costs per tonne for coke were reduced by by-products credits. The amount of by-products credits in the total cash costs per tonne was RUB 767, or 13%, at Mechel Coke in the year ended December 31, 2015.
- (3) Line Costs of other products and services was increased by the amount of by-products credits of RUB 840 million in the year ended December 31, 2015.

**Table of Contents***Selling, distribution and operating expenses*

Selling, distribution and operating expenses increased by RUB 9,442 million, or 12.2%, to RUB 86,997 million in the year ended December 31, 2016 from RUB 77,555 million in the year ended December 31, 2015, as a result of an increase in selling and distribution expenses in the mining, steel and power segments, impairment of goodwill and other non-current assets in the mining and steel segments and loss on write-off of property, plant and equipment in the mining and steel segments in the year ended December 31, 2016. As a percentage of consolidated revenues, selling, distribution and operating expenses increased to 31.5% in the year ended December 31, 2016 from 30.6% in the year ended December 31, 2015. Our selling, distribution and operating expenses consist primarily of selling and distribution expenses, loss on write-off of property, plant and equipment, impairment of goodwill and other non-current assets, allowance for doubtful accounts, taxes other than income taxes, administrative and other operating expenses and other operating income. The table below sets forth these costs by segment for the years ended December 31, 2016 and 2015, including as a percentage of segment revenues.

| <b>Selling, Distribution and Operating Expenses by Segment</b> | <b>Year Ended<br/>December 31,<br/>2016</b> |                                  | <b>Year Ended<br/>December 31,<br/>2015</b> |                                  |
|--|---|----------------------------------|---|----------------------------------|
|  | <b>Amount</b>                               | <b>% of Segment<br/>Revenues</b> | <b>Amount</b>                               | <b>% of Segment<br/>Revenues</b> |
| <b>(In millions of Russian rubles, except for percentages)</b> |   |                                  |   |                                  |
| <b>Mining segment</b>  |   |                                  |   |                                  |
| Selling and distribution expenses                              | 31,132                                      | 25.6%                            | 28,588                                      | 26.3%                            |
| Loss on write-off of property, plant and equipment             | 863   | 0.7%                             | 199   | 0.2%                             |
| Impairment of goodwill and other non-current assets            | 1,335                                       | 1.1%                             |   | 0.0%                             |
| Allowance for doubtful accounts                                | 83  | 0.1%                             | 247   | 0.2%                             |
| Taxes other than income taxes                                  | 3,959                                       | 3.3%                             | 3,706                                       | 3.4%                             |
| Administrative and other operating expenses                    | 9,538                                       | 7.8%                             | 8,872                                       | 8.2%                             |
| Other operating income   | (1,407)                                     | (1.2%)                           | (175)                                       | (0.2%)                           |
| <b>Total</b>   | <b>45,503</b>                               | <b>37.4%</b>                     | <b>41,437</b>                               | <b>38.1%</b>                     |
| <b>Steel segment</b>   |   |                                  |   |                                  |
| Selling and distribution expenses                              | 15,392                                      | 9.1%                             | 13,736                                      | 9.0%                             |
| Loss on write-off of property, plant and equipment             | 1,089                                       | 0.6%                             | 492   | 0.3%                             |
| Impairment of goodwill and other non-current assets            | 3,866                                       | 2.3%                             | 16  | 0.0%                             |
| Allowance for doubtful accounts                                | 231   | 0.1%                             | 948   | 0.6%                             |
| Taxes other than income taxes                                  | 1,826                                       | 1.1%                             | 2,044                                       | 1.3%                             |
| Administrative and other operating expenses                    | 8,569                                       | 5.1%                             | 7,825                                       | 5.1%                             |
| Other operating income   | (356)                                       | (0.2%)                           | (193)                                       | (0.1%)                           |
| <b>Total</b>   | <b>30,617</b>                               | <b>18.1%</b>                     | <b>24,868</b>                               | <b>16.3%</b>                     |
| <b>Power segment</b>   |   |                                  |   |                                  |
| Selling and distribution expenses                              | 9,710                                       | 23.9%                            | 8,792                                       | 21.2%                            |
| Loss on write-off of property, plant and equipment             | 1   | 0.0%                             |   | 0.0%                             |
| Impairment of goodwill and other non-current assets            |   | 0.0%                             | 1,444                                       | 3.5%                             |

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|   |               |              |               |              |
|---|---------------|--------------|---------------|--------------|
| Allowance for doubtful accounts             | 443           | 1.1%         | 312           | 0.8%         |
| Taxes other than income taxes               | 129           | 0.3%         | 103           | 0.2%         |
| Administrative and other operating expenses | 685           | 1.7%         | 603           | 1.5%         |
| Other operating income                      | (91)          | (0.2%)       | (4)           | (0.0%)       |
| <b>Total</b>                                | <b>10,877</b> | <b>26.8%</b> | <b>11,250</b> | <b>27.1%</b> |

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**Table of Contents*****Mining segment***

Selling and distribution expenses consisted almost entirely of transportation expenses related to our selling activities. Such expenses increased by RUB 2,544 million, or 8.9%, to RUB 31,132 million in the year ended December 31, 2016 from RUB 28,588 million in the year ended December 31, 2015, mainly due to the increase in segment export sales volumes by 3%. As a percentage of mining segment revenues, selling and distribution expenses decreased from 26.3% to 25.6% due to an increase in sales prices.

Taxes other than income tax slightly increased by RUB 253 million, or 6.8%, to RUB 3,959 million in the year ended December 31, 2016 from RUB 3,706 million in the year ended December 31, 2015, due to recognition of probable tax risks in respect of penalties related to personal income tax among our mining subsidiaries in 2016.

Allowance for doubtful accounts decreased by RUB 164 million to RUB 83 million in the year ended December 31, 2016 from RUB 247 million in the year ended December 31, 2015, due to the decrease in overdue accounts receivable.

Loss on write-off of property, plant and equipment increased by RUB 664 million, or 333.7%, to RUB 863 million in the year ended December 31, 2016 from RUB 199 million in the year ended December 31, 2015, due to the increase in the number of property, plant and equipment objects that are not planned for further use in production process at our mining service subsidiaries.

Impairment of goodwill and other non-current assets amounted to RUB 1,335 million in the year ended December 31, 2016. The carrying value of non-current assets of mining subsidiaries was impaired due to inability to generate economic benefits. See note 18 to the consolidated financial statements.

General, administrative and other expenses consist of payroll and payroll taxes, depreciation, rent and maintenance, legal and consulting expenses, office overheads and other expenses and income. These expenses decreased by RUB 567 million, or 6.5%, to RUB 8,130 million in the year ended December 31, 2016 from RUB 8,697 million in the year ended December 31, 2015, mainly as a result of recognition of other operating income: salaries and related social taxes increased by RUB 1,154 million, or 21.8%, to RUB 6,453 million in the year ended December 31, 2016 from RUB 5,299 million in the year ended December 31, 2015; legal and consulting fees and insurance services decreased by 7.9% to RUB 256 million in the year ended December 31, 2016 from RUB 278 million in the year ended December 31, 2015; and other administrative and operating expenses decreased by RUB 467 million, or 14.2%, to RUB 2,827 million in the year ended December 31, 2016 from RUB 3,294 million in the year ended December 31, 2015. Other operating income increased by RUB 1,232 million to RUB 1,407 million in the year ended December 31, 2016 from RUB 175 million in the year ended December 31, 2015 due to receiving insurance compensation for long-lived assets loss and revision of pension obligations and rehabilitation provisions in our mining subsidiaries.

***Steel segment***

Selling and distribution expenses consisted almost entirely of transportation expenses related to our selling activities. Such expenses increased by RUB 1,656 million, or 12.1%, to RUB 15,392 million in the year ended December 31, 2016 from RUB 13,736 million in the year ended December 31, 2015, mainly due to the increase in railway tariffs by 9.0% and increase in sales volumes of steel segment products. As a percentage of steel segment revenues, selling and distribution expenses slightly increased to 9.1% in the year ended December 31, 2016 from 9.0% in the year ended December 31, 2015.

Taxes other than income tax decreased by RUB 218 million, or 10.7%, to RUB 1,826 million in the year ended December 31, 2016 from RUB 2,044 million in the year ended December 31, 2015, mainly due to recognition of additional VAT in the amount of RUB 358 million as a result of tax audit in 2015. In 2016, we



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recognized probable tax risks in respect of penalties related to personal income tax in the amount of RUB 181 million. Property and land taxes increased by RUB 47 million to RUB 1,329 million in the year ended December 31, 2016 from RUB 1,282 million in the year ended December 31, 2015.

Allowance for doubtful accounts decreased by RUB 717 million, or 75.6%, to RUB 231 million in the year ended December 31, 2016 from RUB 948 million in the year ended December 31, 2015, due to the decrease in overdue accounts receivable.

Loss on write-off of property, plant and equipment increased by RUB 597 million, or 121.3%, to RUB 1,089 million in the year ended December 31, 2016 from RUB 492 million in the year ended December 31, 2015, due to the increase in the number of idled property, plant and equipment written off by our steel production subsidiaries.

Impairment of goodwill and other non-current assets increased by RUB 3,850 million, or 24,062.5%, to RUB 3,866 million in the year ended December 31, 2016 from RUB 16 million in the year ended December 31, 2015. In 2014, we recognized impairment of property, plant and equipment and construction in progress in relation to Izhstal of RUB 6,669 million. In 2015, we recognized reversal of impairment of other non-current assets in relation to Izhstal of RUB 5,967 million and recognized additional impairment of other non-current assets in relation to Mechel Materials of RUB 5,983 million. In 2016, we recognized impairment of goodwill and other non-current assets in relation to Bratsk Ferroalloy Plant of RUB 3,627 million due to changes in expectations of long-term prices for ferrosilicon and in forecasted production volumes accompanied by increased forecasted costs.

General, administrative and other expenses increased by RUB 745 million, or 9.5%, to RUB 8,570 million in the year ended December 31, 2016 from RUB 7,825 million in the year ended December 31, 2015. Payroll and related social taxes increased by RUB 1,093 million, or 22.6%, to RUB 4,843 million in the year ended December 31, 2016 from RUB 3,750 million in the year ended December 31, 2015. Social expenses increased by RUB 10 million, or 4.7%, to RUB 225 million in the year ended December 31, 2016 from RUB 215 million in the year ended December 31, 2015. Rent and maintenance, business travel expenses, bank charges and office expenses increased by RUB 85 million, or 8.9%, to RUB 1,044 million in the year ended December 31, 2016 from RUB 959 million in the year ended December 31, 2015. Professional expenses, which include auditing, accounting, legal and engineering fees and insurance services increased by RUB 68 million, or 21.6%, to RUB 383 million in the year ended December 31, 2016 from RUB 315 million in the year ended December 31, 2015. Fines and penalties expenses on breach of trading contracts, provisions related to claims decreased by RUB 226 million, or 42.7%, to RUB 303 million in the year ended December 31, 2016 from RUB 529 million in the year ended December 31, 2015. Other administrative and operating expenses decreased by RUB 285 million, or 13.9%, to RUB 1,772 million in the year ended December 31, 2016 from RUB 2,057 million in the year ended December 31, 2015. Other operating income increased by RUB 162 million, or 83.5%, to RUB 356 million in the year ended December 31, 2016 from RUB 194 million in the year ended December 31, 2015, mainly due to revision of rehabilitation provision and receiving of final consideration for the disposed companies.

***Power segment***

Selling and distribution expenses consisted almost entirely of electricity transmission costs incurred by our Kuzbass Power Sales Company for the usage of the power grid through which electricity is distributed to end consumers. These expenses increased by RUB 918 million, or 10%, to RUB 9,710 million in the year ended December 31, 2016 from RUB 8,792 million in the year ended December 31, 2015, due to increase in transmission tariffs despite the reduced sales volumes.

Taxes other than income tax increased by RUB 26 million, or 25.5%, to RUB 129 million in the year ended December 31, 2016 from RUB 103 million in the year ended December 31, 2015, due to increase in property and land taxes caused by the revision of the cadastral valuation of land.

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Allowance for doubtful accounts increased by RUB 131 million to RUB 443 million in the year ended December 31, 2016 from RUB 312 million in the year ended December 31, 2015, mainly due to the increase in overdue receivables.

In 2015, as a result of the goodwill impairment test we recognized the impairment loss of Southern Kuzbass Power Plant in the amount of RUB 1,444 million. No impairment loss was recognized in 2016. See note 18 to the consolidated financial statements.

Administrative and other operating expenses increased by RUB 87 million, or 14.4%, to RUB 685 million in the year ended December 31, 2016 from RUB 598 million in the year ended December 31, 2015, due to accrual of provisions for legal claims.

Other operating income was recognized in the amount of RUB 91 million as a result of income from accrual of fines and penalties for business contracts.

*Operating profit*

Operating profit increased by RUB 18,438 million, or 76.0%, to RUB 42,690 million in the year ended December 31, 2016 from RUB 24,252 million in the year ended December 31, 2015. As a percentage of consolidated revenues, operating profit increased to 15.5% in the year ended December 31, 2016 from 9.6% in the year ended December 31, 2015, mainly due to an increase in consolidated gross profit to 47.0% in the year ended December 31, 2016 from 40.2% in the year ended December 31, 2015 and a decrease in losses from allowance for doubtful accounts as explained above.

The table below sets out operating profit (loss) by segment, including as a percentage of segment revenues.

| <b>Operating Profit (Loss) by Segment</b>                           | <b>Year Ended<br/>December 31, 2016</b>                        |                                  | <b>Year Ended<br/>December 31, 2015</b> |                                  |
|---|--|----------------------------------|---|----------------------------------|
|   | <b>Amount</b>  | <b>% of Segment<br/>Revenues</b> | <b>Amount</b>                           | <b>% of Segment<br/>Revenues</b> |
|   | <b>(In millions of Russian rubles, except for percentages)</b> |                                  |   |                                  |
| Mining segment  | 31,012   | 25.5%                            | 16,005                                  | 14.7%                            |
| Steel segment   | 11,531   | 6.8%                             | 8,526                                   | 5.6%                             |
| Power segment   | 701  | 1.7%                             | 39                                      | 0.1%                             |
| Elimination of intersegment unrealized (profit) loss <sup>(1)</sup> | (554)  |                                  | (318)                                   |                                  |
| <b>Consolidated operating profit</b>                                | <b>42,690</b>  |                                  | <b>24,252</b>                           |                                  |

- (1) Our management evaluates the performance of our segments before the elimination of unrealized profit in inventory balances of segments that was generated by the segments but not recognized as profit in our consolidated financial statements until the sale of such inventories to third parties. Therefore, we present our segments before such elimination, and such elimination is presented separately. The change in intersegment unrealized profit adjustment in the year ended December 31, 2016 as compared to the year ended December 31, 2015 was due to the increase in gross profit of our mining segment in 2016.

*Mining segment*

Mining segment operating profit increased by RUB 15,007 million, or 93.8%, to RUB 31,012 million in the year ended December 31, 2016 from RUB 16,005 million in the year ended December 31, 2015. The operating profit percentage increased to 25.5% in the year ended December 31, 2016 from 14.7% in the year ended December 31, 2015, mainly due to the increase in selling prices caused by the global coal prices rally.

**Table of Contents****Steel segment**

Steel segment operating profit increased by RUB 3,005 million, or 35.2%, to RUB 11,531 million in the year ended December 31, 2016 from RUB 8,527 million in the year ended December 31, 2015. The operating profit percentage decreased to 6.8% in the year ended December 31, 2016 from 5.6% in the year ended December 31, 2015, mainly due to the increase in gross margin resulted from the increase in sales prices for main steel segment products that was partially offset by recognition of losses from impairment of goodwill and other non-current assets of Bratsk Ferroalloy Plant.

**Power segment**

Power segment operating profit increased by RUB 662 million to RUB 701 million in the year ended December 31, 2016 from RUB 39 million in the year ended December 31, 2015, mainly due to the factors that affected operating income in 2016, such as the absence of impairment loss of goodwill in 2016, increase in a provision on trade and other receivables and increase in income from accrual of fines and penalties for business contracts.

**Other income and expense, net**

Other income and expense, net consists of share of loss of an associate, finance income, finance costs, other income and other expenses and foreign exchange gain (loss). The table below sets forth these costs for the years ended December 31, 2016 and 2015, including as a percentage of revenues.

|                                      | Year Ended<br>December 31, 2016                                |                  | Year Ended<br>December 31, 2015 |                  |
|--------------------------------------|--|------------------|---------------------------------|------------------|
|                                      | Amount   | % of<br>Revenues | Amount                          | % of<br>Revenues |
| <b>Other Income and Expense, Net</b> | <b>(In millions of Russian rubles, except for percentages)</b> |                  |                                 |                  |
| Finance income                       | 1,176  | 0.4%             | 183                             | 0.1%             |
| Finance costs                        | (54,240)   | (19.7)%          | (60,453)                        | (23.9)%          |
| Foreign exchange gain (loss)         | 25,947   | 9.4%             | (71,106)                        | (28.1)%          |
| Share of loss of an associate        | (17)   | 0.0%             |                                 | 0.0%             |
| Other income                         | 598  | 0.2%             | 341                             | 0.1%             |
| Other expenses                       | (1,999)  | (0.7)%           | (347)                           | (0.1)%           |
| <b>Total</b>                         | <b>(28,535)</b>  | <b>(10.3)%</b>   | <b>(131,379)</b>                | <b>(51.9)%</b>   |

Finance income increased by RUB 993 million, or 542.6%, to RUB 1,176 million in the year ended December 31, 2016 from RUB 183 million in the year ended December 31, 2015, due to waiving of fines and penalties on loans and finance leases as a result of restructuring primarily with Sberbank.

Finance costs decreased by RUB 6,213 million, or 10.3%, to RUB 54,240 million in the year ended December 31, 2016 from RUB 60,453 million in the year ended December 31, 2015, due to the restructuring of overdue borrowings and respective decrease of fines and penalties.

In the year ended December 31, 2016, we generated foreign exchange gain amounted to RUB 25,947 million compared to foreign exchange loss amounted to RUB 71,106 million in the year ended December 31, 2015, mainly

due to strengthening of the ruble against the U.S. dollar in 2016.

Share of loss of an associate amounted to RUB 17 million in the year ended December 31, 2016 compared to RUB nil in the year ended December 31, 2015 and represented by income in the amount of RUB 25 million from equity investment in Tomusinsky Transportation Management Center and Tomusinsky Auto Repair Shop and loss in the amount of RUB 42 million from investments in Mechel Somani Carbon Private Limited.

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Other income increased by RUB 257 million, or 75.4%, to RUB 598 million in the year ended December 31, 2016 from RUB 341 million in the year ended December 31, 2015, mainly due to gain realized from disposal of subsidiaries during 2016.

Other expenses increased by RUB 1,652 million, or 476.1%, to RUB 1,999 million in the year ended December 31, 2016 from RUB 347 million in the year ended December 31, 2015, mainly due to write-off of Vnesheconombank's commission in the amount of RUB 1,411 million and provision for non-recoverable advances to pension funds in the amount of RUB 408 million.

*Income tax expense*

Income tax expense decreased by RUB 3,429 million, or 41.2%, to RUB 4,893 million in the year ended December 31, 2016 from RUB 8,322 million in the year ended December 31, 2015, due to significant change in deferred tax assets attributable to transactions on conversion of debt. Our effective tax rate changed to negative 34.6% from positive 7.8% mainly due to transition from loss in the year ended December 31, 2015 to profit in the year ended December 31, 2016.

*Net loss (income) from discontinued operations*

Net loss (income) from discontinued operations changed by RUB 1,248 million, or 151.8%, to RUB 426 million loss in the year ended December 31, 2016 from RUB 822 million income in the year ended December 31, 2015, mainly due to the disposal of Bluestone in 2015.

*Net income attributable to non-controlling interests*

Net income attributable to non-controlling interests increased by RUB 1,171 million, or 218.9%, to RUB 1,706 million in the year ended December 31, 2016 from RUB 535 million in the year ended December 31, 2015, mainly due to change of the non-controlling interest in such our subsidiaries as Southern Kuzbass Coal Company and its subsidiaries in the amount of RUB 1,082 million (income), Chelyabinsk Metallurgical Plant in the amount of RUB 625.2 million (income), Korshunov Mining Plant in the amount of RUB 119 million (income), Izhstal in the amount of RUB 371.5 million (loss) and Beloretsk Metallurgical Plant in the amount of RUB 146 million (loss).

*Net profit (loss) attributable to equity holders of the parent*

Net profit (loss) attributable to our equity holders changed by RUB 122,289 million, or 106.2%, to RUB 7,126 million profit in the year ended December 31, 2016 from RUB 115,163 million loss in the year ended December 31, 2015, mainly due to the increase in gross margin and foreign exchange gain and partially due to the decrease in finance costs.

***Year ended December 31, 2015 compared to year ended December 31, 2014****Revenues*

Consolidated revenues increased by RUB 9,149 million, or 3.7%, to RUB 253,141 million in the year ended December 31, 2015 from RUB 243,992 million in the year ended December 31, 2014.

The sales increase was due to an increase in sales prices across our major segments and changes of exchange rates of the U.S. dollar to the Russian ruble.





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The following table sets forth our net revenues by segment, including a breakdown by sales to third parties and other segments.

| Revenues by Segment   | Year Ended December 31,                                 |         |
|-----------------------|---|---------|
|                       | 2015  | 2014    |
|                       | (In millions of Russian rubles, except for percentages) |         |
| <b>Mining segment</b> |   |         |
| To third parties      | 80,632  | 79,509  |
| To power segment      | 1,800   | 1,658   |
| To steel segment      | 26,291  | 19,391  |
| Total                 | 108,723   | 100,558 |
| <b>Steel segment</b>  |   |         |
| To third parties      | 146,032   | 138,660 |
| To power segment      | 5,475   | 5,354   |
| To mining segment     | 1,497   | 2,853   |
| Total                 | 153,004   | 146,867 |
| <b>Power segment</b>  |   |         |
| To third parties      | 26,477  | 25,823  |
| To steel segment      | 11,131  | 10,913  |
| To mining segment     | 3,858   | 2,818   |
| Total                 | 41,467  | 39,554  |
| Eliminations          | 50,052  | 42,986  |
| Consolidated revenues | 253,141   | 243,992 |
| % from mining segment | 31.9%   | 32.6%   |
| % from steel segment  | 57.7%   | 56.8%   |
| % from power segment  | 10.5%   | 10.6%   |
| <b>Mining segment</b> |   |         |

Our total mining segment sales increased by RUB 8,165 million, or 8.1%, to RUB 108,723 million in the year ended December 31, 2015 from RUB 100,558 million in the year ended December 31, 2014.

Coking coal concentrate sales to third parties decreased by RUB 3,436 million, or 11.2%, to RUB 27,210 million in the year ended December 31, 2015 from RUB 30,645 million in the year ended December 31, 2014, as a result of a decrease in sales volumes of RUB 9,975 million that was partially offset by an increase in sales prices of RUB 6,539 million. The growth of prices denominated in Russian rubles for coking coal was due to depreciation of the ruble while export sales of coking coal decreased from 81.8% in the year ended December 31, 2014 to 73.6% in the year ended December 31, 2015. During 2015, global coal prices were under pressure as demand continued to decline

and oversupply remained, therefore coking coal prices continued to decline. The average contract price in 2015 was \$102 per tonne, 18% below the average price in 2014. The average spot price in 2015 was \$90 per tonne (FOB Australia), 21% below the average price in 2014.

The volume of coking coal concentrate sold to third parties decreased by 2,531 thousand tonnes, or 32.5%, to 5,246 thousand tonnes in the year ended December 31, 2015 from 7,777 thousand tonnes in the year ended December 31, 2014. The decrease in sales volumes of coking coal in 2015 was mainly caused by decreased sales from Southern Kuzbass Coal Company.

The volume of coking coal sold to third parties decreased both at Yakutugol and Southern Kuzbass Coal Company. Yakutugol's coking coal sales volumes decreased by 825 thousand tonnes, or 15.5%, to 4,515 thousand tonnes in the year ended December 31, 2015 from 5,340 thousand tonnes in the year ended

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December 31, 2014. Southern Kuzbass Coal Company's coking coal sales volumes decreased by 1,693 thousand tonnes, or 70.4%, to 710 thousand tonnes in the year ended December 31, 2015 from 2,403 thousand tonnes in the year ended December 31, 2014 due to suspension of coal extraction at Olzherasskaya-Novaya Underground caused by high concentration of toxic gases.

Coke sales to third parties increased by RUB 1,002 million, or 11.9%, to RUB 9,429 million in the year ended December 31, 2015 from RUB 8,427 million in the year ended December 31, 2014, as a result of an increase in sales prices of RUB 2,853 million that was offset by a decrease in sales volumes of RUB 1,851 million. Average domestic coke price in 2015 was 10,892 rubles per tonne (including VAT, FCA basis), 56% higher than the average price in 2014, according to Metal-Courier. Price growth in the domestic coke market was due to depreciation of the ruble, higher coking coal prices and strong demand from Ukraine.

Coke supplied to the steel segment increased by RUB 6,510 million, or 51.2%, to RUB 19,234 million in the year ended December 31, 2015 from RUB 12,724 million in the year ended December 31, 2014. The increase was due to an increase in sales prices of RUB 6,733 million that was partially offset by a decrease in sales volumes of RUB 223 million. Coke sales volumes from Mechel Coke to Chelyabinsk Metallurgical Plant decreased by 45 thousand tonnes, or 2.3%, from 1,952 thousand tonnes in the year ended December 31, 2014 to 1,907 thousand tonnes in the year ended December 31, 2015.

Chemical products sales to third parties decreased by RUB 94 million, or 3.9%, to RUB 2,327 million in the year ended December 31, 2015 from RUB 2,422 million in the year ended December 31, 2014, mainly as a result of a decrease in sales volumes.

Anthracite and PCI sales to third parties increased by RUB 2,578 million, or 11.5%, to RUB 24,990 million in the year ended December 31, 2015 from RUB 22,412 million in the year ended December 31, 2014, as a result of an increase in sales prices of RUB 6,748 million that was partially offset by a decrease in sales volumes of RUB 4,169 million. The growth of prices denominated in Russian rubles for anthracite and PCI was due to depreciation of the ruble. In 2015, the contract price for metallurgical coal decreased by 28.3% from \$99 per tonne in January 2015 to \$71 per tonne in December 2015.

Steam coal sales to third parties increased by RUB 2,899 million, or 66.8%, to RUB 7,236 million in the year ended December 31, 2015 from RUB 4,337 million in the year ended December 31, 2014, as a result of an increase in sales volumes of RUB 2,119 million and an increase in sales prices of RUB 779 million. The growth of prices denominated in Russian rubles for steam coal was due to depreciation of the ruble. In 2015, steam coal market was still in oversupply, despite producers' efforts to cut production. Chinese power generation and consumption growth has slowed significantly in 2015. The average price in 2015 was \$56 per tonne, 25% lower than the average price in 2014, according to Platts.

Steam coal supplied to the power segment decreased by RUB 279 million, or 36.8%, to RUB 479 million in the year ended December 31, 2015 from RUB 758 million in the year ended December 31, 2014, as a result of a decrease in sales volumes. Sales of steam coal to the power segment companies decreased by 356 thousand tonnes, or 37.9%, from 937 thousand tonnes in the year ended December 31, 2014 to 582 thousand tonnes in the year ended December 31, 2015 due to steam coal replacement by middlings.

Sales of iron ore to third parties decreased by RUB 2,167 million, or 54%, to RUB 1,844 million in the year ended December 31, 2015 from RUB 4,011 million in the year ended December 31, 2014, as a result of a decrease in sales volumes of RUB 2,333 million that was partially offset by an increase in sales prices of RUB 166 million. Price growth for iron ore was due to depreciation of the ruble. In 2015, new iron ore capacity came on stream which

together with a reduction of steel production in China has led to lower prices. Iron ore spot price declined from \$68 per dry metric tonne (62% Fe, CFR China) in January to \$40 per dry metric tonne in December, according to Platts. The average spot price in 2015 was \$56 per dry metric tonne which was 42% lower than the average price in 2014, according to Platts.

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Supplies of iron ore to the steel segment increased by RUB 250 million, or 4.5%, to RUB 5,843 million in the year ended December 31, 2015 from RUB 5,593 million in the year ended December 31, 2014, as a result of a RUB 1,070 million increase in sales volumes that was partially offset by a RUB 820 million decrease in sales prices. Sales volumes increased due to the group strategy of redirection of iron ore sales volumes from third parties to group iron ore consumers. The share of iron ore consumed at Chelyabinsk Metallurgical Plant and produced by Korshunov Mining Plant increased from 41.2% in the year ended December 31, 2014 to 52.5% in the year ended December 31, 2015.

Excluding intersegment sales, export sales were stable at 74.1% of mining segment sales in the year ended December 31, 2015, compared to 73.9% in the year ended December 31, 2014.

***Steel segment***

Our steel segment revenues increased by RUB 6,137 million, or 4.1%, to RUB 153,004 million in the year ended December 31, 2015 from RUB 146,867 million in the year ended December 31, 2014, mainly due to an increase in sales prices. The decrease in third-party sales volumes was due to the weakened demand from Russian and European construction, engineering and transport sectors and the decline in purchases and resale of products from the former Estar metallurgical plants in 2015. In 2014, Russian rolled steel consumption was at a level of 45.5 million tonnes, in 2015 it declined by 8.7% and amounted to 41.5 million tonnes, according to Metal Expert.

Semi-finished products sales increased by RUB 2,193 million, or 77.4%, to RUB 5,027 million in the year ended December 31, 2015 from RUB 2,834 million in the year ended December 31, 2014, as a result of an increase of RUB 1,045 million in sales prices and an increase of RUB 1,148 million in sales volumes. In 2015, sales prices denominated in Russian rubles increased due to depreciation of the ruble: annual average price for billets (including VAT, FCA basis) was 19,403 rubles per tonne, 18% higher than the average price in 2014. Whereas in 2015 U.S. dollar-denominated prices declined as a result of decreased oil and scrap prices, low demand and increased competition on the background of China's exports growth, according to Metal-Courier. The increase in third-party sales volumes was due to recovery of demand in the domestic market.

Other long products sales increased by RUB 1,836 million, or 7.0%, to RUB 28,152 million in the year ended December 31, 2015 from RUB 26,316 million in the year ended December 31, 2014, as a result of an increase of RUB 5,403 million in sales prices that was partially offset by a decrease of RUB 3,567 million in sales volumes. The increase in sales prices was mainly due to depreciation of the ruble and, consequently, higher prices for steel-making raw materials (iron ore, coke, coking coal, etc.). Sales volumes decreased due to the decrease in sales volumes of products purchased from the former Estar metallurgical plants and low demand in the Russian market (reduction in the volume of constructions).

Other flat products sales increased by RUB 3,782 million, or 33.9%, to RUB 14,926 million in the year ended December 31, 2015 from RUB 11,144 million in the year ended December 31, 2014, as a result of an increase of RUB 2,660 million in sales prices and an increase of RUB 1,122 million in sales volumes. The increase in ruble-denominated sales prices was driven by depreciation of the ruble against the U.S. dollar: annual average price for flat steel products (including VAT, FCA basis) was 35,892 rubles per tonne, 12% higher than in 2014. Whereas annual average price for hot-rolled coil (Russia exports, FOB Black Sea) in U.S. dollars decreased by 35% to \$345 per tonne in the year ended December 31, 2015 from \$530 per tonne in the year ended December 31, 2014, according to Metal Expert. The sales volume increased due to the growth in market share and strengthening of consumer demand in the Russian market.

Wire sales increased by RUB 593 million, or 4.0%, to RUB 15,561 million in the year ended December 31, 2015 from RUB 14,968 million in the year ended December 31, 2014, as a result of an increase of RUB 1,883 million in sales prices that was partially offset by a decrease of RUB 1,290 million in sales volumes. The

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increase in sales prices was driven by the increase in the prices of wire rod used as the main input for wire production, as well as by depreciation of the ruble against the U.S. dollar. Sales volumes decreased due to the weakened demand in Russia and Europe.

Rebar sales increased by RUB 442 million, or 1.1%, to RUB 39,980 million in the year ended December 31, 2015 from RUB 39,538 million in the year ended December 31, 2014, as a result of an increase of RUB 2,405 million in sales prices that was offset by a decrease of RUB 1,963 million in sales volumes. In 2015, the Russian domestic price and prices in the CIS region for rebar increased due to the ruble depreciation. Sales volumes decreased due to lower demand in Russian construction sector.

Steel pipes sales decreased by RUB 83 million, or 2.4%, to RUB 3,308 million in the year ended December 31, 2015 from RUB 3,391 million in the year ended December 31, 2014, as a result of a decrease of RUB 781 million in sales volumes that was offset by an increase of RUB 698 million in sales prices. The price increased due to depreciation of the ruble. The sales volume decreased due to reduction of sales volume of products purchased from the former Estar metallurgical plants and lower demand in the Russian market.

Pig iron sales decreased by RUB 1,964 million, or 60.4%, to RUB 1,287 million in the year ended December 31, 2015 from RUB 3,251 million in the year ended December 31, 2014, as a result of an increase of RUB 175 million in sales prices and a decrease of RUB 2,139 million in sales volumes. The decrease in sales volumes was due to the increase in consumption within our steel segment.

Stampings sales decreased by RUB 503 million, or 6.8%, to RUB 6,918 million in the year ended December 31, 2015 from RUB 7,421 million in the year ended December 31, 2014, as a result of an increase of RUB 967 million in sales prices that was offset by a decrease of RUB 1,470 million in sales volumes. The increase in sales prices was driven by the increase in domestic prices during 2015. The decrease in sales volumes was due to lower demand from the key consuming industries (engineering and transport industries).

Ferrosilicon sales increased by RUB 815 million, or 30.0%, to RUB 3,528 million in the year ended December 31, 2015 from RUB 2,713 million in the year ended December 31, 2014, as a result of an increase of RUB 1,172 million in sales prices that was partially offset by a decrease of RUB 357 million in sales volumes. The increase in sales prices was driven by depreciation of the ruble against the U.S. dollar. The decrease in sales volumes was due to the increased competition from the market's participants.

Sales of non-core products and services slightly decreased by RUB 592 million, or 9.1%, to RUB 5,929 million in the year ended December 31, 2015 from RUB 6,521 million in the year ended December 31, 2014.

Excluding intersegment sales, export sales were 17.7% of steel segment sales in the year ended December 31, 2015, compared to 17.8% in the year ended December 31, 2014.

***Power segment***

Our power segment revenues increased by RUB 1,913 million, or 4.8%, to RUB 41,467 million in the year ended December 31, 2015 from RUB 39,554 million in the year ended December 31, 2014.

Electricity sales to third parties increased by RUB 896 million, or 3.8%, to RUB 24,524 million in the year ended December 31, 2015 from RUB 23,628 million in the year ended December 31, 2014, as a result of an increase of RUB 616 million in sales prices and an increase of RUB 280 million in sales volumes.

Other revenue, which consists mostly of heat energy, decreased by RUB 243 million, or 11.1%, to RUB 1,952 million in the year ended December 31, 2015 from RUB 2,195 million in the year ended December 31, 2014, due to the decrease in sales tariffs and sales volumes.



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Intersegment sales increased by RUB 1,259 million, or 9.2%, to RUB 14,990 million in the year ended December 31, 2015 from RUB 13,731 million in the year ended December 31, 2014, mainly as a result of an increase in electricity sales to our steel segment by 16.0%.

*Cost of goods sold and gross profit*

The consolidated cost of goods sold was 59.8% of consolidated revenues in the year ended December 31, 2015, as compared to 62.7% of consolidated revenues in the year ended December 31, 2014, resulting in an increase in consolidated gross profit to 40.2% in the year ended December 31, 2015 from 37.3% for the year ended December 31, 2014. Cost of goods sold primarily consists of costs relating to raw materials (including products purchased for resale), direct payroll, depreciation and energy. The table below sets forth cost of goods sold and gross profit by segment for the years ended December 31, 2015 and 2014, including as a percentage of segment revenues.

| <b>Cost of Goods Sold and Gross Profit by Segment</b>          | <b>Year Ended<br/>December 31, 2015</b> |                                  | <b>Year Ended<br/>December 31, 2014</b> |                                  |
|--|---|----------------------------------|---|----------------------------------|
|  | <b>Amount</b>                           | <b>% of Segment<br/>Revenues</b> | <b>Amount</b>                           | <b>% of Segment<br/>Revenues</b> |
| <b>(In millions of Russian rubles, except for percentages)</b> |   |                                  |   |                                  |
| <b>Mining segment</b>  |   |                                  |   |                                  |
| Cost of goods sold   | 51,280                                  | 47.2%                            | 51,435                                  | 51.1%                            |
| Gross profit   | 57,442                                  | 52.8%                            | 49,123                                  | 48.9%                            |
| <b>Steel segment</b>   |   |                                  |   |                                  |
| Cost of goods sold   | 119,610                                 | 78.2%                            | 115,485                                 | 78.6%                            |
| Gross profit   | 33,394                                  | 21.8%                            | 31,382                                  | 21.4%                            |
| <b>Power segment</b>   |   |                                  |   |                                  |
| Cost of goods sold   | 30,178                                  | 72.8%                            | 29,215                                  | 73.9%                            |
| Gross profit   | 11,289                                  | 27.2%                            | 10,339                                  | 26.1%                            |

*Mining segment*

Mining segment cost of goods sold decreased by RUB 155 million, or 0.3%, to RUB 51,280 million in the year ended December 31, 2015 from RUB 51,435 million in the year ended December 31, 2014. The gross profit percentage increased to 52.8% in the year ended December 31, 2015 compared to 48.9% in the year ended December 31, 2014, mainly due to the increase in selling prices denominated in rubles caused by the depreciation of the ruble.

Coal production cash costs per tonne (see Cash Costs per Tonne Measure ) at Southern Kuzbass Coal Company increased by RUB 263 per tonne, or 22.0%, from RUB 1,197 in the year ended December 31, 2014 to RUB 1,460 in the year ended December 31, 2015, mainly due to the increase of purchasing prices caused by the depreciation of the ruble.

Production cash costs of coal at Yakutugol decreased by RUB 97 per tonne, or 10.1%, from RUB 957 in the year ended December 31, 2014 to RUB 860 in the year ended December 31, 2015, mainly due to cost cut.

Coke production cash costs increased by 8.8% at Moscow Coke and Gas Plant and by 26.1% at Mechel Coke following the increase in coking coal concentrate purchase prices caused by the depreciation of the ruble.

Production cash costs of iron ore increased by 10.5% due to the increase of share of fixed costs per tonne, resulting from a 15.4% decline in iron ore extraction in 2015 compared to 2014.

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**Table of Contents*****Steel segment***

Steel segment cost of goods sold increased by RUB 4,125 million, or 3.6%, to RUB 119,610 million in the year ended December 31, 2015 from RUB 115,485 million in the year ended December 31, 2014. Steel segment cost of goods sold was 78.2% of the segment's revenues in the year ended December 31, 2015, as compared to 78.6% in the year ended December 31, 2014. The slight increase in gross profit from 21.4% to 21.8% is mainly explained by the increase in ruble sales prices caused by the depreciation of the ruble.

***Power segment***

Power segment cost of goods sold increased by RUB 963 million, or 3.3%, to RUB 30,178 million in the year ended December 31, 2015 from RUB 29,215 million in the year ended December 31, 2014. The power segment gross profit percentage increased to 27.2% in the year ended December 31, 2015 from 26.1% in the year ended December 31, 2014 due to sales price increase.

**Cash Costs per Tonne Measure**

In this document, we present cash costs per tonne for coal, coke and iron ore production for each significant production facility of our mining segment. Cash costs per tonne is a performance indicator that is not defined according to IFRS or U.S. GAAP. Cash costs per tonne includes various production costs, such as raw materials, auxiliary materials, wages and social taxes of production personnel, electricity, gas and fuel costs, repairs and maintenance of production equipment, costs of mining works, mineral extraction tax and royalty payments, but excludes non-cash items such as depreciation, depletion and write-down of inventories to their net realizable value. We use this indicator to evaluate the performance of individual production subsidiaries and their respective ability to generate cash. Cash costs per tonne is a widely used performance indicator in the mining industry to evaluate the cost-effectiveness of mining operations. We believe that investors use this indicator in addition to the financial information prepared in accordance with IFRS to evaluate the performance of our companies. Consequently, this information must be considered supplementary and should not be regarded as a substitute for the performance indicators prepared in accordance with IFRS.

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The reconciliation of mining segment production cash costs per tonne for the year ended December 31, 2015 is presented below:

|  | In thousands of<br>tonnes | Cash cost,<br>in thousands of<br>Russian<br>rubles<br>per tonne | In millions<br>of<br>Russian<br>rubles |
|--|---------------------------|---|--|
| Coal Southern Kuzbass Coal Company sales to third parties  | 5,012                     | 1.5   | 7,317                                  |
| Coal Southern Kuzbass Coal Company intersegment sales  | 1,674                     | 1.5   | 2,444                                  |
| Coal Yakutugol sales to third parties  | 7,540                     | 0.9   | 6,483                                  |
| Coal Yakutugol intersegment sales  |                           | 0.9   |  |
| Coal Elgaugol sales to third parties   | 1,575                     | 0.8   | 1,280                                  |
| Coal Elgaugol intersegment sales   | 6                         | 0.8   | 5                                      |
| Iron ore Korshunov Mining Plant sales to third parties   | 489                       | 2.0   | 983                                    |
| Iron ore Korshunov Mining Plant intersegment sales   | 2,288                     | 2.0   | 4,598                                  |
| Coke Moscow Coke and Gas Plant sales to third parties  | 715                       | 7.4   | 5,268                                  |
| Coke Moscow Coke and Gas Plant intersegment sales  | 3                         | 7.4   | 20                                     |
| Coke Mechel Coke sales to third parties  | 270                       | 6.0   | 1,612                                  |
| Coke Mechel Coke intersegment sales  | 1,924                     | 6.0   | 11,499                                 |
| Depreciation   |                           |   | 6,532                                  |
| Depletion  |                           |   | 1,685                                  |
| Write-down of inventory to their net realizable value  |                           |   | 6                                      |
| Cost of coal produced by third companies and re-sold by our trading subsidiaries, including intersegment sales   |                           |   | 346                                    |
| Stockholding year to year movements, costs of other products and services (coking products, washing services) and costs of other subsidiaries <sup>(3)</sup> |                           |   | 1,200                                  |
| <b>Total mining segment cost of sales</b>  |                           |   | <b>51,280</b>                          |

- (1) Cash costs per tonne for coke were reduced by by-products credits. The amount of by-products credits in the total cash costs per tonne was RUB 283, or 4%, at Moscow Coke and Gas Plant in the year ended December 31, 2015.
- (2) Cash costs per tonne for coke were reduced by by-products credits. The amount of by-products credits in the total cash costs per tonne was RUB 767, or 13%, at Mechel Coke in the year ended December 31, 2015.
- (3) Line Costs of other products and services was increased by the amount of by-products credits of RUB 840 million in the year ended December 31, 2015.

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The reconciliation of mining segment production cash costs per tonne for the year ended December 31, 2014 is presented below:

|  | In thousands of<br>tonnes | Cash cost,<br>in thousands of<br>Russian<br>rubles<br>per tonne | In millions<br>of<br>Russian<br>rubles |
|--|---------------------------|---|--|
| Coal Southern Kuzbass Coal Company sales to third parties  | 8,029                     | 1.2   | 9,611                                  |
| Coal Southern Kuzbass Coal Company intersegment sales  | 1,490                     | 1.2   | 1,783                                  |
| Coal Yakutugol sales to third parties  | 8,338                     | 1.0   | 7,979                                  |
| Coal Yakutugol intersegment sales  |                           | 1.0   |  |
| Coal Elgaugol sales to third parties   | 668                       | 0.8   | 560                                    |
| Coal Elgaugol intersegment sales   |                           | 0.8   |  |
| Iron ore Korshunov Mining Plant sales to third parties   | 1,169                     | 1.8   | 2,125                                  |
| Iron ore Korshunov Mining Plant intersegment sales   | 1,920                     | 1.8   | 3,492                                  |
| Coke Moscow Coke and Gas Plant sales to third parties  | 775                       | 6.8   | 5,248                                  |
| Coke Moscow Coke and Gas Plant intersegment sales  |                           | 6.8   |  |
| Coke Mechel Coke sales to third parties  | 487                       | 4.7   | 2,297                                  |
| Coke Mechel Coke intersegment sales  | 1,961                     | 4.7   | 9,249                                  |
| Depreciation   |                           |   | 5,911                                  |
| Depletion  |                           |   | 1,787                                  |
| Write-down of inventory to their net realizable value  |                           |   | 166                                    |
| Cost of coal produced by third companies and re-sold by our trading subsidiaries, including intersegment sales   |                           |   | 439                                    |
| Stockholding year to year movements, costs of other products and services (coking products, washing services) and costs of other subsidiaries <sup>(3)</sup> |                           |   | 788                                    |
| <b>Total mining segment cost of sales</b>  |                           |   | <b>51,435</b>                          |

- (1) Cash costs per tonne for coke were reduced by by-products credits. The amount of by-products credits in the total cash costs per tonne was RUB 417, or 6%, at Moscow Coke and Gas Plant in the year ended December 31, 2014.
- (2) Cash costs per tonne for coke were reduced by by-products credits. The amount of by-products credits in the total cash costs per tonne was RUB 695, or 15%, at Mechel Coke in the year ended December 31, 2014.
- (3) Line Costs of other products and services was increased by the amount of by-products credits of RUB 834 million in the year ended December 31, 2014.

**Table of Contents***Selling, distribution and operating expenses*

Selling, distribution and operating expenses decreased by RUB 12,473 million, or 13.9%, to RUB 77,555 million in the year ended December 31, 2015 from RUB 90,028 million in the year ended December 31, 2014, as a result of a decrease in impairment of goodwill and other non-current assets in the steel segment, selling and distribution expenses in the mining segment and allowance for doubtful accounts in the mining, steel and power segments in the year ended December 31, 2015. As a percentage of consolidated revenues, selling, distribution and operating expenses decreased to 30.7% in the year ended December 31, 2015 from 36.9% in the year ended December 31, 2014. Our selling, distribution and operating expenses consist primarily of selling and distribution expenses, loss on write-off of property, plant and equipment, impairment of goodwill and other non-current assets, allowance for doubtful accounts, taxes other than income taxes, administrative and other operating expenses and other operating income. The table below sets forth these costs by segment for the years ended December 31, 2015 and 2014, including as a percentage of segment revenues.

| <b>Selling, Distribution and Operating Expenses by Segment</b> | <b>Year Ended<br/>December 31, 2015</b> |                                  | <b>Year Ended<br/>December 31, 2014</b> |                                  |
|--|---|----------------------------------|---|----------------------------------|
|  | <b>Amount</b>                           | <b>% of Segment<br/>Revenues</b> | <b>Amount</b>                           | <b>% of Segment<br/>Revenues</b> |
| <b>(In millions of Russian rubles, except for percentages)</b> |   |                                  |   |                                  |
| <b>Mining segment</b>  |   |                                  |   |                                  |
| Selling and distribution expenses                              | 28,588                                  | 26.3%                            | 33,583                                  | 33.4%                            |
| Loss on write-off of property, plant and equipment             | 199                                     | 0.2%                             | 309                                     | 0.3%                             |
| Impairment of goodwill and other non-current assets            |   | 0.0%                             | (19)                                    | (0.0%)                           |
| Allowance for doubtful accounts                                | 247                                     | 0.2%                             | 981                                     | 1.0%                             |
| Taxes other than income taxes                                  | 3,706                                   | 3.4%                             | 4,878                                   | 4.9%                             |
| Administrative and other operating expenses                    | 8,872                                   | 8.2%                             | 8,002                                   | 7.9%                             |
| Other operating income   | (175)                                   | (0.2%)                           | (329)                                   | (0.3%)                           |
| <b>Total</b>   | <b>41,437</b>                           | <b>38.1%</b>                     | <b>47,405</b>                           | <b>47.1%</b>                     |
| <b>Steel segment</b>   |   |                                  |   |                                  |
| Selling and distribution expenses                              | 13,736                                  | 9.0%                             | 13,393                                  | 9.1%                             |
| Loss on write-off of property, plant and equipment             | 492                                     | 0.3%                             | 242                                     | 0.2%                             |
| Impairment of goodwill and other non-current assets            | 16                                      | 0.0%                             | 8,015                                   | 5.5%                             |
| Allowance for doubtful accounts                                | 948                                     | 0.6%                             | 2,290                                   | 1.6%                             |
| Taxes other than income taxes                                  | 2,044                                   | 1.3%                             | 1,505                                   | 1.0%                             |
| Administrative and other operating expenses                    | 7,825                                   | 5.1%                             | 7,743                                   | 5.3%                             |
| Other operating income   | (193)                                   | (0.1%)                           | (487)                                   | (0.3%)                           |
| <b>Total</b>   | <b>24,868</b>                           | <b>16.3%</b>                     | <b>32,701</b>                           | <b>22.3%</b>                     |
| <b>Power segment</b>   |   |                                  |   |                                  |
| Selling and distribution expenses                              | 8,792                                   | 21.2%                            | 8,685                                   | 22.0%                            |
| Loss on write-off of property, plant and equipment             |   | 0.0%                             | 110                                     | 0.3%                             |
| Impairment of goodwill and other non-current assets            | 1,444                                   | 3.5%                             |   | 0.0%                             |

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|   |               |              |              |              |
|---|---------------|--------------|--------------|--------------|
| Allowance for doubtful accounts             | 312           | 0.8%         | 526          | 1.3%         |
| Taxes other than income taxes               | 103           | 0.2%         | 86           | 0.2%         |
| Administrative and other operating expenses | 603           | 1.5%         | 571          | 1.4%         |
| Other operating income                      | (4)           | (0.0%)       | (56)         | (0.1%)       |
| <b>Total</b>                                | <b>11,250</b> | <b>27.1%</b> | <b>9,922</b> | <b>25.1%</b> |

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**Table of Contents*****Mining segment***

Selling and distribution expenses consisted almost entirely of transportation expenses related to our selling activities. Such expenses decreased by RUB 4,994 million, or 14.9%, to RUB 28,588 million in the year ended December 31, 2015 from RUB 33,582 million in the year ended December 31, 2014, mainly due to the decrease in segment sales volumes by 19.9%. As a percentage of mining segment revenues, selling and distribution expenses decreased from 33.4% to 26.3% due to an increase of 35.6% in sales revenue from sales to steel segment and simultaneous decrease of 14.9% in selling and distribution expenses.

Taxes other than income tax decreased by RUB 1,172 million, or 24.0%, to RUB 3,706 million in the year ended December 31, 2015 from RUB 4,878 million in the year ended December 31, 2014. The decrease was due to several accruals for taxes other than income tax made in the financial statements for the year ended December 31, 2014, namely additional tax liabilities for previous years of RUB 548 million at Tomusinsky Open Pit. There are no similar accruals in 2015. Tax penalties imposed by the tax authorities due to delays in tax payments decreased by RUB 515 million from RUB 697 million in the year ended December 31, 2014 to RUB 181 million in the year ended December 31, 2015.

Allowance for doubtful accounts decreased by RUB 734 million to RUB 247 million in the year ended December 31, 2015 from RUB 981 million in the year ended December 31, 2014, due to the decrease in outstanding accounts receivable at the end of 2015. In accordance with our accounting policy, we apply specific rates to overdue accounts receivable depending on the history of cash collections and events and conditions at the reporting date.

Loss on write-off of property, plant and equipment decreased by RUB 110 million, or 35.4%, to RUB 199 million in the year ended December 31, 2015 from RUB 309 million in the year ended December 31, 2014, due to the decrease in the number of property, plant and equipment objects that are not planned for further use in production process at Yakutugol and Southern Kuzbass Coal Company.

General, administrative and other expenses consist of payroll and payroll taxes, depreciation, rent and maintenance, legal and consulting expenses, office overheads and other expenses. These expenses increased by RUB 1,024 million, or 13.3%, to RUB 8,697 million in the year ended December 31, 2015 from RUB 7,673 million in the year ended December 31, 2014, mainly as a result of the depreciation of the Russian ruble: salaries and related social taxes increased by RUB 690 million, or 15.0%, to RUB 5,299 million in the year ended December 31, 2015 from RUB 4,609 million in the year ended December 31, 2014; legal and consulting fees and insurance services increased by 11.2% to RUB 278 million in the year ended December 31, 2015 from RUB 250 million in the year ended December 31, 2014; and other administrative and operating expenses increased by RUB 306 million, or 10.9%, to RUB 3,120 million in the year ended December 31, 2015 from RUB 2,814 million in the year ended December 31, 2014.

***Steel segment***

Selling and distribution expenses consisted almost entirely of transportation expenses related to our selling activities. Such expenses increased by RUB 343 million, or 2.6%, to RUB 13,736 million in the year ended December 31, 2015 from RUB 13,393 million in the year ended December 31, 2014, mainly due to the increase in railway tariffs by 10.0% that was partially offset by the decrease in sales volume. As a percentage of steel segment revenues, selling and distribution expenses decreased to 9.0% in the year ended December 31, 2015 from 9.1% in the year ended December 31, 2014.



Taxes other than income tax increased by RUB 539 million, or 35.8%, to RUB 2,044 million in the year ended December 31, 2015 from RUB 1,505 million in the year ended December 31, 2014. As a percentage of segment revenues, these taxes increased from 1.0% to 1.3%. Property and land taxes increased by RUB 193 million, or 17.7%, to RUB 1,282 million in the year ended December 31, 2015 from RUB 1,089 million in the year ended December 31, 2014, mainly due to revision of the cadastral valuation of land.

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Allowance for doubtful accounts decreased by RUB 1,342 million, or 58.6%, to RUB 948 million in the year ended December 31, 2015 from RUB 2,290 million in the year ended December 31, 2014, mainly due to the fact that main provision in relation to certain of the former Estar metallurgical plants had entered into bankruptcy proceedings was recognized in 2014 and in previous years.

Loss on write-off of property, plant and equipment increased by RUB 250 million, or 103.3%, to RUB 492 million in the year ended December 31, 2015 from RUB 242 million in the year ended December 31, 2014, due to the increase in the number of idled property, plant and equipment written off by our steel production subsidiaries.

Impairment of goodwill and other non-current assets decreased by RUB 7,999 million or 99.8%. In 2014, we recognized impairment of property, plant and equipment and construction in progress in relation to Izhstal of RUB 6,669 million, Donetsk Electrometallurgical Plant of RUB 1,283 million and Mechel Service Romania of RUB 63 million due to the lack of positive prospects for the recovery of the European market. In 2015, we recognized reversal of impairment of other non-current assets in relation to Izhstal of RUB 5,967 million and recognized additional impairment of other non-current assets in relation to Mechel Materials of RUB 5,983 million.

General, administrative and other expenses increased by RUB 82 million, or 1.1%, to RUB 7,825 million in the year ended December 31, 2015 from RUB 7,743 million in the year ended December 31, 2014. Payroll and related social taxes slightly increased by RUB 144 million, or 4.0%, to RUB 3,750 million in the year ended December 31, 2015 from RUB 3,606 million in the year ended December 31, 2014. Social expenses decreased by RUB 43 million, or 16.8%, to RUB 215 million in the year ended December 31, 2015 from RUB 258 million in the year ended December 31, 2014, due to the cost-cutting measures implemented by our management. Rent and maintenance, business travel expenses, bank charges and office expenses increased by RUB 84 million, or 9.6%, to RUB 959 million in the year ended December 31, 2015 from RUB 875 million in the year ended December 31, 2014. Professional expenses, which include auditing, accounting, legal and engineering fees and insurance services decreased by RUB 122 million, or 27.9%, to RUB 315 million in the year ended December 31, 2015 from RUB 437 million in the year ended December 31, 2014, due to the cost-cutting measures implemented by our management and the decreased involvement of external consultants in 2015. Fines and penalties expenses on breach of trading contracts increased by RUB 317 million, or 149.4%, to RUB 529 million in the year ended December 31, 2015 from RUB 212 million in the year ended December 31, 2014. Other administrative and operating expenses decreased by RUB 298 million, or 12.7%, to RUB 2,057 million in the year ended December 31, 2015 from RUB 2,355 million in the year ended December 31, 2014. Other operating income decreased by RUB 294 million, or 60.4%, to RUB 193 million in the year ended December 31, 2015 from RUB 487 million in the year ended December 31, 2014.

***Power segment***

In 2015, selling and distribution expenses consisted almost entirely of electricity transmission costs incurred by our Kuzbass Power Sales Company for the usage of the power grid through which electricity is distributed to end consumers. These expenses increased by RUB 108 million, or 1.2%, to RUB 8,792 million in the year ended December 31, 2015 from RUB 8,685 million in the year ended December 31, 2014.

Taxes other than income tax increased by RUB 16 million, or 18.8%, to RUB 103 million in the year ended December 31, 2015 from RUB 86 million in the year ended December 31, 2014, due to the increase in property tax accrued by Southern Kuzbass Power Plant.

Allowance for doubtful accounts decreased by RUB 214 million to RUB 312 million in the year ended December 31, 2015 from RUB 526 million in the year ended December 31, 2014, mainly due to the decrease in allowance for trade receivables from the former Estar metallurgical plants.



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In 2015, as a result of the goodwill impairment test we recognized the impairment loss of Southern Kuzbass Power Plant in the amount of RUB 1,444 million. No impairment loss was recognized in 2014. See note 18 to the consolidated financial statements.

General, administrative and other expenses increased by RUB 32 million, or 5.6%, to RUB 603 million in the year ended December 31, 2015 from RUB 571 million in the year ended December 31, 2014, due to reversal of provisions for legal claims and reduction in personnel expenses as a result of power plants organizational optimization.

*Operating profit*

Operating profit increased by RUB 23,345 million, or 2,574%, to RUB 24,252 million in the year ended December 31, 2015 from RUB 907 million in the year ended December 31, 2014. Operating profit as a percentage of consolidated revenues was 9.6% in the year ended December 31, 2015 and 0.4% in the year ended December 31, 2014, mainly due to an increase in consolidated gross profit to 40.2% in the year ended December 31, 2015 from 37.3% in the year ended December 31, 2014 and a decrease in losses from allowance for amounts due from related parties and impairment of goodwill and other non-current assets as explained above.

The table below sets out operating profit (loss) by segment, including as a percentage of segment revenues.

| Operating Profit (Loss) by Segment                                  | Year Ended<br>December 31, 2015                                   |                          | Year Ended<br>December 31, 2014 |                          |
|---|---|--------------------------|---------------------------------|--------------------------|
|   | Amount<br>(In millions of Russian rubles, except for percentages) | % of Segment<br>Revenues | Amount                          | % of Segment<br>Revenues |
| Mining segment  | 16,005  | 14.7%                    | 1,718                           | 1.7%                     |
| Steel segment   | 8,526   | 5.6%                     | (1,319)                         | (0.9%)                   |
| Power segment   | 39  | 0.1%                     | 417                             | 1.1%                     |
| Elimination of intersegment unrealized (profit) loss <sup>(1)</sup> | (318)   |                          | 91                              |                          |
| Consolidated operating profit                                       | 24,252  |                          | 907                             |                          |

- (1) Our management evaluates the performance of our segments before the elimination of unrealized profit in inventory balances of segments that was generated by the segments but not recognized as profit in our consolidated financial statements until the sale of such inventories to third parties. Therefore, we present our segments before such elimination, and such elimination is presented separately. The change in intersegment unrealized profit adjustment in the year ended December 31, 2015 as compared to the year ended December 31, 2014 was due to the increase in gross profit of our mining segment in 2015.

*Mining segment*

Mining segment operating income increased by RUB 14,287 million, or 831.6%, to RUB 16,005 million in the year ended December 31, 2015 from RUB 1,718 million in the year ended December 31, 2014. The operating profit percentage increased to 14.7% in the year ended December 31, 2015 from 1.7% in the year ended December 31, 2014, mainly due to the increase in selling prices denominated in rubles caused by the depreciation of the ruble.

***Steel segment***

Steel segment operating results changed by RUB 9,845 million, or 746.4%, to RUB 8,526 million income in the year ended December 31, 2015 from RUB 1,319 million loss in the year ended December 31, 2014. The operating profit percentage changed to positive 5.6% in the year ended December 31, 2015 from negative 0.9%

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in the year ended December 31, 2014, mainly due to the factors that affected operating income in 2014, such as the recognition of losses from the impairment of non-current assets of Izhstal and Donetsk Electrometallurgical Plant and a provision on trade and other balances due from the former Estar metallurgical plants.

**Power segment**

Power segment operating income decreased by RUB 378 million, or 90.9%, to RUB 39 million in the year ended December 31, 2015 from RUB 417 million in the year ended December 31, 2014. The operating profit percentage decreased to 0.1% in the year ended December 31, 2015 from 1.1% in the year ended December 31, 2014, mainly due to the optimization of expenses and the increase in sales tariffs.

**Other income and expense, net**

Other income and expense, net consists of share of profit of an associate, finance income, finance costs, other income and other expenses and foreign exchange loss. The table below sets forth these costs for the years ended December 31, 2015 and 2014, including as a percentage of revenues.

| <b>Other Income and Expense, Net</b> | <b>Year Ended<br/>December 31, 2015</b>                        |                          | <b>Year Ended<br/>December 31, 2014</b> |                          |
|--------------------------------------|--|--------------------------|---|--------------------------|
|                                      | <b>Amount</b>  | <b>% of<br/>Revenues</b> | <b>Amount</b>                           | <b>% of<br/>Revenues</b> |
|                                      | <b>(In millions of Russian rubles, except for percentages)</b> |                          |   |                          |
| Finance income                       | 183  | 0.1%                     | 107                                     | 0.0%                     |
| Finance costs                        | (60,453)   | (23.9)%                  | (28,110)                                | (11.5)%                  |
| Foreign exchange loss                | (71,106)   | (28.0)%                  | (103,176)                               | (42.3)%                  |
| Share of profit of an associate      |  | 0.0%                     | 7                                       | 0.0%                     |
| Other income                         | 341  | 0.2%                     | 663                                     | 0.3%                     |
| Other expenses                       | (347)  | (0.1)%                   | (1,486)                                 | (0.6)%                   |
| <b>Total</b>                         | <b>(131,382)</b>   | <b>(51.9)%</b>           | <b>(131,995)</b>                        | <b>(54.1)%</b>           |

Finance income increased by RUB 76 million, or 71%, to RUB 183 million in the year ended December 31, 2015 from RUB 107 million in the year ended December 31, 2014, mainly due to fines and penalties on overdue accounts receivable and an increase in exchange rates.

Finance costs increased by RUB 32,343 million, or 115.1%, to RUB 60,453 million in the year ended December 31, 2015 from RUB 28,110 million in the year ended December 31, 2014, due to the increase in the weighted average interest rate from 12.0% in the year ended December 31, 2014 to 15.0% in the year ended December 31, 2015 and the increase of fines and penalties on overdue borrowings and interest payable by RUB 19,288 million.

Foreign exchange loss decreased by RUB 32,070 million, or 31.2%, to RUB 71,106 million in the year ended December 31, 2015 from RUB 103,176 million in the year ended December 31, 2014, mainly due to a decline of volatility of the ruble exchange rate in the year ended December 31, 2015 as compared to the year ended December 31, 2014.

Share of profit of an associate decreased by RUB 7 million to RUB nil in the year ended December 31, 2015 from RUB 7 million in the year ended December 31, 2014. Income earned in 2014 related to our share of income from our equity investment of BWS Bewehrungsstahl GmbH (see note 8 to the consolidated financial statements).

Other income decreased by RUB 322 million, or 48.6%, to RUB 341 million in the year ended December 31, 2015 from RUB 663 million in the year ended December 31, 2014 and other expenses decreased

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by RUB 1,139 million, or 76.6%, to RUB 347 million in the year ended December 31, 2015 from RUB 1,486 million in the year ended December 31, 2014, mainly due to a loss related to the failure of a counterparty to a securities repurchase agreement to return certain securities to our group.

*Income tax expense (benefit)*

Income tax expense changed by RUB 17,144 million, or 194.3%, to RUB 8,322 million expense in the year ended December 31, 2015 from RUB 8,822 million benefit in the year ended December 31, 2014, due to an overall increase in operating income. Our effective tax rate changed to positive 7.8% from negative 6.7%, due to the increase in loss from continuing operations before income tax.

*Net income (loss) from discontinued operations*

Net income (loss) from discontinued operations changed by RUB 12,524 million, or 107.0%, to RUB 822 million income in the year ended December 31, 2015 from RUB 11,702 million loss in the year ended December 31, 2014, mainly due to the recognition of Bluestone as held for sale and recognition of corresponding impairment loss in 2014.

*Net income attributable to non-controlling interests*

Net income attributable to non-controlling interests changed by RUB 1,798 million, or 142.4%, to a RUB 535 million income in the year ended December 31, 2015 from a RUB 1,263 million loss in the year ended December 31, 2014. The non-controlling interest in the loss of our subsidiaries in the year ended December 31, 2015 was RUB 927 million for Southern Kuzbass Coal Company and RUB 104 million for Izhstal and was partially offset by the non-controlling interest in the income of Korshunov Mining Plant of RUB 113 million, Chelyabinsk Metallurgical Plant of RUB 132 million and Kuzbass Power Sales Company of RUB 155 million.

*Net loss attributable to equity holders of the parent*

Net loss attributable to our equity holders decreased by RUB 17,541 million, or 13.2%, to RUB 115,163 million in the year ended December 31, 2015 from RUB 132,704 million in the year ended December 31, 2014, due to the decrease of foreign exchange losses, losses of discontinued operations and partially offset by the increase in finance costs.

**Liquidity and Capital Resources***Capital requirements*

We expect that our principal capital requirements in the near future will be for financing the repayment of maturing debt and regular maintenance capital expenditures.

Our business is heavily dependent on machinery for the production of steel and steel products, as well as investments in our mining operations. Investments to maintain and expand production facilities are, accordingly, an important priority and have a significant effect on our cash flows and future results of operations. We intend to focus our capital spending on the implementation of projects that we view as key to carrying out our business strategy and improve free cash flow. See Item 4. Information on the Company Capital Investment Program for the objectives of our capital investment program and its details. Over the next three years, i.e., 2017-2019, we expect our capital expenditures on our metals production facilities to total approximately 11,703 million rubles, approximately 68% of which will be in 2017-2018, and approximately 32% in 2019. We intend to spend approximately 5,704 million rubles for the development of the Elga coal deposit during the period from 2017 to 2019. We intend to finance our capital



investments with cash flow from operations and external long-term financing sources.

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Our total outstanding debt as of December 31, 2016 and 2015 was RUB 445,809 million and RUB 495,982 million, respectively. See Item 11. Quantitative and Qualitative Disclosures about Market Risk for information regarding the type of financial instruments, currency and interest rate structure.

In 2016 and 2015, we paid dividends of RUB 4.1 million and RUB 4.1 million, respectively, all of which were paid on preferred shares. See Item 8. Financial Information Dividend Distribution Policy for a description of our dividend policy.

***Capital resources***

Our strategy has shifted from growing our business through acquisition and expansion opportunities to extracting the maximum value from our existing core assets. We now intend to concentrate on efficiency improvements and modernization of the business lines, which we expect will increase the business overall profitability. We may also consider further selective disposal of assets.

Historically, our major sources of cash have been cash generated from operations, bank loans and public debt, and we expect these sources will continue to be our principal sources of cash in the future. For financing of our capital investment program we have also relied on financings secured by foreign export credit agency guarantees. We do not use off-balance sheet financing arrangements.

The table below summarizes our cash flows for the periods indicated.

|  | <b>Year Ended December 31,</b>         |             |             |
|--|--|-------------|-------------|
|  | <b>2016</b>                            | <b>2015</b> | <b>2014</b> |
|  | <b>(In millions of Russian rubles)</b> |             |             |
| Net cash provided by operating activities <sup>(1)</sup> | 53,207                                 | 38,867      | 43,013      |
| Net cash used in investing activities <sup>(2)</sup>     | (4,969)                                | (5,218)     | (14,494)    |
| Net cash used in financing activities                    | (45,869)                               | (34,433)    | (34,206)    |

(1) Certain reclassifications were made to conform with current year presentation. Interest received is reflected within investing activities, earlier it was reflected within operating activities. Interest paid is reflected within financing activities, earlier it was reflected within operating activities.

(2) Deferred consideration paid for the acquisition of Donetsk Electrometallurgical Plant's property complex in prior periods is reflected within financing activities, earlier it was reflected within investing activities.

Net cash provided by operating activities was RUB 53,207 million in the year ended December 31, 2016 as compared to net cash provided by operating activities of RUB 38,867 million in the year ended December 31, 2015 and of RUB 43,013 million in the year ended December 31, 2014. The operating cash inflows were derived from payments received from sales of our mining, steel and power products, reduced by cash disbursements for direct labor, raw materials and parts, selling, distribution and operating expenses, interest expense and income taxes.

Net cash from operating activities before changes in working capital items was RUB 64,542 million in the year ended December 31, 2016. Net operating cash outflow of discontinued operations amounted to RUB 436 million. Income taxes paid amounted to RUB 2,101 million. Below we analyze major changes in working capital items which in the aggregate accounted for RUB 8,798 million in cash used in operating activities, resulting in net cash provided by

operating activities of RUB 53,207 million.

Working capital items accretive to operating cash flows:

an increase in advances received of RUB 588 million of Beloretsk Metallurgical Plant, Mechel Service, Urals Stampings Plant and Izhstal due to growth of sales in the year ended December 31, 2016 as compared to the year ended December 31, 2015; and

an increase in accrued taxes and other liabilities of RUB 2,368 million mainly due to change in tax liabilities and increase in probable tax risks.

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Working capital items reducing operating cash flows:

an increase in accounts receivable of RUB 5,542 million primarily due to the increase in sales of Mechel Carbon and Mechel Service;

a decrease in accounts payable of RUB 4,259 million due to the growth of turnover of accounts payable and activated payments;

an increase in inventories of RUB 1,070 million due to an increase in raw materials of Mechel Coke, Elgaugol and Chelyabinsk Metallurgical Plant as of December 31, 2016 as compared to December 31, 2015. The main reason for the change in the stock level was the increase in production volumes in steel and mining segments as a result of the growth of sales; and

an increase in other current assets of RUB 883 million primarily due to an increase in advances paid of Mechel Carbon and Mecheltrans.

Net cash from operating activities before changes in working capital items was RUB 43,227 million in the year ended December 31, 2015. Net operating cash outflow of discontinued operations amounted to RUB 136 million. Income taxes paid amounted to RUB 1,437 million. Below we analyze major changes in working capital items which in the aggregate accounted for RUB 2,787 million in cash used in operating activities, resulting in net cash provided by operating activities of RUB 38,867 million.

Working capital items accretive to operating cash flows:

a decrease in inventories of RUB 1,873 million due to a significant decrease in finished goods of Mechel Carbon Singapore and Southern Kuzbass Coal Company as of December 31, 2015 as compared to December 31, 2014. The main reason for the change in the stock level was the decrease in production volumes in mining segment as a result of the decline of export sales;

a decrease in accounts receivable of RUB 4,597 million primarily due to the decrease in sales of Mechel Carbon, Mechel Carbon Singapore, Urals Stampings Plant and Mechel Service; and

a decrease in other current assets of RUB 997 million primarily due to a decrease in VAT and other taxes receivable of Yakutugol, Chelyabinsk Metallurgical Plant and Mecheltrans.

Working capital items reducing operating cash flows:

a decrease in accrued taxes and other liabilities of RUB 1,465 million due to positive change in tax liabilities, primarily resulting from a release of tax liability related for the year ended December 31, 2015;

a decrease in accounts payable of RUB 8,125 million; and

a decrease in advances received of RUB 664 million of Chelyabinsk Metallurgical Plant, Mechel Service, Mechel Carbon, Donetsk Electrometallurgical Plant and Urals Stampings Plant.

Net cash from operating activities before changes in working capital items was RUB 23,271 million in the year ended December 31, 2014. Net operating cash outflow of discontinued operations amounted to RUB 745 million. Income taxes paid amounted to RUB 2,509 million. Below we analyze major changes in working capital items which in the aggregate accounted for RUB 22,996 million in cash provided by operating activities, resulting in net cash provided by operating activities of RUB 43,013 million.

Working capital items accretive to operating cash flows:

a decrease in inventories of RUB 14,565 million due to a significant decrease in finished goods and raw materials held in stock at the warehouses of Mechel Service Global, Mechel Carbon, Southern Kuzbass Coal Company and Chelyabinsk Metallurgical Plant as of December 31, 2014. The main reason for the change in the stock level was the decrease in production volumes across all our segments as a result of the continuation of weak demand in the European and Russian markets;

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an increase in accrued taxes and other liabilities of RUB 8,771 million due to delays in payments;

a decrease in accounts receivable of RUB 2,130 million primarily due to the decrease in sales of Mechel Service, Korshunov Mining Plant, Mechel Carbon and Mechel Trading; and

an increase in advances received of RUB 62 million.

Working capital items reducing operating cash flows:

a decrease in other current assets of RUB 822 million primarily due to a decrease in VAT and other taxes receivable of Southern Kuzbass Coal Company and Mechel Service Global and repayment of accounts receivable to Romanian companies disposed of in 2013; and

a decrease in accounts payable of RUB 1,710 million.

Net cash used in investing activities was RUB 4,969 million in the year ended December 31, 2016 as compared to net cash used in investing activities of RUB 5,218 million in the year ended December 31, 2015 and of RUB 14,494 million in the year ended December 31, 2014. Substantially all of the cash used in investing activities in the years ended December 31, 2016, 2015 and 2014 related to capital expenditures. Capital expenditures relating to purchases of property, plant and equipment, purchases of mineral licenses and interest paid, capitalized amounted to RUB 5,524 million, RUB 5,977 million and RUB 16,506 million in the years ended December 31, 2016, 2015 and 2014, respectively. Cash provided by investing activities related to disposal of businesses and investments amounted to RUB 248 million, RUB 177 million and RUB 632 million in the years ended December 31, 2016, 2015 and 2014, respectively.

Net cash used in financing activities was RUB 45,869 million in the year ended December 31, 2016 as compared to net cash used in financing activities of RUB 34,433 million in the year ended December 31, 2015 and of RUB 34,206 million in the year ended December 31, 2014. Expenditures related to the deferred consideration payments amounted to RUB 4,732 million, RUB 4,819 million and RUB 3,223 million in the years ended December 31, 2016, 2015 and 2014, respectively. We received debt proceeds of RUB 4,002 million and proceeds from the sale of a 49% stake in the Elga coal complex, with put option granted of RUB 34,300 million and repaid debt of RUB 42,322 million in the year ended December 31, 2016 as compared to received debt proceeds of RUB 13,875 million and repaid debt of RUB 11,896 million in the year ended December 31, 2015 and received debt proceeds of RUB 64,469 million and repaid debt of RUB 77,761 million in the year ended December 31, 2014.

***Liquidity***

We had cash and cash equivalents of RUB 1,689 million, RUB 3,079 million and RUB 3,983 million as of December 31, 2016, 2015 and 2014, respectively. Our cash and cash equivalents were held in rubles (40.9%, 20.6% and 23.3% as of December 31, 2016, 2015 and 2014, respectively), U.S. dollars (28.5%, 37.4% and 45.3% as of December 31, 2016, 2015 and 2014, respectively), euros (23.9%, 37.6% and 23.1% as of December 31, 2016, 2015 and 2014, respectively) and certain other currencies of the CIS and Eastern Europe.

The unused portion under the group's credit facilities as of December 31, 2016, 2015 and 2014 was RUB 373 million, RUB 409 million and RUB 1,879 million, respectively. As of December 31, 2016, 2015 and 2014, the group's credit

facilities provided aggregated borrowing capacity of RUB 446,181 million (of which RUB 134,918 million is repayable during 2017 and RUB 260,653 million represented long-term debt that was reclassified as short-term liabilities as of that date because of covenant violations), RUB 496,390 million and RUB 397,743 million, respectively. The group's borrowings under these credit facilities (except for special-purpose borrowings such as pre-export facilities, Vnesheconombank's facilities as well as factoring and overdraft facilities) carried a weighted average interest rate of approximately 10.3%, 15.0% and 12.0% as of December 31, 2016, 2015 and 2014, respectively. See Restrictive Covenants for further information about our covenant violations.

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The following table summarizes our liquidity as of December 31, 2016, 2015 and 2014.

| <b>Estimated Liquidity</b>                | <b>December 31,<br/>2016</b>           | <b>December 31,<br/>2015</b> | <b>December 31,<br/>2014</b> |
|---|--|------------------------------|------------------------------|
|   | <b>(In millions of Russian rubles)</b> |                              |                              |
| Cash and cash equivalents                 | 1,689                                  | 3,079                        | 3,983                        |
| Amounts available under credit facilities | 373                                    | 409                          | 1,879                        |
| <b>Total estimated liquidity</b>          | <b>2,062</b>                           | <b>3,488</b>                 | <b>5,862</b>                 |

Short-term debt (short-term borrowings and current portion of long-term debt) decreased by RUB 57,509 million, or 11.7%, to RUB 434,164 million as of December 31, 2016 from RUB 491,674 million as of December 31, 2015, as a result of the strengthening of the ruble against the U.S. dollar and partial repayment of current debt.

Long-term debt net of current portion increased by RUB 7,336 million, or 170.3%, to RUB 11,644 million as of December 31, 2016 from RUB 4,308 million as of December 31, 2015, as a result of bonds restructuring.

Our working capital remained negative but during the year decreased by RUB 75,835 million, or 14.7%, to RUB 441,581 million as of December 31, 2016 from RUB 517,416 million as of December 31, 2015. The main reason for decrease in working capital was reduction of financial indebtedness as a result of restructuring and repayment of our debts as well as repayment of trade and other payables.

***Restructuring of financial indebtedness***

In the first half of 2014, we experienced a shortage of liquidity and difficulties with refinancing of our debt; as a result, we failed to fulfill our payment obligations in connection with the servicing of interest and the repayment of our indebtedness. Since 2014, we negotiate restructuring terms with our major lenders, such as Gazprombank, Sberbank and VTB Bank, and other lenders. As a result, in August, September and December 2015, we signed agreements with VTB Bank and Gazprombank contemplating, among other things, extension of the loan tenors, decrease in the interest rates, revision of the collateral requirements and dismissal of all court proceedings. During the period from December 2015 to April 2016, we signed agreements with Sberbank contemplating, among other things, extension of the loan tenors, decrease in the interest rates and dismissal of all court proceedings. These agreements were conditional upon certain undertakings, which we have managed to fulfill. See Debt Financings in 2016, Debt Financings in 2015, Description of Certain Indebtedness, Item 10. Additional Information Material Contracts and Item 8. Financial Information Litigation Debt litigation.

VTB Bank restructuring became effective in October 2015. Gazprombank restructuring became partially effective in the first quarter of 2016 after conversion of the U.S. dollar-denominated credit facilities into Russian rubles. Restructuring under all facilities with Gazprombank became effective in June 2016 after obtainment of approval on suretyship provision by Mechel on our general shareholders meeting. Restructuring agreements with Sberbank came into effect upon signing. In April 2016, Southern Kuzbass Coal Company's debt was assigned from Sberbank to Gazprombank in the amount of 31.5 billion rubles (\$423.1 million or 28.4 billion rubles at the CBR exchange rate on April 12, 2016 and 3.1 billion rubles).

In April 2016, we signed option agreements with Gazprombank providing the bank with an option to acquire a 49% stake in the Elga coal complex for a total consideration of 34.3 billion rubles. According to these agreements, we were



obliged to sell to Gazprombank (after its acceptance of the option) a 49% stake in Elgaugol OOO, the owner of the subsoil license for the Elga coal deposit, a 49% stake in Elga-road OOO, the owner of the Ulak-Elga rail line which had been contributed to the registered capital of this newly established company in March 2016, and a 49% stake in MecheltransVostok OOO, the rail line's transport operator (collectively, the **target companies**), by June 30, 2016. Gazprombank has a put option to sell its stakes (in full or in part) in the

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Elga coal complex within three years following a five-year period or in case of a breach of conditions stipulated by such agreement. Put options were signed by Yakutugol and Mecheltrans (sellers of the stakes in the target companies) and are guaranteed by Mechel Mining and Southern Kuzbass Coal Company. If we fail to perform under these put options Gazprombank will have the right to buy out (call option) the remaining stakes owned by us in the target companies. A 1.99% stake in each of the target companies is pledged in favor of Gazprombank as a security for the call option. The transaction was completed in June 2016 and all proceeds from the sale of these stakes were used for repayment of our debt to Gazprombank, Sberbank and Sberbank Leasing AO.

In December 2016, we signed the last set of agreements with VTB Bank which provide for an extension of the repayment grace period until 2020 and the final maturity until 2022. On April 6 and 10, 2017, we received confirmation from Gazprombank, VTB Bank and Sberbank with respect to coming into effect of the similar provisions under the relevant facility agreements.

As part of the restructuring, in January 2017, VTB Capital Plc and Skyblock Limited entered into a call option agreement for 5% of issued preferred shares in the share capital of Mechel, which we have pledged in favor of VTB Capital Plc to secure performance of our obligations under the call option agreement. VTB Capital Plc has a right to exercise this call option during the period from April 1, 2017 to December 31, 2020. In April 2017, VTB Capital Plc exercised its option right to buy 5% of Mechel's preferred shares, but we have requested the bank to extend the start date of the option period by one year until April 1, 2018. Skyblock Limited did not fulfill its obligations under the option notice. Negotiations on amending the terms of the option are ongoing.

In September 2015, we restructured the debt under two series of Russian ruble bonds in an aggregate amount of 10.0 billion rubles. In June-July 2016, we restructured the debt under four series of Russian ruble bonds in an aggregate amount of approximately 18.4 billion rubles. See [Description of Certain Indebtedness](#) [Russian bonds](#) for a description of the terms of restructuring.

During the period from December 2015 to May 2016, we signed settlement agreements with Sberbank Leasing AO which waived our previous defaults and restructured our future payment schedules. The settlement agreements were approved by the court in March-September 2016. In November 2016 and February 2017, we signed settlement agreements with VTB Leasing JSC which restructured our overdue payments. The settlement agreements became effective upon approval by the court in January-April 2017.

We continue to negotiate financial restructuring with our international lenders.

***Outlook for 2017***

Our objective is to ensure that our group meets its liquidity requirements and payment obligations to creditors, continues capital expenditures, properly services its debt, restructures the remaining part of the non-restructured indebtedness, mainly with international creditors, and continues as a going concern. To accomplish that, we will continue to seek the restructuring of our existing non-restructured indebtedness in order to alleviate the pressure on our cash flows. We intend to make a long-term restructuring of our debt portfolio with repayment grace periods which will allow us to restore working capital, improve efficiency of operations and provide ability to make full service of debt in accordance with new repayment schedules as well as use all available free cash flow for repayment of debt through cash sweep mechanism.

We believe we will not be able to obtain significant new borrowings in the near future; however we may consider certain divestments and invite financial or strategic investors into our businesses in order to reduce the debt burden. We believe that cash generated from operations, subject to successful completion of debt restructuring, improved

market conditions and reduced costs will be sufficient to meet our capital expenditures and debt service payments in 2017. Furthermore, we believe that we have the flexibility in deferring our non-critical capital expenditures and in managing our working capital to provide further financial flexibility as needed.

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**Table of Contents*****Debt Financings in 2017***

We have not entered into new material financing agreements as of the date hereof. For developments relating to existing financings please refer to Description of Certain Indebtedness, Item 10. Additional Information Material Contracts and Item 8. Financial Information Significant Changes.

***Debt Financings in 2016***

During the course of 2016, we managed to reach further agreement with VTB Bank which agreed to extend the final maturity of the loans until 2022 (similarly to Gazprombank and Sberbank), finalized the restructuring of Russian ruble bonds, signed settlement agreements with Sberbank which assigned part of Sberbank's debt to Gazprombank and finalized the restructuring with Gazprombank. See Description of Certain Indebtedness and Item 10. Additional Information Material Contracts.

In December 2016, Yakutugol, Southern Kuzbass Coal Company and Chelyabinsk Metallurgical Plant signed amendments to their credit facility agreements with VTB Bank totaling approximately 25.4 billion rubles (approximately \$419.9 million as of December 31, 2016) which provide for an extension of the repayment grace period until April 2020 and the final maturity until April 2022.

In December 2016, Mechel signed an amendment to its credit facility agreement with VTB Bank totaling 44.8 billion rubles (approximately \$738.1 million as of December 31, 2016) which provides for an extension of the repayment grace period until April 2020 and the final maturity until April 2022. In addition, in December 2016, Chelyabinsk Metallurgical Plant entered into a credit facility agreement with VTB Bank with a credit limit of 30.0 billion rubles (approximately \$494.6 million as of December 31, 2016) to refinance Mechel's debt under the credit facility agreement with VTB Bank. The facility also has a grace period until April 2020 and the final maturity until April 2022.

In June-July 2016, we restructured the debt under Russian bonds of the 04, 17, 18 and 19 series in the aggregate amount of approximately 18.4 billion rubles.

In June 2016, our subsidiaries amended their credit facility agreements with Gazprombank to capitalize accrued and unpaid interests. We must repay these amounts and interests accrued on them during the period from April 15, 2017 to March 30, 2018.

In April 2016, Southern Kuzbass Coal Company signed new settlement agreements with Sberbank which assigned part of the principal amount to Gazprombank. The principal in the total amount of \$423.1 million and 3.1 billion rubles was assigned with \$254.9 million remaining on Southern Kuzbass Coal Company. The remaining debt was restructured with extension of grace period and principal repayment, new interest rates and levels of financial covenants.

In March 2016, Yakutugol's loan from Gazprombank in the amount of \$103.1 million was converted into rubles resulting in the debt of 6.9 billion rubles. Restructuring of this credit facility became effective.

In February 2016, we signed restructuring agreements with Sberbank for Chelyabinsk Metallurgical Plant, Izhstal, Bratsk Ferroalloy Plant, Yakutugol, Korshunov Mining Plant, Mechel Trading and Southern Kuzbass Coal Company facilities totaling approximately 29.3 billion rubles and \$100.0 million. Restructuring granted an extension of grace period and final maturity, new interest rates, partial capitalization of interests, as well as new levels of financial covenants.

In January 2016, part of Gazprombank debt, namely \$400.0 million and \$200.0 million credit facilities for Southern Kuzbass Coal Company and \$385.8 million and \$300.0 million credit facilities for Yakutugol were converted into rubles resulting in the total debt of approximately 99.0 billion rubles. Restructuring of these converted facilities became effective.

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**Table of Contents*****Debt Financings in 2015***

During the course of 2015, we managed to reach an agreement with a part of our major creditors such as VTB Bank, Gazprombank, Sberbank and some others on the restructuring of the group's loan agreements including but not limited to the extension of the tenor of the loans, partial capitalization of interest payments, extension of the grace period and change of the interest rate calculation. See Description of Certain Indebtedness and Item 10. Additional Information Material Contracts.

In December 2015, Southern Kuzbass Coal Company signed settlement agreements with Sberbank on the credit facilities in the total amount of approximately \$678.0 million and 3.1 billion rubles. Upon approval of these agreements by the court, all debt under Southern Kuzbass Coal Company facilities became due and payable. In April 2016, new settlement agreements with Sberbank were signed and approved by the court.

In August and December 2015, Mechel Service, Chelyabinsk Metallurgical Plant, Mechel Energo, Beloretsk Metallurgical Plant, Port Posiet, Mechel Coke and Urals Stampings Plant signed amendments to their credit facility agreements with Gazprombank for a total amount of 26.8 billion rubles (approximately \$367.3 million as of December 31, 2015), providing for an extension of the grace period until June 2020 and the final maturity until April 2022. The extension was subject to fulfillment of certain conditions. In June 2016, restructuring of these credit facilities became effective.

In August and December 2015, Yakutugol and Southern Kuzbass Coal Company signed amendments to their credit facility agreements with Gazprombank to restructure debt in a total amount of approximately \$1.3 billion (approximately 93.7 billion rubles as of December 31, 2015), providing for an extension of the grace period until January 2020 and the final maturity until April 2022, as well as the conversion into Russian rubles. The extension was subject to fulfillment of certain conditions. Restructuring of these credit facilities became effective in January 2016.

In August and December 2015, Yakutugol signed amendments to its credit facility agreement with Gazprombank to restructure debt totaling \$103.1 million (approximately 7.5 billion rubles as of December 31, 2015), providing for an extension of the grace period until March 2020 and the final maturity until April 2022, as well as the conversion into Russian rubles. The extension was subject to fulfillment of certain conditions. Restructuring became effective upon conversion of the loan amount in March 2016.

In November 2015, Mechel Service signed amendments to its credit facilities with Moscow Credit Bank to restructure debt in the total amount of \$83.3 million, providing for an extension of the final maturity until February 2017. In December 2016, the final maturity was extended until December 2019.

In September 2015, we restructured the debt under Russian bonds of the 13 and 14 series in the aggregate amount of approximately 10.0 billion rubles.

In September 2015, Chelyabinsk Metallurgical Plant entered into an approximately 8.0 billion ruble (as calculated based on the market spot rate as of October 27, 2015) credit facility agreement with VTB Bank to refinance debts of Skyblock Limited and HBL Holding GmbH totaling \$107.7 million and 14.5 million, respectively, provided by VTB Bank. The facility had a grace period until April 2017 and the final maturity until April 2020. In December 2016, Chelyabinsk Metallurgical Plant signed an amendment which provides for an extension of the grace period until April 2020 and the final maturity until April 2022.

In September 2015, Yakutugol and Southern Kuzbass Coal Company signed amendments to their credit facility agreements with VTB Bank to restructure debt in the total amount of 15.8 billion rubles (approximately

\$217.1 million as of December 31, 2015), providing for an extension of the repayment grace period until April 2017 and the final maturity until April 2020. The restructuring came into effect on October 13, 2015. In December 2016, we signed amendments which provide extension of the repayment grace period and the final maturity.

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In September 2015, Southern Kuzbass Coal Company signed an amendment to its credit facility agreement with VTB Bank to restructure debt totaling 1.6 billion rubles (approximately \$22.6 million as of December 31, 2015), providing for an extension of the repayment grace period until April 6, 2017 and the final maturity until April 6, 2020. The restructuring came into effect on October 13, 2015. In December 2016, we signed an amendment which provides extension of the repayment grace period and the final maturity.

In September 2015, Mechel signed an amendment to its credit facility agreement with VTB Bank to restructure debt in the total amount of 44.8 billion rubles (approximately \$614.3 million as of December 31, 2015), providing for an extension of the repayment grace period until April 2017 and the final maturity until April 2020. The restructuring came into effect on October 13, 2015. In December 2016, we signed an amendment which provides extension of the repayment grace period and the final maturity.

In September 2015, Yakutugol signed a settlement agreement with Eurasian Development Bank to restructure debt in the amount of approximately 1.9 billion rubles (approximately \$25.5 million as of December 31, 2015). The final maturity of the credit facility agreement is extended until June 2018.

***Debt Financings in 2014***

During the course of 2014, we obtained or amended the following major debt financings. See Description of Certain Indebtedness and Item 10. Additional Information Material Contracts.

In July 2014, Yakutugol and Southern Kuzbass Coal Company entered into amendments to their credit facility agreements with VTB Bank to refinance debt in the total amount of 15.8 billion rubles (approximately \$281.3 million as of December 31, 2014), providing for an extension of the repayment grace period until April 2015 and the final maturity until April 2018. The loan was restructured in October 2015.

In May 2014, Mechel entered into an amendment to its credit facility agreement with VTB Bank to refinance debt in the amount of 40.0 billion rubles (approximately \$711.0 million as of December 31, 2014), providing for an extension of the repayment grace period until April 2015 and the final maturity until April 2018. VTB Bank also provided an additional loan for redemption of ruble bonds in the amount of up to 3.8 billion rubles (approximately \$67.3 million as of December 31, 2014). The loan was restructured in October 2015.

In May 2014, Southern Kuzbass Coal Company entered into an amendment to its facility agreement with VTB Bank to refinance debt in the amount of 1.6 billion rubles (approximately \$28.4 million as of December 31, 2014), providing for an extension of the repayment grace period until April 2015 and the final maturity until April 2018. The loan was restructured in October 2015.

In March 2014, our subsidiary Elgaugol signed two loan agreements for an aggregate amount of \$2.5 billion with Vnesheconombank for the project financing of the development of the Elga coal deposit. The loans have a tenor of 13.5 years, with a repayment grace period of 3.5 years.

***Debt Financings in 2013***

During the course of 2013, we continued our refinancing efforts through extending some of our existing credit facilities, amending financial covenants, including agreeing with the lenders on a covenant holiday for Mechel and Mechel Mining's ratios of net borrowings to EBITDA for the relevant periods ending on December 31, 2013 and June 30, 2014. See Description of Certain Indebtedness and Item 10. Additional Information Material Contracts.



In December 2013, our subsidiaries Yakutugol and Southern Kuzbass Coal Company and a syndicate of banks coordinated by ING Bank N.V., Société Générale and VTB Capital Plc entered into an amendment agreement to the existing pre-export facility agreements for a total amount of \$1.0 billion. The amendments provide that the loan, which was entering the repayment phase in December 2013, will be repayable in equal monthly installments until December 2016 following a grace period of 12 months ending in December 2014.

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In December 2013, several of our subsidiaries and Sberbank entered into separate amendments to their loan agreements totaling 26.6 billion rubles (approximately \$808 million) for the restructuring and refinancing of existing indebtedness and working capital. Of this amount, Chelyabinsk Metallurgical Plant accounted for 21.5 billion rubles (approximately \$655.9 million) and Mechel Trading, Izhstal, Southern Kuzbass Coal Company, Yakutugol, Korshunov Mining Plant and Bratsk Ferroalloy Plant accounted for, in the aggregate, 5.1 billion rubles (approximately \$156.2 million). The facilities totaling 13.4 billion rubles (approximately \$410.7 million) have a tenor of five years with a repayment grace period until March 28, 2015. In February and March 2016, our subsidiaries signed restructuring agreements with Sberbank.

In October 2013, our subsidiary Elgaugol entered into a \$150.0 million bridge loan with Vnesheconombank with a tenor of six months for the development of the Elga coal complex. As of December 31, 2016, the overdue principal and the overdue interest amounted to \$146.4 million and approximately \$4.9 million (approximately 8.9 billion rubles and 297.9 million rubles), respectively. We hold negotiations with Vnesheconombank with respect to restructuring of the bridge loan. See also Item 10. Additional Information Material Contracts Project Finance Credit Facility for Elgaugol from Vnesheconombank.

In August 2013, Chelyabinsk Metallurgical Plant entered into a revolving credit facility with Alfa-Bank for a total amount of \$150.0 million. The facility was provided for working capital financing and was fully drawn as of December 31, 2013. In March 2014, the credit facility was amended providing for full repayment of the loan in five equal weekly installments, the last installment falling due not later than April 25, 2014. In April 2014, the facility was fully repaid.

In April 2013, Mechel entered into a 40.0 billion ruble (approximately \$1.3 billion) credit facility agreement with VTB Bank for a period of five years. The facility allowed a 15-month grace period and was to be repaid in equal installments on a quarterly basis. The proceeds were used to refinance existing indebtedness with VTB Bank as well as to refinance other obligations of the companies within our group (including redemption of ruble bonds). In May 2014, we signed amendments with VTB Bank to refinance the facility, providing for an extension of grace period until April 2015 and final maturity until April 2018.

In April 2013, our subsidiaries Beloretsk Metallurgical Plant and Urals Stampings Plant entered into revolving credit facilities with Gazprombank for a total amount of 3.3 billion rubles (approximately \$106.9 million). The purpose of the facilities was working capital financing. Initially, the term of the facilities was three years with the term of each tranche of up to 24 months. The credit facility agreements were restructured in August and December 2015.

In April 2013, our subsidiaries Southern Kuzbass Coal Company and Yakutugol entered into separate non-revolving credit facility agreements with Gazprombank for a total amount of \$889.0 million: \$400.0 million was made available to Southern Kuzbass Coal Company and \$489.0 million was made available to Yakutugol, both for a period of up to five years with a three-year grace period obtained for the purpose of funding operational activities and refinancing of short-term debt provided by Gazprombank. As of December 31, 2015, the amount outstanding under the Southern Kuzbass Coal Company facility was \$400.0 million and the amount outstanding under the Yakutugol facility was \$385.8 million. The credit facility agreements were restructured and converted into rubles in January 2016. As a result, the debt of Southern Kuzbass Coal Company and Yakutugol amounted to a total of approximately 60.9 billion rubles.

In March and April 2013, our subsidiary Mecheltrans entered into two non-revolving credit facilities with Moscow Credit Bank for a total amount of \$88 million for a period of one year each with a bullet repayment. The facilities were provided for the purpose of working capital financing. In May 2013, the facilities amount was increased to \$105 million. In April 2014, we extended the maturity of the facilities until December 2014 and replaced the borrower

with Mechel Service. In December 2014, the maturity of the facilities was extended until February 2016. In November 2015, the maturity was further extended until February 2017.

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**Table of Contents*****Debt Financings in 2012***

During the course of 2012, we obtained or amended the following major debt financings. See Description of Certain Indebtedness and Item 10. Additional Information Material Contracts.

In December 2012, our subsidiaries Yakutugol and Southern Kuzbass Coal Company and a syndicate of banks coordinated by ING Bank N.V., Société Générale, UniCredit, JSCB Rosbank and ABN AMRO Bank N.V. entered into an amendment and restatement agreement to the existing pre-export facility agreements for a total amount of \$1.0 billion. The amendments provided an extension of repayment grace period under the loan until December 2013. The loan was subsequently amended in December 2013.

In December 2012, following the repayment of the initial drawdown under a revolving credit line extended to Mechel Trading by Sberbank under a long-term framework agreement entered into in October 2011, Mechel Trading re-drew \$100.0 million under this credit line. In December 2013, the facility was restructured for a further period of five years.

In October 2012, Southern Kuzbass Coal Company obtained four non-revolving credit lines for five years from Sberbank for a total amount of 24.0 billion rubles (approximately \$772.3 million) with a three-year grace period. The purpose of the credit lines was working capital financing. In December 2015, Southern Kuzbass Coal Company signed settlement agreements which were approved by the court.

In April 2012, we extended our existing loans from VTB Bank for Yakutugol and Southern Kuzbass Coal Company in the total amount of approximately \$460.0 million for a period of up to three years. In July 2014, Yakutugol and Southern Kuzbass Coal Company signed amendments to the loan agreements, providing for an extension of grace period until April 2015 and final maturity until April 2018.

In April 2012, our subsidiaries Southern Kuzbass Coal Company and Yakutugol entered into separate non-revolving credit facility agreements with Gazprombank for a total amount of \$500.0 million for a period of up to five years for the purpose of funding operational activities and refinancing our short-term debt. As of December 31, 2015, the amount outstanding under the Southern Kuzbass Coal Company facility was \$200.0 million and the amount outstanding under the Yakutugol facility was \$300.0 million. The credit facility agreements were restructured and converted into rubles in January 2016. As a result, the debt of Southern Kuzbass Coal Company and Yakutugol amounted to a total of approximately 38.1 billion rubles.

In April 2012, we completed placement of our non-convertible interest-bearing BO-05, BO-06, BO-07, BO-11 and BO-12 series exchange bonds in an aggregate principal amount of 15.0 billion rubles (approximately \$506.1 million). The proceeds were used to refinance some of our short-term debt. In April 2013, the bonds were redeemed for the entire amount.

In February 2012, we completed placement of our non-convertible interest-bearing BO-04 series exchange bonds in an aggregate principal amount of 5.0 billion rubles (approximately \$167.3 million). The proceeds were used to refinance our short-term debt. In February 2014, this series was redeemed for the total amount of 4.254 billion rubles. In February 2015, this series was fully repaid.

In January 2012, Mechel Trading refinanced its existing loans with Alfa-Bank through a new revolving line in the amount of \$150.0 million with the ability to draw tranches and with the final repayment to be made not later than October 2016. The proceeds were used for working capital and trade financing. The facility was fully repaid in September 2013.

***Restrictive Covenants***

Almost all of our loan agreements contain a number of covenants and restrictions. Such covenants and restrictions include, but are not limited to, financial ratios, various limitations, as well as acceleration and cross-default provisions. Unless a breach is remedied or a waiver is obtained, a breach of such covenants and

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restrictions generally permits lenders to demand accelerated repayment of principal and interest under their respective loan agreements. In addition, in the event of a payment default or the violation of certain other covenants and restrictions, creditors under other loan agreements can demand accelerated repayment of principal and interest under such other loan agreements pursuant to the cross-default provisions in such other agreements. See [Item 3. Key Information Risk Factors Risks Relating to Our Financial Condition and Financial Reporting](#) Our failure to comply with the payment and other obligations in our credit facilities caused some of our creditors to accelerate amounts due under their loan agreements and such failure, or like failure in the future, may cause the acceleration of our other outstanding debt, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects, [Item 3. Key Information Risk Factors Risks Relating to Our Financial Condition and Financial Reporting](#) If we are unable to restructure all of our indebtedness or fail to comply with the new terms of the restructured indebtedness, our lenders may claim for accelerated repayment, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects and [Item 3. Key Information Risk Factors Risks Relating to Our Financial Condition and Financial Reporting](#) We have a substantial amount of outstanding indebtedness with restrictive financial covenants and most shares and assets in our subsidiaries are pledged.

The table below sets out restrictive financial covenants contained in our most significant loan agreements and the actual ratios/amounts as of December 31, 2016.

| <b>Restrictive Covenant</b>                                  | <b>Requirement</b>               | <b>Actual as of<br/>December 31, 2016</b> |
|--|----------------------------------|---|
| Mechel's Net Borrowings <sup>(1)</sup> to EBITDA ratio       | Shall not exceed 9.0:1           | 7.18:1                                    |
| Mechel's Total Borrowings to EBITDA ratio                    | Shall not exceed 7.5:1           | 7.48:1                                    |
| Mechel's EBITDA <sup>(2)</sup> to Net Interest Expense ratio | Shall not be less than<br>1.25:1 | 1.36:1                                    |
| Mechel's EBITDA to Consolidated Financial Expense ratio      | Shall not be less than<br>1.25:1 | 1.28:1                                    |

- (1) Net Borrowings and Total Borrowings are calculated according to the respective definitions set by the credit agreements. Generally, Total Borrowings includes outstanding loans, finance lease, bonds and other financial liability balances; Net Borrowings is equal to Total Borrowings less cash and cash equivalents, and excludes Net Borrowings of Elgaugol (set by the Vnesheconombank's credit facility).
- (2) EBITDA is calculated according to the respective definitions set by the credit agreements and may differ from the disclosed Consolidated Adjusted EBITDA.

As of December 31, 2016, we were in compliance with major financial covenants contained in the group's restructured loan agreements.

Our restructured loan agreements contain a number of non-financial covenants, including but not limited to restrictions on new debt, intra-group loans, new guarantees and/or security, maximum level of indebtedness in respect of various payment obligations, minimum level of net assets, maximum allowed level of legal claims, various information and certain other covenants. The covenants also include limitations on the amount of dividends on our common and preferred shares, and amounts that can be spent for capital expenditures, new investments and acquisitions.

As of December 31, 2016, we were in breach of a number of non-financial covenants under our restructured loan agreements. Such covenant breaches include, among others, the breach of minimum level of the borrowers' net assets and the granting of guarantees for our group companies without the prior consent of the lenders. As of the date hereof, certain breaches of the non-financial covenants under the group's restructured loan agreements have been waived.

As of December 31, 2016, we failed to pay scheduled principal and interest amounts and we were in breach of most financial and non-financial covenants under the group's non-restructured loan agreements, primarily with international lenders. In particular, financial covenants we were not in compliance include the Net Borrowings to

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EBITDA ratio and the EBITDA to Net Interest Expense ratio, as well as the targeted amount of Adjusted Shareholder Equity. As of the date hereof, we did not remedy or obtain the required waivers with respect to the failure to pay amounts due and the breaches of the financial and non-financial covenants under the applicable loan agreements.

The failure to pay the scheduled principal and interest amounts as described above, as well as the breach of financial and other covenants in our loan agreements, which were not remedied by us or waived by our creditors, permit the creditors under those loan agreements to accelerate the payment of principal and interest under those loan agreements, as well as trigger cross-default provisions under a number of other facilities, permitting the respective lenders under such other facilities to accelerate the payment of principal and interest under their loans. For a description of the current terms of our loan agreements, see Description of Certain Indebtedness and Item 10. Additional Information Material Contracts.

The failure to pay amounts due, the non-compliance with financial and non-financial covenants and the triggering of the cross-default provisions resulted in the reclassification of our group's long-term debt into short-term liabilities in the amount of RUB 260,653 million as of December 31, 2016.

For a description of the existing payment defaults, breaches of covenants and restrictions, see Item 13. Defaults, Dividend Arrearages and Delinquencies.

Our ability to meet the debt covenants has been estimated on the basis of our short-term budgets and long-term projection (the **Projection**) of the company. The Projection combines production plans by entities, key products and cost items price dynamics, maintenance and project capital investment program, loans portfolio and repayment schedule and other budgeted and projected items. It includes income and cash flow statements both on separate entities and consolidated level which is being used for purposes of debt covenants calculation. The Projection is prepared using assumptions that comparable market participants would use.

To forecast key product prices, exchange rates dynamics and inflation rates we use a wide variety of sources including the following institutions: Ministry of Economic Development of the Russian Federation, leading investment banks, CRU, Metal Expert, World Bank, Oxford Economics, Consensus Economics, etc. along with our own estimates.

As of December 31, 2016, we projected the following financial covenant ratios for the forthcoming six-month and 12-month periods, which we are required to comply with under our most significant loan agreements:

| <b>Restrictive Covenant</b>                             | <b>Requirement</b>           | <b>Projection as of</b> |   |
|---|------------------------------|-------------------------|---|
|   |                              | <b>June 30, 2017</b>    | <b>Projection as of December 31, 2017</b> |
| Mechel's Net Borrowings to EBITDA ratio                 | Shall not exceed 8.0:1       | 4.9:1                   | 4.4:1                                     |
| Mechel's Total Borrowings to EBITDA ratio               | Shall not exceed 5.5:1       | 5.5:1                   | 5.2:1                                     |
| Mechel's EBITDA to Net Interest Expense ratio           | Shall not be less than 1.5:1 | 2.2:1                   | 2.4:1                                     |
| Mechel's EBITDA to Consolidated Financial Expense ratio | Shall not be less than 1.5:1 | 2.2:1                   | 2.4:1                                     |
| Mechel's operational cash flow to EBITDA ratio          | Shall not be less than 0.8:1 | 1.2:1                   | 1.2:1                                     |
| Mechel's EBITDA to Revenues ratio                       | Shall not be less than 0.2:1 | 0.2:1                   | 0.2:1                                     |



The significant assumptions underlying our debt covenant determination are projected product prices, sales volumes, cost dynamics, inflation rates and discount rates. Some of these assumptions may materially deviate from our historical results primarily due to the market downturns and economic slowdowns in the recent years. All these material assumptions are based on our projections and are subject to risk and uncertainty. See Item 3.

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Key Information Risk Factors Risks Relating to Our Financial Condition and Financial Reporting Our failure to comply with the payment and other obligations in our credit facilities caused some of our creditors to accelerate amounts due under their loan agreements and such failure, or like failure in the future, may cause the acceleration of our other outstanding debt, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects.

**Description of Certain Indebtedness**

See Item 10. Additional Information Material Contracts for a summary description of material contracts related to our indebtedness. In addition, we have described below certain additional contracts related to our indebtedness. For more information, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Restrictive Covenants, Item 13. Defaults, Dividend Arrearages and Delinquencies and Item 8. Financial Information Litigation Debt litigation.

***Credit Facility Agreement for Yakutugol from Gazprombank******General***

On February 6, 2009, our subsidiary Yakutugol entered into a credit facility agreement with Gazprombank for a total amount of \$550.0 million for the purposes of funding financial and operating activities, including funding affiliates and credit repayments. The facility was initially repayable in quarterly installments starting from the first quarter of 2010 through the first quarter of 2012, however in February 2010 the final maturity was extended until February 2015.

As of December 31, 2014, the amount outstanding under the credit facility was \$103.1 million. In August and December 2015, Yakutugol signed amendments to the credit facility agreement with Gazprombank to restructure debt totaling \$103.1 million. In March 2016, the loan amount was converted into rubles resulting in the debt of 6.9 billion rubles. Restructuring of the credit facility became effective.

In June 2016, Yakutugol entered into an amendment to its credit facility agreement under which accrued and unpaid interest in the amount of 584.7 million rubles was capitalized. We must repay this amount and interest accrued on it on a monthly basis during the period from April 15, 2017 to March 30, 2018.

***Interest rate and interest period***

Starting from the effective date, the interest is payable at the CBR key rate plus 1.5% per year. The lender may change the interest rate on the CBR key rate plus 3.5% per year if the borrower fails to meet the payment schedule of accrued and unpaid interest. During the grace period, we apply the rate of 8.75% for interest repayment. The remaining unpaid interests are being capitalized and paid in accordance with the principal repayment schedule.

***Repayment and prepayments***

The final maturity date is April 20, 2022. Repayment is to be made in equal monthly installments starting from March 31, 2020. The lender may change the final maturity date on April 20, 2020 if the borrower fails to meet the payment schedule of accrued and unpaid interest. In this case repayment is to be made in equal monthly installments starting from the month when such failure occurred.

The borrower may prepay the loan in full or in part with a 30 day prior notice to the lender.

*Guarantee*

The borrower's obligations under the credit facility are guaranteed by Mechel Mining, Mechel Carbon, Korshunov Mining Plant, Urals Stampings Plant, Chelyabinsk Metallurgical Plant, Mechel and Southern Kuzbass Coal Company.

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*Security*

The borrower's obligations are secured by a pledge of 25%+1 share in each of Southern Kuzbass Coal Company, Korshunov Mining Plant, Port Posiet, Izhstal, Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant and Urals Stampings Plant, 50%+1 share in Yakutugol and 25% in Port Temryuk. In March 2016, we mortgaged the Ulak-Elga rail line under the credit facility agreement.

*Covenants and other matters*

For the relevant period ending on December 31, 2016, we were not in compliance with certain non-financial covenants. We have requested the bank to waive our breaches.

Under the credit facility agreement, Mechel group's ratio of total borrowings to EBITDA shall not exceed 7.5:1 in 2016, 5.5:1 in 2017, 4.5:1 in 2018, 3.5:1 in 2019 and 3.0:1 in 2020. Mechel group's ratio of EBITDA to consolidated financial expense shall not be less than 1.25:1 in 2016, 1.50:1 in 2017, 1.75:1 in 2018, 2.0:1 in 2019 and 2.5:1 in 2020. During the period from 2017 to 2020, we also have to comply with the ratios of operational cash flow to EBITDA and EBITDA to revenues at the levels of 80% and 20%, respectively.

The credit facility contains certain customary representations and warranties, affirmative covenants, notice provisions and events of default, including change of control provisions and cross-defaults relating to other debt.

The credit facility agreement is governed by Russian law.

***Credit Facility Agreements for Yakutugol and Southern Kuzbass Coal Company from VTB Bank***

*General*

In September 2010, our subsidiaries Yakutugol and Southern Kuzbass Coal Company each entered into agreements further amending the one-year credit facility agreements executed with VTB Bank in November 2008 and further amended in November 2009, for the total amount of 13.6 billion rubles (approximately \$422.4 million). In April 2012, we amended the credit facility agreements to extend their term until 2015 and change certain financial covenants.

In April 2014, VTB Bank converted the 13.6 billion ruble loan into U.S. dollars; as a result the debt of Yakutugol and Southern Kuzbass Coal Company amounted to \$461.8 million. In July 2014, the debt was converted back into rubles and Yakutugol and Southern Kuzbass Coal Company signed amendments to the credit facility agreements in the amount of 5.8 billion rubles and 10.0 billion rubles (approximately \$103.4 million and \$177.9 million as of December 31, 2014), respectively, providing for an extension of the repayment grace period until April 2015 and the final maturity until April 2018.

In September 2015, Yakutugol and Southern Kuzbass Coal Company signed amendments to their credit facility agreements with VTB Bank to restructure debt in the total amount of 15.8 billion rubles (approximately \$217.1 million as of December 31, 2015), providing for an extension of the repayment grace period until April 2017 and the final maturity until April 2020. The restructuring came into effect on October 13, 2015.

In December 2016, Yakutugol and Southern Kuzbass Coal Company signed amendments to their credit facility agreements with VTB Bank which provide for an extension of the repayment grace period until April 2020 and the final maturity until April 2022.

*Interest rate and interest period*

Interest under the credit facilities is payable at the CBR key rate plus 1.5% per year. The lender may increase the interest rate by 1% per year if the borrowers fail to meet certain obligations under the credit facilities. During the grace period, we apply the rate of 8.75% for interest repayment. The remaining unpaid interests are being capitalized and paid on the final maturity date.

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### *Repayment and prepayments*

The final maturity of the credit facilities for both Southern Kuzbass Coal Company and Yakutugol is April 6, 2022. Each of the facilities is to be repaid in equal monthly installments starting on April 6, 2020. Prepayment for all or part of the loan amounts is allowed subject to simultaneous compliance with certain requirements.

### *Guarantee*

The borrowers' obligations are guaranteed by Mechel Mining, Mechel Carbon, Mechel Carbon Singapore, Mechel Trading, Korshunov Mining Plant, Urals Stampings Plant, Chelyabinsk Metallurgical Plant, Mechel and cross guarantee between Southern Kuzbass Coal Company and Yakutugol.

### *Security*

The borrowers' obligations are secured by a pledge of 25%-3 shares of Yakutugol, 25%+1 share of Southern Kuzbass Coal Company, 25%+1 share of Korshunov Mining Plant, 25%+1 share of Urals Stampings Plant and 46.66%-1 share of Chelyabinsk Metallurgical Plant.

### *Covenants and other matters*

For the relevant period ending on December 31, 2016, we were not in compliance with certain non-financial covenants. We have requested the bank to waive our breaches and the respective waivers were obtained for certain of such breaches.

Under the credit facility agreements, Mechel group's ratio of net borrowings to EBITDA shall not exceed 9.00:1 until December 31, 2016, 8.00:1 until December 31, 2017, 7.00:1 until December 31, 2018, 6.00:1 until December 31, 2019, 5.00:1 until December 31, 2020 and thereafter. Mechel group's ratio of EBITDA to net interest expense shall not be less than 1.25:1 until December 31, 2016, 1.50:1 until December 31, 2017, 1.75:1 until December 31, 2018, 2.00:1 until December 31, 2019, 2.25:1 until December 31, 2020 and thereafter. Financial covenants are tested semi-annually.

The credit facility agreements contain certain customary representations and warranties, affirmative covenants, notice provisions and events of default, including change of control and cross-defaults relating to other debt, as well as limitations on payment of dividends, acquisitions and disposals and non-core transactions.

The credit facility agreements are governed by Russian law.

### ***Credit Facility Agreement for Chelyabinsk Metallurgical Plant from Sberbank***

#### *General*

On October 13, 2010, Sberbank opened a credit line for Chelyabinsk Metallurgical Plant for the total amount of 15.0 billion rubles (approximately \$493.9 million) to refinance short-term debt. On December 19, 2013, the borrower and Sberbank entered into an amendment to the loan agreement by extending the term of the facility by five years with a repayment grace period until March 30, 2015 and amending the security structure. As of December 31, 2015, the facility was fully drawn.

In February 2016, Chelyabinsk Metallurgical Plant signed an amendment to its credit facility agreement with Sberbank to restructure debt in the total amount of 15.0 billion rubles. The amendment became effective upon signing, all overdue interest payments were capitalized, except for agreed amount which was paid in June 2016.

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In December 2016, part of the principal was restructured to be paid according to the agreed schedule (final repayment month is October 2017).

### *Interest rate and interest period*

Starting from April 1, 2016, the interest under the credit facility is payable at the CBR key rate plus 1.5% per year. The lender may change the interest rate to the CBR key rate plus 3.5% per year if Gazprombank and VTB Bank decide to change the interest rate. During the grace period, we apply the rate of 8.75% for interest repayment. The remaining unpaid interests are being capitalized and paid at the final maturity date.

### *Repayment and prepayments*

The final maturity date is April 10, 2022. Pursuant to the settlement agreement with Sberbank which was approved by the court in December 2016, the payment of 4.5 billion rubles shall be made until October 2017, as well as we are required to repay approximately 4.5 billion rubles on October 15, 2017. The remaining amount is payable in equal monthly installments starting from January 10, 2020. The borrower may prepay the loan in full or in part with prior notice to the lender.

### *Guarantee*

The borrower's obligations under the credit facility agreement are guaranteed by Mechel, Mecheltrans, Mechel Service, Bratsk Ferroalloy Plant, Izhstal, Yakutugol, Korshunov Mining Plant, Southern Kuzbass Coal Company and Mechel Mining.

### *Security*

Starting from March 2016, the credit facility shares one security package with other credit facilities: a pledge of 25%+1 share of Mechel Mining, a pledge of 25%+1 share of Beloretsk Metallurgical Plant, pledges of movable assets and mortgage over immovable assets of other Sberbank borrowers within Mechel group.

### *Covenants and other matters*

For the relevant period ending on December 31, 2016, we were not in compliance with certain non-financial covenants. We have requested the bank to waive our breaches and the respective waivers were obtained for certain of such breaches.

Under the credit facility agreement, Mechel group's ratio of total borrowings to EBITDA shall not exceed 7.5:1 as of December 31, 2016, 5.5:1 as of June 30, 2017 and December 31, 2017, 4.5:1 as of June 30, 2018 and December 31, 2018, 3.5:1 as of June 30, 2019 and December 31, 2019, 3.0:1 as of June 30, 2020 and thereafter. Mechel group's ratio of EBITDA to consolidated financial expense shall not fall below 1.25:1 as of December 31, 2016, 1.5:1 as of June 30, 2017 and December 31, 2017, 1.75:1 as of June 30, 2018 and December 31, 2018, 2.0:1 as of June 30, 2019 and December 31, 2019, 2.5:1 as of June 30, 2020 and thereafter.

The credit facility agreement contains certain customary representations and warranties, affirmative covenants, notice provisions and events of default, including change of control and cross-defaults to other debt.

The credit facility agreement is governed by Russian law.



***Credit Facility for Mechel Trading from Sberbank***

*General*

In December 2013, Mechel Trading and Sberbank entered into an amendment to the existing \$100.0 million credit facility (two tranches for \$25.0 million and \$75.0 million) by extending the term of the facility by five

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years with a repayment grace period until March 2015 and amending the security structure. The purpose of the credit facility was working capital, intra-group and pre-export financing. As of December 31, 2015, the facility was fully drawn.

In February 2016, Mechel Trading signed an amendment to its credit facility with Sberbank to restructure debt totaling \$100.0 million. The amendment became effective upon signing, all overdue interest payments were capitalized, except for agreed amount which was paid in June 2016.

### *Interest rate and interest period*

The interest rate under both tranches is payable quarterly at 3-month LIBOR plus a margin of 7%. Starting from January 1, 2016 and during the grace period, we apply the rate of 3-month LIBOR plus a margin of 5% for interest repayment. The remaining unpaid interests are being capitalized and paid at the final maturity date.

### *Repayment and prepayments*

The final maturity date is April 10, 2022. The repayment is to be made in equal monthly installments starting from January 10, 2020. The borrower may prepay the loan in full or in part with prior notice to the lender.

### *Guarantee*

The borrower's obligations under the credit facility are guaranteed by Mechel, Mecheltrans, Mechel Service, Bratsk Ferroalloy Plant, Izhstal, Yakutugol, Korshunov Mining Plant, Southern Kuzbass Coal Company and Mechel Mining.

### *Security*

Starting from March 2016, the credit facility shares one security package with other credit facilities: a pledge of 25%+1 share of Mechel Mining, a pledge of 25%+1 share of Beloretsk Metallurgical Plant, pledges of movable assets and mortgage over immovable assets of other Sberbank borrowers within Mechel group.

### *Covenants and other matters*

For the relevant period ending on December 31, 2016, we were in compliance with the financial and non-financial covenants.

Under the credit facility agreement, Mechel group's ratio of total borrowings to EBITDA shall not exceed 7.5:1 as of December 31, 2016, 5.5:1 as of June 30, 2017 and December 31, 2017, 4.5:1 as of June 30, 2018 and December 31, 2018, 3.5:1 as of June 30, 2019 and December 31, 2019, 3.0:1 as of June 30, 2020 and thereafter. Mechel group's ratio of EBITDA to consolidated financial expense shall not fall below 1.25:1 as of December 31, 2016, 1.5:1 as of June 30, 2017 and December 31, 2017, 1.75:1 as of June 30, 2018 and December 31, 2018, 2.0:1 as of June 30, 2019 and December 31, 2019, 2.5:1 as of June 30, 2020 and thereafter.

The credit facility agreement contains certain customary representations and warranties, affirmative covenants, notice provisions and events of default, including change of control and cross-defaults to other debt.

The credit facility agreement is governed by Russian law.



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### ***Credit Facility Agreement for Chelyabinsk Metallurgical Plant from Sberbank***

#### *General*

On December 19, 2013, Sberbank opened a credit line for Chelyabinsk Metallurgical Plant in a total amount of 12.4 billion rubles for a period of five years with a repayment grace period until March 28, 2015. The purpose of the credit line was redemption of Mechel's bonds and financing of day-to-day operations. As of December 31, 2015, the facility was fully drawn.

In February 2016, Chelyabinsk Metallurgical Plant signed an amendment to its credit facility agreement with Sberbank to restructure debt in the total amount of 12.4 billion rubles. The amendment became effective upon signing, all overdue interest payments were capitalized, except for agreed amount which was paid in June 2016.

In December 2016, part of the principal was restructured to be paid according to the agreed schedule (final repayment month is July 2017).

#### *Interest rate and interest period*

Starting from April 1, 2016, the interest under the credit facility is payable at the CBR key rate plus 1.5% per year. The lender may change the interest rate to the CBR key rate plus 3.5% per year if Gazprombank and VTB Bank decide to change the interest rate. During the grace period, we apply the rate of 8.75% for interest repayment. The remaining unpaid interests are being capitalized and paid at the final maturity date.

#### *Repayment and prepayments*

The final maturity date is April 10, 2022. Pursuant to the settlement agreement with Sberbank which was approved by the court in December 2016, the payment of 1.2 billion rubles shall be made until July 2017. The remaining amount is payable in equal monthly installments starting from January 10, 2020. The borrower may prepay the loan in full or in part with prior notice to the lender.

#### *Guarantee*

The borrower's obligations under the credit facility agreement are guaranteed by Mechel, Mecheltrans, Mechel Service, Bratsk Ferroalloy Plant, Izhstal, Yakutugol, Korshunov Mining Plant, Southern Kuzbass Coal Company and Mechel Mining.

#### *Security*

Starting from March 2016, the credit facility shares one security package with other credit facilities: a pledge of 25%+1 share of Mechel Mining, a pledge of 25%+1 share of Beloretsk Metallurgical Plant, pledges of movable assets and mortgage over immovable assets of other Sberbank borrowers within Mechel group.

#### *Covenants and other matters*

For the relevant period ending on December 31, 2016, we were not in compliance with certain non-financial covenants. We have requested the bank to waive our breaches and the respective waivers were obtained for certain of such breaches.

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Under the credit facility agreement, Mechel group's ratio of total borrowings to EBITDA shall not exceed 7.5:1 as of December 31, 2016, 5.5:1 as of June 30, 2017 and December 31, 2017, 4.5:1 as of June 30, 2018 and December 31, 2018, 3.5:1 as of June 30, 2019 and December 31, 2019, 3.0:1 as of June 30, 2020 and thereafter.

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Mechel group's ratio of EBITDA to consolidated financial expense shall not fall below 1.25:1 as of December 31, 2016, 1.5:1 as of June 30, 2017 and December 31, 2017, 1.75:1 as of June 30, 2018 and December 31, 2018, 2.0:1 as of June 30, 2019 and December 31, 2019, 2.5:1 as of June 30, 2020 and thereafter.

The credit facility agreement contains certain customary representations and warranties, affirmative covenants, notice provisions and events of default, including change of control and cross-defaults to other debt.

The credit facility agreement is governed by Russian law.

### ***Credit Facility Agreement for Chelyabinsk Metallurgical Plant from VTB Bank***

#### *General*

In September 2015, Chelyabinsk Metallurgical Plant entered into an approximately 8.0 billion ruble (as calculated based on the market spot rate as of October 27, 2015) credit facility agreement with VTB Bank to refinance debts of Skyblock Limited totaling \$107.7 million, which consists of principal and interest in the amount of \$101.9 million and \$5.8 million, respectively, and HBL Holding GmbH totaling 14.5 million, provided by VTB Bank. The facility had a grace period until April 2017 and the final maturity until April 2020.

In December 2016, Chelyabinsk Metallurgical Plant signed an amendment to its credit facility agreement with VTB Bank which provides for an extension of the repayment grace period until April 2020 and the final maturity until April 2022.

#### *Interest rate and interest period*

Interest under the credit facility is payable at the CBR key rate plus 1.5% per year. The lender may increase the interest rate by 1% per year if the borrower fails to meet certain obligations under the credit facility. During the grace period, we apply the rate of 8.75% for interest repayment. The remaining unpaid interest is being capitalized and paid on the final maturity date.

#### *Repayment and prepayments*

The credit facility is repayable in equal monthly installments starting on April 6, 2020. The final maturity date is April 6, 2022. The borrower may prepay the loan in full or in part subject to simultaneous compliance with certain requirements.

#### *Guarantee*

The borrower's obligations are guaranteed by Southern Kuzbass Coal Company, Korshunov Mining Plant, Urals Stampings Plant, Mechel, Yakutugol, Mechel Mining, Mechel Trading, Mechel Carbon Singapore and Mechel Carbon.

#### *Security*

The borrower's obligations are secured by a pledge of 25%-3 shares of Yakutugol, 25%+1 share of Southern Kuzbass Coal Company, 25%+1 share of Korshunov Mining Plant, 25%+1 share of Urals Stampings Plant and 46.66%-1 share of Chelyabinsk Metallurgical Plant.

*Covenants and other matters*

For the relevant period ending on December 31, 2016, we were not in compliance with certain non-financial covenants. We have requested the bank to waive our breaches and the respective waivers were obtained for certain of such breaches.

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Under the credit facility agreement, Mechel group's ratio of net borrowings to EBITDA shall not exceed 9.00:1 until December 31, 2016, 8.00:1 until December 31, 2017, 7.00:1 until December 31, 2018, 6.00:1 until December 31, 2019, 5.00:1 until December 31, 2020 and thereafter. Mechel group's ratio of EBITDA to net interest expense shall not be less than 1.25:1 until December 31, 2016, 1.50:1 until December 31, 2017, 1.75:1 until December 31, 2018, 2.00:1 until December 31, 2019, 2.25:1 until December 31, 2020 and thereafter. Financial covenants are tested semi-annually.

The credit facility contains certain customary representations and warranties, affirmative covenants, notice provisions and events of default, including change of control and cross-defaults relating to other debt, as well as limitations on payment of dividends, acquisitions and disposals and non-core transactions.

The credit facility agreement is governed by Russian law.

***Russian bonds***

On July 30, 2009, we placed series 04 non-convertible interest-bearing bonds in an aggregate principal amount of 5.0 billion rubles. The bonds are registered with the FFMS and admitted to trading and listed at MICEX. The bonds are secured by a guarantee from Yakutugol. The proceeds were used to fund the construction of the Elga coal complex. The bonds are due on July 21, 2016. The bonds bear a coupon to be paid quarterly. The interest rate for the first 12 coupons was set at 19% per annum, for the 13-16 coupons was set at 11.25% per annum, for the 17-22 coupons was set at 13% per annum, for the 23-24 coupons was set at 8% per annum and for the 25-28 coupons was set at 2% per annum. We partially redeemed the bonds ahead of maturity on July 29, 2013 in the amount of 1.349 billion rubles, on January 27, 2014 in the amount of 1.276 billion rubles, on July 28, 2014 in the amount of 858 million rubles, on January 26, 2015 in the amount of 325 million rubles and on July 27, 2015 in the amount of 372.43 million rubles. In July 2016, we restructured the series 04 bonds. On June 20, 2016, we published public irrevocable offers through which the bondholders were proposed to amend current schedules of redemption of the bonds and to waive the right to demand early redemption of the bonds. On July 7, 2016, the majority of the series 04 bondholders approved the new terms at the general meeting of bondholders. On July 28, 2016, the CBR registered amendments to the equity documents, including a schedule of partial redemption of the par value. The maturity of the bonds is extended until July 15, 2021. The interest rate is set as follows: for the 29 coupon at 13%, for the 30 coupon at 12.5%, for the 31 coupon at 12.75%, for the 32 coupon at 12.625%, for the 33-36 coupons at  $(12\% + (\text{key rate} + 2.5\%))/2$ , for the 37-40 coupons at  $(11\% + (\text{key rate} + 2.5\%))/2$ , for the 41-44 coupons at  $(10\% + (\text{key rate} + 2.5\%))/2$  and for the 45-48 coupons at  $(9\% + (\text{key rate} + 2.5\%))/2$ . On August 11, 2016 and October 20, 2016, we partially redeemed 3.5% of the par value. On January 19, 2017, we partially redeemed 4% of the par value. We will gradually redeem the par value of the series 04 bonds: 4% of par value on April 20, 2017 and 5% of par value on each of July 20, 2017, October 19, 2017, January 18, 2018, April 19, 2018, July 19, 2018, October 18, 2018, January 17, 2019, April 18, 2019, July 18, 2019, October 17, 2019, January 16, 2020, April 16, 2020, July 16, 2020, October 15, 2020, January 14, 2021, April 15, 2021 and July 15, 2021.

On September 7, 2010, we placed series 13 and series 14 non-convertible interest-bearing bonds in an aggregate principal amount of 10.0 billion rubles. The bonds are registered with the FFMS and admitted to trading and listed at MICEX. The proceeds were used to fund the working capital of our group, refinance the existing loan agreements, as well as to finance the construction of the Elga coal complex and other investment projects of our group. The bonds bear a coupon to be paid on a semi-annual basis. The interest rate for the first 10 coupons was set at 10% per annum. In September 2015, we restructured the debt under series 13 and series 14 bonds. We were entitled to redeem the bonds on September 3, 2015, but failed to fulfill our obligations. On September 14, 2015, we published public irrevocable offers through which the bondholders were proposed to amend current schedules of redemption of the bonds and to waive the right to demand early redemption of the bonds. On September 17, 2015, the majority of the



series 13 and 14 bondholders approved the new terms at the general meeting of bondholders. On October 21, 2015, the CBR registered amendments to the equity documents. In accordance with the new terms, the interest rate is set for the 11-13 coupons at 15% per annum, for the 14-15

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coupons at 14% per annum and for the following coupon periods is determined by a formula based on the CBR key rate. The interest rate is set as follows: for the 16-17 coupons at  $(13\%+(\text{key rate}+4\%))/2$  and for the 18-19 coupons at  $(12\%+(\text{key rate}+4\%))/2$ . We have to redeem the bonds amounting up to 500 thousand bonds of each series on September 28, 2015 and amounting up to 250 thousand bonds of each series on March 1, 2016 and August 30, 2016. On February 28, 2017, we partially redeemed 10% of the par value. We will gradually redeem the par value of both series of the bonds: 10% of par value on August 29, 2017 and February 27, 2018, 15% of par value on August 28, 2018 and February 26, 2019 and 20% of par value on August 27, 2019 and February 25, 2020. The bonds are due on February 25, 2020. On September 28, 2015, we partially redeemed the bonds of both series in the total amount of 999.34 million rubles which equaled to 999,341 bonds. On March 1, 2016, we partially redeemed the bonds of both series in the total amount of 485.1 million rubles which equaled to 485,089 bonds. On August 30, 2016, we partially redeemed the bonds of both series in the total amount of 499.65 million rubles which equaled to 499,654 bonds.

On February 22, 2011, we placed series 15 and series 16 non-convertible interest-bearing bonds in an aggregate principal amount of 10.0 billion rubles. The bonds are registered with the FFMS and admitted to trading and listed at MICEX. The proceeds were used to fund the working capital of our group, refinance the existing loan agreements, as well as to finance the construction of the Elga coal complex and other investment projects of our group. The bonds are due on February 9, 2021. The bonds bear a coupon to be paid on a semi-annual basis. The interest rate for the first 6 coupons was set at 8.25% per annum, for the 7-8 coupons was set at 13% per annum, for the 9-11 coupons was set at 8% per annum and for the 12-20 coupons was set at 8% per annum. We partially redeemed the series 15 and series 16 bonds ahead of maturity on February 20, 2014 in the amount of 8.149 billion rubles, on August 21, 2014 in the amount of 75 million rubles and on February 19, 2015 in the amount of 37.2 million rubles. On August 18, 2016, we partially redeemed the series 15 bonds in the amount of 6.16 million rubles. The option to demand early redemption of the series 16 bonds was replaced with the novation agreement approved at the general meeting of bondholders on August 4, 2016.

On June 9, 2011, we placed series 17 and series 18 non-convertible interest-bearing bonds in an aggregate principal amount of 10.0 billion rubles. The bonds are registered with the FFMS and admitted to trading and listed at MICEX. The proceeds were used to refinance our short-term debt. The bonds are due on May 27, 2021. The bonds bear a coupon to be paid on a semi-annual basis. The interest rate for the first 10 coupons was set at 8.40% per annum. In June 2016, we restructured the debt under series 17 and series 18 bonds. On May 11, 2016, we published public irrevocable offers through which the bondholders were proposed to amend current schedules of redemption of the bonds and to waive the right to demand early redemption of the bonds. On May 25, 2016, the majority of the series 17 and 18 bondholders approved the new terms at the general meeting of bondholders. On June 28, 2016, the CBR registered amendments to the equity documents, including a schedule of partial redemption of the par value. The interest rate is set as follows: for the 11 coupon at 13.5%, for the 12 coupon at 13%, for the 13-14 coupons at  $(12.5\%+(\text{key rate}+2.5\%))/2$ , for the 15-16 coupons at  $(11.5\%+(\text{key rate}+2.5\%))/2$ , for the 17-18 coupons at  $(10.5\%+(\text{key rate}+2.5\%))/2$  and for the 19-20 coupons at  $(9.5\%+(\text{key rate}+2.5\%))/2$ . We partially redeemed 3.5% of the par value on July 12, 2016 and September 1, 2016 and 4% of the par value on December 1, 2016 and March 2, 2017. We will gradually redeem the par value of both series of the bonds: 5% of par value on each of June 1, 2017, August 31, 2017, November 30, 2017, March 1, 2018, May 31, 2018, August 30, 2018, November 29, 2018, February 28, 2019, May 30, 2019, August 29, 2019, November 28, 2019, February 27, 2020, May 28, 2020, August 27, 2020, November 26, 2020, February 25, 2021 and May 27, 2021.

On June 14, 2011, we placed series 19 non-convertible interest-bearing bonds in an aggregate principal amount of 5.0 billion rubles. The bonds are registered with the FFMS and admitted to trading and listed at MICEX. The proceeds were used to refinance our short-term debt. The bonds are due on June 1, 2021. The bonds bear a coupon to be paid on a semi-annual basis. The interest rate for the first 10 coupons was set at 8.40% per annum. In July 2016, we restructured the bonds series 19. On May 11, 2016, we published public irrevocable offers through which the

bondholders were proposed to amend current schedules of redemption of the bonds and to waive the right to demand early redemption of the bonds. On May 25, 2016, the majority of the series 19 bondholders approved the new terms at the general meeting of bondholders. On July 21, 2016, the CBR

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registered amendments to the equity documents, including a schedule of partial redemption of the par value. The interest rate is set as follows: for the 11 coupon at 13.5%, for the 12 coupon at 13%, for the 13-14 coupons at  $(12.5\%+(\text{key rate}+2.5\%))/2$ , for the 15-16 coupons at  $(11.5\%+(\text{key rate}+2.5\%))/2$ , for the 17-18 coupons at  $(10.5\%+(\text{key rate}+2.5\%))/2$  and for the 19-20 coupons at  $(9.5\%+(\text{key rate}+2.5\%))/2$ . We partially redeemed 3.5% of the par value on August 4, 2016 and September 6, 2016 and 4% of the par value on December 6, 2016 and March 7, 2017. We will gradually redeem the par value of the bonds series 19: 5% of par value on each of June 6, 2017, September 5, 2017, December 5, 2017, March 6, 2018, June 5, 2018, September 4, 2018, December 4, 2018, March 5, 2019, June 4, 2019, September 3, 2019, December 3, 2019, March 3, 2020, June 2, 2020, September 1, 2020, December 1, 2020, March 2, 2021 and June 1, 2021.

In March 2017, Moscow Exchange registered our 30-year exchange-traded bonds program. During the term of this program, we are able to place exchange-traded bonds for a total amount of up to 100.0 billion rubles. However, our ability to implement the program in the future is limited by restrictions under the existing loan agreements and market conditions.

**Contractual Obligations and Commercial Commitments**

The following table sets forth the amount of our contractual obligations and commercial commitments as of December 31, 2016.

| Contractual Obligations and Commercial Commitments                                      | Total          | Payments Due by Period |               |               |                      |
|---|----------------|------------------------|---------------|---------------|----------------------|
|   |                | Less Than<br>1 Year    | 2-3 Years     | 4-5 Years     | More Than<br>5 Years |
| (In millions of Russian rubles)   |                |                        |               |               |                      |
| Short-Term Borrowings and Current Portion of Long-Term Debt                             | 395,569        | 395,569                |               |               |                      |
| Long-Term Debt Obligations, Net of Current Portion                                      | 11,645         |                        | 6,733         | 4,912         |                      |
| Interest Payable <sup>(1)</sup>   | 16,918         | 16,918                 |               |               |                      |
| Fines and penalties on credit facilities <sup>(2)</sup>                                 | 21,677         | 21,677                 |               |               |                      |
| Operating Lease Obligations   | 63,861         | 1,870                  | 3,696         | 3,700         | 54,595               |
| Purchase Obligations <sup>(3)</sup>   | 2,964          | 2,964                  |               |               |                      |
| Restructured Taxes Payable  | 118            | 118                    |               |               |                      |
| Rehabilitation provision <sup>(4)</sup>   | 3,678          | 258                    | 479           | 347           | 2,594                |
| Pension obligations <sup>(5)(6)</sup>   | 4,243          | 944                    | 1,413         |               | 1,886                |
| Short-Term Finance Lease Obligations  | 10,176         | 10,176                 |               |               |                      |
| Long-Term Finance Lease Obligations   | 421            |                        | 299           | 122           |                      |
| Fines and penalties on finance lease contracts <sup>(7)</sup>                           | 435            | 435                    |               |               |                      |
| Contractual commitments to acquire plant, property and equipment <sup>(8)</sup>         | 21,932         | 20,675                 | 594           |               | 663                  |
| Contractual commitments to acquire raw materials and for delivery of goods and services | 65,650         | 61,891                 | 3,035         | 45            | 679                  |
| Estimated financial costs <sup>(9)</sup>  | 146,018        | 30,740                 | 59,184        | 56,094        |                      |
| Estimated average interest rate <sup>(9)</sup>  | 7.7%           | 7.2%                   | 7.2%          | 8.3%          |                      |
| <b>Total Contractual Obligations and Commercial Commitments</b>                         | <b>765,305</b> | <b>564,235</b>         | <b>75,433</b> | <b>65,220</b> | <b>60,417</b>        |

- (1) Interest payable is included in amount of RUB 16,918 million in current period figure. In the year ended December 31, 2016, our loan interest expense was RUB 44,164 million and we paid out RUB 30,705 million of loan interest. As of December 31, 2016, interest payable in the amount of RUB 23,034 million was included in the loan principal amount with grace period until April 2020 and final maturity until April 2022 according to debt restructuring agreements.

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- (2) In the year ended December 31, 2016, we recognized RUB 5,537 million penalties on credit facilities. During the period, the amount of RUB 1,914 million was paid in cash and the amount of RUB 731 million was waived.
  - (3) Accounts payable for capital expenditures.
  - (4) See note 22 to the consolidated financial statements.
  - (5) See note 23 to the consolidated financial statements.
  - (6) Includes RUB 3,299 million pension obligations due in more than one year.
  - (7) In the year ended December 31, 2016, we recognized RUB 476 million penalties on finance lease contracts. During the period, the amount of RUB 128 million was paid in cash and the amount of RUB 261 million was waived.
  - (8) See note 28 to the consolidated financial statements.
  - (9) Interest expense is estimated for a five-year period based on (1) estimated cash flows and change of the debt level, (2) forecasted LIBOR rate where applicable, (3) actual long-term contract interest rates and fixed rates, forecasted with reasonable assurance on the basis of historic relations with major banking institutions.
- As of December 31, 2016, we guaranteed the fulfillment of obligations to third parties for a total amount of RUB 56 million. These guarantees are given by us under promissory notes, which were transferred by endorsement.

Commitments for capital expenditures were RUB 21,932 million as of December 31, 2016. This amount includes our contractual commitments related to acquisition of property, plant and equipment arising from various purchase and construction agreements in respect of railway construction for the Elga coal complex in the amount of RUB 17,782 million. See note 28 to the consolidated financial statements.

The total carrying and discounted amount of commitments under lease contracts as of December 31, 2016 is equal to RUB 103 million. See note 28 to the consolidated financial statements.

**Inflation**

Inflation in the Russian Federation was 5.4% in 2016, 12.9% in 2015 and 11.4% in 2014. Inflation has generally not had a material impact on our results of operations during the period under review in this section. However, we cannot guarantee that inflation will not materially adversely impact our results of operations in the future in case inflation accelerates. See Item 3. Key Information Risk Factors Risks Relating to Our Financial Condition and Financial Reporting Inflation could increase our costs and decrease operating margins.

**Critical Accounting Policies and Estimates**

***Basis of preparation***

Our consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

The consolidated financial statements have been prepared on a historical cost basis, except for specific financial assets and liabilities that have been measured at fair value and certain exemptions applied by us under IFRS 1 First-time Adoption of International Financial Reporting Standards.

Russian associates and subsidiaries of our group maintain their books and records in Russian rubles and prepare accounting reports in accordance with the accounting principles and practices mandated by Russian Accounting Standards ( **RAS** ). Foreign subsidiaries and associates maintain their books and records in different foreign functional currencies and prepare accounting reports in accordance with generally accepted accounting principles (GAAP) in various jurisdictions. Our and our subsidiaries and associates financial statements and



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accounting reports for the purposes of preparation of the consolidated financial statements in accordance with IFRS have been translated and adjusted on the basis of the respective standalone RAS or other GAAP financial statements.

The accompanying consolidated financial statements differ from the financial statements issued for the RAS and other GAAP purposes in that they reflect certain adjustments, not recorded in the statutory books, which are appropriate to present the financial position, results of operations and cash flows in accordance with IFRS. The principal adjustments relate to: (1) purchase accounting; (2) recognition of interest expense and certain operating expenses; (3) valuation and depreciation of property, plant and equipment and mineral licenses; (4) defined benefit plans and other long-term benefits; (5) foreign currency translation; (6) deferred income taxes; (7) accounting for tax penalties, uncertainties and contingencies; (8) revenue recognition; (9) valuation allowances for unrecoverable assets; and (10) recording investments at fair value.

For all periods up to and including the year ended December 31, 2014, we prepared our financial statements in accordance with generally accepted accounting principles in U.S. GAAP. The consolidated financial statements for the year ended December 31, 2015 are the first we have prepared in accordance with IFRS.

Our consolidated financial statements comply with Russian Federal Law No. 208-FZ On Consolidated Financial Statements ( **Federal Law No. 208-FZ** ) which was adopted on July 27, 2010. The Federal Law No. 208-FZ provides the legal basis for certain entities for mandatory preparation of financial statements in accordance with IFRS as issued by the IASB and subsequently endorsed for use in the Russian Federation. As at December 31, 2016, all currently effective standards and interpretations issued by the IASB have been endorsed for use in Russia.

The consolidated financial statements are presented in millions of Russian rubles, except when otherwise indicated.

***Basis of consolidation***

The consolidated financial statements comprise our and our subsidiaries financial statements for the year ended December 31, 2016. Control is achieved when our group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, we control an investee if, and only if, we have:

power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee);

exposure, or rights, to variable returns from its involvement with the investee; and

the ability to use its power over the investee to affect its returns.

Consolidation of a subsidiary begins when we obtain control over the subsidiary and ceases when we lose control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated financial statements from the date our group gains control until the date our group ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income (loss) ( **OCI** ) are attributed to the equity holders of the parent of our group and to the non-controlling interests, even if this results in the non-controlling interests having a



deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with our group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of our group are eliminated in full on consolidation.

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A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.

If our group loses control over a subsidiary, it derecognizes the related assets (including goodwill), liabilities, non-controlling interest and other components of equity, while any resultant gain or loss is recognized in the consolidated statement of profit (loss) and other comprehensive income (loss). Any investment retained is recognized at fair value.

## **Summary of Significant Accounting Policies**

### ***Business combinations and goodwill***

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, we elect whether to measure the non-controlling interests in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses.

When our group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as of the acquisition date.

Any contingent consideration to be transferred by the acquirer will be recognized at fair value at the acquisition date. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IAS 39 Financial Instruments: Recognition and Measurement, is measured at fair value with the changes in fair value recognized in the consolidated statement of profit (loss) and other comprehensive income (loss).

Goodwill is initially measured at cost (being the excess of the aggregate of the consideration transferred and the amount recognized for non-controlling interests) and any previous interest held over the net identifiable assets acquired and liabilities assumed. If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, our group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognized at the acquisition date. If the reassessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognized in the consolidated statement of profit (loss) and other comprehensive income (loss).

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of our group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill has been allocated to a cash-generating unit ( CGU ) and part of the operation within that unit is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss on disposal. Goodwill disposed in these circumstances is measured based on the relative values of the disposed operation and the portion of the cash-generating unit retained.

### ***Investments in associates***

An associate is an entity over which we have significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

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The considerations made in determining significant influence are similar to those necessary to determine control over subsidiaries.

Our investments in our associate are accounted for using the equity method.

Under the equity method, the investment in an associate is initially recognized at cost. The carrying amount of the investment is adjusted to recognize changes in our share of net assets of the associate since the acquisition date. Goodwill relating to the associate is included in the carrying amount of the investment and is not tested for impairment separately.

The consolidated statement of profit (loss) and other comprehensive income (loss) reflects our group's share of the results of operations of the associate. Any change in OCI of those investees is presented as part of our group's OCI. In addition, when there has been a change recognized directly in the equity of the associate, our group recognizes its share of any changes, when applicable, in the statement of changes in equity. Unrealized gains and losses resulting from transactions between us and the associate are eliminated to the extent of the interest in the associate.

The aggregate of our group's share of profit or loss of an associate is shown on the face of the consolidated statement of profit (loss) and other comprehensive income (loss) outside operating profit and represents profit or loss after tax and non-controlling interests in the subsidiaries of the associate.

The financial statements of the associate are prepared for the same reporting period as ourselves. When necessary, adjustments are made to bring the accounting policies in line with those of our group.

After application of the equity method, our group determines whether it is necessary to recognize an impairment loss on its investment in its associate. At each reporting date, we determine whether there is objective evidence that the investment in the associate is impaired. If there is such evidence, our group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value, and then recognizes the loss as

Share of profit of an associate in the consolidated statement of profit (loss) and other comprehensive income (loss).

Upon loss of significant influence over the associate, our group measures and recognizes any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognized in the consolidated statement of profit (loss) and other comprehensive income (loss).

### ***Current versus non-current classification***

We present assets and liabilities in the consolidated statement of financial position based on current/non-current classification. An asset is current when it is:

Expected to be realized or intended to be sold or consumed in the normal operating cycle;

Held primarily for the purpose of trading;

Expected to be realized within twelve months after the reporting period; or

Cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

All other assets are classified as non-current.

A liability is current when:

It is expected to be settled in the normal operating cycle;

It is held primarily for the purpose of trading;

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It is due to be settled within twelve months after the reporting period; or

There is no unconditional right to defer the settlement of the liability for at least twelve months after the reporting period.

We classify all other liabilities as non-current. Deferred tax assets and liabilities are classified as non-current assets and liabilities.

### ***Fair value measurement***

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

In the principal market for the asset or liability; or

In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by our group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

We use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Level 1 Quoted (unadjusted) market prices in active markets for identical assets or liabilities.

Level 2 Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.

Level 3 Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognized in the financial statements at fair value on a recurring basis, we determine whether transfers have occurred between levels in the hierarchy by re-assessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

### ***Revenue recognition***

Revenue is recognized to the extent that it is probable that the economic benefits will flow to our group and the revenue can be reliably measured, regardless of when the payment is received. Revenue is measured at the fair value

of the consideration received or receivable, taking into account contractually defined terms of payment and excluding discounts, rebates, and sales taxes or duty.

Revenues are inflows from sales of goods that constitute ongoing major operations of our group and are reported as such in the consolidated statement of profit (loss) and other comprehensive income (loss). Inflows

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from incidental and peripheral operations are considered gains and are included, net of related costs, in other income in the consolidated statement of profit (loss) and other comprehensive income (loss).

The following criteria are also applicable to other specific revenue transactions:

### *Sales of goods*

Revenue from the sale of goods is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer. Revenue from the sale of goods is measured at the fair value of the consideration received or receivable, net of returns and allowances, trade discounts, associated sales taxes (VAT) and export duties.

### *Principal vs agent arrangements*

We are involved in re-selling goods and services produced or rendered by other entities. Revenues are reported based on the gross amount billed to the customer when our group has earned revenue as a principal from the sale of goods or services, or the net amount retained (that is, the amount billed to the customer reduced by the amount billed by the supplier) when our group has earned a commission or fee as an agent.

### *Shipping and handling costs*

We classify all amounts billed to customers in a sale transaction and related to shipping and handling as part of sales revenue and all related shipping and handling costs as selling and distribution expenses when we are acting as a principal in accordance with the requirements of IAS 18 Revenue.

### *Sales of power*

In the power segment (see note 27 to the consolidated financial statements), revenue is recognized based on unit of power measure (kilowatts) delivered to customers, since at that point revenue recognition criteria are met. The billings are usually done on a monthly basis, several days after each month end.

### *Interest income*

For all financial instruments measured at amortized cost, interest income is recorded using the effective interest rate ( **EIR** ). The EIR is the rate that exactly discounts the estimated future cash receipts over the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset. Interest income is included in finance income in the consolidated statement of profit (loss) and other comprehensive income (loss).

## ***Taxes***

### *Current income tax*

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the reporting date in the countries where our group operates and generates taxable income.

### *Uncertain tax positions*



Our policy is to comply fully with the applicable tax regulations in the jurisdictions where our operations are subject to income taxes. Our estimates of current income tax expense and liabilities are calculated assuming that all tax computations filed by our subsidiaries will be subject to a review or audit by the relevant tax authorities. We and the relevant tax authorities may have different interpretations of how regulations should be applied to actual transactions. Such uncertain tax positions are accounted for in accordance with IAS 12 Income Taxes and IAS 37 Provisions, Contingent Liabilities and Contingent Assets. We apply single most likely outcome method of uncertain tax positions estimation.

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*Deferred tax*

Deferred tax is provided using the liability method on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date.

Deferred tax liabilities are recognized for all taxable temporary differences, except:

When the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint arrangements, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary differences, the carry forward of unused tax credits and any unused tax losses. Deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilized, except:

When the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint arrangements, deferred tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are re-assessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred tax relating to items recognized outside profit or loss is recognized in correlation to the underlying transaction either in OCI or directly in equity.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Tax benefits acquired as part of a business combination, but not satisfying the criteria for separate recognition at that date, are recognized subsequently if new information about facts and circumstances change. The adjustment is either treated as a reduction in goodwill (as long as it does not exceed goodwill) if it was incurred during the measurement period or recognized in profit or loss.

***Foreign currencies***

Our consolidated financial statements are presented in Russian rubles to comply with the Federal Law No. 208-FZ. Russian rubles are also the parent company's functional currency.

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For each entity, we determine the functional currency and items included in the financial statements of each entity are measured using that functional currency. The functional currencies for our main Russian and European subsidiaries are the Russian ruble and euro, respectively. The U.S. dollar is the functional currency of our other main international operations. We use the direct method of consolidation and on disposal of a foreign operation, the gain or loss that is reclassified to profit or loss reflects the amount that arises from using this method.

**Transactions and balances**

Transactions in foreign currencies are initially recorded by our group's entities at their respective functional currency spot rates at the date the transaction first qualifies for recognition.

Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency spot rates of exchange at the reporting date.

Differences arising on settlement or translation of monetary items are recognized in profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

The following table presents the exchange rates for the functional and operating currencies at various subsidiaries, other than the presentation currency:

| Currency    | Average exchange rates* for the years |       |       |                    |       |       |
|-------------|---------------------------------------|-------|-------|--------------------|-------|-------|
|             | Year-end rates* at December 31,       |       |       | ended December 31, |       |       |
|             | 2016                                  | 2015  | 2014  | 2016               | 2015  | 2014  |
| U.S. dollar | 60.66                                 | 72.88 | 56.26 | 67.03              | 60.96 | 38.42 |
| Euro        | 63.81                                 | 79.70 | 68.34 | 74.23              | 67.78 | 50.82 |

(\*) Exchange rates shown in Russian rubles for one local currency unit.

The majority of the balances and operations not already denominated in the presentation currency were denominated in the U.S. dollar and euro.

The Russian ruble is not a convertible currency outside the territory of Russia. Official exchange rates are determined daily by the CBR and are generally considered to be a reasonable approximation of market rates.

**Group companies**

On consolidation, the assets and liabilities of foreign operations are translated into rubles at the rate of exchange prevailing at the reporting date and their statements of profit (loss) and other comprehensive income (loss) are translated at the weighted average exchange rate for the period. The exchange differences arising on translation for consolidation are recognized in OCI. On disposal of a foreign operation, the component of OCI relating to that particular foreign operation is recognized in profit or loss.

Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operation and translated at the spot rate of exchange at the reporting date.

***Non-current assets held for sale and discontinued operations***

We classify non-current assets (or disposal group) as held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. Such non-current assets (or disposal group) classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

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The criteria for held for sale classification is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups). For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active program to locate a buyer and complete the plan must have been initiated.

Property, plant and equipment and intangible assets are not depreciated or amortized once classified as held for sale.

Assets and liabilities classified as held for sale are presented separately as current items in the statement of financial position.

A disposal group qualifies as discontinued operation if it is a component of an entity that either has been disposed of, or is classified as held for sale, and:

Represents a separate major line of business or geographical area of operations;

Is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations; or

Is a subsidiary acquired exclusively with a view to resale.

Discontinued operations are excluded from the results of continuing operations and are presented as a single amount as profit or loss after tax from discontinued operations in the consolidated statement of profit (loss) and other comprehensive income (loss).

Additional disclosures are provided in note 16. All other notes to the financial statements include amounts for continuing operations, unless otherwise mentioned.

## ***Mineral licenses***

Mineral licenses acquired separately are measured on initial recognition at cost. The cost of mineral licenses acquired in a business combination is their fair value at the date of acquisition. Mineral licenses are amortized under a unit of production basis over proved and probable reserves of the relevant area.

In order to calculate proved and probable reserves, estimates and assumptions are used about a range of geological, technical and economic factors, including but not limited to quantities, grades, production techniques, recovery rates, production costs, transport costs, commodity demand, commodity prices and exchange rates. There are numerous uncertainties inherent in estimating proved and probable reserves, and assumptions that are valid at the time of estimation may change significantly when new information becomes available.

We established a policy according to which internal mining engineers review our proved and probable reserves annually. This policy does not change our approach to the measurement of proved and probable reserves as of their acquisition dates as part of business combinations that involve independent mining engineers. Our proved and probable reserve estimates as of the reporting date were made by internal mining engineers and the majority of the assumptions underlying these estimates had been previously reviewed and verified by independent mining engineers.

***Property, plant and equipment***

Property, plant and equipment and construction in progress are stated at cost, net of accumulated depreciation and accumulated impairment losses, if any. The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the

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rehabilitation provision, and, for qualifying assets (where relevant), borrowing costs and other costs incurred in connection with the borrowings. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

When significant parts of property, plant and equipment are required to be replaced at intervals, we depreciate them separately based on their specific useful lives. Likewise, when a major inspection is performed, its cost is recognized in the carrying amount of the property, plant and equipment as a replacement if the recognition criteria are satisfied. Where a separately depreciated asset, or part of an asset, is replaced, the expenditure is capitalized. Where part of the asset was not separately considered as a component and therefore not depreciated separately, the replacement value is used to estimate the carrying amount of the replaced asset(s) which is immediately written off. All other repair and maintenance costs are recognized in the consolidated statement of profit (loss) and other comprehensive income (loss) as incurred.

The capitalized value of a finance lease is also included in property, plant and equipment. The present value of the expected cost for the rehabilitation of an asset after its use is included in the cost of the respective asset if the recognition criteria for a provision are met.

Inventories planned to be used for construction and spare parts with useful lives over one year are recorded within property, plant and equipment.

### *Mining assets and processing plant and equipment*

Mining assets and processing plant and equipment are those assets, including construction in progress, which are intended to be used only for the needs of a certain mine or field, and upon full extraction exhausting of the reserves of such mine or the field, these assets cannot be further used for any other purpose without a capital reconstruction.

Items of production mines are stated at cost, less accumulated depletion and accumulated impairment losses, if any.

Costs of developing new underground mines are capitalized. Underground development costs, which are costs incurred to make the mineral physically accessible, include costs to prepare property for shafts, driving main entries for ventilation, haulage, personnel, construction of airshafts, roof protection and other facilities. Additionally, interest expense subject to allocation to the cost of developing mining properties and to constructing new facilities is capitalized until assets are ready for their intended use.

Exploration and evaluation activity involves the search for mineral resources, the determination of technical feasibility and the assessment of commercial viability of identified proved and probable reserves. Once the legal right to explore has been acquired, exploration and evaluation expenditure is charged to profit or loss as incurred, unless we conclude that a future economic benefit is more likely than not to be realized.

Stripping costs incurred in the development phase of a mine, before the production phase commences, are capitalized as part of cost of constructing the mine. The capitalization of development stripping costs ceases when the mine is commissioned and ready for use as intended by management. Stripping costs undertaken during the production phase of mine are charged to profit and loss as cost of goods sold as incurred.

When mining assets and processing plant and equipment are placed in production, the applicable capitalized costs, including mine development costs, are depleted using the unit-of-production method at the ratio of tonnes of mineral mined or processed to the estimated proved and probable mineral reserves that are expected to be mined during the estimated lives of the mines. The unit-of-production method is used for the underground mine development structure



costs as their useful lives coincide with the estimated lives of mines, provided that all repairs and maintenance are timely carried out.

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A decision to abandon, reduce or expand activity on a specific mine is based upon many factors, including general and specific assessments of mineral reserves, anticipated future mineral prices, anticipated costs of developing and operating a producing mine, the expiration date of mineral licenses, and the likelihood that we will continue exploration on the mine. Based on the results at the conclusion of each phase of an exploration program, properties that are not economically feasible for production are re-evaluated to determine if future exploration is warranted and that carrying values are appropriate. The ultimate recovery of these costs depends on the discovery and development of economic ore reserves or the sale of the companies owning such mineral rights.

*Other property, plant and equipment*

Capitalized production costs for internally developed assets include material, direct labor costs, and allocated material and manufacturing overhead costs. When construction activities are performed over an extended period, borrowing costs incurred in connection with the borrowing of funds are capitalized. Construction in progress and equipment held for installation are not depreciated until the constructed or installed asset is substantially ready for its intended use.

Property, plant and equipment (apart from railway of the Elga coal deposit) are depreciated using the straight-line method. Upon sale or retirement, the acquisition or production cost and related accumulated depreciation are removed from the consolidated statement of financial position and any gain or loss is included in the consolidated statement of profit (loss) and other comprehensive income (loss).

The following useful lives are used as a basis for calculating depreciation:

| <b>Category of asset</b>          | <b>Useful economic lives estimates, years</b> |
|-----------------------------------|---|
| Buildings and constructions       | 5-85  |
| Operating machinery and equipment | 2-30  |
| Transportation vehicles           | 2-25  |
| Other equipment                   | 2-15  |

*Leases*

The determination of whether an arrangement is (or contains) a lease is based on the substance of the arrangement at the inception of the lease. The arrangement is, or contains, a lease if fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset or assets, even if that right is not explicitly specified in an arrangement.

A lease is classified at the inception date as a finance lease or an operating lease. A lease that transfers substantially all the risks and rewards incidental to ownership to our group is classified as a finance lease.

Finance leases are capitalized at the commencement of the lease at the inception date fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognized in finance costs in the consolidated statement of profit (loss) and other comprehensive income (loss).

A leased asset is depreciated over the useful life of the asset. However, if there is no reasonable certainty that we will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset and the lease term.

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An operating lease is a lease other than a finance lease. Operating lease payments are recognized as an operating expense in the consolidated statement of profit (loss) and other comprehensive income (loss) on a straight-line basis over the lease term.

***Borrowing costs***

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale (a qualifying asset) are capitalized as part of the cost of the respective asset. Borrowing costs consist of interest including exchange differences arising from foreign currency borrowings and other costs that an entity incurs in connection with the borrowing of funds.

Where funds are borrowed specifically to finance a project, the amount capitalized represents the actual borrowing costs incurred. Where the funds used to finance a project form part of general borrowings, the amount capitalized is calculated using a weighted average of rates applicable to relevant general borrowings of our group during the period.

According to IAS 23 Borrowing Costs, borrowing costs may include exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. Foreign exchange differences on borrowings directly attributable to the acquisition, construction or production of a qualifying asset are considered by us to be eligible for capitalization in the amount of difference between actual amount of interest costs and potential amount of interest costs calculated using a weighted average of rates applicable to ruble-nominated borrowings of our group during the period. All other borrowing costs are recognized in the consolidated statement of profit (loss) and other comprehensive income (loss) in the period in which they are incurred.

***Intangible assets***

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and accumulated impairment losses.

Intangible assets with determinable useful lives are amortized using the straight-line method over their estimated period of benefit, ranging from two to sixteen years.

***Financial instruments initial recognition and subsequent measurement***

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

**Financial assets*****Initial recognition and measurement***

Financial assets are classified, at initial recognition, as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale ( **AFS** ) financial assets, or as derivatives. All financial assets are recognized initially at fair value plus, in the case of financial assets not recorded at fair value through profit or loss, transaction costs that are attributable to the acquisition of the financial asset.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) are recognized on the trade date, i.e., the date that we commit to

purchase or sell the asset.

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### *Subsequent measurement*

For purposes of subsequent measurement, financial assets are classified in four categories:

Financial assets at fair value through profit or loss;

Loans and receivables;

Held-to-maturity investments; and

AFS financial assets.

### *Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value presented as finance costs (negative net changes in fair value) or finance income (positive net changes in fair value) in the consolidated statement of profit (loss) and other comprehensive income (loss).

### *Loans and receivables*

This category is the most relevant to our group. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortized cost using the EIR method, less impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortization is included in finance income in the consolidated statement of profit (loss) and other comprehensive income (loss). The losses arising from impairment are recognized in the consolidated statement of profit (loss) and other comprehensive income (loss) in finance costs for loans and in other operating expenses for receivables.

This category generally applies to trade and other receivables. For more information on receivables, refer to note 12.

### *AFS financial assets*

AFS financial assets include equity investments and debt securities. Equity investments classified as AFS are those that are neither classified as held for trading nor designated at fair value through profit or loss. Debt securities in this category are those that are intended to be held for an indefinite period of time and that may be sold in response to needs for liquidity or in response to changes in the market conditions.

After initial measurement, AFS financial assets are subsequently measured at fair value with unrealized gains or losses recognized in OCI and credited in the AFS reserve until the investment is derecognized, at which time, the cumulative gain or loss is recognized in other operating income, or the investment is determined to be impaired, when the cumulative loss is reclassified from the AFS reserve to the consolidated statement of profit (loss) and other

comprehensive income (loss) in finance costs. Interest earned whilst holding AFS financial assets is reported as interest income using the EIR method.

*Derecognition*

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognized (i.e., removed from our consolidated statement of financial position) when:

The rights to receive cash flows from the asset have expired; or

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We have transferred our rights to receive cash flows from the asset or have assumed an obligation to pay the received cash flows in full without material delay to a third party under a pass-through arrangement; and either (a) we have transferred substantially all the risks and rewards of the asset, or (b) we have neither transferred nor retained substantially all the risks and rewards of the asset, but have transferred control of the asset.

*Impairment of financial assets*

Further disclosures relating to impairment of financial assets are also provided in the following notes to the consolidated financial statements: Financial assets (note 10) and Trade and other receivables (note 12).

We assess, at each reporting date, whether there is objective evidence that a financial asset or a group of financial assets is impaired. An impairment exists if one or more events that has occurred since the initial recognition of the asset (an incurred loss event), has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and observable data indicating that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

*Financial assets carried at amortized cost*

For financial assets carried at amortized cost, we first assess whether impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If our group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

**Financial liabilities***Initial recognition and measurement*

Financial liabilities are classified, at initial recognition, as financial liabilities at fair value through profit or loss, loans and borrowings, payables, or as derivatives.

All financial liabilities are recognized initially at fair value and, in the case of loans and borrowings and payables, net of directly attributable transaction costs.

Our financial liabilities include trade and other payables, loans and borrowings including bank overdrafts, financial guarantee contracts and derivative financial instruments.

*Subsequent measurement*

The measurement of financial liabilities depends on their classification, as described below:

**Financial liabilities at fair value through profit or loss**



Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

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Financial liabilities are classified as held for trading if they are incurred for the purpose of repurchasing in the near term. Gains or losses on liabilities held for trading are recognized in the consolidated statement of profit (loss) and other comprehensive income (loss).

Financial liabilities designated upon initial recognition at fair value through profit or loss are designated at the initial date of recognition, and only if the criteria in IAS 39 Financial Instruments: Recognition and Measurement are satisfied.

**Loans and borrowings**

This is the category most relevant to our group. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortized cost using the EIR method. Gains and losses are recognized in profit or loss when the liabilities are derecognized as well as through the EIR amortization process. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortization is included as finance costs in the consolidated statement of profit (loss) and other comprehensive income (loss). This category generally applies to interest-bearing loans and borrowings (see note 10 to the consolidated financial statements).

**Financial guarantee contracts**

Financial guarantee contracts issued by our group are those contracts that require a payment to be made to reimburse the holder for a loss it incurs because the specified debtor fails to make a payment when due in accordance with the terms of a debt instrument. Financial guarantee contracts are recognized initially as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the reporting date and the amount recognized less cumulative amortization.

**Put options written on non-controlling interests**

We initially measure a financial liability at the present value of the redemption amount in the parent's consolidated financial statements for written puts on non-controlling interest, therefore when we grant non-controlling interests a put option to sell part or all of their interests in a subsidiary during a certain period, on the date of grant, the non-controlling interests are classified as a financial liability. We remeasure the financial liability at the end of each reporting period based on the estimated present value of the consideration to be transferred upon the exercise of the put option. The respective financial cost on discounting is recognized in the consolidated statement of profit (loss) and other comprehensive income (loss) within finance costs.

**Derecognition**

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognized in the consolidated statement of profit (loss) and other comprehensive income (loss).

**Derivative financial instruments**

We use derivative financial instruments, such as cross currency swap and cross currency option. Such derivative financial instruments are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative.

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For the years ended December 31, 2016, 2015 and 2014, we did not have any derivatives designated as hedging instruments.

***Inventories***

Inventories are measured at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

The cost of inventories is determined under the weighted average cost method, and includes all costs in bringing the inventory to its present location and condition. The elements of costs include direct material, labor and allocable material and manufacturing overhead.

Costs of production in process and finished goods include the purchase costs of raw materials and conversion costs such as direct labor and allocation of fixed and variable production overheads. Raw materials are valued at a purchase cost inclusive of freight and other shipping costs.

Coal and iron ore inventory costs include direct labor, supplies, depreciation of equipment, depletion of mining assets and amortization of licenses to use mineral reserves, mine operating overheads and other related costs. Operating overheads are charged to expenses in the periods when the production is temporarily paused or abnormally low.

***Impairment of non-current assets***

Further disclosures relating to impairment of non-current assets are also provided in the following notes to the consolidated financial statements: Intangible assets (note 19) and Impairment of goodwill and other non-current assets (note 18).

We assess, at each reporting date, whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, we estimate the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or CGU's fair value less costs of disposal and its value in use. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. When the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. Our CGUs represent single entities with one component of business in each case. As of December 31, 2016, we performed the impairment testing for the following number of CGUs by segments: Steel 8, Mining 7 and Power 2.

In assessing value in use, we use assumptions that include estimates regarding the discount rates, growth rates and expected changes in selling prices, sales volumes and operating costs, as well as capital expenditures and working capital requirements during the forecasted period. The estimated future cash flows expected to be generated by the asset, when the quoted market prices are not available, are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. The growth rates are based on our growth forecasts, which are largely in line with industry trends. Changes in selling prices and direct costs are based on historical experience and expectations of future changes in the market. In determining fair value less costs of disposal, recent market transactions are taken into account.

We base our impairment calculation on detailed budgets and forecast calculations, which are prepared separately for each of our CGUs to which the individual assets are allocated. These budgets and forecast calculations generally cover a period of five years. A long-term growth rate is calculated and applied to project future cash flows after the fifth year.



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For CGUs involved in mining activity future cash flows include estimates of recoverable minerals that will be obtained from proved and probable reserves, mineral prices (considering current and historical prices, price trends and other related factors), production levels, capital and reclamation costs, all based on the life of mine models prepared by our engineers.

Impairment losses of continuing operations are recognized in the consolidated statement of profit (loss) and other comprehensive income (loss) in expense categories consistent with the function of the impaired asset.

For assets excluding goodwill, an assessment is made at each reporting date to determine whether there is an indication that previously recognized impairment losses no longer exist or have decreased. If such indication exists, we estimate the asset's or CGU's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of profit (loss) and other comprehensive income (loss) unless the asset is carried at a revalued amount, in which case, the reversal is treated as a revaluation increase.

Goodwill is tested for impairment annually as of December 31 and when circumstances indicate that the carrying value may be impaired.

Impairment is determined for goodwill by assessing the recoverable amount of each CGU to which the goodwill relates. When the recoverable amount of the CGU is less than its carrying amount, an impairment loss is recognized. Impairment losses relating to goodwill cannot be reversed in future periods.

### ***Cash and cash equivalents***

Cash and cash equivalents in the statement of financial position comprise cash at banks and on hand and short-term deposits with a maturity of three months or less, which are subject to an insignificant risk of changes in value.

For the purpose of the consolidated statement of cash flows, cash and cash equivalents consist of cash and short-term deposits, as defined above, net of outstanding bank overdrafts as they are considered an integral part of our group's cash management.

### ***Provisions***

#### ***General***

Provisions are recognized when our group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation including legal or tax proceedings obligations and a reliable estimate can be made of the amount of the obligation. The expense relating to a provision is presented in the consolidated statement of profit (loss) and other comprehensive income (loss).

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, when appropriate, the risks specific to the liability. When discounting is used, the increase in the provision due to the passage of time is recognized as a finance cost.

*Rehabilitation provision*

Mine rehabilitation costs will be incurred by us either while operating, or at the end of the operating life of, our facilities and mine properties. We assess our mine rehabilitation provision at each reporting date. Our group

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recognizes a rehabilitation provision where it has a legal and constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of obligation can be made. The nature of these restoration activities includes: dismantling and removing structures; rehabilitating mines and tailings dams; dismantling operating facilities; closing plant and waste sites; and restoring, reclaiming and revegetating affected areas.

The obligation generally arises when the asset is installed or the ground/environment is disturbed at the mining operation's location. When the liability is initially recognized, the present value of the estimated costs is capitalized by increasing the carrying amount of the related mining assets to the extent that it was incurred as a result of the development/construction of the mine.

Changes in the estimated timing of rehabilitation or changes to the estimated future costs are dealt with prospectively by recognizing an adjustment to the rehabilitation provision and a corresponding adjustment to the asset to which it relates, if the initial estimate was originally recognized as part of an asset measured in accordance with IAS 16 Property, Plant and Equipment.

Any reduction in the rehabilitation provision and, therefore, any deduction from the asset to which it relates, may not exceed the carrying amount of that asset. If it does, any excess over the carrying value is taken immediately to the consolidated statement of profit (loss) and other comprehensive income (loss).

Over time, the discounted liability is increased for the change in present value based on the discount rates that reflect current market assessments and the risks specific to the liability. The periodic unwinding of the discount is recognized in the consolidated statement of profit (loss) and other comprehensive income (loss) as part of finance costs.

For closed sites, changes to estimated costs are recognized immediately in the consolidated statement of profit (loss) and other comprehensive income (loss).

#### *Environmental expenditures and liabilities*

Environmental expenditures that relate to current or future revenues are expensed or capitalized as appropriate. Expenditures that relate to an existing condition caused by past operations and do not contribute to current or future earnings are expensed. Liabilities for environmental costs are recognized when a clean-up is probable and the associated costs can be reliably estimated. Generally, the timing of recognition of these provisions coincides with the commitment to a formal plan of action or, if earlier, on divestment or on closure of inactive sites. The amount recognized is the best estimate of the expenditure required. Where the liability will not be settled for a number of years, the amount recognized is the present value of the estimated future expenditure.

#### *Pensions and other post-employment benefits*

##### *Defined benefit pension and other post-retirement plans*

We have a number of defined benefit pension plans and other long-term benefits that cover the majority of production employees. Benefits under these plans are primarily based upon years of service and average earnings. We account for the cost of defined benefit plans and other long-term benefits using the projected unit credit method. Under this method, the cost of providing pensions is charged to the consolidated statement of profit (loss) and other comprehensive income (loss), so as to attribute the total pension cost over the service lives of employees in accordance with the benefit formula of the plan.



Our obligation in respect of defined retirement benefit plans and other long-term benefits is calculated separately for each defined benefit plan and other long-term benefit plan by discounting the amounts of future benefits that employees have already earned through their service in the current and prior periods. The discount rate applied represents the yield at the year end on highly rated long-term bonds.

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Where there is a change in actuarial assumptions, the resulting actuarial gains and losses are recognized directly in the consolidated statement of profit (loss) and other comprehensive income (loss).

For unfunded plans, we recognize a pension liability, which is equal to the projected benefit obligation. For funded plans, our group offsets the fair value of the plan assets with the projected benefit obligations and recognizes the net amount of pension liability. The market value of plan assets is measured at each reporting date.

### *State pension fund*

Our Russian subsidiaries are legally obligated to make defined contributions to the Russian Pension Fund, managed by the Russian Federation Social Security (a defined contribution plan financed on a pay-as-you-go basis). Our contributions to the Russian Pension Fund relating to defined contribution plans are charged to income in the year, to which they relate.

### *Significant accounting judgments, estimates and assumptions*

The preparation of the consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported carrying amounts of assets and liabilities, and disclosure of contingent assets and liabilities as of the date of the financial statements, and the amounts of revenues and expenses recognized during the reporting period. Estimates and assumptions are continually evaluated and are based on our experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results could differ from those estimates. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

### *Judgments*

In the process of applying our accounting policies, management has made the following judgments, which have the most significant effect on the amount recognized in the consolidated financial statements.

### *Abandoned Activity*

As of January 1, 2014, Southern Urals Nickel Plant was recognized as abandoned activity according to a decision to close Southern Urals Nickel Plant without sale. In July 2013, we received an approval from the governmental authorities to abandon the industrial complex. The closure of Southern Urals Nickel Plant is aligned with the revised strategy aimed at restructuring the group's assets and development of its core businesses. During 2014-2015, the works related to closure of the plant were ongoing. Starting the fourth quarter of 2016 we stopped liquidation activities (see note 16); therefore we present the results of Southern Urals Nickel Plant as discontinued operations in the consolidated statement of profit (loss) and other comprehensive income (loss) for the nine months ended September 30, 2016 and prior periods and as continuing operations from the fourth quarter of 2016.

### *Capitalization of Interest Related to the Elga Coal Deposit and Railway Construction*

In 2013 and 2014, Elgaugol and Vnesheconombank signed credit agreements for financing of the Elga coal project approved by the Vnesheconombank's Supervisory Board in September 2013. The use of proceeds under these facilities is limited to the development of the Elga coal project. Borrowing costs under these Vnesheconombank's facilities that are directly attributable to the construction of the Elga coal project are capitalized. Borrowing costs consist of interest including exchange differences arising from revaluation of foreign currency borrowings and other costs that we incur in connection with the debt servicing.



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**Table of Contents****Railway Depreciation Method**

In 2015, we commenced to depreciate the railway of the Elga coal deposit using units of production method. In applying the units of production method, depreciation is normally calculated based on produced and delivered tonnes in the period as a percentage of total expected tonnes to be produced and delivered in current and future periods over the Elga coal deposit life cycle. Our analysis has shown that the consumption of the economic benefits of the asset is linked to production and delivery of coal. We assess the total or ultimate railway capacity in tonnes at least at each financial year end and, if expectations differ from previous estimates, the changes will be accounted for as a change in an accounting estimate in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

**Donetsk Electrometallurgical Plant's Property Complex**

On June 25, 2016, by the decree of the Council of Ministers of the self-proclaimed People's Republic of Donetsk, the State Enterprise Yuzovsky Metallurgical Plant was established on the basis of the property complex of our subsidiary Donetsk Electrometallurgical Plant. Our ability to manage and control the assets of the Donetsk Electrometallurgical Plant's property complex is restricted by this decree. We concluded that the assets included in the Donetsk Electrometallurgical Plant's property complex do not meet the recognition criteria and we derecognized these assets in our consolidated financial statements.

The Donetsk Electrometallurgical Plant's assets were fully impaired based on the results of impairment tests as of January 1, 2014 and December 31, 2014 due to conservation of production since 2013. The loss of control over the assets of nil carrying value has no impact on our financial result for the year ended December 31, 2016.

**Principal vs Agent Arrangements**

We make significant judgment on gross or net revenue recognition. We evaluate the relevant facts and circumstances and take into consideration the following factors in determining whether to recognize revenue on a gross basis: (1) we have the primary responsibility for providing the goods or services to the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer; (2) we have inventory risk before or after the customer order, during shipping or on return; (3) we have latitude in establishing prices, either directly or indirectly, for example by providing additional goods or services; and (4) we bear the customer's credit risk for the amount receivable from the customer.

Otherwise, revenues are reported net when our group performs as an agent or a broker without assuming the risks and rewards of ownership of goods. The evaluations of these factors, which at times can be contradictory, are subject to significant judgment and subjectivity. In the situation when we act as a supplier and as a buyer with the same counterparty, we analyze the respective purchase and sales agreements to identify whether these transactions were concluded in contemplation with each other and, therefore, should be combined for accounting purposes deferring the revenue recognition to the point when the earnings process has culminated.

**Estimates and Assumptions**

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below or in the related accounting policy note. We based our assumptions and estimates on parameters available when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market change or circumstances arising beyond the control of our group.



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In particular, we have identified a number of areas where significant estimates and assumptions are required. Further information on each of these areas and how they impact the various accounting policies are described with the associated accounting policy note within the related qualitative and quantitative note as described below.

*Deferred Tax Assets and Uncertain Tax Positions*

Deferred tax assets are recognized for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits and the existence of taxable temporary differences (see note 20 to the consolidated financial statements). Various factors are considered to assess the probability of the future utilization of deferred tax assets, including past operating results, operational plans, expiration of tax losses carried forward, and tax planning strategies. If actual results differ from these estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected. In the event that the assessment of future utilization of deferred tax assets must be reduced, this reduction will be recognized in the consolidated statement of profit (loss) and other comprehensive income (loss).

*Impairment of Property, Plant and Equipment and Other Non-current Assets*

We assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, we make an estimate of the asset's recoverable amount. An impairment exists when the carrying value of an asset or CGU exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use. The fair value less costs of disposal calculation is based on available data from binding sales transactions, conducted at arm's length for similar assets or observable market prices less incremental costs for disposing of the asset. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the assets.

Impairment is based on a large number of factors, such as changes in current competitive conditions, expectations of growth in the industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, and other changes in circumstances that indicate that impairment exists. The determination of the recoverable amount of a cash-generating unit involves the use of estimates by management. Methods used to determine the value in use include discounted cash flow-based methods, which require us to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. These estimates, including the methodologies used, may have a material impact on the value in use and, ultimately, the amount of any impairment (see note 18).

*Impairment of Goodwill*

We determine whether goodwill is impaired at least on an annual basis and when circumstances indicate that the carrying value may be impaired. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires us to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. More details of the assumptions used in estimating the value in use of the cash-generating units to which goodwill is allocated are provided in note 18 to the consolidated financial statements.

*Useful Lives of Items of Property, Plant and Equipment*

We assess the remaining useful lives of items of property, plant and equipment at least at each financial year end and, if expectations differ from previous estimates, the changes are accounted for as a change in an

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accounting estimate in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. These estimates may have a material impact on the amount of the carrying values of property, plant and equipment and on depreciation expense for the period.

### *Mineral Reserves*

Mineral reserves and the associated mine plans are a material factor in our computation of a depletion charge. Estimation of reserves involves some degree of uncertainty. The uncertainty depends mainly on the amount of reliable geological and engineering data available at the time of the estimate and the interpretation of this data, which also requires use of subjective judgment and development of assumptions. Mine plans are periodically updated which can have a material impact on the depletion charge for the period. More details are provided in note 3(i) to the consolidated financial statements.

### *Fair Value of Financial Instruments*

Where the fair value of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, their fair value is determined using valuation techniques, including discounted cash flow models. The inputs to these models are taken from observable markets where possible, but when this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments (see note 9 to the consolidated financial statements).

### *Provisions*

We are subject to various legal proceedings, disputes and claims, including regulatory discussions related to our group's business, licenses, tax positions and the outcomes are subject to significant uncertainty. Management evaluates, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Unanticipated events or changes in these factors may require us to increase or decrease the amount recorded or to be recorded for a matter that has not been previously recorded because it was not considered probable (see note 22 to the consolidated financial statements).

### *Pensions and Other Post-employment Benefits*

The cost of defined benefit pension plans and other post-employment benefits and the present value of the pension obligation are determined using actuarial valuations. An actuarial valuation involves making various assumptions which may differ from actual developments in the future. These include the determination of the discount rate, future salary increases, mortality rates and future pension increases. Due to the complexity of the valuation, the underlying assumptions and its long-term nature, a defined benefit obligation and other long-term benefit plans are highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date. More details are provided in note 23 to the consolidated financial statements.

### *Rehabilitation Provisions*

We review rehabilitation provisions at each reporting date and adjust them to reflect the current best estimate. Rehabilitation provisions are recognized in the period in which they arise and are stated at the best estimate of the present value of estimated future costs. These estimates require extensive judgment about the nature, cost and timing of the work to be completed, and may change with future changes to costs, environmental laws and regulations and remediation practices. Changes in the estimated timing of rehabilitation or changes to the estimated future costs are



dealt with prospectively by recognizing an adjustment to the rehabilitation provision and a corresponding adjustment to the asset to which it relates, if the initial estimate was originally recognized as part of an asset measured in accordance with IAS 16 Property, Plant and Equipment (see note 17 to the consolidated financial statements).

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**Table of Contents***Impairment of Financial Assets*

We make allowances for doubtful receivables to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of an allowance for doubtful accounts, management bases its estimates on the current overall economic conditions, the ageing of accounts receivable balances, historical write-off experience, customer creditworthiness and changes in payment terms. Changes in the economy, industry or specific customer conditions may require adjustments to the allowance for doubtful accounts recorded in the consolidated financial statements.

*Determining Net Realizable Value of Inventories*

We make write-downs for obsolete and slow-moving raw materials and spare parts. In addition, finished goods of our group are carried at net realizable value (see note 14 to the consolidated financial statements). Estimates of net realizable value of finished goods are based on the most reliable evidence available at the time the estimates are made. These estimates take into consideration fluctuations of price or cost directly relating to events occurring subsequent to the end of the reporting period to the extent that such events confirm conditions existing at the end of the period.

For other judgments, estimates and assumptions and details refer to: Mineral licenses (note 3(i)), Property, plant and equipment (note 3(j)), Recovery of deferred tax assets (note 3(f)), Non-current assets held for sale and discontinued operations (note 3(h)), Inventories (note 3(p)), Impairment of non-current assets (note 3(q)), Pensions and other post-employment benefits (note 3(t)), Provisions (note 3(s)) and Fair value measurement (note 3(d)).

**Reclassifications**

Certain reclassifications have been made to the prior periods consolidated financial statements to conform to the current year presentation. Such reclassifications affect the presentation of certain items in the consolidated statement of financial position, consolidated statement of profit (loss) and other comprehensive income (loss) and consolidated statement of cash flows and have no impact on net income or equity.

**New and amended standards and interpretations**

We applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after January 1, 2016. We have not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective. The nature and the effect of these changes are described below.

***Amendments to IAS 1 Disclosure Initiative.*** The amendments to IAS 1 Presentation of Financial Statements clarify existing IAS 1 requirements:

the materiality requirements in IAS 1;

the requirements that apply when additional subtotals are presented in the statement of financial position and the statements of profit or loss and OCI;

that specific line items in the statements of profit or loss and OCI and the statement of financial position may be disaggregated;

that entities have flexibility as to the order in which they present the notes to financial statements; and

that the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

***Amendments to IFRS 11 Accounting for Acquisitions of Interests in Joint Operations.*** The amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint

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operation, in which the activity of the joint operation constitutes a business, must apply the relevant IFRS 3 principles for business combinations accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation while joint control is retained. In addition, a scope exclusion has been added to IFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party. The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation and are prospectively effective for annual periods beginning on or after January 1, 2016, with early adoption permitted.

***Amendments to IAS 16 and IAS 38 Clarification of Acceptable Methods of Depreciation and Amortization.*** The amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortize intangible assets.

***Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exemption.*** The amendments address issues that have arisen in applying the investment entities exception under IFRS 10 Consolidated Financial Statements. The amendments to IFRS 10 clarify that the exemption from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures all of its subsidiaries at fair value. Furthermore, the amendments to IFRS 10 clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value. The amendments to IAS 28 Investments in Associates and Joint Ventures allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries. These amendments are applied retrospectively. The adoption of the amendments do not have significant impact on our group as we do not apply the consolidation exception.

***Amendments to IAS 27 Equity Method in Separate Financial Statements.*** The amendments allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying IFRS and electing to change to the equity method in their separate financial statements will have to apply that change retrospectively.

***Annual Improvements to IFRSs 2010-2012 Cycle***

The amendments relate to IFRS 2 Share-based Payment, IFRS 3 Business Combinations, IFRS 8 Operating Segments, IAS 16 Property, Plant and Equipment, IAS 38 Intangible Assets and IAS 24 Related Party Disclosures.

***Annual Improvements to IFRSs 2012-2014 Cycle***

The amendments relate to IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, IFRS 7 Financial Instruments: Disclosures, IAS 19 Employee Benefits and IAS 34 Interim Financial Reporting.

The amendments and improvements described above had no significant impact on our financial position and performance or the disclosures in the consolidated financial statements.

**Standards issued but not effective**

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of our financial statements are discussed below. We intend to adopt these standards, if applicable, when they become effective.

**Table of Contents*****Annual Improvements to IFRSs 2014-2016 Cycle (issued in December 2016)***

This annual improvements package amended three standards:

*IFRS 1 First-time Adoption of International Financial Reporting Standards.* Short-term exemptions in paragraphs E3-E7 of IFRS 1 were deleted, because they have now served their intended purpose.

*IAS 28 Investments in Associates and Joint Ventures.* The amendment clarified that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organization, or other qualifying entity, is available for each investment in an associate or a joint venture on an investment-by-investment basis, upon initial recognition.

*IFRS 12 Disclosure of Interests in Other Entities.* The amendment clarified the scope of the standard by specifying that the disclosure requirements in the standard, except for those in paragraphs B10-B16, apply to an entity's interests in a subsidiary, a joint venture or an associate that are classified as held for sale, as held for distribution or as discontinued operations in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

The amendments described above had no significant impact on the financial position and performance of our group or the disclosures in the consolidated financial statements. We have not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

Management is in the process of assessing of impact of the adoption of the pronouncements listed below on our group's consolidated financial statements:

Amendments to IAS 7 Disclosure Initiative effective for annual periods beginning on or after January 1, 2017;

Amendments to IAS 12 Recognition of Deferred Tax Assets for Unrealized Losses January 1, 2017;

Amendments to IAS 40 Transfers of Investment Property January 1, 2018;

Amendments to IFRS 2 Classification and Measurement of Share-based Payment Transactions January 1, 2018;

Amendments to IFRS 4 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts January 1, 2018;

Annual Improvements to IFRSs 2014-2016 Cycle January 1, 2018;

IFRS 9 Financial Instruments January 1, 2018;

IFRS 15 Revenue from Contracts with Customers January 1, 2018;

IFRIC 22 Foreign Currency Transactions and Advance Consideration January 1, 2018;

IFRS 16 Leases January 1, 2019.

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments. The final version of IFRS 9 replaces IAS 39 Financial Instruments: Recognition and Measurement, and all previous versions of IFRS 9. IFRS 9 brings together the requirements for the classification and measurement, impairment and hedge accounting of financial instruments. In respect of impairment, IFRS 9 replaces the incurred loss model used in IAS 39 with a new expected credit loss model that will require a more timely recognition of expected credit losses. The standard is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

In January 2016, the IASB issued IFRS 16 Leases. IFRS 16 eliminates the classification of leases as either operating leases or finance leases and establishes a single lessee accounting model. The most significant effect of the new requirements for the lessee will be an increase in lease assets and financial liabilities. The new standard replaces the previous leases standard, IAS 17 Leases, and the related interpretations.

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Management plans to apply IFRS 9 and IFRS 16 starting from the respective effective dates. We are currently assessing the impact of these standards on our consolidated financial statements.

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers. IFRS 15 establishes a single framework for revenue recognition and contains requirements for related disclosures. The new standard supersedes IAS 18 Revenue, IAS 11 Construction Contracts, and the related interpretations on revenue recognition. The standard is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

IFRS 15 establishes a five-step model to account revenue arising from contracts with customers. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

IFRS 15 provides presentation and disclosure requirements, which are more detailed than under the current IFRS. The presentation requirements represent a significant change from current practice and increase the volume and level of details of disclosures required in our consolidated financial statements. We expect to adopt the new standard from January 1, 2018 retrospectively. During 2016, we performed a preliminary assessment of IFRS 15, which is subject to change arising from a more detailed ongoing analysis. In 2017, a further review of contracts will be undertaken at all businesses. Furthermore, we are considering the clarification issued by the IASB in an exposure draft in April 2016 and will monitor any further developments.

**Trend Information*****Demand***

*Mining.* The demand for coking coal is dependent on the steel industry, which is directly tied to global economic cycles. In 2014, China's coking coal imports fell by 13 million tonnes due to growing usage of domestic material and a slowdown in demand, according to Platts. As a result, global metallurgical coal imports stagnated, according to CRU. In 2015, total global metallurgical coal imports fell by 3.3% as China continued its policy to decrease coal imports to support domestic producers. As a result of such policy, imports of metallurgical coal in China fell by 20 million tonnes in 2015, according to CRU. In 2016, Chinese government implemented its 276 working days policy at Chinese coal mines which led to reduced coal production in China and to higher demand for imported material. As a result of such policy, imports of metallurgical coal in China rose by 10 million tonnes in 2016, according to CRU. Global metallurgical coal imports increased by 1.7% in 2016, according to CRU.

The steam coal market is driven by non-steel related factors, such as growth in electricity consumption, balance between supply and demand and seasonality. In 2015, total global seaborne steam coal imports dropped by 8.3% compared to 2014 driven by drastic fall in China import volumes, according to CRU. In 2016, total global seaborne steam coal imports decreased by 1.7% due to a drop in European and Indian steam coal imports, according to CRU.

According to the Department of Industry, Innovation and Science of Australian Government, in 2014, global iron ore trade increased by 11% due to world pig iron production growth and higher proportion of imported iron ore in Chinese consumption. Global iron ore trade increased by 1.2% in 2015, the lowest rate of growth since 2001, according to the Department of Industry, Innovation and Science of Australian Government. The main reason of such growth slowdown was decreased steel production in China. In 2016, global iron ore trade is estimated to have increased by 3% due to strong Chinese demand for imported iron ore which hit an all-time high in 2016, according to the Department of Industry, Innovation and Science of Australian Government and CRU.



*Steel.* Russia is our largest market for steel products. In 2014, Russian rolled steel consumption reached a level of 45.8 million tonnes, according to Metal Expert. In 2015, Russian rolled steel consumption declined by 8.5% and amounted to 41.9 million tonnes, according to Metal Expert. In 2016, Russian rolled steel consumption declined by 3.8% and amounted to 40.3 million tonnes, according to Metal Expert.

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In 2014, exports of steel products increased by 5.6% and reached 25.2 million tonnes as a result of the ruble devaluation, according to Metal Expert. In 2015, the volume of steel products exports from Russia grew by 8.7% and amounted to 27.4 million tonnes due to the growth in the exchange rate, according to Metal Expert. In 2016, exports of steel products increased by 4.5% and amounted to 28.6 million tonnes. The increase was due to the growth in manufacturing of steel products and decrease in domestic supplies.

In 2014, imports of steel declined by 23.5% and amounted to 5.5 million tonnes, according to Metal Expert. In 2015, imports of steel decreased significantly by 27.3% and amounted to 4.0 million tonnes, according to Metal Expert. The decline was due to the ruble devaluation and growth in supplies of domestic producers. In 2016, imports of steel declined by 5.7% and amounted to 3.8 million tonnes, according to Metal Expert.

*Power.* In 2016, the electricity output of our generating facilities decreased by 18% as compared to 2015 due to interseasonal scheduled repairs of main equipment at Southern Kuzbass Power Plant. Heat energy generated for sale increased by 1%. Power demand in Russia depends on its consumption by the industrial sector. In Russia, the steel and mining industries are major consumers of power and the level of production of steel and mining companies impact demand for power.

***Sales***

*Mining.* In 2017, we expect sales volumes of our mining segment to remain at the level of 2016 with an increase in the share of exports due to the increasing volumes of production at the Elga coal deposit. We believe that our policy of concluding long-term contracts for coal sales will strengthen our relationships with our customers and will give us long-term presence in both the domestic and export markets.

*Steel.* Our steel segment sales volumes are expected to increase in 2017 due to the increased production at the universal rolling mill resulting in an increase of structural shapes and rails sales. In addition, we believe that our strategy aimed at increasing the efficiency of the existing distribution network in conjunction with direct sales from our plants to the largest customers will allow us to strengthen our leading position in the market, to provide us with greater stability in steel sales and to improve our cash flow in the current economic slowdown.

*Power.* In 2017, we expect sales volumes of our power segment to increase as compared to 2016. We do not expect that consumption by small and mid-sized businesses and households, which are also customers of power and heat-supply companies, will change significantly. We plan to expand our sales channels to build a new customer base among small and mid-sized businesses, as well as public utilities. We also plan to optimize our production capacity through further integration of our intra-group assets. We hope that further integration of our power assets, as well as diversification of our customer portfolio will allow us to avoid a fall in power segment sales caused by a decrease in demand from large industrial companies that are shifting their business from power supply companies.

***Inventory***

Overall, our inventory increased by RUB 38 million, or 0.1%, to RUB 35,227 million as of December 31, 2016 from RUB 35,189 million as of December 31, 2015, due to the increase in finished goods production costs, which was due to the increase in raw materials costs as well as the increase in production volumes in the steel segment as a result of growth in steel products demand.

***Costs***

*Mining.* Within our mining segment, we expect our iron ore cash costs per tonne to increase in 2017 as a result of increasing prices of power, explosives, automotive tires and tubes for open pit equipment and land use fees, while coal cash costs per tonne should remain relatively stable in 2017 as a result of increasing operational efficiency and decreasing semi-fixed costs.

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*Steel.* Excluding the effects of imposition of international sanctions against Russia and exchange rate fluctuations, our steel cash costs per tonne should remain relatively stable in 2017 as a result of achieving cost savings, as well as efficiency and output gains arising as a result of our targeted capital investment program. Specifically, as we continue to introduce operational and technical changes at our plants allowing us to better integrate their products, we expect to be better able to control our costs.

*Power.* We expect that in 2017 the cost of the production of electricity and heat energy will increase due to an increase in the prices of key raw materials, particularly natural gas, as well as some ancillary materials. We intend to maintain strict control over costs, which should enable us to cut expenditures by reducing fixed production costs, optimizing administrative expenses and increasing productivity to satisfy increased market demand in some regions.

**Seasonality**

Seasonal effects have a relatively limited impact on our results. Nevertheless, a slowing of demand and, thus, a reduction in sales volumes (and a related increase in inventories) is typically evident in the first and fourth quarters of the financial year as a result of the general reduction in economic activity associated with the New Year holiday period in Russia and elsewhere. We generally maintain increased stockpiles of scrap during the winter months in order to avoid potential supply disruptions due to inclement weather. We are dependent on the Russian construction market, which also experiences slowdowns in the winter months. By contrast, our power segment sales volumes are generally higher in the first and the fourth quarters of the year, due to increased electricity and steam consumption in the winter period.

Consumption of combustive, lubricative and energy supplies during the winter months is generally higher than during the rest of the year. In addition, railroad carriers demand that iron ore concentrate be fully dried and coal concentrate be partially dried for transportation during the winter months, resulting in higher costs during that time.

**Item 6. Directors, Senior Management and Employees****Directors and Executive Officers****Board of Directors**

All of our current directors were elected on June 30, 2016, and their terms expire on the date of our next annual general shareholders meeting, which will take place not later than June 30, 2017. The business and mailing address for all our directors and executive officers is Krasnoarmeyskaya Street 1, Moscow 125167, Russian Federation.

| <b>Name</b>                              | <b>Year of Birth</b> | <b>Position</b>  |
|--|----------------------|--|
| Igor V. Zyuzin                           | 1960                 | Chairman, Chief Executive Officer of Mechel Mining                               |
| Alexander N. Shokhin <sup>(1)</sup>      | 1951                 | Deputy Chairman  |
| Oleg V. Korzhov <sup>(4)</sup>           | 1970                 | Director, Chief Executive Officer, Chairman of Management Board                  |
| Victor A. Trigubko                       | 1956                 | Director, Senior Vice President Government Relations, Member of Management Board |
| Tigran G. Khachaturov <sup>(4)</sup>     | 1979                 | Director   |
| Alexander N. Kotsky <sup>(1)(2)(4)</sup> | 1957                 | Director   |
|  | 1932                 | Director   |

|   |      |          |
|---|------|----------|
| Alexander D.<br>Orishchin <sup>(1)(2)(3)(4)</sup> |      |          |
| Yuriy N. Malyshev <sup>(1)(3)(4)</sup>            | 1939 | Director |
| Vladimir Yu. Korovkin <sup>(1)(2)(3)</sup>        | 1960 | Director |

(1) Independent Director under the applicable NYSE regulations and Russian regulations.

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- (2) Member of the Audit Committee of the Board of Directors.
- (3) Member of the Committee on Appointments and Remuneration.
- (4) Member of the Committee on Investments and Strategic Planning.

*Igor V. Zyuzin* has been Chairman of our Board of Directors since July 2010. He was our Chief Executive Officer from December 2006 to June 2010 and Chairman of our Management Board from September 2007 to June 2010. He served as Chairman of our Board of Directors from March 2003, when Mechel was founded, to December 2006 and has been a member of our Board of Directors since that time. Mr. Zyuzin has been a member of the Board of Directors of Mechel Mining since April 2008 and Chief Executive Officer of Mechel Mining since July 2011. Mr. Zyuzin has also served as Chairman of the Board of Directors of Southern Kuzbass Coal Company since May 1999 and has been a member of the Board of Directors of Chelyabinsk Metallurgical Plant since 2001 and a member of the Board of Directors of Yakutugol since October 2007. He has served as Chairman of the Board of Directors of Yakutugol since June 2013. From July 2011 to April 2014, he was Chairman of the Management Board of Mechel Mining. From April 2008 to June 2011, Mr. Zyuzin served as Chairman of the Board of Directors of Mechel Mining. Mr. Zyuzin has over 30 years of experience in the coal mining industry. Mr. Zyuzin has a degree in technology and complex mechanization of underground mining from the Tula Polytechnic Institute. Mr. Zyuzin also has a degree in mining engineering economics and a Ph.D. in technical sciences in the coal mining field. Mr. Zyuzin may be deemed to be the beneficial owner of approximately 36.34% of our common shares. See Item 7. Major Shareholders and Related Party Transactions.

*Alexander N. Shokhin* has been Deputy Chairman of our Board of Directors since June 2016. He has been President of the Russian Union of Industrialists and Entrepreneurs since 2005. From 2005 to 2009, he was a member of the Public Chamber of the Russian Federation. From 2002 to 2005, he served as Chairman of the Supervisory Board of Renaissance Capital Investment Group. Since 1995, he has been President of the National Research University Higher School of Economics (HSE), Head of the Department of the Theory and Practice of Business – Government Interaction. From 1994 to 2002, Mr. Shokhin was a Deputy of the State Duma, as well as he held the posts of First Deputy Chairman of the State Duma, leader of the Duma faction Our Home is Russia and chairman of the State Duma's Credit Institutions and Financial Markets Committee. In 1991-1994 and in 1998, he was Deputy Chairman of the Government of the Russian Federation. In 1991-1994, he also held the positions of Minister of Labor, Minister of Economics, Chairman of the Russian Agency for International Cooperation and Development. Mr. Shokhin graduated from the Lomonosov Moscow State University. He is a D.Sc. in economics, professor.

*Oleg V. Korzhov* has been a member of our Board of Directors since June 2014. Mr. Korzhov has been our Chief Executive Officer and Chairman of our Management Board since January 2014. He was our Senior Vice President for Economics and Management from February 2012 to December 2013. He has been a member of our Management Board since March 2009. Mr. Korzhov was our Senior Vice President for Business Planning and Analysis from November 2011 to February 2012, and our Vice President for Business Planning and Analysis from April 2009 to October 2011. Mr. Korzhov has been a member of the Board of Directors of Mechel Mining since June 2011 and Chairman of the Board of Directors of Mechel Mining since June 2014. He was a member of the Board of Directors of Port Posiet from May 2008 to June 2014, Beloretsk Metallurgical Plant and Mecheltrans from 2010 to 2014, Southern Kuzbass Power Plant from 2009 to 2014, Kuzbass Power Sales Company from 2010 to 2014, Chelyabinsk Metallurgical Plant from 2009 to 2011 and from June 2014 to June 2015, as well as Vyartsilya Metal Products Plant from 2008 to 2010. From July 2008 to April 2009, he was Deputy Chief Executive Officer for Economics and Finance of Mechel-Steel Management. From September 2005 to January 2006, he served as Economic Planning Director of Mechel and from February 2006 to July 2008 he held the same position at Mechel-Steel Management. From 2003 to 2005, Mr. Korzhov was Director for Finance and Economics of EvrazHolding OOO. From 1998 to 2003, he was Deputy Director for Economic Analysis and Pricing and then Director for Economics of Nizhniy Tagil Iron and Steel Works OAO. Mr. Korzhov has a degree in economics and management in metallurgy from the Urals Polytechnic Institute and a degree in general management from the Academy of National Economy under the Government of the

Russian Federation. Mr. Korzhov also has a Ph.D. in economics.

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*Victor A. Trigubko* has been a member of our Board of Directors since June 2016. He has been our Senior Vice President – Government Relations since August 2006 and a member of our Management Board since February 2016. He was a member of our Board of Directors from June 2012 to March 2016. He served as our Vice President – Government Relations from 2005 to August 2006. From 2003 to 2005, he was our Vice President for Representation in Central and Eastern Europe, Chairman of the Board of Directors of Mechel Campia Turzii S.A. and a member of the Board of Directors of Mechel Targoviste S.A. From 2002 to 2003, Mr. Trigubko held the position of Director of Mechel International Holdings AG’s representative office in Romania. From 1997 to 2002, he was Head of Izhstal’s representative office in Moscow. From 1992 to 1997, he held various executive positions in the metallurgical company Unibros Steel Co. LTD, including Deputy General Director. Mr. Trigubko also worked in the Foreign Relations Department of the USSR State Committee for Labor and Social Issues and in the USSR Trade Representation Office in Romania. Mr. Trigubko has a degree in economics from the Kalinin State University.

*Tigran G. Khachaturov* has been a member of our Board of Directors since March 2016. Since September 2016, he has served as Head for restructured assets management at Gazprombank JSC. From February 2015 to October 2016, he was an Adviser to our Chief Executive Officer for Finance. From July to December 2014, he was an Adviser to Director of Atomenergoprom JSC. From June 2013 to July 2014, he served as First Executive Vice President, as well as Head of Moscow representative office of Uranium One Holding N.V. From August 2007 to May 2013, Mr. Khachaturov was First Deputy General Director and Acting General Director at Atomredmetzoloto OAO. From April 2002 to August 2007, he held various positions at Techsnabexport OJSC, including First Deputy General Director since July 2004. Mr. Khachaturov has a degree in finance and credit from the Plekhanov Russian Academy of Economics.

*Alexander N. Kotsky* has been a member of our Board of Directors since March 2016. From June 2015 to June 2016, he was a member of the Board of Directors of Port Vanino. From 2008 to 2015, he was a member of the Board of Directors of Southern Kuzbass Coal Company. Mr. Kotsky has a degree in railway engineering from the Novosibirsk Institute of Railway Engineers.

*Alexander D. Orishchin* has been a member of our Board of Directors since March 2016. He was a member of the Board of Directors of Mechel Mining from June 2010 to June 2014. Mr. Orishchin has a degree in mining from the Tomsk Polytechnic Institute. He also holds a Ph.D. in technical sciences from the Moscow Mining Institute.

*Yuriy N. Malyshev* has been a member of our Board of Directors since June 2013. Mr. Malyshev is currently President of the State Geological Museum of V.I. Vernadsky. He has been President of the Academy of Mining Sciences of Russia since 1993. He has been a member of the Board of Directors of Acron PJSC since May 2015. From 2010 to 2016, he served as Chairman of the Board of Directors of OShK Soyuzspetsstroy ZAO. From 1999 to 2013, he was President of the Nonprofit Partnership Russian Mining Operators. Mr. Malyshev has over 50 years of experience in various executive positions in the coal mining industry. He is a member of the Russian Academy of Sciences and has a D.Sc. in technical sciences. He has the honorary title of Honored Worker of Science and Technology of the Russian Federation. He is the recipient of several prizes and awards, including the order “For Merit to the Motherland” of the third grade, the Order of Honour and all three grades of the “Miner’s Glory” order. Mr. Malyshev has a degree in mining from the Kemerovo Mining Institute.

*Vladimir Yu. Korovkin* has been a member of our Board of Directors since June 2014. From June 2011 to June 2014, he served as Chairman of the Board of Directors of Mechel Mining. Since 1995, Mr. Korovkin has held various positions at Federal Stock Corporation OAO, including President from 1999 to 2004 and Chairman since 2004. From 1982 to 1995, he held various positions at the Institute of World Economy and International Relations of the Russian Academy of Sciences. Mr. Korovkin has a degree in economic geography of foreign countries and a Ph.D. in economics from the Lomonosov Moscow State University.





**Table of Contents***Executive Officers*

| <b>Name</b>         | <b>Year of Birth</b> | <b>Position</b>  |
|---------------------|----------------------|--|
| Oleg V. Korzhov     | 1970                 | Chief Executive Officer, Director, Chairman of Management Board                  |
| Victor A. Trigubko  | 1956                 | Senior Vice President Government Relations, Director, Member of Management Board |
| Valery A. Sheverdin | 1963                 | Vice President for Corporate Security, Member of Management Board                |
| Sergey V. Rezontov  | 1983                 | Chief Financial Officer, Member of Management Board                              |
| Minas A. Darbinyan  | 1983                 | Deputy Chief Executive Officer for Financial Control, Member of Management Board |
| Irina N. Ipeeva     | 1963                 | Director of Legal Department, Member of Management Board                         |
| Natalya O. Trubkina | 1964                 | Human Resources Director, Member of Management Board                             |
| Nelli R. Galeeva    | 1973                 | Director of Accounting and Tax Department, Member of Management Board            |
| Pavel V. Shtark     | 1969                 | Chief Executive Officer of Mechel Mining Management, Member of Management Board  |
| Andrey A. Ponomarev | 1977                 | Chief Executive Officer of Mechel-Steel Management, Member of Management Board   |
| Petr A. Pashnin     | 1977                 | Chief Executive Officer of Mechel Energo   |
| Alexey V. Lebedev   | 1974                 | Chief Executive Officer of Mecheltrans Management, Member of Management Board    |

For brief biographies of Messrs. Korzhov and Trigubko, see Board of Directors.

*Valery A. Sheverdin* has been our Vice President for Corporate Security since March 2014 and a member of our Management Board since August 2014. From June 2009 to March 2014, Mr. Sheverdin held the positions of our Director of the Department of Safety of Property Complex and Director of the Corporate Security Department. From April 2011 to March 2014, he was Chief Executive Officer of Mechel Garant OOO. From July 2007 to April 2011, he worked in PSC Mechel-Centre OOO, including as General Director from December 2007. From April 2003 to June 2007, Mr. Sheverdin held various positions in Lukom-A Agency ZAO. From February 2001 to March 2003, he was Chairman of the Belgorod regional office of the Russian Fund of Social Progress. From September 1995 to February 2001, he held various executive positions in security agencies. From November 1981 to August 1995, he served in the Armed Forces of the Russian Federation. Mr. Sheverdin graduated from the Moscow Border Institute of the Federal Security Service of the Russian Federation with a degree in law and the Kolomna Higher Artillery Command College of the October Revolution.

*Sergey V. Rezontov* has been our Chief Financial Officer since June 2016 and a member of our Management Board since July 2016. He has been a member of the Board of Directors of Southern Urals Nickel Plant since May 2015, a member of the Board of Directors of Beloretsk Metallurgical Plant since June 2015, Chairman of the Board of Directors of Urals Stampings Plant since March 2016 and a member of the Board of Directors of Mechel Mining since June 2016. From November 2014 to June 2016, Mr. Rezontov headed our Finance Department. From 2013 to 2014, he served as Chief Financial Officer and then Deputy General Director of Management Company Lysva Metallurgical Company OOO. In 2012, he was our Deputy Treasurer. From 2006 to 2012, he held various positions in our Corporate

Finance Department, including Head of the Department since February 2009. From October 2004 to August 2006, he was a manager of metal and mining industry division of the corporate clients department of Commerzbank (Eurasia) ZAO. Mr. Rezontov has a degree in management from the Plekhanov Russian Academy of Economics.

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*Minas A. Darbinyan* has been our Deputy Chief Executive Officer for Financial Control since June 2015 and a member of our Management Board since July 2015. He has been a member of the Board of Directors of Port Posiet since March 2016. From November 2013 to January 2015, he served as Director for Strategic Planning at Uranium One Holding N.V., part of state-owned corporation Rosatom. From April to November 2013, he headed Investment Planning and Development Department at Atomredmetzoloto OAO, also part of Rosatom. From May 2011 to April 2013, Mr. Darbinyan was senior consultant at KPMG ZAO. From 2008 to 2011, he held various positions at MIEL-DPM OOO, including Chief Financial Officer since 2010. From 2006 to 2008, he was an assistant to the Vice President-head of Moscow regional office in Moscow Industrial bank. Mr. Darbinyan has a degree in management from the Academy of National Economy under the Government of the Russian Federation and a degree in economics from the State Academic University for Humanities.

*Irina N. Ipeeva* has been Director of our Legal Department since April 2009 and a member of our Management Board since September 2007. She has been a member of the Board of Directors of Southern Kuzbass Coal Company since 2007 and a member of the Board of Directors of Mechel Mining since June 2014. From September 2007 to April 2009, she was our General Counsel, Deputy Director of the Legal Department Director of the Department of Corporate Governance and Property. From 2003 to 2007, Mrs. Ipeeva held the position of General Counsel and Director of the Department of Corporate Governance and Property. From February to July 2006, she was Director of the Department of Corporate Governance and Property of Mechel-Steel Management. From March to June 2003, Mrs. Ipeeva held the position of Deputy General Director for Property Matters of Uglemet-Trading OOO. From December 2001 to March 2003, she was Head of the Department for Regulation of Corporate Relations and Property of Southern Kuzbass Coal Company and, from January to November 2001, she was Head of the Share Capital Department. From August 1988 to January 2001, Mrs. Ipeeva worked at the Kuzbassugleobogashcheniye Industrial Amalgamation and the Tomusinskaya Washing Plant, where she held positions ranging from a legal adviser to head of the legal department. Mrs. Ipeeva has a degree in law from the Kuibyshev State University.

*Natalya O. Trubkina* has been our Human Resources Director since September 2015 and a member of our Management Board since February 2016. From August 2009 to August 2015, she held the position of Human Resources Director of Mechel-Steel Management. She has been a member of the Board of Directors of Chelyabinsk Metallurgical Plant since June 2015. She was a member of the Board of Directors of Urals Stampings Plant from June 2014 to June 2015. In 2009, she served as Human Resources Director in Souzmetallresource Management Company ZAO. From 2004 to 2009, Mrs. Trubkina worked in United Company RUSAL, including as Head of the Human Resources Department of secondary alloys business since 2006. From 2003 to 2004, she was HR manager in Texas Nafta Industries Inc. From 1994 to 2002, she was HR manager in Belpromstroybank OAO. Mrs. Trubkina has a degree in heat and gas supply and ventilation from the Novopolotsk Polytechnic Institute, as well as a diploma of further education in personnel management psychology from the Lomonosov Moscow State University.

*Nelli R. Galeeva* has been Director of our Accounting and Tax Department since March 2014 and a member of our Management Board since July 2016. She served as Chief Accountant of Mechel Mining Management from April 2009 to March 2014 and Chief Accountant of Mechel Mining from May 2008 to April 2009. From August 2005 to May 2008, she was Chief Accountant of Southern Kuzbass Coal Company. From March 2000 to August 2005, Mrs. Galeeva worked at Southern Kuzbass Coal Company, first as chief of consolidated and international reporting department and then as deputy chief accountant, chief of consolidated reporting department. From June 1995 to February 2000, she was an accountant of finance department and then a deputy chief production accountant at Krasnogorsky Open Pit OAO. Mrs. Galeeva has a degree in accounting and audit from the Kuzbass State Technical University and a degree in finance and credit from the Kemerovo State University.

*Pavel V. Shtark* has been Chief Executive Officer of Mechel Mining Management since July 2013 and a member of our Management Board since August 2014. He has been a member of the Board of Directors of Moscow Coke and

Gas Plant since June 2013, a member of the Board of Directors of Elgaugol since August 2013 and a member of the Board of Directors of Mechel Mining, Korshunov Mining Plant and Yakutugol since

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June 2014. He was a member of the Board of Directors of Southern Kuzbass Coal Company from June 2014 to March 2016. He was a member of the Management Board of Mechel Mining from July 2013 to April 2014. From October 2012 to July 2013, he held the position of Deputy General Director for Coke and Chemical Products Production Managing Director of Moscow Coke and Gas Plant. From April 2008 to October 2012, Mr. Shtark served as Deputy Director, Director and Managing Director of Mechel Coke. From October 1996 to March 2008, he was Head of the Workshop, Chief Engineer of Coke and Chemical Products Production at Nizhniy Tagil Iron and Steel Works OAO. Mr. Shtark has a degree in equipment and technology of welding production from the Urals State Technical University and a degree in chemical technology of natural energy carriers and carbon materials from the same university.

*Andrey A. Ponomarev* has been Chief Executive Officer of Mechel-Steel Management since December 2015 and a member of our Management Board since February 2016. From August 2012 to November 2015, he served as First Deputy Chief Executive Officer of Mechel-Steel Management. He has been a member of the Board of Directors of Chelyabinsk Metallurgical Plant since 2013. He was a member of the Board of Directors of Vyartsilya Metal Products Plant and Beloretsk Metallurgical Plant from 2013 to 2014, Urals Stampings Plant from 2013 to 2015 and Izhstal from 2014 to 2015. From August 2009 to August 2013, he headed Mechel Service Global. From May 2005 to August 2009, Mr. Ponomarev was Managing Director of Mechel Service. From 2002 to 2005, he held various positions at Uglemet Trading OOO and Mechel Trading House OOO, including Head of Regional Sales Department. From 2000 to 2002, he served as chief of the analysis bureau in Chelyabinsk Metallurgical Plant's marketing and sales service. From 1999 to 2000, he was an engineer in the special steels sales department of Chelyabinsk Metallurgical Plant's marketing and sales service. Mr. Ponomarev has a degree in pressure metal treatment and a degree in finance from the Southern Urals State University.

*Petr A. Pashnin* has been Chief Executive Officer of Mechel Energo since November 2013. He has been a member of the Board of Directors of Kuzbass Power Sales Company since May 2014 and a member of the Board of Directors of Southern Kuzbass Power Plant since June 2015. He was a member of the Board of Directors of Tomusinsk Energo Management from June 2014 to June 2015. From July to November 2013, he held the position of Technical Director of Mechel Energo. From March 2012 to June 2013, he was Chief Operating Officer of Toplofikatsia Rouse. From September 2011 to February 2012, he served as Head of Energy Efficiency and Energy Audit Department of Mechel Energo. From February 2008 to September 2011, he held various positions at the Chelyabinsk branch of Mechel Energo. From July 1999 to January 2008, he worked at Chelyabinsk Metallurgical Plant, where he held positions ranging from steam turbine operator to heat and power station chief engineer. Mr. Pashnin has a degree in industrial heat power engineering from the Southern Urals State University.

*Alexey V. Lebedev* has been Chief Executive Officer of Mecheltrans Management since December 2013 and a member of our Management Board since August 2014. He has been a member of the Board of Directors of Port Kambarka and Port Vanino since June 2014. He was a member of the Board of Directors of Port Posiet from June 2014 to March 2016 and a member of the Board of Directors of Mecheltrans from April 2014 to August 2016. He served as Chief Executive Officer of Mecheltrans Auto from February 2011 to December 2013 and Director of Motor Transportation Department of Mecheltrans from June 2010 to January 2011. From 2005 to 2010, Mr. Lebedev was Director of Uraltechstroy NN OOO. From 2004 to 2005, he held the position of Deputy General Director of Region Express TK OOO. From 1998 to 2003, he held various positions at UralPromSnab OOO. From 1993 to 1998, he was Head of Railway Transportation Department of Transfero EAFC OOO. Mr. Lebedev has a degree in industrial management from the Izhevsk State Technical University.

***Compensation***

Our directors and executive officers were paid an aggregate of approximately 542.5 million rubles for services in all capacities provided to us during 2016. Our directors and executive officers are also provided with voluntary medical insurance and the use of wireless services.

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### **Board of Directors**

Members of our Board of Directors are elected by a majority of the voting stock present at our annual general shareholders meeting using a cumulative voting system. Directors are elected to serve until the next annual general shareholders meeting and may be re-elected an unlimited number of times. Our Board of Directors currently consists of nine members, five of whom are independent pursuant to the director independence criteria set forth both in the applicable Russian regulations and NYSE regulations, as well as in the Charter and the Bylaw on the Board of Directors of Mechel PAO. The Board of Directors is responsible for our overall management, except matters reserved for our shareholders. See Item 10. Additional Information General Meetings of Shareholders for more information regarding the competence of our general shareholders meetings. Members of the Board of Directors do not have service contracts with us or with any of our subsidiaries that provide them benefits upon termination of their service.

### **Committees of the Board of Directors**

#### ***Audit Committee***

The Audit Committee consists of Vladimir Korovkin, Alexander Orishchin and Alexander Kotsky, each of whom is an Independent Director. Our Audit Committee operates pursuant to a bylaw, which is available at [www.mechel.com](http://www.mechel.com). The purpose of this Committee is to assist the Board of Directors with its oversight responsibilities regarding:

the quality and integrity of our financial statements;

our compliance with legal and regulatory requirements;

the independent auditor's qualifications and independence; and

the performance of our internal audit function and independent auditor.

#### ***Committee on Investments and Strategic Planning***

The members of the Committee on Investments and Strategic Planning are Yuriy Malyshev, Alexander Orishchin, Alexander Kotsky, Tigran Khachaturov and Oleg Korzhov. The Committee on Investments and Strategic Planning defines our strategic goals and defines our priorities. The Committee makes recommendations to the Board of Directors on our dividend policy and on the adjustments to our strategy as required in order to enhance our efficiency. Our Committee on Investments and Strategic Planning operates pursuant to a bylaw, which is available at [www.mechel.com](http://www.mechel.com).

The following sub-committees function under the Committee on Investments and Strategic Planning:

Sub-committee on metallurgical production strategy, with members Alexander Orishchin and Oleg Korzhov;  
and



Sub-committee on mining production strategy, with members Yuriy Malyshev and Alexander Kotsky.

***Committee on Appointments and Remuneration***

The members of the Committee on Appointments and Remuneration are Alexander Orishchin, Vladimir Korovkin and Yuriy Malyshev, each of whom is an Independent Director. The Committee on Appointments and Remuneration has been established to maintain continuity and high professional standards, as well as to work out a competitive remuneration system, within our group. The Committee prepares recommendations to the Board of Directors on candidates for appointment to the Management Board or as our Chief Executive Officer or other executive officers or senior officers of our subsidiaries. It also prepares appraisals of their performance and makes recommendations regarding their remuneration. The Committee also defines the requirements applicable to nominees to the Board of Directors and informs the shareholders of such nominees. The Committee operates pursuant to a bylaw, which is available at [www.mechel.com](http://www.mechel.com).

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### **Management Board**

In September 2007, we created a Management Board to provide for greater oversight of our operations. Currently, our Management Board consists of eleven members. For more information, see Item 10. Additional Information Management Board. The members of the Management Board are set out above under Directors and Executive Officers.

### **Management Companies**

We have four management companies within our group which provide management services to the companies within the mining, steel and power segments and to our companies within our transport division.

#### ***Mechel Mining Management***

Mechel Mining Management was established in July 2008 as a wholly-owned subsidiary of Mechel Mining with the purpose to provide management services to the production subsidiaries within our mining segment. Mechel Mining Management presently performs the functions of the sole executive body of the following companies: Southern Kuzbass Coal Company, Korshunov Mining Plant, Yakutugol, Moscow Coke and Gas Plant, Mechel Coke, Mechel Engineering, Elgaugol, Elga-road and Vzryvprom.

#### ***Mechel-Steel Management***

Mechel-Steel Management was established in October 2005 as a wholly-owned subsidiary of Mechel with the initial purpose to provide management services to our subsidiaries by performing the functions of their respective management bodies. The company's former name was Mechel Management OOO which was changed in September 2009 in line with the reorganization of our group's management structure. Mechel-Steel Management presently provides management services to our subsidiaries within the steel segment by performing the functions of the sole executive body of Chelyabinsk Metallurgical Plant, Urals Stampings Plant, Izhstal and Bratsk Ferroalloy Plant.

#### ***Mechel Energo***

Mechel Energo was established in May 2001 under the name of Regional Energy Company ENERGOSBYT OOO. In February 2004, we acquired the company with a view to make the strategic and operational management of our power assets more efficient. The name of the company was changed to its current name in April 2004. Mechel Energo performs the functions of the sole executive body of Southern Kuzbass Power Plant in our power segment.

#### ***Mecheltrans Management***

Mecheltrans Management was established in March 2010 as a wholly-owned subsidiary of Mechel. Mecheltrans Management presently provides management services to the companies within our transport division by performing the functions of the sole executive body of Mecheltrans, MecheltransVostok, Port Posiet, Port Kambarka and Port Temryuk.

### **Review Commission**

The Review Commission verifies the accuracy of our financial reporting under Russian law and generally supervises our financial activity. The members of our Review Commission are nominated and elected by our shareholders to

serve until the next annual general shareholders meeting. Our Chief Executive Officer, a member of our Board of Directors and a member of our Management Board may not simultaneously be a member of the Review Commission. Our Review Commission currently has three members: Alexander N. Kapralov, Irina V. Bolkhovskikh and Natalya S. Zykova. The powers and duties of our Review Commission are governed by a bylaw approved by our general shareholders meeting.

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### **Internal Audit Department**

The Internal Audit Department's main function is to systematically, consistently and independently from our management assess and improve the efficiency of our group's risk management, internal control, corporate governance and information systems. The activities of the Internal Audit Department are governed by the Bylaw on the Internal Audit Department. Natalya S. Zykova serves as the Director of the Internal Audit Department. The Department is functionally subordinated to the Audit Committee of the Board of Directors, and administrated by our Chief Executive Officer.

### **Corporate Governance Principles**

Our corporate governance principles are based on the Russian Corporate Governance Code recommended by the CBR and supplemented by the obligations of the Board of Directors prescribed by Russian law, our charter and internal rules of procedure. The principles are intended to ensure that we are managed and monitored in a responsible and value-driven manner. They include the protection of shareholders' rights, comprehensive disclosure and transparency requirements and rules governing conflicts of interest. We are committed to continuing to adapt our corporate governance principles to developments in best-practices. Our corporate governance principles are reflected in our corporate documents, such as:

the Charter;

the Bylaw on the Board of Directors;

the Bylaw on the General Meeting of Shareholders;

the Bylaw on the General Director;

the Bylaw on the Collegial Executive Body (Management Board);

the Bylaw on the Review Commission;

the Bylaw on the Internal Audit Department;

the Code of Business Conduct and Ethics;

the Bylaw on the Prohibition and Prevention of Insider Trading;

the Bylaw on the Disclosure of Information that may Significantly Impact the Market Value of our Shares;

the Bylaw on Information Policy;

the Bylaw on Appointments and Remuneration Committee of the Board of Directors;

the Bylaw on Investments and Strategic Planning Committee of the Board of Directors;

the Bylaw on the Audit Committee of the Board of Directors;

the Code of Corporate Governance; and

the Bylaw on Dividend Policy.

These documents or summary thereof are available at [www.mechel.com](http://www.mechel.com) and [www.mechel.ru](http://www.mechel.ru).

We also comply with the corporate governance requirements applicable to Russian public companies listed on Russian stock exchanges. Such requirements include: (1) the obligation to have at least three independent directors, who shall represent at least one-fifth of the members of the board of directors; (2) the establishment of an audit committee chaired by an independent director and a committee on appointments and remuneration consisting of independent directors, or, if not practicable, of independent directors and members of the board of directors who are not a sole executive body and/or members of the collegial executive body; (3) the

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establishment of a corporate body responsible for the internal audit (control) and adoption of an internal audit (control) policy; (4) the existence of the corporate secretary or special structural unit(s) performing the functions of the corporate secretary; and (5) the adoption of a dividend policy.

We also comply with applicable corporate governance requirements of the NYSE. The NYSE permits listed companies that are foreign private issuers, such as Mechel, to follow their home jurisdiction governance practice where it differs from the NYSE requirements. In addition, we have voluntarily complied with certain other requirements applicable to U.S. companies under the NYSE Listing Standard 303A. For a summary description of the NYSE Listing Standard 303A showing our compliance therewith and/or the alternative corporate governance practices followed by us see Item 16G. Corporate Governance.

**Employees**

As of December 31, 2016, 2015 and 2014, we employed 61,455, 65,888 and 67,880 people as follows:

| Segment      | 2016            |             | 2015            |             | 2014            |             |
|--------------|-----------------|-------------|-----------------|-------------|-----------------|-------------|
|              | Total Employees | % Unionized | Total Employees | % Unionized | Total Employees | % Unionized |
| Mining       | 22,452          | 65%         | 24,322          | 66%         | 24,969          | 68%         |
| Steel        | 34,070          | 58%         | 36,430          | 61%         | 37,769          | 60%         |
| Power        | 4,288           | 38%         | 4,447           | 34%         | 4,436           | 36%         |
| Other        | 645             | 8%          | 689             | 8%          | 706             | 16%         |
| <b>Total</b> | <b>61,455</b>   | <b>59%</b>  | <b>65,888</b>   | <b>61%</b>  | <b>67,880</b>   | <b>61%</b>  |

Set out below is information about membership of our employees in trade unions:

Employees of Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant, Southern Urals Nickel Plant, Korshunov Mining Plant, Moscow Coke and Gas Plant, Mechel Coke, Izhstal, Bratsk Ferroalloy Plant, Mechel Materials and Pugachevsky Open Pit are members of the Ore Mining and Smelting Trade Union of Russia.

Employees of Urals Stampings Plant are members of the Trade Union of Machinists of the Russian Federation, employees of Chelyabinsk branch of Urals Stampings Plant are members of the Ore Mining and Smelting Trade Union of Russia.

Employees of Southern Kuzbass Coal Company and its subsidiaries Tomusinsky Open Pit, Vzryvprom and Shakhtspetsstroy are members of the Russian Independent Trade Union of Coal Industry Workers and of the Independent Trade Union of Miners of Russia.

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Employees of Yakutugol, Neryungry Car Fleet and Mechel-Remservice are members of the Russian Independent Trade Union of Coal Industry Workers.

Employees of Mechel Energo are members of the Ore Mining and Smelting Trade Union of Russia.

Employees of Port Posiet are members of the Russian Stevedores Trade Union.

Employees of Mecheltrans separate business unit in the city of Myski are members of the Russian Independent Trade Union of Coal Industry Workers.

Employees of Southern Kuzbass Power Plant are members of the All-Russian Power Industry Trade Union and of the Russian Independent Trade Union of Coal Industry Workers.

Employees of Kuzbass Power Sales Company are members of the All-Russian Power Industry Trade Union.

Employees of Mechel Nemunas are members of the Trade Union Nemunas.

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We consider our relationships with our employees to be good.

**Item 7. Major Shareholders and Related Party Transactions**

The following table sets forth information regarding our major shareholders, which means shareholders that are the beneficial owners of 5% or more of our common shares, as of March 31, 2017, based on the information available to us:

| Name of Beneficial Owner         | Number of<br>Common<br>Shares | % of<br>Common<br>Shares |
|----------------------------------|-------------------------------|--------------------------|
| Igor V. Zyuzin <sup>(1)</sup>    | 151,273,468                   | 36.34%                   |
| Irina V. Zyuzina <sup>(2)</sup>  | 77,826,997                    | 18.70%                   |
| Ksenia I. Zyuzina <sup>(2)</sup> | 77,826,997                    | 18.70%                   |
| Kirill I. Zyuzin <sup>(2)</sup>  | 77,826,997                    | 18.70%                   |
| Other <sup>(3)(4)</sup>          | 187,170,280                   | 44.96%                   |

- (1) Mr. Zyuzin is the Chairman of our Board of Directors. See Item 6. Directors, Senior Management and Employees Directors and Executive Officers. Mr. Zyuzin may be deemed to be the beneficial owner of approximately 36.34% of our common shares through (i) his record ownership of 21.54% of our common shares; and (ii) his ownership of 100% of the equity interest in Calridge Limited ( **Calridge** ). Calridge is the owner of 14.80% of our common shares. Further information regarding the shareholdings of Mr. Zyuzin is available in the Schedule 13D filed by him with the SEC.
- (2) In the course of 2016, MetHol OOO ( **MetHol** ), which is owned by Mrs. Irina V. Zyuzina, Ms. Ksenia I. Zyuzina and Mr. Kirill I. Zyuzin (the **Zyuzin Family Members** ), acquired 77,826,997 of our common shares from Calridge. As a result, MetHol is now the owner of 18.70% of our common shares. As a result, each of the Zyuzin Family Members may be deemed to share beneficial ownership of the 18.70% shareholding held of record by MetHol. Further information regarding the shareholdings of the Zyuzin Family Members is available in the Schedule 13D that each Zyuzin Family Member has filed with the SEC.
- (3) According to Deutsche Bank Trust Company Americas, as of March 31, 2017, 41,133,311 common ADSs and 26,750,001 GDSs were outstanding, representing 32.61% of our total issued common shares.
- (4) We believe our directors and executive officers as a group, other than Mr. Zyuzin and Zyuzin Family Members, beneficially own less than 1% of our shares.

None of our common shareholders have voting rights which differ from any other holders of our common shares. Based on our share register, we believe we are not directly or indirectly owned or controlled by another corporation or government, and that there are no arrangements the operation of which may result in a change of control.

**Related Party Transactions**

See note 13 to the consolidated financial statements.

**Item 8. Financial Information**

See Item 18. Financial Statements.



**Litigation**

Other than the legal proceedings described below, we are not involved in any legal proceedings that we believe to be material.

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On January 16, 2012, Mechel Trading House received an assessment from the tax authorities for profit tax, interest and incurred penalties in a total amount of 5.9 billion rubles for the 2008-2009 period. We contested this assessment through the administrative procedure with the higher-level tax authorities which reduced the assessment to 5.5 billion rubles. On June 5, 2012, Mechel Trading House filed a claim with the Moscow Arbitrazh Court to contest the amount of 5.5 billion rubles. On January 9, 2014, the Moscow Arbitrazh Court sustained the Mechel Trading House claims in part of 1.6 billion rubles, including penalties and fines, and the remaining claims were denied. Mechel Trading House did not appeal the decision. On June 19, 2014, the Moscow Arbitrazh Court sustained the application of Mechel Trading House, requesting leave to repay the remaining 3.9 billion ruble assessment on an installment basis by May 2016. On March 15, 2016, Mechel Trading House reapplied with the court for installment payment. On March 31, 2016, the Moscow Arbitrazh Court extended the installment payment until May 2017. On December 14, 2016, Mechel Trading House and the tax authority entered into a settlement agreement under which the payment of the debt is extended until April 25, 2018.

We believe that we have paid or accrued all taxes that are applicable. Where uncertainty exists, we have accrued tax liabilities based on management's best estimate of the probable outflow of resources embodying economic benefits, which will be required to settle these liabilities. We accrued RUB 760 million, RUB 480 million and RUB 620 million of tax claims other than income tax that management believes are probable as of December 31, 2016, 2015 and 2014, respectively. In addition, income tax claims that management believes are probable were accrued. See note 20 to the consolidated financial statements.

***Environmental and safety***

Pursuant to a claim of the Novokuznetsk Environmental Prosecutor's Office against Southern Kuzbass Power Plant concerning the discharge of pollutants into the atmosphere above the maximum allowable level, the court ruled in September 2008 that we must limit the discharge of pollutants into the atmosphere to comply with the maximum allowable level. We have complied with the ruling effective as of November 2009. The court also mandated us to reconstruct the de-dusting system. Since then, we have applied several times for stay of execution, the last time being in April 2016, and the court allowed us to stay execution of this mandate until June 1, 2017. We are continuing with the reconstruction and replacement of the dust and gas scrubber equipment. During 2013-2016, we completed the reconstruction of five of the boilers and have commenced the reconstruction of another boiler.

On June 11, 2013, the Department of Rosprirodnadzor for the Republic of Bashkortostan filed a lawsuit against Beloretsk Metallurgical Plant with the Arbitrazh Court of the Republic of Bashkortostan seeking the recovery of damages caused to water resources as a result of non-compliance with water legislation in the amount of 408.2 million rubles. During the court hearings claims under the lawsuit were reduced to 398.6 million rubles. On October 3, 2013, the Arbitrazh Court of the Republic of Bashkortostan rendered a decision to collect from Beloretsk Metallurgical Plant the amount of damages in the amount of 398.6 million rubles. We contested this decision with the Eighteenth Arbitrazh Court of Appeal. On January 28, 2014, the court upheld the decision of the lower court. On February 7, 2014, Beloretsk Metallurgical Plant filed a cassation appeal with the Federal Arbitrazh Court of Ural District. At the court hearing held on April 14, 2014 Beloretsk Metallurgical Plant withdrew its cassation appeal. On May 27, 2014, the Arbitrazh Court of the Republic of Bashkortostan approved a settlement agreement between Rosprirodnadzor for the Republic of Bashkortostan and Beloretsk Metallurgical Plant. In accordance with the settlement agreement, Beloretsk Metallurgical Plant was obliged to develop project documentation for the technical upgrading and/or reconstruction (construction) of waste treatment facilities system in order to bring the quality of discharged waste water into compliance with applicable regulatory requirements. The reconstruction of waste treatment facilities system was to be completed by December 31, 2016. In November 2016, Beloretsk Metallurgical Plant applied for a stay of

execution and the court ruled to complete the reconstruction by December 31, 2023.

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In February 2016, the Bratsk Environmental Prosecutor's Office filed a claim with the Bratsk City Court of Irkutsk region against Bratsk Ferroalloy Plant seeking to ban (suspend) operation of one ore-thermal furnace until the complete replacement of the filter elements of its gas-cleaning unit and to oblige Bratsk Ferroalloy Plant to carry out the replacement of the filter elements by June 1, 2016. The court sustained the claims of the Bratsk Environmental Prosecutor's Office regarding the replacement of the filter elements by June 1, 2016 and dismissed the rest of claims. In May 2016, we completed the replacement of the filter elements.

***Commercial litigation***

During the period from February 2014 to April 2015, Novatek Chelyabinsk OOO filed 18 claims against Chelyabinsk Metallurgical Plant with the Arbitrazh Court of Chelyabinsk region seeking recovery of debt for gas supplied from December 2013 to March 2015 in an aggregate amount of approximately 8.0 billion rubles and penalty for delay in payment in an aggregate amount of approximately 145.0 million rubles. During the court hearings the amounts of claims were reduced to approximately 7.1 billion rubles of principal and approximately 160.0 million rubles of penalties. From April 2014 to October 2015, the Arbitrazh Court of Chelyabinsk region sustained the plaintiff's claims under 18 cases. We appealed 16 cases. From July 2014 to October 2015, the Eighteenth Arbitrazh Court of Appeal dismissed our claims with respect to all these cases. Chelyabinsk Metallurgical Plant repaid debt in the amount of 7.1 billion rubles as principal and 45.5 million rubles as penalty.

In November 2014, Minmetals initiated proceedings at the Arbitration Institute of the Stockholm Chamber of Commerce against Chelyabinsk Metallurgical Plant to recover alleged amounts due under the construction contract, whereas Chelyabinsk Metallurgical Plant filed its own counter-claims, which include a penalty for delay and recovery of damages for failing to perform works and rectifying works of poor quality. In 2015-2017, both parties submitted a number of procedural statements to the arbitral tribunal providing for the adjustment of claims and at present the claims of Minmetals amount to approximately \$143.0 million (plus applicable interest) and those by Chelyabinsk Metallurgical Plant to approximately \$57.5 million and 4.1 million (plus applicable interest). During the arbitral proceedings three arbitrators resigned from their duty and in November 2016 new arbitral tribunal has been formed. The arbitral hearings are scheduled for May 15-26, 2017 and the final award is expected by September 29, 2017.

From May 2015 to April 2016, Novatek Chelyabinsk OOO filed 20 claims against Chelyabinsk Metallurgical Plant with the Arbitrazh Court of Chelyabinsk region seeking recovery of debt for gas supplied from April 2015 to March 2016 in an aggregate amount of approximately 6.3 billion rubles and penalty for delay in payment in an aggregate amount of approximately 229.4 million rubles. During the period from July 2015 to July 2016, the Arbitrazh Court of Chelyabinsk region sustained the plaintiff's claims under 20 cases. We appealed all these cases. The Eighteenth Arbitrazh Court of Appeal dismissed our claims in full. Chelyabinsk Metallurgical Plant repaid debt in the amount of approximately 6.3 billion rubles as principal.

In December 2015, ERG SALES AG filed a claim against Chelyabinsk Metallurgical Plant with the LCIA seeking recovery of debt under iron ore feed supply contract in the amount of \$10.7 million and penalty for delay in payment in the amount of \$513.4 thousand. In June 2016, the LCIA approved a settlement agreement according to which Chelyabinsk Metallurgical Plant is obliged to repay \$12.3 million in monthly installments until June 25, 2017. As of March 31, 2017, Chelyabinsk Metallurgical Plant repaid \$9.0 million.

From May 2016 to February 2017, Novatek Chelyabinsk OOO filed 10 claims against Chelyabinsk Metallurgical Plant with the Arbitrazh Court of Chelyabinsk region seeking recovery of debt for gas supplied from April to December 2016 in an aggregate amount of approximately 4.5 billion rubles and penalty for delay in payment for gas supplied from August to December 2015 in an aggregate amount of approximately 99.0 million rubles. During the period from August 2016 to March 2017, the Arbitrazh Court of Chelyabinsk region sustained the plaintiff's claims

under six cases. We appealed four cases. From November 2016 to February 2017, the Eighteenth Arbitrazh Court of Appeal dismissed our claims under three cases. Chelyabinsk Metallurgical Plant repaid debt in the amount of approximately 4.1 billion rubles as principal.

**Table of Contents*****Debt litigation***

Litigations with VTB Bank PJSC and Sberbank of Russia were discontinued by means of the restructuring of the debt, termination of proceedings and signing of settlement agreements and there were no new claims from these banks in 2016.

***Banks***

On January 7, 2015, Mechel Carbon received two notices of Betreibungsamt of Baar where it was informed about the proceedings against Mechel Carbon based on the claims of VTB Bank: (i) CHF 194.0 million and CHF 6.2 million resulting from a guarantee issued by Mechel Carbon in favor of VTB Bank as to the payment obligations of Southern Kuzbass Coal Company under the credit facility agreement, and (ii) CHF 112.8 million and CHF 3.6 million resulting from a guarantee issued by Mechel Carbon in favor of VTB Bank as to the payment obligations of Yakutugol under the credit facility agreement. On January 8, 2015, Mechel Carbon rejected the proceedings by submission of two Rechtsvorschlag (i.e., a motion exercising the right to refuse the procedure for compulsory execution). The proceedings were stopped. On February 16, 2015, Mechel Carbon received two claims of VTB Bank dated February 10, 2015 and court orders of canton Zug dated February 13, 2015 with respect to the following amounts: (i) CHF 184.7 million and CHF 6.2 million resulting from a guarantee issued by Mechel Carbon in favor of VTB Bank as to the payment obligations of Southern Kuzbass Coal Company under the credit facility agreement, and (ii) CHF 107.4 million and CHF 3.6 million resulting from a guarantee issued by Mechel Carbon in favor of VTB Bank as to the payment obligations of Yakutugol under the credit facility agreement. In court of canton Zug, VTB Bank is challenging Mechel Carbon's refusal to participate in the enforcement proceedings. The Cantonal Court of Zug asked Mechel Carbon to submit a statement of defense within seven days. Mechel Carbon has applied for the extension. The Cantonal Court of Zug has granted the extension until April 17, 2015. Statement of defense of Mechel Carbon has been filed. The hearings were suspended until April 1, 2017 based on the parties mutual request. On April 4, 2017, VTB Bank issued its motion to terminate the proceedings.

On January 7, 2015, Mechel Trading received the notice of Betreibungsamt of Baar where it was informed about the proceedings against Mechel Trading based on the claim of VTB Bank in the amount of CHF 51.6 million and CHF 1.3 million resulting from the guarantee issued by Mechel Trading in favor of VTB Bank under the payment obligations of Mechel. On January 8, 2015, Mechel Trading rejected the proceedings by submission of Rechtsvorschlag. The proceedings were stopped. On January 14, 2015, Mechel Trading received the notice of Betreibungsamt of Baar about the proceedings against Mechel Trading based on the claim of VTB Bank in the amount of CHF 694.9 million and CHF 50.1 million (interest) and CHF 2.3 million (penalty for the payment default) resulting from the guarantee issued by Mechel Trading in favor of VTB Bank under the payment obligations of Mechel. On January 19, 2015, Mechel Trading rejected the proceedings by submission of Rechtsvorschlag. The proceedings were stopped. On February 16, 2015, Mechel Trading received one claim of VTB Bank dated February 10, 2015 and court order of canton Zug dated February 13, 2015, with respect to the amount of CHF 747.3 million. In court of canton Zug, VTB Bank is challenging Mechel Trading's refusal to participate in the enforcement proceedings. The Cantonal Court of Zug asked Mechel Trading to submit a statement of defense within seven days. Mechel Trading has applied for the extension. The Cantonal Court of Zug has granted the extension until April 17, 2015. Statement of defense of Mechel Trading has been filed. The hearings were suspended until April 1, 2017 based on the parties mutual request. On April 4, 2017, VTB Bank issued its motion to terminate the proceedings.

On March 2, 2015, we received notice from the LCIA that VTB Bank has filed a request for arbitration against Mechel, claiming \$101.9 million (plus interest, expenses and any other amounts awarded by the arbitral tribunal) pursuant to a guarantee under which Mechel has allegedly guaranteed the performance of obligations of Skyblock Limited under a 2012 ISDA Master Agreement currency derivative transaction between Skyblock Limited and VTB

Bank (Austria) AG (the **2012 ISDA Master Agreement** ). On March 4, 2015, VTB Bank delivered its demand for immediate payment of the \$101.9 million amount, threatening to petition for the

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winding-up of Skyblock Limited in case Skyblock Limited fails to pay this outstanding amount. On March 27, 2015, Mechel sent to the LCIA its response to the request for arbitration, rejecting VTB Bank's claim, including, inter alia, the validity of early termination of the 2012 ISDA Master Agreement. On March 31, 2015, notice was served on Mechel Service Global concerning the seizure of shares of the company in favor of VTB Bank. Such shares were seized according to the judgment of the court in the Hague dated March 30, 2015 as an interim measure in support of the LCIA arbitration claim by VTB Bank against Mechel. On April 10, 2015, VTB Bank submitted a request for arbitration against Skyblock Limited under the 2012 ISDA Master Agreement. Due to the restructuring negotiations initially the parties have agreed on the moratorium for any arbitration proceedings until July 1, 2015, since then this moratorium has been extended until April 1, 2017. In October 2015, the payment obligations of Skyblock Limited under the 2012 ISDA Master Agreement have been repaid. In April 2017, VTB Bank withdrew its claims and the LCIA terminated the arbitrations; Mechel Service Global's shares were released from seizure.

On March 16, 2015, we received notice from the LCIA that VTB Bank and VTB Capital Plc have filed 14 requests for arbitration against our group companies. The 14 requests claim amounts allegedly due, including during the arbitration, plus expenses and any other amounts awarded by the arbitral tribunal, pursuant to two syndicated credit agreements (one involving Yakutugol and the other involving Southern Kuzbass Coal Company) and 12 deeds of guarantee with respect to those syndicated credit agreements. Under these deeds of guarantee, the guarantors (Mechel, Mechel Mining, Mechel Carbon, Mechel Carbon Singapore, Korshunov Mining Plant, Yakutugol and Southern Kuzbass Coal Company) each guaranteed the obligations of the borrowers (Yakutugol and Southern Kuzbass Coal Company) under each of the syndicated credit agreements. As of the date of the filing of the requests for arbitration, the claim against Yakutugol as the borrower and the claims against each of the Yakutugol guarantors amount to \$16.2 million, and the claim against Southern Kuzbass Coal Company as the borrower and the claims against each of the Southern Kuzbass Coal Company guarantors amount to \$16.3 million. On March 17-18, 2015, we received notice from the LCIA concerning the initiation of the 14 arbitration cases described above. On April 13, 2015, the relevant Mechel group companies filed preliminary response letters in respect of the 14 arbitration cases described above. On April 24, 2015, in support of the 14 aforementioned LCIA arbitration proceedings, VTB Bank and VTB Capital Plc filed an arbitration claim with the High Court of Justice Queen's Bench Division Commercial Court in England seeking injunctive relief to secure their arbitration claims. The first hearing regarding injunctions took place on April 29, 2015, following the hearing and considering parties position the court postponed the hearing until May 18, 2015, however, later due to the restructuring negotiations the parties agreed on the moratorium for injunction hearing until July 1, 2015, afterwards the moratorium for hearing and arbitration proceedings has been extended until June 1, 2017.

In February 2017, a number of lenders filed 14 requests for arbitration with the LCIA. The 14 requests claim amounts allegedly due, including during the arbitration, plus expenses and any other amounts awarded by the arbitral tribunal, pursuant to two syndicated credit agreements (one involving Yakutugol and the other involving Southern Kuzbass Coal Company) and 12 deeds of guarantee with respect to those syndicated credit agreements. Under these deeds of guarantee, the guarantors (Mechel, Mechel Mining, Mechel Carbon, Mechel Carbon Singapore, Korshunov Mining Plant, Yakutugol and Southern Kuzbass Coal Company) each guaranteed the obligations of the borrowers (Yakutugol and Southern Kuzbass Coal Company) under each of the syndicated credit agreements. As of the date of the filing of the requests for arbitration, the claim against Yakutugol as the borrower and the claims against each of the Yakutugol guarantors amount to \$230.1 million plus default interest and costs, and the claim against Southern Kuzbass Coal Company as the borrower and the claims against each of the Southern Kuzbass Coal Company guarantors amount to \$231.0 million plus default interest and costs. These recent claims trigger an event of default and cross-default under various loan agreements and our lenders may claim for accelerated repayments. We have requested our major Russian lenders to waive cross-default provisions in this respect, however we have no clarity when and whether such waivers will be granted. See also Item 3. Key Information Risk Factors Risks Relating to Our Financial Condition and Financial Reporting If we are unable to restructure all of our indebtedness or fail to comply with the new terms of the



restructured indebtedness, our lenders may claim for accelerated repayment, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects.

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**Table of Contents***Leasing*

In September-October 2014, Sberbank Leasing AO filed 14 lawsuits against Mechel and our subsidiaries with the arbitrazh courts of first instance in five regions of the Russian Federation seeking recovery of lease payments and penalties under equipment finance leases totaling approximately 952.3 million rubles and \$3.0 million. From November 2014 to May 2015, the arbitrazh courts of first instance ruled in favor of Sberbank Leasing AO for all cases. Our appeals were considered and rejected by the courts of appeal during the period from May to November 2015. All of the disputes between the parties were resolved by signing of settlement agreements which were approved by the courts in the second half of 2016.

In 2015, Sberbank Leasing AO filed 32 lawsuits against Mechel and our subsidiaries with the arbitrazh courts of first instance in five regions of the Russian Federation seeking recovery of lease payments, penalties and transfer of leasing assets under equipment finance leases totaling approximately 1.3 billion rubles and \$4.5 million. The arbitrazh courts of first instance sustained in full and in part the plaintiff's claims on recovery of debt under 31 cases, taking into account our counterclaims, as well as sustained in full the plaintiff's claims on recovery of property under 29 of these cases. We appealed all these cases. Sberbank Leasing AO appealed those cases under which the claims were sustained in part. In March-September 2016, the courts of various instances approved settlement agreements regarding all cases. The terms of 11 settlement agreements were revised in part of the payment schedule. We expect the approval of these revised versions by the court in April-May 2017.

From June to September 2015 and in March 2016, Caterpillar Financial OOO filed eight lawsuits with the Moscow Arbitrazh Court against Yakutugol, Mechel Engineering, Korshunov Mining Plant, Mechel Materials, Metallurgshakhtspetsstroy, Tomusinsky Open Pit and Southern Kuzbass Coal Company, as well as Mechel (as the guarantor under four lease agreements) seeking termination of lease agreements, withdrawal of leasing assets and recovery of debt in an aggregate amount of approximately \$5.0 million and 313.9 thousand. During the period from October 2015 to July 2016, the Moscow Arbitrazh Court sustained the claims regarding the recovery of debt in the amount of approximately \$4.5 million and 380.2 thousand and dismissed the claims regarding the withdrawal of leasing assets under six cases; sustained the claims regarding the withdrawal of leasing assets and dismissed the rest of claims under one case; sustained in full the plaintiff's claims under one case. During the period from October 2015 to November 2016, we appealed all these cases with the higher courts. The higher courts upheld the decisions of the Moscow Arbitrazh Court under seven cases and recovered penalty in the amount of approximately \$88.6 thousand under one case. In addition, in July 2016, Caterpillar Financial OOO filed a lawsuit with the Moscow Arbitrazh Court against Southern Kuzbass Coal Company seeking withdrawal of a leasing asset under one lease agreement and recovery of debt in an aggregate amount of approximately \$235.8 thousand under two other lease agreements. During the court hearings, the court divided the lawsuit into three cases. In January 2017, the Moscow Arbitrazh Court sustained the plaintiff's claims regarding the withdrawal of the leasing asset and recovery of debt in the amount of approximately \$56.6 thousand. We continue to negotiate restructuring with Caterpillar Financial OOO. In April 2017, the Ninth Arbitrazh Court of Appeal approved the first settlement agreement between Mechel Engineering and Caterpillar Financial OOO.

During the period from May to November 2016, VTB Leasing JSC filed 18 lawsuits with the Moscow Arbitrazh Court against Mecheltrans seeking recovery of debt under lease payments totaling approximately 929.7 million rubles and penalties for delay in payment of lease payments totaling approximately 187.1 million rubles. In the course of negotiations with VTB Leasing JSC we repaid part of the debt and reduced the amount of claims for lease payments to 499.4 million rubles and for penalties to 82.7 million rubles. In January-April 2017, the courts of various instances approved settlement agreements regarding all cases.

*Other*

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On January 9, 2017, Atrix B.V. filed a lawsuit with the Arbitrazh Court of Rostov region against Mechel, Mechel Mining Management, Mechel-Steel Management, NK INVEST OOO and former general director of Rostov Electrometallurgical Plant OOO seeking jointly and severally recovery of damages related to the

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management of Rostov Electrometallurgical Plant OOO in the amount of approximately 10.1 billion rubles. In February 2017, the amount of claims under the lawsuit was increased to 10.9 billion rubles. On April 13, 2017, the proceedings have been suspended due to judicial expertise.

Rostov Electrometallurgical Plant OOO and Lomprom Rostov OOO within the bankruptcy cases of Zlatoust Metallurgical Plant AO and Guryevsk Metallurgical Plant OAO (hereinafter referred to as the **debtors** ) reviewed in the Arbitrazh Court of Chelyabinsk region and the Arbitrazh Court of Kemerovo region, respectively, requested to hold Mechel secondarily liable for obligations of the debtors. The claimants state that Mechel was the controlling entity in relation to the debtors and pursuant to the Bankruptcy Law should be liable in the amount equal to the aggregate amount of creditor claims that remained unsettled due to insufficiency of the debtors' property. The amount of claims is not currently defined; the court hearings are scheduled for April 28 and May 4, 2017.

***Securities litigation***

On December 16, 2013, SAVEN ENTERPRISES LTD. ( **SAVEN** ) filed a claim in the Arbitrazh Court of Kemerovo region against Tomusinsky Open Pit and Southern Kuzbass Coal Company seeking invalidation of coal supply contracts signed between Tomusinsky Open Pit and Southern Kuzbass Coal Company, application of the consequences of their invalidity in the form of repayment of 21.1 billion rubles and interest recovery in favor of Tomusinsky Open Pit. During the trial, the amount of claims was reduced to 16.4 billion rubles and several expert examinations regarding the determination of the market price of coal sold under these contracts were conducted. The experts confirmed that the coal was sold based on market prices. On January 30, 2015, the Arbitrazh Court of Kemerovo region ruled to dismiss the claims of SAVEN. SAVEN filed an appeal with the Seventh Arbitrazh Court of Appeal. The court dismissed the appeal. SAVEN filed a cassation appeal with the Arbitrazh Court of West Siberian District. On September 14, 2015, the Arbitrazh Court of West Siberian District reversed the lower courts' decisions and remanded the case for a new proceeding with the court of first instance. On April 28, 2016, the Arbitrazh Court of Kemerovo region ruled to conduct a judicial expertise until August 2016 and suspended the proceedings. In October 2016, the judicial expertise was completed and the court resumed the proceedings. On March 15, 2017, the Arbitrazh Court of Kemerovo region dismissed the claim.

In May 2014, SAVEN filed with the District Court of Nicosia a lawsuit against Tomusinsky Open Pit and other Russian group companies, Mr. Zyuzin and Russian and Cypriot companies belonging to him and his family members, claiming damages amounting to \$781.4 million for losses allegedly caused to Tomusinsky Open Pit and SAVEN as a minority shareholder in Tomusinsky Open Pit. In the context of the above lawsuit, SAVEN applied for the seizure of assets of the defendant Cypriot companies and Mr. Zyuzin and on May 20, 2014 the Cyprus Court granted ex parte such freezing injunctions. In May 2015, Tomusinsky Open Pit filed an appeal. On February 15, 2017, the litigation was terminated based upon mutual request of the parties, including freezing injunctions; the appeal claim was revoked as well.

In April 2015, Vadim Varshavsky filed a lawsuit with the Moscow Arbitrazh Court seeking to oblige Mechel and Mechel Steel OOO to perform share purchase agreements by transferring 2,000 shares of our Cypriot company Daveze Limited and to recognize the plaintiff's title to these shares. In August 2015, the Moscow Arbitrazh Court ruled to terminate the proceedings. Vadim Varshavsky appealed to the higher courts. In December 2015, the Arbitrazh Court of Moscow District reversed the lower courts' decisions and remanded the case for a new proceeding. In June 2016, the Moscow Arbitrazh Court dismissed the claim. During the period from October 2016 to February 2017, the higher courts upheld the decision of the Moscow Arbitrazh Court.

**Dividend Distribution Policy**

We determine the amount of dividends payable on our common shares based on cash needs of our business, which will be influenced by the market situation, results of our operations, the level and availability of debt and debt servicing requirements and the requirements of our capital investment program.

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We determine the amount of dividends payable on our preferred shares based on the provisions of our charter. See Item 10. Additional Information Description of Capital Stock Dividends.

In addition, some of our credit facility agreements impose certain restrictions on the payment of dividends on our shares. Mechel may not pay dividends on its common shares without the prior written consent of the lenders. The amount of permitted dividends paid on our preferred shares is limited to 7.5 million rubles.

The decision to pay dividends and the amount thereof must be recommended by our Board of Directors taking into account the charter's provisions and approved by our shareholders. The amount of dividends, if any, approved by the shareholders may not be higher than the amount proposed by the Board of Directors. In particular, dividends may be declared and paid only out of net profits calculated under Russian accounting standards and as long as the following conditions have been met:

our charter capital has been paid in full;

the value of our net assets, calculated under Russian accounting standards, is not less (and would not become less as a result of the proposed dividend payment) than the sum of our charter capital, our reserve fund and the difference between the liquidation value and the par value of our issued and outstanding preferred shares;

we have repurchased all shares from shareholders having the right to demand repurchase; and

we are not, and would not become, insolvent as the result of the proposed dividend payment.

For a further description, please refer to Item 10. Additional Information Description of Capital Stock Dividends. See also Item 3. Key Information Risk Factors Risks Relating to Our Shares and the Trading Market Our ability to pay dividends depends primarily upon receipt of sufficient funds from our subsidiaries.

On June 30, 2016, our general shareholders' meeting decided not to pay dividends for 2015 on common shares and declared a dividend of 6.9 million rubles on preferred shares (of which 2.8 million rubles was paid to Skyblock Limited), which was paid in July and August 2016. On June 30, 2015, our general shareholders' meeting decided not to pay dividends for 2014 on common shares and declared a dividend of 6.9 million rubles on preferred shares (of which 2.8 million rubles was paid to Skyblock Limited), which was paid in July and August 2015. On June 30, 2014, our general shareholders' meeting decided not to pay dividends for 2013 on common shares and declared a dividend of 6.9 million rubles on preferred shares (of which 2.8 million rubles was paid to Skyblock Limited), which was paid in July and August 2014. In each case we could not pay dividends to those shareholders who did not provide us with their bank account details.

We anticipate that any dividends we may pay in the future on shares represented by ADSs will be declared and paid to the depositary in rubles (subject to Russian withholding tax) and will be converted into U.S. dollars by the depositary and distributed to holders of ADSs, net of the depositary's fees and expenses. Accordingly, the value of dividends received by holders of ADSs will be less than the amounts declared and subject to fluctuations in the exchange rate between the ruble and the U.S. dollar. For information on risks associated with Russian withholding tax on dividends to holders of ADSs, see Item 10. Additional Information Taxation Russian Income and Withholding Tax Considerations.

## **Significant Changes**

### ***Confirmation of restructuring terms with Russian state banks***

On April 6 and 10, 2017, our major Russian lenders Gazprombank, VTB Bank and Sberbank confirmed restructuring terms under the relevant credit facilities, including an extension of the repayment grace period until 2020 and the final maturity until 2022, interest rate of the CBR key rate plus 1.5% per year for ruble-denominated credit facilities and 3M LIBOR plus 7% per year for U.S. dollar-denominated credit facilities, and partial capitalization of interest payments.

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**Table of Contents*****Call option agreement with VTB Capital Plc***

On January 20, 2017, VTB Capital Plc and Skyblock Limited entered into a call option agreement providing the bank with an option to buy all or any of 6,937,846 preferred shares representing 5% of issued preferred shares in the share capital of Mechel (the **option shares**) or to receive a cash sum in lieu of option shares or to buy some of the option shares and to receive a cash sum for the remaining option shares. The strike price is 47.3682 rubles per share. VTB Capital Plc has a right to exercise this call option during the period from April 1, 2017 to December 31, 2020. We have pledged option shares in favor of VTB Capital Plc to secure performance of our obligations under the call option agreement. In April 2017, VTB Capital Plc exercised its option right to buy all option shares, but we have requested the bank to extend the start date of the option period by one year until April 1, 2018. Skyblock Limited did not fulfill its obligations under the option notice. Negotiations on amending the terms of the option are ongoing.

***Item 9. The Offer and Listing***

Our common ADSs have been listed on the NYSE under the symbol **MTL** since October 2004. Our common shares were listed on Open Joint Stock Company Russian Trading System Stock Exchange (**RTS**) under the symbol **MTLR** in June 2004, and in October 2008 were promoted to the quotation list **A-2**. In December 2011, RTS ceased to exist as a result of its reorganization through accession to Closed Joint Stock Company Moscow Interbank Currency Exchange (**MICEX**), now Public Joint-Stock Company Moscow Exchange MICEX-RTS (**Moscow Exchange**), and our common shares were excluded from the quotation list **A-2** on RTS. In October 2008, our common shares were admitted to trading on MICEX and included in the quotation list **V**, and were promoted to the quotation list **A-1** in March 2009. Since June 2014, our common shares have been trading on the MICEX Level 1 quotation list. The change is associated with the Moscow Exchange's new listing rules which came into effect on June 9, 2014. Level 1 includes securities that were on the **A-1** and **A-2** quotation lists before this date. In December 2016, MICEX ceased to exist as a result of accession to Moscow Exchange. Since the liquidity of our shares on MICEX was typically much higher than on RTS, in the table below starting from January 2009 we use MICEX data (conversion from rubles into U.S. dollars is made using the CBR exchange rate).



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The following table sets forth the high and low closing prices per common ADS and common share for: (1) the most recent six months; (2) the most recent nine quarters; and (3) all years following our initial public offering in 2004. Effective January 12, 2016, we changed the ratio of our common shares to common ADSs from 1:1 to 2:1. See Item 3. Key Information Risk Factors Risks Relating to Our Shares and the Trading Market The price of our shares and ADSs could be volatile and could drop unexpectedly, making it difficult for investors to resell our shares or ADSs at or above the price paid. The common ADS prices below have been recalculated to reflect the new common ADS-to-common share ratio.

|                     | Common ADSs       |       | Common Shares |       |
|---------------------|-------------------|-------|---------------|-------|
|                     | High              | Low   | High          | Low   |
|                     | (In U.S. dollars) |       |               |       |
| March 2017          | 5.65              | 4.36  | 2.83          | 2.26  |
| February 2017       | 6.22              | 4.87  | 3.10          | 2.53  |
| January 2017        | 6.79              | 5.91  | 3.28          | 2.96  |
| December 2016       | 6.19              | 5.14  | 3.21          | 2.61  |
| November 2016       | 6.61              | 4.35  | 3.20          | 2.23  |
| October 2016        | 5.19              | 2.81  | 2.53          | 1.41  |
| First Quarter 2017  | 6.79              | 4.36  | 3.28          | 2.26  |
| Fourth Quarter 2016 | 6.61              | 2.81  | 3.21          | 1.41  |
| Third Quarter 2016  | 2.90              | 1.46  | 1.44          | 0.82  |
| Second Quarter 2016 | 2.15              | 1.56  | 1.03          | 0.80  |
| First Quarter 2016  | 2.05              | 1.29  | 0.94          | 0.69  |
| Fourth Quarter 2015 | 2.02              | 1.52  | 1.03          | 0.91  |
| Third Quarter 2015  | 2.48              | 1.34  | 1.07          | 0.75  |
| Second Quarter 2015 | 2.94              | 2.34  | 1.35          | 1.20  |
| First Quarter 2015  | 3.65              | 1.26  | 1.51          | 0.44  |
| 2016                | 6.61              | 1.29  | 3.21          | 0.69  |
| 2015                | 3.65              | 1.26  | 1.51          | 0.44  |
| 2014                | 5.12              | 0.87  | 1.99          | 0.28  |
| 2013                | 14.80             | 3.94  | 7.22          | 1.72  |
| 2012                | 24.74             | 10.54 | 11.89         | 5.35  |
| 2011                | 69.18             | 15.80 | 32.74         | 8.05  |
| 2010                | 61.60             | 34.90 | 30.11         | 17.64 |
| 2009                | 43.64             | 5.14  | 17.81         | 2.29  |
| 2008                | 115.24            | 7.32  | 45.00         | 4.10  |
| 2007                | 69.26             | 15.82 | 25.71         | 8.30  |
| 2006                | 20.64             | 12.68 | 10.20         | 6.25  |
| 2005                | 24.34             | 14.04 | 11.20         | 7.75  |
| 2004                | 14.96             | 10.52 | 17.00         | 0.36  |

Our preferred ADSs have been listed on the NYSE under the symbol MTL PR since May 2010. In April 2011, our preferred shares were admitted to trading without listing on RTS and MICEX. Our preferred shares were included in the quotation list A-1 on MICEX in July 2011. In December 2011, RTS ceased to exist as a result of accession to MICEX, now Moscow Exchange, and our preferred shares were excluded from the list of securities admitted to trading without listing on RTS. Since June 2014, our preferred shares have been trading on the MICEX Level 1 quotation list. The change is associated with the Moscow Exchange's new listing rules which came into effect on June 9, 2014. Level 1 includes securities that were on the A-1 and A-2 quotation lists before this date. In December

2016, MICEX ceased to exist as a result of accession to Moscow Exchange. Each preferred ADS represents one-half of a preferred share.

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The following table sets forth the high and low closing prices per preferred ADS and preferred share for: (1) the most recent six months; (2) the most recent nine quarters; and (3) all years following the public offering in 2010.

|                     | Preferred ADSs    |      | Preferred Shares |      |
|---------------------|-------------------|------|------------------|------|
|                     | High              | Low  | High             | Low  |
|                     | (In U.S. dollars) |      |                  |      |
| March 2017          | 1.20              | 0.98 | 2.44             | 2.15 |
| February 2017       | 1.32              | 1.16 | 2.74             | 2.32 |
| January 2017        | 1.28              | 1.12 | 2.73             | 2.45 |
| December 2016       | 1.15              | 0.99 | 2.44             | 2.10 |
| November 2016       | 1.12              | 0.95 | 2.38             | 1.99 |
| October 2016        | 1.00              | 0.55 | 2.28             | 1.19 |
| First Quarter 2017  | 1.32              | 0.98 | 2.74             | 2.15 |
| Fourth Quarter 2016 | 1.15              | 0.55 | 2.44             | 1.19 |
| Third Quarter 2016  | 0.59              | 0.21 | 1.19             | 0.55 |
| Second Quarter 2016 | 0.30              | 0.22 | 0.66             | 0.53 |
| First Quarter 2016  | 0.29              | 0.20 | 0.59             | 0.46 |
| Fourth Quarter 2015 | 0.35              | 0.25 | 0.67             | 0.64 |
| Third Quarter 2015  | 0.38              | 0.20 | 0.89             | 0.54 |
| Second Quarter 2015 | 0.42              | 0.35 | 0.94             | 0.86 |
| First Quarter 2015  | 0.46              | 0.09 | 1.03             | 0.30 |
| 2016                | 1.15              | 0.20 | 2.44             | 0.46 |
| 2015                | 0.46              | 0.09 | 1.03             | 0.30 |
| 2014                | 0.47              | 0.08 | 1.09             | 0.17 |
| 2013                | 2.23              | 0.39 | 4.11             | 1.01 |
| 2012                | 4.91              | 1.92 | 11.82            | 3.86 |
| 2011                | 11.27             | 3.24 | 8.99             | 6.15 |
| 2010                | 9.66              | 6.60 | n/a              | n/a  |

**Item 10. Additional Information****Charter and Certain Requirements of Russian Legislation**

We describe below our registered common and preferred shares, the material provisions of our charter in effect on the date of this document and certain requirements of Russian legislation. In addition to this description, we urge you to review our charter, which is included as an exhibit to this document, to review its complete terms. The description of our charter is qualified in its entirety by reference to the charter.

**Our Purpose**

Article 4.1 of our charter provides that our primary purpose is to earn profit, as well as to provide the highest-quality products and services for our customers.

**Description of Capital Stock***General*

Pursuant to our charter, we have the right to issue registered common shares, preferred shares and other securities provided for by the legislation of the Russian Federation with respect to securities. Our capital stock currently consists of 555,027,660 shares, including 416,270,745 common shares, each with a nominal value of 10 rubles, and 138,756,915 preferred shares, each with a nominal value of 10 rubles, all of which are fully paid, issued and outstanding under Russian law. Under Russian legislation, charter capital refers to the aggregate

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nominal value of the issued and outstanding shares. We are authorized to issue an additional 81,698,341 common shares with a nominal value of 10 rubles each. None of our capital stock is under option or agreed conditionally or unconditionally to be put under option. Any of our shares that are owned by our subsidiaries are not considered treasury shares under Russian law (i.e., they are considered outstanding shares), and we are able to vote such shares and dispose of such shares without any further corporate actions by our shareholders or Board of Directors, provided that such disposals are not major or interested party transactions. Currently, our wholly-owned subsidiary Skyblock Limited holds 55,502,766 preferred shares. The shares are considered issued and outstanding shares under Russian law and have all the rights attaching to other preferred shares. The preferred shares owned by Skyblock Limited are not considered outstanding for purposes of our IFRS financial statements.

Currently, we have more than 1,000 holders of voting shares, which determines the applicability of certain provisions of the Joint-Stock Companies Law, as described below.

A resolution of our Board of Directors dated May 14, 2008 approved an increase in our charter capital through the issuance of 55,000,000 preferred shares with a nominal value of 10 rubles. On September 19, 2008, our Board of Directors amended its resolution to increase the number of preferred shares being issued to 138,756,915 preferred shares which is the maximum number of preferred shares authorized by our charter. The decision to issue 138,756,915 preferred shares was registered with the FFMS on October 23, 2008. On April 2, 2009, we placed all 138,756,915 of the preferred shares authorized for issuance at the placement price of 10 rubles per share. All the preferred shares were taken up by our wholly-owned subsidiary Skyblock Limited, which was the sole offeree. A report on the placement of the preferred shares was registered with the FFMS on April 14, 2009. We transferred 83,254,149 preferred shares to the sellers of 100% of the shares and interest of Bluestone Industries, Inc., Dynamic Energy, Inc. and JCJ Coal Group, LLC and certain other companies as part of the consideration in our acquisition of the Bluestone. Our preferred shares are not convertible into common shares, bonds or other securities of Mechel.

***Rights attaching to common shares***

Holders of our common shares have the right to vote at general shareholders' meetings. As required by the Joint-Stock Companies Law and our charter, all of our common shares have the same nominal value and grant to their holders identical rights. Each fully paid common share, except for treasury shares, gives its holder the right to:

freely transfer the shares without the consent of other shareholders or the company;

receive dividends in accordance with our charter and current legislation;

participate in general shareholders' meetings and vote on all matters of shareholders' competence;

transfer voting rights to its representative on the basis of a power of attorney;

elect and be elected to the governing and controlling bodies of the company;

if holding, alone or with other holders, 2% or more of the voting stock, within 45 days after the end of our fiscal year, make proposals to the agenda of the annual general shareholders meeting and nominate candidates to the board of directors, review commission and counting commission;

if holding, alone or with other holders, 10% or more of the voting stock, demand that the board of directors call an extraordinary general shareholders meeting or an unscheduled audit by our review commission or an independent auditor;

demand, under the following circumstances, the repurchase by us of all or some of the shares owned by it, as long as such holder voted against or did not participate in the voting on the decision approving the following:

our reorganization;

conclusion of a major transaction (in the form of consent or subsequent approval), which involves property in excess of 50% of the balance sheet value of the company's assets determined

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according to its accounting statements on the last reporting date (including those which are simultaneously interested party transactions);

amendment of our charter or approval of a new version of our charter that restricts the holder's rights; and

amendment of the company's charter which eliminates indication that the company is public, simultaneously with the decision on applying to the CBR on release from obligation to disclose information under the laws of the Russian Federation on securities and the decision on applying for delisting of shares and securities convertible into shares;

upon liquidation, receive a proportionate amount of our property after our obligations to our creditors are fulfilled;

have access to certain company documents, receive copies for a reasonable fee and, if holding alone or with other holders, 25% or more of the voting stock, have free access to accounting documents and minutes of meetings of the collegial executive body (Management Board);

if holding, alone or with other shareholders at least 1% of the voting shares, demand consent for the interested party transaction; and

exercise other rights of a shareholder provided by our charter, Russian legislation and decisions of general shareholders' meetings approved in accordance with its competence.

***Rights attaching to preferred shares***

Pursuant to our charter, all of our preferred shares have the same nominal value and grant to their holders identical rights. Each fully paid preferred share gives its holder the right to:

freely transfer preferred shares without the consent of other shareholders;

receive dividends in accordance with our charter and current legislation;

upon liquidation, receive a portion of our liquidation value, which is equal to a portion of our property calculated pro rata to the portion represented by one preferred share in our charter capital;

have access to certain company documents and receive copies for a reasonable fee;

transfer all or part of the rights attached to the preferred shares to its representative on the basis of a power of attorney; and

participate in shareholders' meetings and vote on the following matters:

our reorganization, liquidation and in case of amendment of the company's charter which eliminates indication that the company is public, simultaneously with the decision on applying to the CBR on release from obligation to disclose information under the laws of the Russian Federation on securities and the decision on applying for delisting of shares and securities convertible into shares;

any amendment of our charter or approval of a new version of our charter that restricts the preferred shareholders' rights, including determination or increase of a dividend amount and/or determination or increase of the liquidation value paid on preferred shares of previous priority, as well as provision to shareholders of another type of preferred shares of advantages in the priority of payment of dividends and/or the liquidation value of shares;

participate in shareholders' meetings and vote on all matters on which common shareholders are entitled to vote if for any reason the annual shareholders' meeting did not adopt a resolution to pay the full amount of dividends to which preferred shareholders are entitled under our charter. The holders of preferred shares enjoy this right effective from the first shareholders' meeting to be held after the relevant annual shareholders' meeting and until the date when dividends on preferred shares are paid in full;



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filing of an application with a stock exchange for listing or delisting of our preferred shares; and

in other cases provided for in the applicable laws of the Russian Federation.

***Pre-emptive rights***

The Joint-Stock Companies Law and our charter provide existing shareholders with a pre-emptive right to purchase additional shares or securities convertible into shares issued by way of open subscription in an amount proportionate to their existing holding of shares of the same category (type) as the newly issued shares. In addition, the Joint-Stock Companies Law and our charter provide shareholders with a pre-emptive right to purchase shares or securities convertible into shares during a closed subscription if the shareholders voted against or did not participate in the voting on the decision approving such subscription. The pre-emptive right does not apply to placement of shares or other securities convertible into shares through a closed subscription among existing shareholders only, provided that such shareholders may each acquire a whole number of shares or other securities convertible into shares being placed in an amount proportionate to their existing holding of shares of the corresponding category (type). We must notify shareholders of the opportunity to exercise their pre-emptive rights and the period thereof in accordance with the procedure and time limits provided by Russian law.

***Dividends***

The Joint-Stock Companies Law and our charter set forth the procedure for determining the dividends that we distribute to our shareholders. Shareholders may decide on whether or not to pay the dividends upon results of a reporting quarter, half a year, nine months and/or year. Dividends are recommended to a general shareholders meeting by the board of directors, and approved by the general shareholders meeting by a majority vote. A decision on quarterly dividends may be taken at a general shareholders meeting within three months of the end of the respective quarter; a decision on annual dividends must be taken at the annual general shareholders meeting. The company shall not be entitled to resolve (declare) on payment of dividends on common and preferred shares, the amount of dividends on which has not been determined, unless it is resolved to fully pay dividends on all types of preferred shares, the amount of dividends on which is determined by the company's charter. The dividend approved at the general shareholders meeting may not be more than the amount recommended by the board of directors. The date on which in accordance with the decision on payment (declaration) of dividends are determined the persons entitled to receive them, cannot be earlier than 10 days from the date of the decision to pay (declare) dividends and later than 20 days from the date of such decision. Dividends are not paid on treasury shares. Dividend payment period to a nominee holder and a trustee who is a professional participant of the securities market, which are registered in the register of shareholders, shall not exceed 10 business days, and to other persons registered in the register of shareholders shall not exceed 25 business days from the date on which the persons entitled to receive dividends are defined. A shareholder who is entitled to the declared dividends but has not received them due to the fact that the company or the registrar has no exact and necessary address information or bank details, or in connection with the other creditor's delay, has a right to make a claim to the company for the unpaid dividends within three years from the date of the decision on their payment. Upon the expiration of this three year period, declared and unclaimed dividends are restored in retained earnings of the company and the obligation on their payment terminates.

Starting from January 1, 2014, a new cascade dividend payment mechanism is introduced with respect to shares recorded on custodians' account as opposite to the shareholders' register. The cascade payment mechanism provides that Russian issuers will pay dividends to the NSD for further transfer to nominee holders (custodians), who in turn will be obliged to further transfer dividends to their clients (shareholders, foreign nominee holders and depositary banks for further transfer to depositary receipt owners). Under the new regime no disclosure will be required by ultimate beneficial owners in order to receive dividends. See also Item 3. Key Information Risk Factors Risks

Relating to Our Shares and the Trading Market Upon introduction of a new system of recording the depositary's rights to the shares underlying depositary receipts, the depositary is required to disclose information on ADS and GDS owners in order to exercise voting rights and receive dividends with respect to the shares underlying ADSs and GDSs.

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The Joint-Stock Companies Law allows dividends to be declared only out of net profits calculated under Russian accounting standards and as long as the following conditions have been met:

the charter capital of the company has been paid in full;

the value of the company's net assets on the date of adoption of the decision to pay dividends is not less (and would not become less as a result of the proposed dividend payment) than the sum of the company's charter capital, the company's reserve fund and the difference between the liquidation value and the par value of the issued and outstanding preferred shares of the company;

the company has repurchased all shares from shareholders who demanded repurchase; and

the company is not, and would not become, insolvent as the result of the proposed dividend payment.

Pursuant to our charter, we may calculate the dividends for preferred shares on the basis of our consolidated financial statements prepared under accepted international accounting standards which we apply for the relevant accounting period, including IFRS and U.S. GAAP. The annual fixed dividend for one preferred share amounts to 20% of our net profit under our annual consolidated financial statements prepared in accordance with the applicable international accounting standards and audited by an independent auditor, divided by 138,756,915, and is declared and paid subject to sufficiency of the company's net profit for those purposes.

If the dividend to be paid for one common share exceeds the dividend to be paid for one preferred share for the same year, we must increase the dividend to be paid for one preferred share up to the amount of dividend to be paid for one common share. For this purpose, if the nominal value of our common shares has changed (e.g., through a share split), the dividend to be paid for one common share is calculated as if its nominal value has not changed. If dividends for common shares are to be paid in kind, the monetary valuation of the property directed for dividend payment must be determined by the Board of Directors involving an independent appraiser.

***Distributions to shareholders on liquidation***

Under Russian legislation, liquidation of a company results in its termination without the transfer of rights and obligations to other persons as legal successors. The Joint-Stock Companies Law and our charter allow us to be liquidated:

voluntarily, by a three-quarters majority of the voting stock present at a general shareholders' meeting; or

involuntarily, by a court order.

Following a decision to liquidate the company, the right to manage our affairs would pass to a liquidation commission which, in the case of voluntary liquidation, is appointed by a general shareholders' meeting and, in an involuntary liquidation, is appointed by the court. Creditors may file claims within a period to be determined by the liquidation commission, but which may not be less than two months from the date of publication of notice of liquidation by the

liquidation commission.

The Civil Code gives creditors the following order of priority during liquidation:

individuals owed compensation for injuries or deaths;

payments related to disbursement of accrued vacation pay and wages of persons currently or formerly employed under an employment agreement and remuneration to owners of intellectual property rights;

federal and local governmental entities claiming taxes and similar payments to the budgets and non-budgetary funds; and

other creditors in accordance with Russian legislation.

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Claims of creditors in connection with obligations secured by a pledge of the company's property ( **secured claims** ) are satisfied out of the proceeds of the sale of the pledged property prior to claims of any other creditors except for the creditors of the first and second priorities described above, provided that claims of such creditors arose before the pledge agreements in respect of the company's property were made. To the extent that the proceeds of sale of the pledged property are not sufficient to satisfy secured claims, the latter are satisfied simultaneously with claims of the fourth priority creditors as described above.

The Joint-Stock Companies Law and our charter provide for the following order of priority for distribution of remaining assets after settlement with creditors:

payments to repurchase shares from shareholders having the right to demand repurchase;

payments of accrued but unpaid dividends on preferred shares and the liquidation value of the preferred shares determined by the company's charter; and

payments to holders of common and preferred shares.

### ***Liability of shareholders***

The Civil Code and the Joint-Stock Companies Law generally provide that shareholders in a Russian joint-stock company are not liable for the obligations of a joint-stock company and bear only the risk of loss of their investment. This may not be the case, however, when one entity is capable of determining decisions made by another entity. The entity capable of determining such decisions is called an effective parent. The entity whose decisions are capable of being so determined is called an effective subsidiary. The effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in course of carrying out these decisions if:

this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between such entities; and

the effective parent gives binding instructions or consent for a transaction to the effective subsidiary based on the above-mentioned decision-making capability.

Thus, a shareholder of an effective parent is not itself liable for the debts of the effective parent's effective subsidiary, unless that shareholder is itself an effective parent of the effective subsidiary. Accordingly, a shareholder will not be personally liable for our debts or those of our effective subsidiaries unless such shareholder controls our business and the conditions set forth above are met. See Risk Factors Legal risks and uncertainties Shareholder liability under Russian legislation could cause us to become liable for the obligations of our subsidiaries.

In addition, an effective parent is secondarily liable for an effective subsidiary's debts if an effective subsidiary becomes insolvent or bankrupt resulting from the fault of an effective parent only when the effective parent has used the right to give binding instructions, knowing that the consequence of carrying out this action would be insolvency or bankruptcy of this effective subsidiary. This is the case regardless of how the effective parent's capability to determine decisions of the effective subsidiary arises, for example, whether through ownership of voting securities or by

contract. If the effective subsidiary is a joint-stock company, the effective parent has secondary liability only if the effective parent has caused the effective subsidiary to take any action or fail to take any action, knowing that such action or failure to take action would result in insolvency or bankruptcy of the effective subsidiary. If the effective subsidiary is a limited liability company, the effective parent may be held secondarily liable if the effective subsidiary's insolvency is caused by the willful misconduct or negligence of such effective parent and if the effective subsidiary's assets are insufficient to cover its obligations. To be relieved from the liability, the effective parent would need to prove before the court that it acted in good faith and in the interests of the effective subsidiary.

Shareholders of an effective subsidiary that is a joint-stock company may also claim compensation for the effective subsidiary's losses from the effective parent if: (1) the effective parent caused the effective subsidiary

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to take any action or fail to take any action that resulted in a loss and (2) the effective parent knew that such action or failure to take such action would result in an effective subsidiary's loss. Members of an effective subsidiary that is a limited liability company may claim compensation for the effective subsidiary's losses from the effective parent if the effective parent through its willful misconduct or negligence caused the effective subsidiary to take any action that resulted in a loss.

Russian law also provides for other cases in which shareholders may be held liable to us.

***Charter capital increase***

We may increase our charter capital by:

issuing additional shares, or

increasing the nominal value of already issued shares.

A decision on any issuance of shares or securities convertible into shares by closed subscription, or an issuance by open subscription of common shares or securities convertible into common shares constituting more than 25% of the number of issued common shares, requires a three-quarters majority of the voting stock present at a general shareholders' meeting. A decision to increase the charter capital by increasing the nominal value of issued shares requires a majority of the voting stock present at a general shareholders' meeting. In addition, the issuance of shares above the number of authorized and non-issued shares provided in our charter necessitates a charter amendment, which requires a three-quarters majority of the voting stock present at a general shareholders' meeting.

The Joint-Stock Companies Law requires that the value of newly issued shares be determined by the board of directors based on their market value but not less than their nominal value, except in limited circumstances where: (1) existing shareholders exercise a pre-emptive right to purchase shares at the price which is not more than 10% lower than the price paid by third parties, or (2) fees of up to 10% are paid to intermediaries. The price may not be set at less than the nominal value of the shares. The board of directors shall value any in-kind contributions for new shares, based on the appraisal report of an independent appraiser.

Russian securities regulations set out detailed procedures for the issuance and registration of shares of a joint-stock company. These procedures require:

taking a decision on share placement;

approval of a resolution on share issuance;

registration of a share issuance with the CBR;

placement of the shares;

registration and filing with the CBR of a report or a notice (as applicable) on results of share issuance; and

public disclosure of information relating to the share issuance.

***Charter capital decrease***

The Joint-Stock Companies Law does not allow a company to reduce its charter capital below the minimum charter capital required by law, which is 100,000 rubles for a public joint-stock company. The Joint-Stock Companies Law and our charter require that any decision to reduce our charter capital, whether through a repurchase and cancellation of shares or a reduction in the nominal value of the shares, be made at a general shareholders meeting.



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The Joint-Stock Companies Law allows a company to reduce its share capital only if, at the time of such reduction:

its share capital is paid up in full;

the company is not, and would not become, as a result of the payment to, or the modification of the securities of, the shareholders, as described above, insolvent;

the value of its net assets is not less (and would not become less, as a result of the payment or the modification of the securities to the shareholders) than the sum of its share capital, the reserve fund and the difference between the liquidation value and the par value of its issued and outstanding preferred shares;

the company has repurchased all shares from shareholders that have the right to demand repurchase of their shares under legislation protecting the rights of minority shareholders, as described below;

the company has fully paid all declared dividends; and

the company complies with other requirements of Russian legislation.

In addition, within three business days after taking the decision to reduce our charter capital, we must notify this decision to the authority which carries out state registration of legal entities and publish this decision twice with a monthly interval. Within 30 days of the latest of such publications, our creditors, whose claim rights had occurred prior to the publication, would then have the right to accelerate our indebtedness and to demand reimbursement of applicable damages.

***Share buy-back***

Under the Joint-Stock Companies Law, our board of directors is entitled to decide on the acquisition of our shares representing up to 10% of our charter capital. The repurchased shares must be resold at a value not less than a market value within one year of their repurchase or, failing that, the shareholders must decide to cancel such shares and decrease the charter capital. Repurchased shares do not bear voting rights.

The Joint-Stock Companies Law allows us to repurchase our shares only if:

our charter capital is paid in full;

we are not and would not become, insolvent as a result of the repurchase;

the value of our net assets is not less (and would not become less, as a result of the proposed repurchase) than the sum of our charter capital, the reserve fund and the difference between the liquidation value and par value of our issued and outstanding preferred shares; and

we have repurchased all shares from shareholders having the right to demand repurchase of their shares in accordance with Russian law, as described immediately below.

The Joint-Stock Companies Law and our charter provide that our shareholders may demand repurchase of all or some of their shares if the shareholder demanding repurchase voted against or did not participate in the voting on the decision approving any of the following actions:

reorganization;

consent or subsequent approval of a major transaction, which involves property in excess of 50% of the balance sheet value of the company's assets determined according to its accounting statements on the last reporting date (including those which are simultaneously interested party transactions);

amendment of our charter or approval of a new version of our charter in a manner which restricts shareholders' rights; or

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amendment of the public company's charter which eliminates indication that the company is public, simultaneously with the decision on applying to the CBR on release from obligation to disclose information under the laws of the Russian Federation on securities and the decision on applying for delisting of shares and securities convertible into shares.

A shareholder demanding repurchase must send to us a written request within 45 days following the date when the relevant decision of the general shareholders' meeting is taken. We must purchase the shares of the demanding shareholder within 30 days following the expiration of the above 45-day period. We may spend up to 10% of our net assets calculated under Russian accounting standards on the date of the adoption of the decision which gives rise for a share redemption demanded by the shareholders. If the value of shares in respect of which shareholders have exercised their right to demand repurchase exceeds 10% of our net assets, we will repurchase shares from each such shareholder on a pro-rata basis.

A shareholders' decision on filing of an application for delisting of our shares enters into effect if the consideration to be paid for the repurchase of shares does not exceed 10% of our net assets.

***Registration and transfer of shares***

Russian legislation requires that a joint-stock company maintain a register of its shareholders which, for a public joint-stock company, shall be maintained by a registrar. Since July 2014, our shareholder register has been maintained by Computershare Registrar JSC which was renamed to Independent Registrar Company JSC in October 2015. Ownership of our shares is evidenced by entries made in the shareholders' register or on the books of a Russian licensed depository.

The Federal Law No. 414-FZ "On the Central Depository" dated December 7, 2011 (the **Central Depository Law**), which came into force on January 1, 2012, set out a legal framework for establishment and operation of the central depository. On November 6, 2012, the FFMS granted the NSD the status of central depository which opened its nominee holder accounts in, among others, all securities registers of the issuers which are obliged to disclose information in accordance with Russian securities law. As we are required to make public disclosures, the above requirement is applicable to us, which means that the central depository became the only person having a nominee holder account in our share register. Also, the Central Depository Law prohibits persons maintaining securities registers from opening and depositing securities (save for limited exceptions) to other nominee holder accounts from the date of the opening of a nominee holder account with the central depository.

Any of our shareholders may obtain an extract from the register of our shareholders maintained by the registrar or from their respective depository, as the case may be, certifying the number of shares that such shareholder holds. We are entitled to obtain an extract from our shareholders' register which sets out all of our shareholders registered directly therein in cases provided under Russian law. In addition, we are entitled to request through the registrar a list of clients of nominee holders which are entitled to participate in the general shareholders' meeting. However, we are unable to monitor transfers of our shares that are held on the books of depositaries registered with the central depository because underlying shareholders have no obligation to reveal and such depositaries have no obligation to notify us about such transfers. As a result, we can currently only identify our actual shareholders in a limited number of cases provided for by Russian law, including when requesting our registrar to compile a list of shareholders of record for the general shareholders' meeting and when shareholders and ADSs or GDSs holders provide voting instructions together with disclosure of information, including ownership information, in accordance with Russian securities regulations.

Our shareholders and beneficial owners of our shares shall notify us and the CBR of an acquisition of 5% or more of our common shares or of an acquisition of the right to vote on 5% or more of our common shares by virtue of an

agreement or otherwise, and of any subsequent change in the number of such common shares above

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or below 5%, 10%, 15%, 20%, 25%, 30%, 50%, 75% or 95% of the total amount of votes attached to the voting shares in the charter capital, and we are required to disclose such information in accordance with Russian securities regulations.

The purchase, sale or other transfer of shares is accomplished through the registration of such transfer in the shareholder register, or the registration of such transfer with a depository if shares are held and recorded by a depository. The registrar or depository may not require any documents in addition to those required by Russian legislation in order to transfer shares in the register or with a depository. Refusal to register the shares in the name of the transferee or, upon request of the beneficial holder, in the name of a nominee holder, is not allowed except in certain instances provided for by Russian legislation, and may be challenged in court.

### ***Reserve fund***

Russian legislation requires that each joint-stock company establish a reserve fund to be used only to cover the company's losses, redeem the company's bonds and repurchase the company's shares in cases when other funds are not available. Our charter provides for a reserve fund of 5% of our charter capital, funded through mandatory annual transfers of at least 5% of our statutory net profits until the reserve fund has reached the 5% requirement.

### **Disclosure of Information**

Under Russian legislation, disclosure of information on the securities market means making it available to all interested parties, regardless of the purpose of obtaining this information. We are required to make the following periodic public disclosures and filings in the newswire of authorized information agency Interfax ([www.e-disclosure.ru](http://www.e-disclosure.ru)), on our websites at [www.mechel.ru](http://www.mechel.ru) and [www.mechel.com](http://www.mechel.com), as well as on the webpage provided by authorized information agency Interfax ([www.e-disclosure.ru/portal/company.aspx?id=1942](http://www.e-disclosure.ru/portal/company.aspx?id=1942)):

disclosure of quarterly reports containing information about us, our shareholders, registrar and depository, the structure of our management bodies, the members of the board of directors, management board and review commission, our branches and representative offices, our subsidiaries and affiliates, our shares, bank accounts and auditors, important developments during the reporting quarter, quarterly accounting statements prepared in accordance with Russian accounting standards, and other information about our financial and business activity;

disclosure of any information concerning material facts and other official disclosures, including, among other things, our reorganization; certain changes in the amount of our assets; decisions on share issuances; certain changes in ownership and shareholding; information about controlled organizations which are material to us or organizations controlling us, reorganization, liquidation or bankruptcy of such organizations; conclusion of agreement with our controlled or controlling organization, where we are required to buy securities issued by such controlled or controlling organization; as well as shareholder and management bodies resolutions;

notifying Moscow Exchange about the disclosure of aforementioned information;

disclosure of the documents that we have received in connection with any of the following:

a voluntary offer (including any competing offer) to acquire us;

a mandatory offer (including any competing offer) to acquire us;

a notice of the right of shareholders to sell their shares to the person that has acquired more than 95% of our common shares; and

a request that minority shareholders sell their shares to the person that has acquired more than 95% of our common shares;

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disclosure of information on various stages of securities placement, issuance and registration through publication of certain data as required by the securities legislation;

disclosure of our charter and internal corporate governance documents;

disclosure of our annual report and annual financial statements prepared in accordance with Russian accounting standards and our annual and interim U.S. GAAP/IFRS financial statements;

disclosure on a quarterly basis of a list of our affiliated companies and individuals;

disclosure of a list of information which is considered an insider information and approved by the company ( **insider information** );

disclosure of insider information; and

disclosure of other information as required by applicable Russian securities legislation.

**General Meetings of Shareholders**

***Procedure***

A general shareholders meeting may exercise only the powers that are set forth in the Joint-Stock Companies Law and in our charter. Among the issues which our shareholders have the exclusive power to decide are:

approval of charter amendments or of a new version of the charter;

reorganizations or liquidations;

election and early removal of the members of the board of directors;

determination of the number, nominal value and type of authorized shares and rights granted by such shares;

changes in the company's charter capital;

appointment and early removal of the members of our review commission and counting commission;

approval of our independent auditor;

consent or subsequent approval of certain interested party transactions and major transactions;

distribution of profits and losses, including approval of dividends payment;

decisions on our participation in commercial or industrial groups or other associations of commercial entities;

redemption by the company of issued shares in cases provided for by the Joint-Stock Companies Law;

approval of certain internal documents regulating the activity of our governing bodies;

decision on filing of an application for delisting of our shares or securities convertible into shares; and

other issues, as provided by the Joint-Stock Companies Law and our charter.

Voting at a general shareholders meeting is generally carried out on the principle of one vote per voting share, with the exception of the election of the board of directors, which is done through cumulative voting. Decisions are generally passed by a majority of the voting stock present at a general shareholders meeting. However, Russian law requires a three-quarters majority of the voting stock present at a general shareholders meeting to approve the following:

approval of charter amendments or of a new version of the charter;

reorganizations or liquidations;

determination of the number, nominal value and category (type) of authorized shares and the rights granted by such shares;



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repurchase by the company of its issued shares;

any issuance of shares or securities convertible into common shares by closed subscription;

issuance by open subscription of common shares or securities convertible into common shares, in each case, constituting 25% or more of the number of issued and outstanding common shares;

approval of a major transaction the subject matter of which is property with the value exceeding 50% of the balance sheet value of the company's assets; and

decision on filing of an application for delisting of our shares or securities convertible into shares.

A resolution of the shareholders' meeting to apply for delisting of our preferred shares requires a three-quarters majority vote of the voting common stock present at the meeting and a three-quarters majority vote of the total preferred stock. The Joint-Stock Companies Law provides that a charter may require a larger number of the votes for passing such resolution.

The quorum requirement for our general shareholders' meeting is met if shareholders (or their representatives) accounting for more than 50% of the issued voting shares are present. If the quorum requirement is not met, another general shareholders' meeting with the same agenda may (and, in the case of an annual meeting, must) be scheduled and the quorum requirement is satisfied if shareholders (or their representatives) accounting for at least 30% of the issued voting shares are present at that meeting.

The annual general shareholders' meeting must be convened by the board of directors and be held between March 1 and June 30 of each year, and the agenda must include the following items:

election of the members of the board of directors and review commission;

approval of distribution of profits, including approval of annual dividends and losses, if any; and

appointment of an independent auditor.

A shareholder or group of shareholders owning in the aggregate at least 2% of the outstanding voting shares may introduce proposals for the agenda of the annual general shareholders' meeting and may nominate candidates to the board of directors, general director and the review commission. Any agenda proposals or nominations must be provided to the company not later than 45 days after the preceding calendar year ends.

Extraordinary general shareholders' meetings may be called either by the board of directors on its own initiative, or at the request of the review commission, the independent auditor of the statutory accounts or a shareholder or group of shareholders owning in the aggregate at least 10% of the issued voting shares as of the date of the request.

A general shareholders meeting may be held in a form of a meeting or by an absentee ballot. The form of a meeting contemplates the adoption of resolutions by the general shareholders meeting through the attendance of the shareholders or their authorized representatives for the purpose of discussing and voting on issues of the agenda, provided that if a ballot is mailed to shareholders for participation at a meeting convened in such form, the shareholders may complete and mail the ballot back to the company without personally attending the meeting. A general shareholders meeting by absentee ballot contemplates the determination of shareholders opinions on issues on the agenda by means of a written poll.

The following issues cannot be decided by a general shareholders meeting by absentee ballot:

election of directors;

election of the review commission; and

approval of a company s independent auditor for statutory accounts.

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The voting ballots, which must be used when conducting a general shareholders meeting in form of a meeting in a joint-stock company, must be sent to persons registered in the register of shareholders and entitled to participate in the general shareholders meeting at least 20 days in advance of the general shareholders meeting.

### ***Notice and participation***

Persons registered in the register of shareholders and entitled to participate in a general shareholders meeting must be notified of the meeting, whether the meeting is to be held in direct form or by absentee ballot, not less than 30 days prior to the date of the meeting, and such notification shall specify the agenda for the meeting. However, if it is an extraordinary general shareholders meeting to elect the board of directors or it is a general shareholders meeting to elect the board of directors of a reorganized company, persons registered in the register of shareholders and entitled to participate in the general shareholders meeting must be notified at least 50 days prior to the date of the meeting (according to our charter and amendments to the Russian law effective from July 1, 2016). Under our charter, we may either provide notice by mail or deliver notice with the acknowledgement of receipt to each of our shareholders or publish a notice in *Rossiyskaya Gazeta*, an official newspaper founded by the Russian government, and on our website stated in the charter or on our website stated in the charter. Only those items that were set out in the agenda may be voted upon at a general shareholders meeting. In addition, nominee holders included in the shareholder register will be notified of the shareholders meeting by way of an electronic communication and will be required to convey such information to the depositors within a prescribed period.

Under our charter and in accordance with amendments to the Russian law (effective from July 1, 2016), we may notify persons registered in the register of shareholders and entitled to participate in the general shareholders meeting of a meeting by sending an electronic message to the email address of a shareholder, as well as by sending the text message containing the procedure for reviewing the notice of the general meeting of shareholders at the contact phone number or email address of a shareholder.

Under our charter and in accordance with amendments to the Russian law (effective from July 1, 2016), a list of persons entitled to participate in the general shareholders meeting is compiled by the registrar of the company pursuant to the regulations of Russian securities law. It is compiled on the basis of the data from the register, as well as taking into account information provided to the registrar by the nominee holder to whom the relevant client account was opened in the register. The owners of the company's shares are not included in the list if the nominee holder has not submitted to the registrar information about them. The list of persons entitled to participate in the general shareholders meeting is compiled on the date established by the board of directors, which date may neither be earlier than 10 days from the date of adoption of the resolution to hold a general shareholders meeting nor more than 25 days before the date of the meeting (or, in the case of an extraordinary general shareholders meeting to elect the board of directors, not more than 55 days before the date of the meeting).

The right to participate in a general shareholders meeting may be exercised by shareholders as follows:

by personally participating in the discussion of agenda items and voting thereon;

by sending an authorized representative to participate in the discussion of agenda items and to vote thereon;

by absentee ballot;

by delegating the right to fill out the absentee ballot to an authorized representative; or

by sending information about their willingness to the nominee holder for further transfer to the registrar in accordance with the requirements of Russian securities law.

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The Federal Law No. 415-FZ also sets forth new obligations for a depositary to disclose information on depositary receipt owners in order to exercise voting rights with respect to the shares represented by depositary receipts. The regulation setting forth the requirements for the provision of information was approved by the Order of the FFMS dated February 5, 2013. Information about the depositary receipt owners is provided to the issuer in the form of a list of persons who exercise the rights under the depositary receipts. The list is provided to the issuer by the foreign depositary which opens the depo account of depositary programs. The list is provided for the preparation and holding of a shareholders meeting. See also Item 3. Key Information Risk Factors Risks Relating to Our Shares and the Trading Market Upon introduction of a new system of recording the depositary's rights to the shares underlying depositary receipts, the depositary is required to disclose information on ADS and GDS owners in order to exercise voting rights and receive dividends with respect to the shares underlying ADSs and GDSs.

Furthermore, on July 1, 2016, provisions of the Federal Law No. 210 stipulating the new procedure for corporate actions became effective which, inter alia, provides for a possibility of participation at general meetings of security holders by means of electronic voting for those shareholders who hold their shares either directly on a share register or through a depositary. This new procedure may lead to delays in voting process and inconsistencies and may entail additional risks due to its novelty to the Russian market.

## **Board of Directors**

The Joint-Stock Companies Law and our charter provide that our entire board of directors is up for election at each annual general shareholders meeting and that our board of directors is elected through cumulative voting. Under cumulative voting, each shareholder has a number of votes equal to the number of voting shares held by such shareholder multiplied by the number of persons to be elected to our board of directors, and the shareholder may give all such votes to one candidate or spread them between two or more candidates. Before the expiration of their term, the members of the board of directors may be removed as a group at any time without cause by a majority of the voting stock present at a general shareholders meeting.

The Joint-Stock Companies Law requires at least a nine-member board of directors for a joint-stock company with more than 10,000 holders of voting shares. Only natural persons (as opposed to legal entities) are entitled to sit on the board. Members of the board of directors are not required to be shareholders of the company. Members of the management board are not permitted to constitute more than 25% of the members of the board of directors. The actual number of directors is determined by the company's charter or decision of the general shareholders meeting. Our charter provides that our board of directors shall consist of nine members, and the majority of our directors shall be independent.

The Joint-Stock Companies Law prohibits the board of directors from acting on issues that fall within the exclusive competence of the general shareholders meeting. Our board of directors has the power to direct the general management of the company, and to decide the following issues:

determination of our business priorities and their significant change, including approval of our annual and quarterly budgets;

convening of annual and extraordinary general shareholders meetings, except in certain circumstances specified in the Joint-Stock Companies Law;

approval of the agenda of the general shareholders meeting and determination of the record date for shareholders entitled to participate in a general shareholders meeting;

placement of our bonds and other securities;

determination of the price of our property and of our securities to be placed or repurchased, as provided for by the Joint-Stock Companies Law;

repurchase of our shares, bonds and other securities in certain cases provided for by the Joint-Stock Companies Law;

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appointment of the general director and members of the management board, and early termination of their powers and the establishment of their compensation;

recommendation to the general shareholders' meeting on the amount of a dividend and the payment procedure thereof;

recommendation on the amount of remuneration and compensation to be paid to the members of our review commission and on the fees payable for the services of an independent auditor;

the use of our reserve fund and other funds;

the creation and liquidation of branches and representative offices;

approval of internal documents, except for those documents whose approval falls within the competence of the company's shareholders or general director or the management board;

consent or subsequent approval of major and interested party transactions in the cases provided for by the Joint-Stock Companies Law;

approval of the procedures of internal control over financial and business operations of the company;

control over establishment of the risk management system;

increasing our charter capital by issuing additional shares within the limits of the authorized charter capital, except in certain circumstance specified in our charter;

approval of decisions on securities issuances and of the prospectus relating to such securities issuances, as well as of reports on the results of such securities issuances;

approval of our share registrar;

decision on filing of an application for listing of our shares or securities convertible into shares;

decision on alienation by the company of treasury and quasi-treasury shares, as well as determination of the procedure for alienation of such shares;

approval of financing transactions, as defined in our charter;

conclusion of transactions exceeding 5% of the balance sheet value of the company's assets according to accounting statements on the last reporting date;

approval of our annual report and annual financial statements; and

other issues, as provided for by the Joint-Stock Companies Law and our charter.

Our charter requires a unanimous vote of the directors present for an action to pass, with the exception of actions for which our charter requires a majority vote of the directors or a majority vote of the disinterested and independent directors, as described herein. A board meeting is considered duly assembled and legally competent to act when the elected directors are present in a number necessary for the adoption of resolutions on items of the agenda in accordance with the charter. Quorum for a board meeting shall be at least half of the elected members of the board and certain issues require presence all of the elected members of the board, unless otherwise provided by the law or the company's charter.

### **Management Board**

In June 2011, an annual general shareholders' meeting approved a new version of the Bylaw on the Collegial Executive Body (Management Board). Pursuant to the Bylaw, the management board engages in discussions regarding important corporate issues within its powers and makes recommendations to our board of directors. The management board operates on the basis of our charter and applicable internal regulations. The management board's size is defined by the board of directors, and it is comprised of senior management of Mechel and our subsidiaries, with each member of the management board elected by the board of directors for an indefinite period. A meeting of the management board is quorate if at least half of its members participate in the meeting.



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The management board decides on the following issues, among others:

developing and submitting to the board of directors long-term plans for the implementation of the company's priorities and proposals regarding its development strategy;

reporting to the board of directors on the realization of investment projects in the amount of more than \$30 million;

developing and submitting to the board of directors investment projects in the amount of more than \$50 million;

submitting to the board of directors proposals on bonds placement and acquisitions;

submitting to the board of directors proposals on participation (obtaining or increasing participation) or giving up (reducing) our participation in other entities;

approving annual and long-term investment programs;

approving transactions related to alienation by the company of non-current assets with a value of between 10% to 25% of the balance sheet value of the company's assets, except for transactions provided by our charter and interested party transactions;

making certain decisions regarding the exercise of our rights as a shareholder or a participant of other entities;

making recommendations on certain matters relating to the management of our affiliates included in the list approved by our management board;

developing and establishing methods of compensation and monetary motivation for our employees; and

other issues related to our day-to-day business referred to the management board by its chairman, the board of directors or by a shareholder holding not less than 10% of our voting shares.

Together with the general director, the management board is responsible for our day-to-day management and administration. The management board's activities are coordinated by the general director (chairman of the management board) and are regulated by applicable Russian law and our charter.

## **General Director**

The general director (also referred to in this document as chief executive officer) is our sole executive body and manages our current operations within its powers and organizes the implementation of resolutions of our general shareholders' meeting and the board of directors. The general director acts on our behalf without a power of attorney and has the following rights and responsibilities:

performing the routine management of our operations;

exercising the right of first signature on financial documents;

managing our property to provide for our current operations within the limits established by our charter and prevailing Russian legislation within its powers;

representing our interests both in Russia and abroad;

approving staff, executing labor contracts with our employees and rewarding and disciplining employees;

entering into transactions on our behalf within its powers;

issuing powers of attorney on our behalf;

opening and closing our bank accounts;

organizing our accounting and reporting process;

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issuing orders and instructions binding on all our employees;

organizing the implementation of resolutions of our general shareholders' meeting and our board of directors; and

performing other functions necessary to achieve our aims and to provide for our normal operations, in compliance with prevailing legislation and our charter, except for the functions laid upon our other management bodies by the Joint-Stock Companies Law and our charter.

The general director is appointed by the board of directors for a period of one year. The term of office runs from the time of his appointment until such time as a general director is appointed by the board of directors one year later. The general director may be re-appointed an unlimited number of times.

The general director may on his own initiative renounce his powers at any time by written notice to the board of directors. The authority of the general director may be terminated before the expiration of his term of office by a resolution of the board of directors on the following grounds:

failure to comply with the requirements of our charter, resolutions of the general shareholders' meeting or the board of directors or our internal documents;

in the cases stipulated by the employment agreement with the general director; and

in other events provided by current legislation.

Upon resolution of the general shareholders' meeting, the authority of the sole executive body may be vested in a commercial organization (a **managing organization**) or an individual entrepreneur (a **manager**) on a contractual basis. Under the Civil Code, if the authority of a company's sole executive body has been vested in a managing organization or a manager, the company exercises its legal rights and assumes its legal obligations through such managing organization or manager. A resolution to transfer the authority of a company's sole executive body to a managing organization or a manager shall be passed by the general meeting of shareholders only upon recommendation of the board of directors of the company.

Our general director is required under Russian law to disclose information on his holdings of our securities and on sales and/or purchases of our securities, as well as if he is a member of the Board of Directors to inform of the circumstances by virtue of which he can be recognized interested in transactions.

### **Role of the Review Commission**

The review commission exercises control over our financial and business operations.

On the basis of the results of its examination of our financial and business operations, the review commission prepares opinions, which contain the following:

confirmation of the reliability of the data contained in our reports and other financial documents; and

information on any identified cases of violations of accounting and reporting procedures stipulated by Russian legislation and violations of Russian legislation identified in financial and business operations.

Upon a request from the review commission, the general director and members of the board of directors, the management board and the liquidation commission must undertake to make available documents pertaining to our financial and business operations. The review commission is entitled to request that an extraordinary general shareholders meeting be convened in accordance with the procedure provided by our charter.

The review commission is elected by our general shareholders meeting for a period of one year and consists of three persons. Shares owned by members of our board of directors or persons holding positions in our management bodies cannot participate in the voting, when members of the review commission are elected. The term of office of the review commission runs from the moment it is elected by the shareholders to the moment it

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is elected or re-elected by the next annual general shareholders meeting. The authority of individual members or the whole review commission may be terminated before the expiration of the term of office thereof by a resolution of the general shareholders meeting on the grounds and in compliance with the procedure stipulated by our internal documents. If the number of members of the review commission falls to less than half of the required membership thereof, the board of directors must convene an extraordinary general shareholders meeting to elect a new review commission. The remaining members of the review commission continue to perform their functions until a new review commission is elected.

A shareholder or any person proposed by a shareholder may become a member of the review commission. A member of the review commission cannot simultaneously be a member of the board of directors, a member of the liquidation commission, the general director or a member of the management board. The review commission elects its chairman and secretary from within its members.

The general shareholders meeting determines remuneration and compensation of expenses to the members of the review commission.

## **Interested Party Transactions**

In accordance with amendments to the Joint-Stock Companies Law which entered into force on January 1, 2017, transactions defined as interested party transactions do not require a mandatory prior consent of disinterested directors or shareholders of a company. However, the Joint-Stock Companies Law introduces an obligation to notify members of the board of directors, members of the collegial executive body and in case all members of the board of directors are interested (or in case such notification is prescribed by the charter) all shareholders about such transactions prior to their accomplishment. After receiving such a notice, the above-mentioned persons may demand convocation of a meeting of the board of directors or a general shareholders meeting to obtain relevant consent.

The following persons may be deemed interested parties: a member of the board of directors; the sole executive body; a member of a collegial executive body; a person directly or indirectly controlling over 50% of the voting shares in another legal entity (on the basis of an instruction, a shareholders agreement or other agreements); a person having the right to appoint the sole executive body or more than half of the management board members; and a person having the right to give binding instructions on the company.

A person directly or indirectly holding over 50% of the voting shares in another legal entity shall be deemed controlling. A person in which such holding is exercised shall be deemed controlled.

A transaction shall be deemed an interested party transaction if the persons referred to above and/or their spouses, parents, children, adoptive parents and adopted children, full and half brothers and sisters and/or controlled entities:

act as parties to, beneficiaries in, representatives or agents in the transaction;

control another legal entity that is a party, beneficiary, representative or agent in the transaction; or

act as members of any management body of the company which is a party, beneficiary, representative or agent in the transaction, or members of any governing body of the managing organization of such company.

In public joint-stock companies approval for the transaction shall be granted by a majority vote of disinterested directors of the company who within one year prior to the decision: (1) have not acted as general directors (or persons performing functions of the sole executive body), members of any executive body of the company or its management company or managers; (2) did not have spouses, parents, children, adoptive parents and adopted children, full and half brothers and sisters acting as members of any executive body of the company or its management company or managers; and (3) did not control the company or its management and were not entitled to give instructions binding on the company.

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If the value of a transaction or a number of related transactions is 10% or more of the balance sheet value of the company's assets calculated in accordance with Russian accounting standards, as well as in other cases provided by the Joint-Stock Companies Law, the approval for such transaction shall be granted by a majority vote of disinterested shareholders participating in the meeting.

At the same time, the Joint-Stock Companies Law provides cases in which the relevant requirements do not apply. These include transactions entered into within the ordinary course of business (even if the company did not enter into similar transactions before), transactions in respect of property with the value not exceeding 0.1% of the balance sheet value of the company's assets calculated in accordance with Russian accounting standards as of the last reporting date, or transactions on the acquisition or redemption by the company of its issued shares, as well as in other cases provided by the Joint-Stock Companies Law.

For information on certain risks relating to interested party transactions see Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry. In the event that the minority shareholders of our subsidiaries were to successfully challenge past interested party transactions or do not approve interested party transactions in the future, we could be limited in our operational flexibility.

## **Major Transactions**

The Joint-Stock Companies Law defines a major transaction as a transaction or a number of related transactions entered into beyond the ordinary course of business and, at the same time, associated with the direct or indirect acquisition, disposal or possibility of disposal of property with a value of 25% or more of the balance sheet value of the company's assets determined in accordance with Russian accounting standards as of the last reporting date preceding the transaction, as well as in other cases provided by the Joint-Stock Companies Law.

Under the Joint-Stock Companies Law a decision to issue consent to, or to grant a subsequent approval of, major transactions shall be adopted in accordance with the following procedure:

major transactions involving property ranging from 25% to 50% of the balance sheet value of the company's assets require unanimous approval by all members of the board of directors or, if unanimity is not reached, a majority of the voting stock held by shareholders participating in the meeting; and

major transactions involving property in excess of 50% of the balance sheet value of the company's assets require a three-quarters majority of the voting stock held by shareholders participating in the meeting.

At the same time, the Joint-Stock Companies Law sets out the cases to which requirements to the procedure of executing of major transactions do not apply:

transactions related to the placement of shares or other securities convertible into shares;

transactions entered into in the course of property rights transfer in a reorganization;

transactions mandatory for companies pursuant to the federal laws (settlements under such transactions are effected at fixed prices and tariffs set by the relevant governmental authorities); and

other cases provided by the Joint-Stock Companies Law.

For information on our largest shareholders' potential ability to approve major transactions see Item 3. Key Information Risk Factors Risks Relating to Our Business and Industry The concentration of our shares with our largest shareholders will limit your ability to influence corporate matters and transactions with largest shareholders may present conflicts of interest, potentially resulting in the conclusion of transactions on less favorable terms than could be obtained in arm's length transactions.



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**Table of Contents****Change in Control*****Anti-takeover protection***

Russian legislation requires the following:

A person intending to acquire more than 30% of the total number of a public company's common shares and voting preferred shares (including, for such purposes, shares already owned by such person and its affiliates), will be entitled to make a public offer to other holders of the corresponding categories (types) of shares of the public company (the **voluntary offer**). The voluntary offer may also contain an offer to purchase securities convertible into such shares from other holders of such securities convertible into such shares of the public company.

A person that has acquired more than 30% of the total number of a public company's common shares and voting preferred shares (including, for such purposes, shares already owned by such person and its affiliates) will be required to make, within 35 days of such shares being recorded in the name of such person or the moment when the person learnt, or should have learnt that it individually or together with its affiliates owned the relevant number of the shares, a public offer for other shares of the same class and for securities convertible into such shares (the **mandatory offer**), at a price which is not less than (i) the price determined based on a weighted average market price of the shares and securities convertible into such shares during trading sessions on a stock exchange for the six months preceding the date when a mandatory offer was sent to the CBR; or (ii) the market price, which must be determined by an appraiser if the shares and securities convertible into such shares are not traded on a stock exchange or their trading history is less than six months. The public offer price may not be less than the highest price at which the offeror or its affiliates purchased or undertook to purchase the relevant shares or securities over the six month period before the offer was sent to the public company. From the moment of acquisition of more than 30% of the total number of the shares until the moment of sending of an offer to the public company, the person making the offer and its affiliates will be able to vote only 30% of the common shares and voting preferred shares of the public company (regardless of the size of their actual holdings). These rules are also applied (or reapplied) to acquisitions resulting in a person and its affiliates owning more than 50% and 75% of a public company's outstanding common shares and voting preferred shares.

A person that, as a result of such a voluntary or mandatory offer, becomes (individually or together with its affiliates) the owner of more than 95% of the total number of the public company's common shares and voting preferred shares, must buy out the remaining shares of the public company as well as other securities convertible into such shares upon request of the holders of such shares or other securities, and may require such holders to sell such shares and other securities convertible into such shares. The price for the shares and other securities convertible into such shares should be determined in the manner described above for a mandatory offer, but it may not be less than (i) the price of the preceding acquisition of the public company's shares or other securities convertible into such shares under the voluntary or mandatory offer as a result of which the offeror and its affiliates acquired over 95% of the total number of the public company's common shares and voting preferred shares; or (ii) the highest price at which after the expiration date of the voluntary or mandatory offer the offeror or its affiliates acquired or undertook to acquire such shares or other securities convertible into such shares of the public company. The offeror is entitled to require the holders of the

remaining shares of the public company, as well as other securities convertible into such shares, to sell such shares and other securities, provided that the offeror acquired not less than 10% of the total number of shares or other securities of the public company as a result of acceptance by other shareholders of the voluntary or mandatory offer as described above.

An offer of the kind described in the preceding three paragraphs must be accompanied by a bank guarantee of payment. Prior notice of the offer must be filed with the CBR which may order amendments to the terms of the offer (including price) in order to bring them into compliance with the requirements of the current legislation.

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Once a voluntary or mandatory offer has been made, competing offers for the same securities can be made by third parties and, in certain circumstances, acceptance of the initial offer may be withdrawn by the security holders who choose to accept such competing offer. From the date of receipt of a voluntary or mandatory offer by the public company until 20 days after its expiration the public company's general shareholders' meeting will have the sole power to make decisions on charter capital increase by way of issuance of additional shares within the number and category (type) of authorized shares, issuance of securities convertible into shares, including options of a public company, consent or subsequent approval of certain transactions or a number of related transactions, involving the acquisition or disposal, or a possibility of disposal (whether directly or indirectly), of property having a value of 10% or more of the balance sheet value of the assets of a public company as determined under Russian accounting standards as of the last reporting date preceding the transaction, with the exception of, inter alia, transactions completed in the ordinary course of business, and on certain other significant matters.

The above rules may be supplemented through rulemaking by the CBR, which may result in a broader, narrower or more specific interpretation of these rules by the governmental and judicial authorities, as well as by market participants.

***Approval of the Russian Federal Antimonopoly Service***

Pursuant to the Competition Law, acquisitions of voting shares of a joint-stock company, involving companies with a combined value of assets or annual revenues, exceeding a certain threshold under Russian accounting standards, which would result in a shareholder (or a group of shareholders defined under Russian law) holding more than 25%, 50% or 75% of the voting capital stock of such company, or in a transfer between such companies of assets or rights to assets, the value of which exceeds a certain amount, or obtaining rights to determine the conditions of business activity of an entity or to exercise the authorities of its executive body must be approved in advance by the FAS. Such transactions executed between members of a group of companies may require only a subsequent notification to the FAS if prior notification about the members of the group of companies has been filed with the FAS and the information contained in this notification is still accurate as of the date of the relevant transaction and had not been changed within 30 days from the date of group's disclosure and prior to the date of the transaction's settlement. See Item 4. Information on the Company Regulatory Matters Russian Antimonopoly Regulation.

***Foreign ownership***

Under the Strategic Industries Law any acquisition, whether direct or indirect, by a foreign investor or its group of entities (except for the acquisition by a foreign investor controlled by the Russian Federation, the constituent entity of the Russian Federation and/or Russian nationals provided such Russian nationals are Russian tax residents and do not have other nationality) of a certain stake, or certain rights, in a Strategic Company or a Subsoil Strategic Company, as well as acquisition, ownership or use by them of property of such companies which relates to core production facilities and the cost of which is 25% or more of the balance sheet value, must be previously approved by the Governmental Commission. Under the Strategic Industries Law, acquisition of 5% or more of the charter capital of a Strategic Company by a foreign investor or its group of entities require notification of Russian authorities. The FAS is the federal executive authority for execution of control over making foreign investments in the Russian Federation. See Item 3. Key Information Risk Factors Legal risks and uncertainties Expansion of limitations on foreign investment in strategic sectors could affect our ability to attract and/or retain foreign investments and Item 4. Information on the Company Regulatory Matters The Strategic Industries Law.

The Federal Law No. 160-FZ On Foreign Investments in the Russian Federation, dated July 9, 1999, as amended ( **Foreign Investments Law** ), provides that any acquisition (whether direct or indirect) by a foreign state or international organization or entities controlled by them of more than 25% of voting shares in a Russian



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company or any other powers to block decisions of the management bodies in a Russian company, requires a prior approval of the Governmental Commission in accordance with the procedures set forth in the Strategic Industries Law.

### **Disclosure of Ownership**

Under Russian law, a holder of common shares of a joint-stock company, which has a CBR registered prospectus, must notify the company and the CBR of an acquisition of 5% or more of the company's common shares or of an acquisition of the right to cast votes attached to 5% or more of the common shares by virtue of an agreement or otherwise, and of any subsequent change in the number of the common shares above or below a 5%, 10%, 15%, 20%, 25%, 30%, 50%, 75% or 95% threshold. Such notifications must be given not later than 10 days after the common shares have been transferred to such shareholder's securities account or after the acquisition of the right to cast votes attached to such common shares, whether by virtue of an agreement or otherwise.

Russian taxpayers (organizations and individual entrepreneurs), as well as foreign persons, registered as individual entrepreneurs in Russia, who acquire more than 10% of shares in a Russian joint-stock company, need to notify the Russian tax authorities within one month following such acquisition.

### **Negative Net Assets**

If the net assets of a Russian joint-stock company calculated on the basis of the Russian accounting standards as of the end of its second or any subsequent reporting year are lower than its share capital, the joint-stock company's board of directors must disclose it in the annual report. Furthermore, if the net assets of a Russian joint-stock company calculated on the basis of the Russian accounting standards as of the end of the reporting year that follows its second or any subsequent reporting year, at the end of which the net assets of such company were lower than its share capital, remain lower than its share capital, the company must decrease its share capital to the amount of its net assets or liquidate. In addition, if a Russian joint-stock company's net assets calculated on the basis of the Russian accounting standards as of the end of its second or any subsequent reporting year are lower than the minimum amount of the share capital required by law, the company must liquidate.

Moreover, if a Russian joint-stock company fails to comply with any of the requirements stated above within six months from the end of the relevant reporting year, governmental or local authorities will be able to seek involuntary liquidation of such company in court. In addition, if a Russian joint-stock company fails to comply with any of the requirements stated above within six months from the end of the relevant reporting year or decreases its share capital, the company's creditors will have the right to accelerate their claims or demand early performance of the company's obligations owed to them and demand compensation of damages.

In addition, if a Russian joint-stock company's net assets calculated on the basis of the Russian accounting standards are lower than its share capital by more than 25% as of the end of three, six, nine or twelve months of the reporting year that follows its second or any subsequent reporting year, at the end of which the net assets of such company were lower than its share capital, a joint-stock company is obliged to make a public disclosure of this fact. In this case, the company's creditors whose claims arose before the publication will have the right to accelerate their claims or demand early performance of the company's obligations owed to them and demand compensation of damages.

However, if a Russian joint-stock company is able to demonstrate that the creditors' rights were not violated as a result of a decrease of its share capital or a decrease of the amount of its net assets, as the case may be, and that the security provided for due performance of the company's obligations is sufficient, a court may dismiss the creditors' claims that are brought in the following cases: (1) in the event of a decrease of the share capital of the company, including when

the share capital of the company must be decreased to the amount of its net assets in

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compliance with the requirements of Russian law; and (2) in the event the company's net assets calculated on the basis of the Russian accounting standards are lower than its share capital by more than 25% at the end of three, six, nine or twelve months of the reporting year that followed its second or any subsequent reporting year, at the end of which the net assets of such company became lower than its share capital. Moreover, the existence of negative assets, generally, may not accurately reflect the actual ability to pay debts as they come due. Some Russian courts, in deciding whether or not to order the liquidation of a company for having negative net assets, have looked beyond the fact that the company failed to comply fully with all applicable legal requirements and have taken into account other factors, such as the financial standing of the company and its ability to meet its tax obligations, as well as the economic and social consequences of its liquidation. Nonetheless, creditors have the right to accelerate claims, including damages claims, and governmental or local authorities may seek the liquidation of a company with negative net assets. Courts have, on rare occasions, ordered the involuntary liquidation of a company for having net assets less than the minimum share capital required by law, even if the company had continued to fulfill its obligations and had net assets in excess of the minimum share capital required by law at the time of liquidation. See Item 3. Key information Risk Factors Legal risks and uncertainties One or more of our subsidiaries could be forced into liquidation on the basis of formal non-compliance with certain requirements of Russian law, which could materially adversely affect our business, financial condition, results of operations and prospects.

**Material Contracts**

The following is a description of contracts that we and/or our subsidiaries are a party to and that are or may be material to our business. The descriptions of the contracts are qualified in their entirety by reference to the relevant contracts. For more information, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Restrictive Covenants, Item 13. Defaults, Dividend Arrearages and Delinquencies and Item 8. Financial Information Litigation Debt litigation.

***Credit Facility for Mechel from VTB Bank******General***

On December 27, 2010, Mechel obtained a credit line for the total amount of 10.0 billion rubles (approximately \$329.3 million) from VTB Bank to finance our general activity. In November 2011, the amount of the credit line was increased up to 13.0 billion rubles (approximately \$442.2 million).

On April 10, 2013, Mechel executed an amendment to the loan agreement increasing the amount of the facility to 40.0 billion rubles (approximately \$1.3 billion as of that date). The term of the facility was extended to five years and the covenants were amended. The proceeds were used to refinance existing indebtedness with VTB Bank as well as to refinance other obligations of the companies within our group (including redemption of ruble bonds).

In May 2014, Mechel entered into an amendment to the credit facility agreement to refinance debt in the amount of 40.0 billion rubles (approximately \$711.0 million as of December 31, 2014), providing for an extension of the repayment grace period until April 2015 and the final maturity until April 2018. VTB Bank also provided an additional loan for redemption of ruble bonds in the amount of up to 3.8 billion rubles (approximately \$67.3 million as of December 31, 2014). As of December 31, 2014, the facility was fully drawn.

In September 2015, Mechel signed restructuring with VTB Bank for the amount of principal and accrued compounded interest totaling 44.8 billion rubles (approximately \$614.3 million as of December 31, 2015), providing for an extension of the repayment grace period until April 2017 and the final maturity until April 2020. The restructuring came into effect on October 13, 2015.

In December 2016, Mechel signed an amendment to its credit facility agreement with VTB Bank which provides for an extension of the repayment grace period until April 2020 and the final maturity until April 2022.



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In December 2016, Chelyabinsk Metallurgical Plant entered into a credit facility agreement with VTB Bank with a credit limit of 30.0 billion rubles (approximately \$494.6 million as of December 31, 2016) to refinance Mechel's debt under the credit facility with VTB Bank. The loans are provided to the borrower until February 28, 2020 in the amount of 5.0 billion rubles twice a year in 2017 and 2018 and once a year in 2019 and 2020. The borrower's obligations are guaranteed by Mechel and the same guarantors as under the Mechel's credit facility, except for Bratsk Ferroalloy Plant, Mecheltrans and Mechel Service. The credit facility is secured by the same pledges as the Mechel's credit facility, except for 37.5%+1 share of Mechel Mining. In all other material aspects the terms of the credit facility are identical to the Mechel's credit facility.

*Interest rate and interest period*

Interest under the credit facility is payable at the CBR key rate plus 1.5% per year. The lender may increase the interest rate by 1% per year if the borrower fails to meet certain obligations under the credit facility. During the grace period, we apply the rate of 8.75% for interest repayment. The remaining unpaid interest is being capitalized and paid on the final maturity date.

*Repayment and prepayments*

The facility has a grace period until April 6, 2020 and is to be repaid in equal monthly installments. The final maturity date is April 6, 2022. Mechel may prepay the loan in full or in part subject to simultaneous compliance with certain requirements.

*Guarantee*

The borrower's obligations under the credit facility are guaranteed by Mechel Mining, Mechel Carbon, Mechel Carbon Singapore, Mechel Trading, Yakutugol, Southern Kuzbass Coal Company, Korshunov Mining Plant, Urals Stampings Plant, Chelyabinsk Metallurgical Plant, Bratsk Ferroalloy Plant, Mecheltrans and Mechel Service.

*Security*

The credit facility is secured by a pledge of 37.5%+1 share of Mechel Mining, 46.66%-1 share of Chelyabinsk Metallurgical Plant, 25%+1 share of Southern Kuzbass Coal Company, 25%-3 shares of Yakutugol, 25%+1 share of Korshunov Mining Plant and 25%+1 share of Urals Stampings Plant.

*Covenants and other matters*

For the relevant period ending on December 31, 2016, we were not in compliance with certain non-financial covenants. We have requested the bank to waive our breaches and the respective waivers were obtained for certain of such breaches.

Under the credit facility agreement, Mechel group's ratio of net borrowings to EBITDA shall not exceed 9.00:1 until December 31, 2016, 8.00:1 until December 31, 2017, 7.00:1 until December 31, 2018, 6.00:1 until December 31, 2019, 5.00:1 until December 31, 2020 and thereafter. Mechel group's ratio of EBITDA to net interest expense shall not be less than 1.25:1 until December 31, 2016, 1.50:1 until December 31, 2017, 1.75:1 until December 31, 2018, 2.00:1 until December 31, 2019, 2.25:1 until December 31, 2020 and thereafter. Financial covenants are tested semi-annually.

The credit facility agreement contains certain customary representations and warranties, affirmative covenants, notice provisions and events of default, including change of control and cross-defaults relating to other debt, as well as limitations on payment of dividends, acquisitions and disposals and non-core transactions.

The credit facility agreement is governed by Russian law.

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**Table of Contents*****Credit Facilities for Southern Kuzbass Coal Company from Sberbank******General***

On October 9, 2012, Sberbank opened four credit lines to our subsidiary Southern Kuzbass Coal Company in the total amount of 24.0 billion rubles (approximately \$772.3 million) for the purpose of working capital financing. As of December 31, 2012, we had drawn 15.1 billion rubles (approximately \$497.2 million) under the credit lines. In February 2013, we drew down an additional 1.0 billion rubles. Due to the amendment in March 2013, we drew down a further 7.9 billion rubles (such drawdowns also contained a built-in cross-currency derivative instrument). As of December 31, 2013, the facilities were fully drawn. In December 2014, due to substantial depreciation of the ruble, the exchange rate threshold of 50.00 rubles per one U.S. dollar (as stipulated in the agreements) was exceeded and Sberbank converted the 20.9 billion rubles loans into U.S. dollars. As of December 31, 2015, the outstanding balance was \$678.0 million for the U.S. dollar-denominated part of the credit lines and 3.1 billion rubles for the ruble-denominated part of the credit lines.

In December 2015, Southern Kuzbass Coal Company signed settlement agreements with Sberbank making all the debt due and payable to be further assigned to Gazprombank in the amount of 31.5 billion rubles. In April 2016, Southern Kuzbass Coal Company signed new settlement agreements with Sberbank which assigned part of the principal amount to Gazprombank. The principal in the total amount of \$423.1 million (28.4 billion rubles as of April 12, 2016) and 3.1 billion rubles was assigned with \$254.9 million remaining on Southern Kuzbass Coal Company. The overdue interest on ruble-denominated and U.S. dollar-denominated debt was added to the principal outstanding in the amount of 189.4 million rubles and \$40.2 million, respectively. Part of the overdue interest and penalties remained on Southern Kuzbass Coal Company was capitalized with extended maturity similar to the principal outstanding. The rest of the overdue interest and penalties were paid in June 2016.

***Interest rate and interest period***

Under the U.S. dollar-denominated part of the credit lines, the interest is payable monthly at 3-month LIBOR plus a margin of 7%. Starting from April 13, 2016, the payable part of interest equals to the rate of 3-month LIBOR plus a margin of 5%, with the remaining unpaid interest being capitalized and paid at the final maturity date. The level of margin being paid depends on Mechel group's ratio of total borrowings to EBITDA.

Under the ruble-denominated part of the credit lines, the interest is payable monthly at the CBR key rate plus 1.5% per year. The lender may change the interest rate on the CBR key rate plus 3.5% per year if Gazprombank and VTB Bank decide to change the interest rate. The payable part of interest equals to 8.75%, with the remaining unpaid interest being capitalized and paid at the final maturity date. The level of interest being paid depends on Mechel group's ratio of total borrowings to EBITDA.

***Repayment and prepayments***

The final maturity date is April 10, 2022. The debt is payable in equal monthly installments starting from January 10, 2020. The borrower may prepay the loans in full or in part with prior notice to the lender.

***Guarantee***

The borrower's obligations under the credit facility agreements are guaranteed by Mechel, Mecheltrans, Mechel Service, Bratsk Ferroalloy Plant, Izhstal, Yakutugol, Korshunov Mining Plant, Chelyabinsk Metallurgical Plant and Mechel Mining.

*Security*

Starting from March 2016, the credit facilities share one security package with other credit facilities: a pledge of 25%+1 share of Mechel Mining, a pledge of 25%+1 share of Beloretsk Metallurgical Plant, pledges of movable assets and mortgage over immovable assets of other Sberbank borrowers within Mechel group.

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*Covenants and other matters*

For the relevant period ending on December 31, 2016, we were not in compliance with certain non-financial covenants. We have requested the bank to waive our breaches.

Under the credit facility agreements, Mechel group's ratio of total borrowings to EBITDA shall not exceed 7.5:1 as of December 31, 2016, 5.5:1 as of June 30, 2017 and December 31, 2017, 4.5:1 as of June 30, 2018 and December 31, 2018, 3.5:1 as of June 30, 2019 and December 31, 2019, 3.0:1 as of June 30, 2020 and thereafter. Mechel group's ratio of EBITDA to consolidated financial expense shall not fall below 1.25:1 as of December 31, 2016, 1.5:1 as of June 30, 2017 and December 31, 2017, 1.75:1 as of June 30, 2018 and December 31, 2018, 2.0:1 as of June 30, 2019 and December 31, 2019, 2.5:1 as of June 30, 2020 and thereafter.

The credit facility agreements contain certain customary representations and warranties, affirmative covenants, notice provisions and events of default, including change of control and cross-defaults to other debt.

The credit facility agreements are governed by Russian law.

***Pre-Export Facility Agreements***

*General*

On December 3, 2013, our subsidiaries Yakutugol and Southern Kuzbass Coal Company entered into an amendment agreement to the existing \$1.0 billion pre-export facility agreements (as amended and restated on December 4, 2012) with a syndicate of banks coordinated by ING Bank N.V., Société Générale and VTB Capital Plc. The amendments provide that the loan, which was entering the repayment phase in December 2013, will be repayable in equal monthly installments until December 2016 following a grace period of 12 months ending in December 2014. The terms of the facility agreements are identical in all material aspects, except for the security provided under each facility. In December 2016, the final maturity under the facility agreements expired making all the debt due and we failed to repay it.

As of December 31, 2016, we had overdue principal in the amount of \$1.0 billion (approximately 60.9 billion rubles) and overdue interest in the amount of \$117.5 million (approximately 7.1 billion rubles) under these facility agreements. We have requested the banks to restructure the repayment schedule of the facilities in 2015 but so far no agreement has been reached. In February 2017, a number of lenders filed 14 requests for arbitration with the LCIA. See Item 8. Financial Information – Litigation – Debt litigation.

*Interest rate and interest period*

Interest under the facilities is payable at 1M LIBOR plus a margin, or at fixed rate that may be agreed with the lenders. Based on results for the period ending on December 31, 2012, the margin levels were reset during 2013 at 5.5% per year. The overdue principal bears interest rate of 1M LIBOR plus 7.5% per year.

*Repayment and prepayments*

The facility is repayable in equal monthly installments after a 12-month grace period ending in December 2014. The borrowers are entitled to prepay the loan subject to 10 business days' prior notice to the syndicate of banks and certain other conditions specified in the credit facility agreements. Starting from December 2014, the borrowers have failed to pay the installments. As of December 31, 2016, the facility has matured without being repaid.

*Guarantee*

Yakutugol's obligations under the credit facility agreement are guaranteed in full by Mechel, Mechel Mining, Mechel Carbon, Mechel Carbon Singapore as well as by Southern Kuzbass Coal Company and

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Korshunov Mining Plant (for Southern Kuzbass Coal Company and Korshunov Mining Plant in the amount of up to 2% of the value of their total assets as determined under Russian accounting standards). Southern Kuzbass Coal Company's obligations under the credit facility agreement are guaranteed in full by Mechel, Mechel Mining, Mechel Carbon, Mechel Carbon Singapore and Yakutugol, as well as by Korshunov Mining Plant (for the latter in the amount of up to 2% of the value of its total assets as determined under Russian accounting standards). The guarantee provided by Mechel can be released subject to certain conditions.

### *Security*

Yakutugol's obligations under the credit facility agreement are secured by a pledge of all equipment and machinery of the borrower having a balance sheet value of \$10.0 million or higher and a pledge of 15%+1 share of Yakutugol and of 10% of shares of Southern Kuzbass Coal Company. Southern Kuzbass Coal Company's obligations under the credit facility agreement are secured by a pledge of all equipment and machinery of the borrower having a balance sheet value of \$10.0 million or higher and a pledge of 15%+1 share of Southern Kuzbass Coal Company and of 10% of shares of Yakutugol.

The number of shares of each of Yakutugol and Southern Kuzbass Coal Company under pledge will be decreased from 25%+1 share to 15% if certain conditions are met. Such conditions include, among others, the ratio of Mechel Mining's net borrowings to EBITDA being less than or equal to 2.5:1, the outstanding debt under the facility not exceeding 50% of the original principal amount and there being no event of default continuing under the facility.

The obligations of each of the borrowers are also secured by the assignment of rights under their export and offtake contracts and a charge over their collection accounts.

### *Covenants and other matters*

Although the credit facility agreements matured as of December 31, 2016, they have not been repaid or restructured, thus the new set of non-financial covenants as well as the new ratios of financial covenants for the future periods were not agreed and implemented into the documentation.

The credit facility agreements contain certain customary representations and warranties, affirmative covenants, including negative pledges and limitation on lending to third parties, as well as notice provisions and events of default, including change of control and cross-defaults relating to other debt with certain limitations.

The credit facility agreements are governed by English law.

## ***Project Finance Credit Facility for Elgaugol from Vnesheconombank***

### *General*

On March 12, 2014, our subsidiary Elgaugol signed two credit facilities in an aggregate amount of \$2.5 billion with Vnesheconombank for the development of the Elga coal complex: (i) a facility in the amount of \$2.085 billion for the total budgeted financing necessary until commissioning (the main credit line) and (ii) a facility in the amount of \$418.7 million to be used for the repayment of the \$150.0 million bridge loan and payment of the fees and commissions associated with the main credit line and interest during the grace period (the second credit line). The facilities have a tenor of 13.5 years, including a repayment grace period of 3.5 years.

As of December 31, 2016, a total of \$20.9 million was drawn under the second credit line. Disbursement under the facilities has been suspended by Vnesheconombank due to our failure to fulfill conditions precedent. We hold negotiations with Vnesheconombank with respect to possibility of further financing of the Elga project. As of December 31, 2016, the overdue interest under the second credit line amounted to approximately \$1.3 million (approximately 76.0 million rubles).



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### *Interest rate and interest period*

Main credit line: fixed rate of 7.5% per year for the first 60 months after the date of the loan agreement; and 6-month LIBOR plus 6% per year after the first 60 months.

Second credit line: fixed rate of 8% per year for the first 60 months after the date of the loan agreement; and 6-month LIBOR plus 6% per year after the first 60 months.

The interest is paid quarterly.

### *Repayment and prepayments*

Identical for both facilities, the first principal repayment is 42 months after the date of signing of the loan agreement and takes place on a yearly basis according to a defined schedule.

### *Security*

The facilities are secured with a pledge of 49% of shares in Elgaugol, a pledge of Elgaugol proprietary land and land lease rights, a pledge of immovable property of Elgaugol including construction in progress and a pledge over all movable property of Elgaugol with a book value over one million rubles per unit.

### *Covenants and other matters*

For the relevant period ending on December 31, 2016, we were not in compliance with certain non-financial covenants.

There are no guarantees and financial covenants issued in support of these facilities, except for the requirement to maintain a positive value of the borrower's net assets starting from the calendar quarter following the date of the commissioning of the facilities and ending on the date of the complete repayment of the credit.

The credit facility agreements are governed by Russian law.

## ***Facility Agreement for Chelyabinsk Metallurgical Plant from BNP Paribas, Gazprombank and UniCredit Universal Rolling Mill Facility Agreement***

### *General*

On September 15, 2010, we signed a credit facility agreement to finance the universal rolling mill installation project at our subsidiary Chelyabinsk Metallurgical Plant. The credit facility consists of three tranches underwritten by BNP Paribas S.A., Gazprombank and UniCredit. Gazprombank's tranche is \$219.4 million, BNP Paribas's tranche is 102.8 million and UniCredit's tranche is 89.2 million. The credit facility benefits from insurance coverage of the Italian, German and Chinese export credit agencies: SACE, Euler Hermes and Sinasure, respectively.

The purpose of the facility is to finance payments under two contracts: the equipment and technology supply contract executed with Danieli and the general construction contract executed with Minmetals.

As of December 31, 2016, the principal amount outstanding under the facility was \$154.9 million and 154.7 million (in aggregate approximately 19.3 billion rubles), with overdue principal in the amount of \$70.4 million and

55.2 million (in aggregate approximately 7.8 billion rubles) and overdue interest in the amount of \$11.2 million and 2.7 million (in aggregate approximately 852.5 million rubles). We hold negotiations with the lenders on the restructuring of the facility.

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### *Interest rate and interest period*

Interest on the facility tranche underwritten by Gazprombank (Facility A) is payable at 6M LIBOR plus a margin of 6.75% per year during the period until the construction completion date and at 6M LIBOR plus a margin of 6.25% per year after that date. Interest on the facility tranche underwritten by UniCredit (Facility B) is payable at 6M EURIBOR plus a margin of 1.50% per year. Interest on the facility tranche underwritten by BNP Paribas (Facility C) is payable at 6M EURIBOR plus a margin of 1.60% per year.

Accrued interest is payable twice a year on payment dates January 21 and July 21.

### *Repayment and prepayments*

The borrower must repay the tranches in 13 equal semi-annual installments in respect of Facility A; 16 equal semi-annual installments in respect of Facility B; and 16 equal semi-annual installments in respect of Facility C.

Repayment starts on the first repayment date, which means in respect of each of the tranches, the first payment date (January 21 or July 21) falling after the earlier of (a) the end of the availability period and (b) the construction completion date. The availability period under all three tranches is 30 months from the signing date. Facility A must be repaid in full after six years following the first repayment date, Facilities B and C must be repaid in full after seven and a half years following the first repayment date.

The borrower may make a pro rata prepayment of the loan with the prior written consent of the lenders. A prepayment of part of the loan must be of a minimum amount of \$10.0 million in respect of Facility A, and 10.0 million in respect of Facility B and Facility C.

Starting from July 2014, the borrower failed to pay the installments.

### *Guarantee*

The borrower's obligations under the credit facility agreement are guaranteed by Mechel.

### *Security*

The borrower's obligations under the credit facility agreement are secured by a pledge of 20% of the common shares of Chelyabinsk Metallurgical Plant. The borrower has also granted security over certain of its assets, including real estate and equipment to secure its obligations.

### *Covenants and other matters*

For the relevant period ending on December 31, 2016, we were not in compliance with certain financial and non-financial covenants.

Under the credit facility agreement, Mechel's ratio of net borrowings to EBITDA shall not exceed 6.3:1 as of December 31, 2016, 6.0:1 as of June 30, 2017, 5.8:1 as of December 31, 2017 and thereafter, provided that if during any period the ratio of net borrowings to EBITDA is 3.0:1 or less, then the ratio of 3.0:1 continues to apply thereafter. Mechel's ratio of EBITDA to net interest expense shall not fall below 2.0:1 as of December 31, 2016 and thereafter. Mechel's shareholder equity shall be equal to or exceed \$3.0 billion.

Mechel may pay dividends: (i) on our common and preferred shares, provided that the ratio of Mechel's net borrowings to EBITDA does not exceed 3.0:1, and if such dividends are funded from available excess cash flow, provided that no default occurs or would occur as a result of that payment; and (ii) if dividends on our preferred

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shares do not exceed 20% of Mechel's net profit. If Mechel records a loss as shown in the financial statements, the amount of permitted dividends paid on our preferred shares shall be limited to 7.5 million rubles for any such financial year.

Acquisitions by members of our group are permitted if (1) such acquisitions in aggregate do not exceed (i) \$5.0 million when the ratio of our net borrowings to EBITDA exceeds 3.5:1, (ii) \$50.0 million when the ratio of our net borrowings to EBITDA is within the range of 3.0:1 – 3.5:1, (iii) \$250.0 million when the ratio of our net borrowings to EBITDA is within the range of 2.5:1 – 3.0:1, (iv) \$375.0 million when the ratio of our net borrowings to EBITDA is within the range of 2.0:1 – 2.5:1, or (v) \$500.0 million when the ratio of our net borrowings to EBITDA is 2.0:1 or less; or (2) the total amount of such acquisition is fully financed by available excess cash flow.

The borrower may not, without prior consent from the lender, enter into any amalgamation, demerger, merger or reorganization except an intra-group reorganization on a solvent basis.

The credit facility agreement contains certain customary representations and warranties, affirmative covenants, notice provisions and events of default, including change of control and cross-defaults to other debt.

The credit facility agreement is governed by English law.

***Credit Facility Agreements for Yakutugol and Southern Kuzbass Coal Company from Gazprombank******General***

In April 2012, our subsidiaries Yakutugol and Southern Kuzbass Coal Company entered into two separate non-revolving credit facility agreements with Gazprombank for a total amount of \$500.0 million: \$300.0 million was made available to Yakutugol and \$200.0 million was made available to Southern Kuzbass Coal Company, both for a period of up to five years with a three-year grace period obtained for the purpose of funding operational activities and refinancing of short-term debt. As of December 31, 2014, the facilities were fully drawn.

In August and December 2015, Yakutugol and Southern Kuzbass Coal Company signed amendments to their credit facility agreements with Gazprombank to restructure debt in a total amount of \$500.0 million. In January 2016, the restructuring of these credit facilities became effective. As a result of the conversion into rubles, the debt of Yakutugol amounted to approximately 22.8 billion rubles and of Southern Kuzbass Coal Company amounted to approximately 15.3 billion rubles.

In June 2016, we signed amendments to the credit facility agreements under which accrued and unpaid interests in the amount of 3.9 billion rubles were capitalized. We must repay this amount and interest accrued on it on a monthly basis during the period from April 15, 2017 to March 30, 2018.

***Interest rate and interest period***

Starting from the effective date, the interest under the credit facilities is payable at the CBR key rate plus 1.5% per year until April 2022. The lender may change the interest rate on the CBR key rate plus 3.5% per year if the borrowers fail to meet the payment schedule of accrued and unpaid interests. During the grace period, we apply the rate of 8.75% for interest repayment. The remaining unpaid interests are being capitalized and paid in accordance with the principal repayment schedule.

***Repayment and prepayments***

The final maturity date is April 20, 2022. Repayment is to be made in equal monthly installments starting from January 12 and 13, 2020. The lender may change the final maturity date on April 20, 2020 if the borrowers fail to meet the payment schedule of accrued and unpaid interests. In this case repayment is to be made in equal monthly installments starting from the month when such failure occurred.

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The borrowers may prepay the loans in full or in part with a 30 day prior notice to the lender.

### *Guarantee*

The borrowers' obligations are guaranteed by Mechel Mining, Mechel Carbon, Korshunov Mining Plant, Urals Stampings Plant, Chelyabinsk Metallurgical Plant, Mechel and cross guarantee between Southern Kuzbass Coal Company and Yakutugol.

### *Security*

Yakutugol's obligations under the credit facility agreement are secured by a pledge of 25%+1 share in each of Southern Kuzbass Coal Company, Korshunov Mining Plant, Port Posiet, Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant and Urals Stampings Plant, 50%+1 share in Yakutugol and 25% in Port Temryuk, as well as 33.3% of common shares of Izhstal.

Southern Kuzbass Coal Company's obligations under the credit facility agreement are secured by a pledge of 25%+1 share in each of Southern Kuzbass Coal Company, Korshunov Mining Plant, Port Posiet and Beloretsk Metallurgical Plant, 50%+1 share in each of Yakutugol and Urals Stampings Plant and 25% in each of Port Temryuk and Bratsk Ferroalloy Plant, as well as 33.3% of common shares of Izhstal.

In March 2016, we mortgaged the Ulak-Elga rail line under the credit facility agreements.

### *Covenants and other matters*

For the relevant period ending on December 31, 2016, we were not in compliance with certain non-financial covenants. We have requested the bank to waive our breaches.

Under the credit facility agreements, Mechel group's ratio of total borrowings to EBITDA shall not exceed 7.5:1 in 2016, 5.5:1 in 2017, 4.5:1 in 2018, 3.5:1 in 2019 and 3.0:1 in 2020. Mechel group's ratio of EBITDA to consolidated financial expense shall not be less than 1.25:1 in 2016, 1.50:1 in 2017, 1.75:1 in 2018, 2.0:1 in 2019 and 2.5:1 in 2020. During the period from 2017 to 2020, we also have to comply with the ratios of operational cash flow to EBITDA and EBITDA to revenues at the levels of 80% and 20%, respectively.

The credit facility agreements contain certain customary representations and warranties, affirmative covenants, notice provisions and events of default, including change of control and cross-defaults to other debt.

The credit facility agreements are governed by Russian law.

### ***Credit Facility Agreements for Yakutugol and Southern Kuzbass Coal Company from Gazprombank***

#### *General*

In April 2013, our subsidiaries Yakutugol and Southern Kuzbass Coal Company entered into separate non-revolving credit facility agreements with Gazprombank for a total amount of \$889.0 million: \$400.0 million was made available to Southern Kuzbass Coal Company and \$489.0 million was made available to Yakutugol, both for a period of up to five years with a three-year grace period obtained for the purpose of funding operational activities and refinancing of short-term debt provided by Gazprombank. As of December 31, 2014, the amount outstanding under the Southern Kuzbass Coal Company facility was \$400.0 million and the amount outstanding under the Yakutugol facility was

\$385.8 million.

In August and December 2015, Yakutugol and Southern Kuzbass Coal Company signed amendments to their credit facility agreements with Gazprombank to restructure debt in a total amount of \$785.8 million. In



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January 2016, the restructuring of these credit facilities became effective. As a result of the conversion into rubles, the debt of Yakutugol amounted to approximately 30.5 billion rubles and of Southern Kuzbass Coal Company amounted to approximately 30.4 billion rubles.

In June 2016, we signed amendments to the credit facility agreements under which accrued and unpaid interests in the amount of 6.4 billion rubles were capitalized. We must repay this amount and interest accrued on it on a monthly basis during the period from April 15, 2017 to March 30, 2018.

### *Interest rate and interest period*

Starting from the effective date, the interest under the credit facilities is payable at the CBR key rate plus 1.5% per year until April 2022. The lender may change the interest rate on the CBR key rate plus 3.5% per year if the borrowers fail to meet the payment schedule of accrued and unpaid interests. During the grace period, we apply the rate of 8.75% for interest repayment. The remaining unpaid interests are being capitalized and paid in accordance with the principal repayment schedule.

### *Repayment and prepayments*

The final maturity date is April 20, 2022. Repayment is to be made in equal monthly installments starting from January 26 and 28, 2020. The lender may change the final maturity date on April 20, 2020 if the borrowers fail to meet the payment schedule of accrued and unpaid interests. In this case repayment is to be made in equal monthly installments starting from the month when such failure occurred.

The borrowers may prepay the loans in full or in part with a 10 day prior notice to the lender.

### *Guarantee*

The borrowers' obligations are guaranteed by Mechel Mining, Mechel Carbon, Korshunov Mining Plant, Urals Stampings Plant, Chelyabinsk Metallurgical Plant, Mechel and cross guarantee between Southern Kuzbass Coal Company and Yakutugol.

### *Security*

Yakutugol's obligations under the credit facility agreement are secured by a pledge of 25%+1 share in each of Southern Kuzbass Coal Company, Korshunov Mining Plant, Port Posiet, Chelyabinsk Metallurgical Plant, Beloretsk Metallurgical Plant and Urals Stampings Plant, 50%+1 share in Yakutugol and 25% in Port Temryuk, as well as 33.3% of common shares of Izhstal.

Southern Kuzbass Coal Company's obligations under the credit facility agreement are secured by a pledge of 25%+1 share in each of Southern Kuzbass Coal Company, Korshunov Mining Plant, Port Posiet and Beloretsk Metallurgical Plant, 50%+1 share in each of Yakutugol and Urals Stampings Plant and 25% in each of Port Temryuk and Bratsk Ferroalloy Plant, as well as 33.3% of common shares of Izhstal.

In March 2016, we mortgaged the Ulak-Elga rail line under the credit facility agreements.

### *Covenants and other matters*

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For the relevant period ending on December 31, 2016, we were not in compliance with certain non-financial covenants. We have requested the bank to waive our breaches.

Under the credit facility agreements, Mechel group's ratio of total borrowings to EBITDA shall not exceed 7.5:1 in 2016, 5.5:1 in 2017, 4.5:1 in 2018, 3.5:1 in 2019 and 3.0:1 in 2020. Mechel group's ratio of EBITDA to

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consolidated financial expense shall not be less than 1.25:1 in 2016, 1.50:1 in 2017, 1.75:1 in 2018, 2.0:1 in 2019 and 2.5:1 in 2020. During the period from 2017 to 2020, we also have to comply with the ratios of operational cash flow to EBITDA and EBITDA to revenues at the levels of 80% and 20%, respectively.

The credit facility agreements contain certain customary representations and warranties, affirmative covenants, notice provisions and events of default, including change of control and cross-defaults to other debt.

The credit facility agreements are governed by Russian law.

## **Exchange Controls**

The Federal Law On Currency Regulation and Currency Control, effective from June 18, 2004, as amended, sets forth certain restrictions on settlements between residents of Russia with respect to transactions involving foreign securities (including ADSs), including requirements for settlement in Russian rubles.

### ***Repatriation of Export Proceeds***

Russian companies must repatriate 100% of their receivables from the export of goods and services (with a limited number of exceptions concerning, in particular, certain types of secured financing) within the time frame provided under the respective agreement.

### ***Restrictions on Remittance to Non-residents***

The Foreign Investments Law guarantees foreign investors the right to repatriate their earnings from Russian investments. However, the evolving Russian exchange control regime may affect investors' ability to do so. Ruble dividends on shares may be paid to the depositary or its nominee and converted into U.S. dollars by the depositary for distribution to owners of ADSs without restriction. In addition, ADSs may be sold by non-residents of Russia for U.S. dollars outside Russia without regard to Russian currency control laws so long as the buyer is not a Russian resident for currency control purposes.

## **Taxation**

The following discussion is not intended as tax advice to any particular investor. No opinion of counsel will be issued with respect to the following discussion and, therefore, such discussion is not based on an opinion of counsel. It is also not a complete analysis or listing of all potential U.S. federal or Russian income and withholding tax consequences of ownership of shares or ADSs. We urge such holders to consult their tax advisers regarding the specific U.S. federal, state and local and Russian tax consequences of the ownership and disposition of the shares or ADSs, including their eligibility for the benefits of a double tax treaty between the Russian Federation and their country of residence, in light of their particular facts and circumstances, as well as the applicability and effect of state, regional and local tax laws and foreign tax law.

### **Russian Income and Withholding Tax Considerations**

The following is a summary of certain Russian tax considerations relevant to payments to Russian resident and non-resident holders of the shares and ADSs and to the purchase, ownership and disposition of the shares and ADSs by Russian resident and non-resident holders. This summary is based on the laws of Russia in effect as of the date of this document. The discussion with respect to Russian legislation is based on our understanding of current Russian law and tax rules, which are subject to frequent change and varying interpretations.

This summary does not seek to address the applicability of, and procedures in relation to, taxes levied by the regions, municipalities or other non-federal level authorities of the Russian Federation. Nor does the summary seek to address the availability of double tax treaty relief, and it should be noted that there might be practical

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difficulties involved in claiming relief under an applicable double tax treaty. You should consult your own professional advisors regarding the tax consequences of investing in the shares and ADSs. No representations with respect to the Russian tax consequences to any particular holder are made hereby.

The Russian tax rules applicable to ADSs are characterized by uncertainties and by an absence of special provisions with respect to transactions involving ADSs. Both the substantive provisions of Russian tax law and the interpretation and application of those provisions by the Russian authorities may be subject to more rapid and unpredictable change than in a jurisdiction with more developed capital markets and a more developed taxation system. In particular, the interpretation and application of such provisions will in practice rest substantially with local tax inspectors.

For the purposes of this summary, a **Russian resident holder** means: (1) an individual holder of the shares and ADSs, actually present in the Russian Federation for 183 days or more in 12 consecutive months; or (2) an organization recognized as a tax resident of the Russian Federation, namely (i) an organization or an individual entrepreneur, organized under Russian law, (ii) a foreign organization recognized as a tax resident of the Russian Federation in accordance with the international tax treaty of the Russian Federation, and (iii) a foreign organization which place of management is the Russian Federation, unless otherwise provided by the international tax treaty of the Russian Federation; or (3) an organization, organized under a foreign law, that holds and disposes of the shares and ADSs through its permanent establishment in Russia. Individual presence in Russia is not considered interrupted if an individual departs for short periods (less than six months) for the purpose of medical treatment or education, as well as for the performance of labor or other duties related to the execution of work or services at offshore raw hydrocarbon deposits.

For the purposes of this summary, a **non-resident holder** is a holder of the shares or ADSs which is not qualified to be a Russian resident holder as defined in the previous paragraph.

***Taxation of acquisition of the shares and ADSs***

No Russian tax implications should arise for holders of the shares and ADSs upon purchase of the shares and ADSs. However, starting from 2015, Russian resident holders are required to notify tax authorities about their participation in Russian organizations (in case of direct participation interests in excess of 10%) not later than one month from the date of commencement of such participation. In addition, under certain conditions a taxable material gain may arise for individuals if the shares and ADSs are purchased at a price below the deemed market value. Also, in certain circumstances, a Russian resident holder that is an organization acquiring the shares or ADSs is generally obliged to act as a tax agent to withhold profit tax on proceeds from the sale of the shares or ADSs to be transferred to a non-resident holder disposing such shares or ADSs. We urge such holders to consult their tax advisers regarding specific tax consequences of acquisition of the shares or ADSs.

***Taxation of dividends***

A Russian company that pays dividends is generally obliged to act as a tax agent to withhold tax on the dividends and remit the amount of tax due to the Russian Federation state budget. In some cases, tax agent's functions are performed by other legal entities. However, the applicable withholding tax rate will depend on the status of the dividend's recipient and on the availability with the Russian company paying dividends on the date of such payment of documents confirming the status of the tax resident of the respective state (country) in relation to the recipient of income.

***Russian resident holders***

**Shares**

Dividends paid to a Russian resident holder of the shares that is a Russian organization or an individual will be generally subject to Russian withholding tax at the rate of 13%. Dividends received by Russian organizations

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are subject to withholding tax at the rate of 0% provided that the recipient organization constantly owns for a period of 365 calendar days or more at least 50% of participation shares in the share capital of the paying organization or share depositary receipts qualifying for dividends equal to at least 50% of the total amount of dividends paid by the organization. However it is difficult to predict how the Russian tax authorities may interpret the conditions listed above. Therefore, there can be no assurance that the 0% withholding tax rate will apply.

The effective rate of this tax may be lower than 13% (other than to non-resident companies and non-resident individuals) owing to the fact that generally this tax should be calculated by multiplying the basic tax rate (13%) by the difference between (i) the dividends to be distributed by us to our shareholders, and (ii) dividends collected by us in the current and preceding tax periods from other Russian persons (except for dividends which under the current Russian tax law are taxable at the rate of 0% and provided that the amount of dividends previously was not included when determining the tax base which is determined in respect of income received by a Russian organization in the form of dividends).

Since 2014, when paying dividends in respect of shares that are recorded on depo account of foreign nominee holder and depo account of foreign authorized holder, the tax should be calculated and withheld by the depositary (tax agent), which opened these accounts. Effective from January 1, 2014, the reduced tax rate of 0% does not apply on dividend payments for such shares. Under Russian law, the general rate of 13% is applied, subject to the submission of certain information to the tax agent. If such information has not been submitted to the tax agent in the prescribed manner and in a certain period of time, the tax rate of 15% is applied.

A holder that is a foreign organization holding shares through a permanent establishment in Russia is entitled to pay this tax to the Russian budget on its own behalf (i.e., without a Russian entity that distributes the dividends to such holder acting as a tax agent for withholding tax) if such holder provides the Russian entity that acts as the Russian tax agent with specific documentary evidence confirming dividend income is attributable to a permanent establishment of the holder in Russia. Such evidence includes a notarized copy of the form confirming registration of the holder with the Russian tax authorities. A notification must also be issued by the local tax authorities at the holder's place of tax registration confirming dividend income is attributable to the permanent establishment of the holder in Russia.

Dividends paid to a Russian establishment of a foreign organization are taxable at a rate which is set based on non-discrimination provisions of a double tax treaty between Russia and the country of tax residence of the respective foreign organization. As the Russian Tax Code does not specifically provide for the application by the Russian establishment of a foreign organization of a rate of 0% in respect of received dividends, it is not possible to guarantee the application of this rate.

**ADSs**

There are uncertainties in relation to withholding tax on dividends payable to Russian resident holders of ADSs primarily because the taxation of dividends payable under ADSs is not specifically addressed under Russian tax law.

Effective from January 1, 2014, so as to apply the tax rate of 13% when paying dividends under ADSs to residents the tax agent must be submitted with certain information in the prescribed manner and in a certain period of time. If such information has not been submitted to the tax agent, the tax rate of 30% is applied. Thus, starting from 2014, the tax agent may be obliged to withhold tax at the rate of 30% (due to the absence of the required information) and Russian holders of ADSs may be unable to use the rate of 13% provided by Russian tax law for residents.

Upon receiving dividends, Russian holders which are organizations may be required to pay additional Russian profit tax at the rate of 13% (the rate applied to dividends received from non-residents) or 20% (if the





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income received will not be recognized as dividends) while Russian holders who are individuals may be required to pay Russian income tax at the rate of 13%. There is also no established procedure providing for the refund of tax withheld from dividends payable through the depository to Russian resident holders of ADSs. Accordingly, Russian residents are urged to consult their own tax advisors regarding the tax treatment of the purchase, ownership and disposition of the ADSs.

A holder of the ADSs that is a foreign organization conducting its business through a permanent establishment in Russia is entitled to pay this tax to the Russian budget on its own behalf (i.e., without a Russian entity that distributes the dividends to such holder acting as a tax agent for withholding tax) if such holder provides the Russian entity that acts as the Russian tax agent with specific documentary evidence confirming dividend income is attributable to a permanent establishment of the holder in Russia. Such evidence includes a notarized copy of the form confirming registration of the holder with the Russian tax authorities. A notification must also be issued by the local tax authorities at the holder's place of tax registration confirming dividend income is attributable to the permanent establishment of the holder in Russia.

*Non-resident holders***Shares**

Dividends paid to non-resident holders of shares will generally be subject to Russian withholding tax, which the tax agent will withhold. Under Russian law dividends paid to a non-resident holder which is an organization or individual will be subject to Russian withholding tax at rates of 15% or 30% in certain cases. Withholding tax on dividends may be generally reduced under the terms of a double tax treaty between the Russian Federation and the country of tax treaty residence of a non-resident holder of the shares.

Since 2014, when paying dividends in respect of shares issued by Russian organizations that are recorded on depo account of foreign nominee holder, depo account of foreign authorized holder and/or depo account of depository programs, the tax should be calculated and withheld by the depository (tax agent), which opened these accounts. Effective from January 1, 2014, the reduced tax rate established in accordance with certain provisions of the double tax treaty does not apply on dividend payments under such shares. The general rate established by such treaty and not accounting for benefits or the rate of 15% provided by Russian law are applied, subject to the submission of certain information to the tax agent. If such information has not been submitted to the tax agent in the prescribed manner and in a certain period of time, a tax rate of 30% is applied.

Thus, starting from 2014, the tax agent is obliged to withhold tax at the general rate established by the tax treaty or at the rate of 15% (in the absence of the tax treaty) or at the rate of 30% (in the absence of the required information) and non-resident holders of shares may be unable to benefit from the tax treaty. Although non-resident holders of shares may apply for a refund of a portion of the tax withheld under an applicable tax treaty, the procedure to do so may be time-consuming and no assurance can be given that the Russian tax authorities will grant a refund.

**ADSs**

Comments provided in the previous section (see *Taxation of dividends Non-resident holders Shares*) are also applicable to ADSs. Effective from January 1, 2014, the reduced tax rate established in accordance with certain provisions of the double tax treaty does not apply on dividend payments under ADSs. The general rate established by such treaty and not accounting for benefits or the rate of 15% provided by Russian law are applied, subject to the submission of certain information to the tax agent. If such information has not been submitted to the tax agent in the prescribed manner and in a certain period of time, a tax rate of 30% is applied.

Thus, starting from 2014, the tax agent is obliged to withhold tax at the general rate established by the tax treaty or at the rate of 15% (in the absence of the tax treaty) or at the rate of 30% (in the absence of the required

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information) and non-resident holders of ADSs may be unable to benefit from the tax treaty. Although non-resident holders of ADSs may apply for a refund of a portion of the tax withheld under an applicable tax treaty, the procedure to do so may be time-consuming and no assurance can be given that the Russian tax authorities will grant a refund. See Tax treaty procedures below.

The dividends taxation rate may be reduced to 10% under the United States-Russia income tax treaty for U.S. non-resident holders. Under current regulations, authorization from the Russian tax authorities is not required to allow the tax agent to withhold tax at a reduced rate under applicable double tax treaties provided that all other requirements are met. See Tax treaty procedures.

If the tax agent is not submitted with the prescribed by the tax legislation information, it will be obliged to withhold tax at the rate of 30%. In this case, U.S. holders qualifying for a reduced rate under the United States-Russia income tax treaty may claim a refund from the Russian tax authorities/tax agents, depending on the status of a holder, within three years. There is significant uncertainty regarding the availability and timing of such refunds.

### ***Taxation of capital gains***

The following sections summarize the taxation of capital gains in respect of the disposition of the shares and ADSs.

#### ***Russian resident holders***

As the Russian legislation related to taxation of capital gains derived by Russian resident holders (including organizations and individuals) in connection with ADSs is not entirely clear, we urge Russian residents to consult their own tax advisors regarding the tax treatment of the purchase, ownership and disposition of ADSs.

However, since 2015, Russian tax legislation does not recognize as a sale or other disposition of securities: (i) the cancellation of ADSs upon receipt of representing securities; (ii) the transfer of securities at placement of ADSs certifying the rights for represented securities.

#### **Organizations**

Capital gains arising from the sale of the shares and ADSs by a Russian resident holder that is an organization will be taxable at the regular Russian corporate profit tax rate of 20%.

Since 2016, sale of the shares and ADSs which were acquired after January 1, 2011 is taxable at a rate of 0% provided that there is a documentary evidence that on the date of sale of such shares they were continuously owned by Russian resident holders on the basis of the right of ownership or other proprietary right for more than five years, and provided that such shares constitute the charter capital of Russian organizations in which no more than 50% of assets directly or indirectly consist of immovable property located in Russia.

However, it should be noted that the determination of whether more than 50% of our assets consist of immovable property located in Russia is inherently factual and is made on an ongoing basis, and the relevant Russian legislation in this respect is not entirely clear. Hence, there can be no assurance that immovable property owned by us and located in Russia will not constitute more than 50% of the company's assets as at the date of the sale of shares and ADSs by residents.

Russian tax legislation contains a requirement that a profit arising from activities connected with securities quoted on a stock exchange must be calculated and accounted for separately from a profit from activities connected with

securities that are not quoted on a stock exchange and from other profits. Since 2015, income (expenses) from operations with securities quoted on a stock exchange is recorded in the general tax base in accordance with generally established procedures. Therefore, Russian resident holders may be able to apply losses arising in respect of the listed shares and ADSs in the current base for profit tax.

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**Individuals**

Capital gains arising from the sale, exchange or other disposition of the shares and ADSs by individuals who are Russian resident holders must be declared on the holder's tax return and are subject to personal income tax at a rate of 13%.

Since 2016, sale of the shares and ADSs which were acquired after January 1, 2011 by Russian individuals resident holders is not subject to income tax provided that there is a documentary evidence that on the date of sale of such shares they were continuously owned by Russian resident holders on the basis of the right of ownership or other proprietary right for more than five years, and provided that such shares constitute the charter capital of Russian organizations in which no more than 50% of assets directly or indirectly consist of immovable property located in Russia.

However, it should be noted that the determination of whether more than 50% of our assets consist of immovable property located in Russia is inherently factual and is made on an ongoing basis, and the relevant Russian legislation in this respect is not entirely clear. Hence, there can be no assurance that immovable property owned by us and located in Russia will not constitute more than 50% of the company's assets as at the date of the sale of shares and ADSs by residents.

The income in respect of sale of the shares or ADSs by an individual is calculated as sale proceeds less documented expenses related to the purchase of these securities (including cost of securities and expenses associated with purchase, safe-keeping and sale of these securities).

Under Russian law, the acquisition value can be deducted by the source of the payment, if the sale was made by a holder through a professional trustee, dealer or broker that is a Russian organization or a foreign company with a permanent establishment in Russia. This professional trustee, dealer or broker should also act as a tax agent and withhold the applicable tax. Such a tax agent will be required to report to the Russian tax authorities the amount of income realized by the individual and tax withheld upon the sale of the shares and ADSs not later than April 1 of the year following the reporting year.

Furthermore, according to certain conditions, individuals may have taxable material gain at the rate of 13% if the shares and ADSs are acquired at a price below conventional market value.

*Non-resident holders*

Since 2015, Russian tax legislation does not recognize as a sale or other disposition of securities: (i) the cancellation of ADSs upon receipt of representing securities; (ii) the transfer of securities at placement of ADSs certifying the rights for represented securities.

**Organizations**

Capital gains arising from the sale, exchange or other disposition of the shares and ADSs by organizations that are non-resident holders should not be subject to tax in Russia if more than 50% of our assets directly or indirectly consist of immovable property located in Russia. If more than 50% of our assets were to consist of immovable property located in Russia, organizations that are non-resident holders of the shares and ADSs should be subject (except as described below) to a 20% withholding tax on the gross proceeds from sale, exchange or other disposition of the shares and ADSs or 20% withholding tax on the difference between the sales, exchange or other disposition price and the acquisition costs of the shares and ADSs.

However, it should be noted that the determination of whether more than 50% of our assets consist of immovable property located in Russia is inherently factual and is made on an ongoing basis, and the relevant Russian legislation in this respect is not entirely clear. Hence, there can be no assurance that immovable property

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owned by us and located in Russia will not constitute more than 50% of the company's assets as at the date of the sale of shares and ADSs by non-residents. Certain international double tax treaties may provide for protection from the Russian taxation in such instances.

Where the shares and ADSs are sold by organizations being non-resident holders to persons being organizations recognized as tax residents of the Russian Federation, even if the resulting capital gain is considered taxable in Russia, there is currently no mechanism under which the purchaser will be able to withhold the tax and remit it to the Russian budget.

## **Individuals**

The taxation of the income of non-resident individuals depends on whether the income is received from Russian or non-Russian sources. Russian tax law considers the place of sale as an indicator of source. Accordingly, the sale of the shares and ADSs outside of Russia by individuals who are non-resident holders should not be considered Russian source income and, therefore, should not be taxable in Russia. However the Russian tax law gives no clear indication as to how the place of sale of the shares and ADSs should be defined in this respect. Therefore, the Russian tax authorities may have a certain amount of flexibility in concluding whether a transaction is within Russia or outside of Russia.

The sale, exchange or other disposal of the shares and ADSs by non-resident holders in Russia will be considered Russian source income and will be subject to tax at the rate of 30% on the difference between the sales price and the acquisition value of such shares and ADSs as well as other documented expenses, such as depository expenses and broker fees, among others. Under Russian law, the acquisition value can only be deducted by the source of the payment, if the sale was made by a non-resident holder through a professional trust manager, dealer or broker that is a Russian organization or a foreign company with a permanent establishment in Russia. Such professional trust manager, dealer or broker should also act as a tax agent and withhold the applicable tax. Such a tax agent will be required to report to the Russian tax authorities the amount of income realized by the non-resident individual and tax withheld upon the sale of the shares and ADSs not later than on April 1 of the year following the reporting year.

Otherwise, if the sale is made to other organizations and individuals, generally no withholding needs to be made and the non-resident holder will have an obligation to file a tax return, report his realized profit and apply for a deduction of acquisition expenses (which includes filing of support documentation).

Although Russian tax law imposes this responsibility only on professional trust manager, brokers or dealers, in practice, the tax authorities may require organizations recognized as tax residents of the Russian Federation that are not professional trust manager, dealers or brokers to act as tax agents and withhold the applicable tax when purchasing securities from non-resident individuals.

In some circumstances, a non-resident holder may be exempt from Russian personal income tax on the sale, exchange or other disposition of the shares and ADSs under the terms of a double tax treaty between the Russian Federation and the country of residence of the non-resident holder. Under the United States-Russia income tax treaty, capital gains from the sale of the shares and/or ADSs by U.S. holders should be relieved from taxation in Russia, unless 50% or more of our assets (as the term "fixed assets" is used in the Russian version of the United States-Russia income tax treaty) were to consist of immovable property located in Russia. If this 50% threshold is not met, individuals who are U.S. holders may seek to obtain the benefit of the United States-Russia income tax treaty in relation to capital gains resulting from the sale, exchange or other disposition of the shares and/or ADSs.

In order to apply the provisions of relevant double tax treaties, the individual holders should receive clearance from the Russian tax authorities as described below. See Tax treaty procedures below.



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**Table of Contents*****Tax treaty procedures***

The Russian Tax Code does not contain a requirement that a non-resident holder that is an organization must obtain tax treaty clearance from the Russian tax authorities prior to receiving any income in order to qualify for benefits under an applicable tax treaty. However, a non-resident organization seeking to obtain relief from Russian withholding tax under a tax treaty must provide to a tax agent, before the income payment date, a confirmation of its tax treaty residence that complies with the applicable requirements in advance of receiving the relevant income. Starting from 2016, in order to apply the provisions of the international treaties of the Russian Federation, foreign organizations will also have to provide to the Russian organization which pays the income a confirmation that the foreign organization has an actual right to receive income.

Starting from 2016, the rules of elimination of double taxation in respect of individuals act in a new version. A non-resident individual who derives income from a source in the Russian Federation in order to implement the provisions of international tax treaties will have to provide the tax agent on the income payment date a confirmation that an individual-recipient of income is a tax resident in the respective foreign country. In order to confirm the status of a tax resident an individual may use the passport of a foreign citizen or any other identification document, established by the federal law or recognized by the international treaty as such. If these documents do not make it possible to confirm the existence of an individual's tax resident status of a foreign country with which the international treaty is concluded, the tax agent should also be provided with the official confirmation of this status. Such confirmation should be issued by the competent authority of the respective foreign country authorized to issue such confirmations on the basis of the international tax treaty of the Russian Federation. If such confirmation is in a foreign language, an individual provides a notarized translation into Russian. It should be noted that the tax agent in the application of preferential provisions of the international treaty must submit to the tax authority at the place of its registration the information on foreign individuals, income paid to them from which tax had not been withheld on the basis of the international treaty, as well as the refund of the tax.

In order to apply the provisions of the international treaties of the Russian Federation, foreign organizations will have to provide to the tax agent which pays the income a confirmation that the foreign organization has a residence in the country with which the Russian Federation has the international tax treaty. Such confirmation should be certified by the competent authority of the respective foreign country. If such confirmation is in a foreign language, the tax agent should be provided with a translation into Russian. In addition, starting from 2017, foreign organizations will have to provide the tax agent which pays the income with a confirmation that the foreign organization has an actual right to receive income.

The submission by the foreign organization of the above confirmations to the tax agent which pays the income before the income payment date constitutes grounds for an exemption of such income from withholding or withholding at reduced rates.

In the absence of such information, the tax agent is not entitled to apply rates established in accordance with the terms of the double tax treaty between the Russian Federation and the country of residence of the non-resident holder, and will have to apply the rate of 15% or 30% in certain cases.

At the same time, the Russian legislation does not contain a specific list of documents that can be used as a confirmation of both the actual right to receive income and the actual residence of the foreign organization, thereby admitting their ambiguous interpretation which may lead to an additional tax burden for the foreign organization.

If a non-resident holder that is an organization does not obtain double tax treaty relief at the time that income is received and tax is withheld by a Russian tax agent, the non-resident holder may apply for a refund within three years

from the end of the tax period (a calendar year) in which the tax was withheld. To process a claim for a refund, the Russian tax authorities require (i) a confirmation of the tax treaty residence of the

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non-resident at the time the income was paid, (ii) an application for the refund of the tax withheld in a format provided by the Russian tax authorities, and (iii) copies of the relevant contracts under which the foreign entity received income as well as payment documents confirming the payment of the tax withheld to the Russian budget (Form 1012DT for dividends and interest and Form 1011DT for other income are designed by the Russian tax authorities to combine requirements (i) and (ii) specified above and recommended for application). The Russian tax authorities will require a Russian translation of the above documents if they are prepared in a foreign language. The refund of the tax withheld should be granted within one month of the filing of the above set of documents with the Russian tax authorities. However, procedures for processing such claims have not been clearly established, and there is significant uncertainty regarding the availability and timing of such refunds.

Since 2014, in respect of dividend payments on shares (including represented by ADSs) that are recorded on depo account of foreign nominee holder, depo account of foreign authorized holder and depo account of depository programs, a general rate established by the double tax treaty and not accounting for benefits is applied. Refund of the overpaid tax is made to the taxpayer upon the submission to the tax authorities of the documents mentioned above, as well as the following documents: (i) document confirming the ownership of shares by the taxpayer on the date determined by the decision of the Russian company on payment of income, (ii) document confirming the amount of income actually received on shares, (iii) documents containing information about the depository, which transferred the income on shares in favor of a foreign organization (management company), which lawfully carried out the record of rights to shares held by the taxpayer, and (iv) document confirming that the legal entity, which carried out the record of rights of share ownership on the date determined by the decision of the Russian company on payment of income, complied with additional conditions provided by Russian tax legislation or international double tax treaty for the application of the reduced tax rate when paying dividends on shares. Due to the fact that these regulations entered into force only on January 1, 2014, the practice of such refunds have not been established yet, and that is why it is not possible to exclude risks associated with a possible non-refund of the tax withheld.

A resident of the United States who is fully eligible for benefits under the United States-Russia income tax treaty is referred to in this Russian Income and Withholding Tax Considerations section as a U.S. holder. Subject to certain provisions of the United States-Russia income tax treaty relating to limitations on benefits, a person generally will be a resident of the United States for treaty purposes and entitled to treaty benefits if such person is:

liable, under the laws of the United States, for U.S. federal income tax (other than taxes in respect only of income from sources in the United States or capital situated therein) by reason of the holder's domicile, residence, citizenship, place of incorporation, or any other similar criterion (and, for income derived by a partnership, trust or estate, residence is determined in accordance with the residence of the person liable to tax with respect to such income); and

not also a resident of the Russian Federation for purposes of the United States-Russia income tax treaty. The benefits under the United States-Russia income tax treaty discussed in this document generally are not available to United States persons who hold shares or ADSs in connection with the conduct of a business in the Russian Federation through a permanent establishment as defined in the United States-Russia income tax treaty. Subject to certain exceptions, a United States person's permanent establishment under the United States-Russia income tax treaty is a fixed place of business through which such person carries on business activities in the Russian Federation (generally including, but not limited to, a place of management, a branch, an office and a factory). Under certain circumstances, a United States person may be deemed to have a permanent establishment in the Russian Federation as a result of activities carried on in the Russian Federation through agents of the United States person. This summary

does not address the treatment of those holders.

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**Table of Contents*****United States-Russia income tax treaty procedures***

Under current rules, to claim the benefit of a reduced rate of withholding under the United States-Russia income tax treaty, a non-resident generally must provide official certification from the U.S. tax authorities of eligibility for the treaty benefits in the manner required by Russian law.

A U.S. holder may obtain the appropriate certification by mailing completed forms, together with the holder's name, taxpayer identification number, the tax period for which certification is required, and other applicable information, to the U.S. Internal Revenue Service (the **IRS**). The procedures for obtaining certification are described in greater detail in the instructions to IRS Form 8802. As obtaining the required certification from the IRS may take at least six to eight weeks, U.S. holders should apply for such certification as soon as possible.

If tax is withheld by a Russian resident on dividends or other amounts at a rate different from that provided in the tax treaty, a U.S. holder may apply for a tax refund by filing a package of documents with the Russian local tax inspectorate to which the withholding tax was remitted within three years from the withholding date for U.S. holders which are legal entities, and within one year from the withholding date for individual U.S. holders. The package should include confirmations of residence of the foreign holder (IRS Form 6166), a copy of the agreement or other documents substantiating the payment of income, documents confirming the beneficial ownership of the dividends recipient and the transfer of tax to the budget. Under the provisions of the Russian Tax Code the refund of the tax should be effected within one month after the submission of the documents. However, procedures for processing such claims have not been clearly established, and there is significant uncertainty regarding the availability and timing of such refunds.

Neither the depositary nor we will have any obligation to assist a U.S. holder of shares or ADSs with the completion and filing of any tax forms.

***Stamp duty***

No Russian stamp duty will be payable by the holders upon any of the transactions with the shares or ADSs discussed in this section (e.g., on a purchase or sale of the shares or ADSs), except for transactions involving the receipt of the shares or ADSs by way of inheritance.

**Certain U.S. Federal Income Tax Considerations**

The following is a summary of material U.S. federal income tax consequences of the purchase, ownership and disposition of shares or ADSs by a U.S. Holder. Solely for purposes of this Certain U.S. Federal Income Tax Considerations section, a U.S. Holder is a beneficial owner of shares or ADSs that is, for U.S. federal income tax purposes: (1) an individual who is a citizen or resident of the United States, (2) a corporation created or organized in or under the laws of the United States, any state thereof or the District of Columbia, (3) an estate the income of which is subject to U.S. federal income tax regardless of its source or (4) a trust, if a United States court can exercise primary supervision over the administration of the trust and one or more United States persons can control all substantial trust decisions, or if the trust has a valid election in effect under applicable U.S. Treasury Regulations to be treated as a United States person.

If an entity treated as a partnership for U.S. federal income tax purposes is a beneficial owner of shares or ADSs, the U.S. federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. A partner of a partnership holding shares or ADSs should consult its tax adviser regarding the associated tax consequences.

This summary does not discuss all aspects of U.S. federal income taxation that may be relevant to investors in light of their particular circumstances, such as investors subject to special tax rules (including, without

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limitation: (i) financial institutions; (ii) insurance companies; (iii) dealers in stocks, securities, or currencies or notional principal contracts; (iv) regulated investment companies; (v) real estate investment trusts; (vi) tax-exempt organizations; (vii) partnerships, pass-through entities, or persons that hold shares or ADSs through pass-through entities; (viii) holders that are not U.S. Holders; (ix) holders that own (directly, indirectly or constructively) 10% or more of our voting stock; (x) investors that hold shares or ADSs as part of a straddle, hedge, conversion, constructive sale or other integrated transaction for U.S. federal income tax purposes; (xi) investors that have a functional currency other than the U.S. dollar and (xii) U.S. expatriates and former long-term residents of the United States), all of whom may be subject to tax rules that differ significantly from those summarized below. This summary does not address tax consequences applicable to holders of equity interests in a holder of the shares or ADSs, including, but not limited to, U.S. federal estate, gift or alternative minimum tax considerations, or non-U.S., state or local tax considerations. This summary only addresses investors that will acquire shares or ADSs in an original offering, and it assumes that investors will hold their shares or ADSs as capital assets for U.S. federal income tax purposes (generally, property held for investment).

This summary is based upon current U.S. federal income tax law, including the U.S. Internal Revenue Code of 1986 (the **Code**), its legislative history, existing, temporary and proposed regulations thereunder, published rulings and court decisions, all of which are subject to differing interpretation or change (possibly with retroactive effect), and the United States-Russia income tax treaty, which is subject to change, possibly with retroactive effect. We have not sought, and will not seek, any ruling from the IRS or any opinion of counsel with respect to the tax consequences discussed below, and we cannot provide assurance that the IRS will not take a position contrary to the tax consequences discussed below or that any position taken by the IRS would not be sustained.

Investors should consult their tax advisers as to the consequences under U.S. federal, estate, gift, state, local and applicable non-U.S. tax laws of the purchase, ownership and disposition of shares or ADSs.

### ***Ownership of ADSs in general***

U.S. Holders of ADSs should generally be treated for U.S. federal income tax purposes as owners of the underlying shares represented by those ADSs, assuming the relevant deposit agreement and any related agreement include customary representations and obligations (particularly relating to any pre-release of ADSs) and such representations and obligations are properly complied with. In such case, except as noted, the U.S. federal income tax consequences discussed below should apply equally to U.S. Holders of ADSs and shares, and no gain or loss will be recognized upon an exchange of an ADS for the share represented by that ADS. A U.S. Holder's tax basis in such shares will be the same as the U.S. Holder's tax basis in such ADSs, and the holding period in such shares will include the holding period in such ADSs.

### ***Taxation of dividends on shares or ADSs***

Subject to the passive foreign investment company rules described below, for U.S. federal income tax purposes, the gross amount of a distribution, including any Russian withholding taxes, with respect to shares or ADSs will be treated as a taxable dividend to the extent of our current and accumulated earnings and profits, computed in accordance with U.S. federal income tax principles. Certain dividends received by non-corporate U.S. Holders may be taxed at the lower applicable capital gains rate. This lower capital gains rate is only applicable to dividends paid by qualified foreign corporations (which term excludes PFICs, as defined below) and only with respect to shares or ADSs held for a minimum holding period (generally, 61 days during the 121-day period beginning 60 days before the ex-dividend date). A company will be a qualified foreign corporation if: (a) it is eligible for the benefits of an applicable United States income tax treaty; or (b) the stock with respect to which such dividend is paid is readily tradable on an established securities market in the United States. Non-corporate U.S. Holders are strongly urged to

consult their tax advisers as to the applicability of the lower capital gains rate to dividends received with respect to shares or ADSs. Distributions in excess of our current and accumulated earnings and profits will be applied against and will reduce a U.S. Holder's tax basis in



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shares or ADSs and, to the extent in excess of such tax basis, will be treated as gain from a sale or exchange of such shares or ADSs and will be treated as described under "Taxation on sale or other disposition of shares or ADSs" below. We do not intend to calculate our earnings and profits for U.S. federal income tax purposes and, unless we make such calculations, U.S. Holders should expect that any distributions with respect to shares or ADSs generally will be reported to them as a dividend, even if that distribution would otherwise be treated as a return of capital or as a capital gain pursuant to the rules described above. Such dividends will not be eligible for the dividends received deduction allowed to corporations.

If a dividend distribution is paid in rubles, the amount includible in income will be the U.S. dollar value of the dividend, calculated using the exchange rate in effect on the date the dividend is received by the U.S. Holder (or the date of the depositary's receipt in the case of the ADSs), regardless of whether the payment is actually converted into U.S. dollars on that date. Generally, any gain or loss resulting from currency exchange rate fluctuations during the period from the date the dividend is includible in the income of the U.S. Holder to the date the rubles are converted into U.S. dollars will be treated as U.S. source ordinary income or loss. U.S. Holders may be required to recognize foreign currency gain or loss on the receipt of a refund of Russian withholding tax pursuant to the United States-Russia income tax treaty to the extent the U.S. dollar value of the refund differs from the U.S. dollar equivalent of that amount on the date of receipt of the underlying dividend.

Russian withholding tax under the United States-Russia income tax treaty should be treated as a foreign income tax that, subject to generally applicable limitations and conditions, is eligible for a U.S. foreign tax credit against the U.S. federal income tax liability of the U.S. Holder. If Russian tax is withheld at a rate in excess of the applicable rate under the United States-Russia income tax treaty for which a U.S. Holder qualifies, a U.S. foreign tax credit for the excess amount may not be allowed to be claimed.

For U.S. foreign tax credit purposes, a dividend distribution will be treated as foreign source income and will generally be classified as "passive category income" but could, in the case of certain U.S. Holders, constitute "general category income." Additionally, a U.S. Holder who does not elect to claim a foreign tax credit may instead be eligible to claim a deduction for U.S. federal income tax purposes in respect of Russian withholding tax, but only for a year in which such holder elects to do so for all creditable foreign income taxes. The rules relating to the determination of the U.S. foreign tax credit, or deduction in lieu of the U.S. foreign tax credit, are complex and U.S. Holders should consult their tax advisers with respect to those rules.

***Taxation on sale or other disposition of shares or ADSs***

Subject to the passive foreign investment company rules described below, the sale or other disposition of shares or ADSs will generally result in the recognition of gain or loss in an amount equal to the difference between the amount realized on the sale or other disposition and the adjusted basis in such shares or ADSs. Such gain or loss generally will be treated as long-term capital gain or loss if the shares or ADSs have been held for more than one year as of the time of the sale or other disposition. Capital gains of non-corporate U.S. Holders derived from capital assets held for more than one year are eligible for reduced rates of taxation. The deductibility of capital losses is subject to significant limitations.

Gain or loss realized on the sale or other disposition of shares or ADSs will generally be treated as U.S. source income and as a result any Russian taxes imposed upon such sale or other disposition may not be creditable against a U.S. Holder's U.S. federal income tax liability. U.S. Holders are strongly urged to consult their tax advisers as to the availability of tax credits for any Russian taxes withheld on the sale or other disposition of shares or ADSs.

If a U.S. Holder receives any foreign currency on the sale or other disposition of shares or ADSs, such U.S. Holder generally will realize an amount equal to the U.S. dollar value of such foreign currency on the settlement date of such sale or other disposition if (1) such U.S. Holder is a cash basis or electing accrual basis taxpayer and the shares or ADSs are treated as being traded on an established securities market or (2) such

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settlement date is also the date of such sale or other disposition. If the foreign currency so received is converted to U.S. dollars on the settlement date, such U.S. Holder should not recognize foreign currency gain or loss on such conversion. If the foreign currency so received is not converted into U.S. dollars on the settlement date, such U.S. Holder will have a basis in such foreign currency equal to its U.S. dollar value on the settlement date. Any gain or loss on a subsequent conversion or other disposition of such foreign currency generally will be treated as ordinary income or loss to such U.S. Holder and generally will be income or loss from sources within the United States for U.S. foreign tax credit purposes. Each U.S. Holder should consult its tax adviser regarding the U.S. federal income tax consequences of receiving foreign currency from the sale or other disposition of shares or ADSs.

***Passive foreign investment company status***

A non-U.S. company is a passive foreign investment company ( **PFIC** ) in any taxable year in which, after taking into account the income and assets of certain subsidiaries, either (1) at least 75% of its gross income is passive income or (2) at least 50% of the average value of its assets (based on an average of the quarterly values of the assets) is attributable to assets that produce or are held to produce passive income. We believe that for U.S. federal income tax purposes, we were not a PFIC for the taxable year ending in 2016. However, the PFIC determination is made annually and may involve facts that are not within our control. In addition, there are special requirements that apply to income from the sale and ownership of commodities that need to be satisfied in order for amounts attributable to commodities to be treated as non-passive. If we were classified as a PFIC at any time that you hold our ADSs and shares, you may be subject to materially adverse U.S. federal income tax consequences compared to an investment in a company that is not considered a PFIC, including being subject to greater amounts of U.S. tax on distributions and gains on the sale or disposition of the ADSs and shares as well as being subject to additional U.S. tax filing requirements. Additionally, dividends paid by the company to non-corporate U.S. holders would not be eligible for the special reduced rate of tax described above under Taxation of dividends on shares or ADSs. You should consult your tax advisers as to the consequences of an investment in a PFIC.

***Information reporting and backup withholding***

U.S. Holders may be subject to information and backup withholding on the payment of dividends on, and the proceeds received from the disposition of, shares or ADSs, unless: (1) the U.S. Holder is an exempt recipient, or (2) in the case of backup withholding, the U.S. Holder provides a correct taxpayer identification number and certifies that it is not subject to backup withholding. Backup withholding is not an additional tax. Amounts withheld as backup withholding may be credited against a U.S. Holder's federal income tax liability, and a U.S. Holder may obtain a refund of any excess amounts withheld under the backup withholding rules by timely filing the appropriate claim for refund with the IRS and furnishing all required information. U.S. Holders should consult their tax advisors regarding their qualification for exemption from backup withholding and the procedure for obtaining such an exemption, if applicable.

***FATCA***

Provisions under Sections 1471 through 1474 of the Code and applicable U.S. Treasury Regulations commonly referred to as **FATCA** generally impose 30% withholding on certain withholdable payments and, in the future, may impose such withholding on foreign passthru payments made by a foreign financial institution (each as defined in the Code) that has entered into an agreement with the IRS to perform certain diligence and reporting obligations with respect to the foreign financial institution's U.S.-owned accounts. Prospective investors should consult their tax advisors regarding the potential impact of FATCA and any non-U.S. legislation implementing FATCA on the investment in ADSs.

**Documents on Display**

The documents that are exhibits to or incorporated by reference in this document can be read at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the Public

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Reference Room can be obtained by calling the SEC at +1 800-SEC-0330. These filings are also available at the website maintained by the SEC at [www.sec.gov](http://www.sec.gov).

Some of our reports and other information can also be inspected at the offices of the NYSE at 20 Broad Street, New York, New York 10005.

## **Glossary**

*Blast furnace:* A towering cylinder lined with heat-resistant (refractory) bricks, used by integrated steel mills to smelt pig iron from ore. Its name comes from the blast of hot air and gases forced up through the iron ore, coke and limestone that load the furnace.

*Carbon steel:* A type of steel generally having no specified minimum quantity of any alloying element and containing only an incidental amount of any element other than carbon, silicon, manganese, copper, sulfur and phosphorus.

*CIF:* Cost, Insurance and Freight, a commercial term pursuant to which the seller must pay the costs, insurance and freight necessary to bring the goods to the named port of destination but the risk of loss or damage to the goods, as well as any additional costs due to events occurring after the time of delivery, are transferred from the seller to the buyer.

*Coils:* Steel sheet that has been wound. A slab, once rolled in a hot-strip mill, can be more than one mile long; coils are the most efficient way to store and transport sheet steel.

*Continuous casting:* A method of pouring steel directly from a ladle through a tundish into a special machine shaped to form billets and slabs. Continuous casting avoids the need for blooming mills for rolling billets into slabs. Continuous cast metal solidifies in a few minutes, versus several hours for an ingot. As a result of this, the chemical composition and mechanical properties of billets are more uniform.

*FCA:* Free Carrier, a commercial term pursuant to which the seller must deliver the goods, cleared for export, to the carrier nominated by the buyer at the named place. Costs for transportation and risk of loss transfer to the buyer after delivery to the carrier.

*Flat-rolled steel/Flat products:* Category of steel that includes sheet and strip, among others.

*FOB:* Free on Board, a commercial term pursuant to which the buyer bears all costs and risks of loss of or damage to the goods from the point the goods pass the ship's rail at the named point of shipment.

*Galvanized steel:* Steel coated with a layer of zinc to provide corrosion resistance in underbody auto parts, garbage cans, storage tanks, fencing wire, etc. Sheet steel normally must be cold-rolled prior to galvanizing. Galvanized steel is subdivided into hot-dipped galvanized and electrogalvanized steel.

*Hot-rolled:* Section that is sold in its as-produced state off the hot mill with no additional treatment, aside from being pickled and oiled (if specified).

*Magnetic separator:* A device used in a process when magnetically susceptible mineral is separated from gangue minerals by applying a strong magnetic field.

*Pipes:* Tubes used to transport fluids or gases. Pipe and tube are often used interchangeably, with a given label applied primarily as a matter of historical use.

*Probable reserves:* In accordance with the JORC Code, those reserves which are the economically mineable part of the indicated mineral resources. Indicated reserves include all minerals conforming to the thickness and depth limits defined in the resource base, and for which known data points are not more than 2,000 meters apart.

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*Proved reserves:* In accordance with the JORC Code, those reserves which are the economically mineable part of the measured mineral resources. Measured mineral resources means the tonnages of in-situ minerals contained in seams or sections of seams for which sufficient information is available to enable detailed or conceptual mine planning.

*Raw steel:* Steel in primary form of hot molten metal.

*Rebar or Reinforcement bars:* Round rolled products of plain or die-rolled sections of various types and classes used to strengthen concrete in highway and building construction.

*Reserve:* In accordance with the JORC Code, virgin and/or accessed parts of a mineral resource base, which could be economically extracted or produced at the time of determination, considering environmental, legal and technological constraints.

*Rolled steel (products):* Steel with certain forms and geometric dimensions manufactured by drafting metal between rotary rolls of rolling mills.

*Run-of-mine, or ROM, coal:* Coal that has not undergone the processes of classification and washing.

*Saleable coal:* Coal that has undergone the processes of classification and washing.

*Scrap (Ferrous):* Ferrous (iron-containing) material that generally is remelted and recast into new steel in EAFs. Integrated steel mills also use scrap metal for up to 25% of their basic oxygen furnace charge. Scrap metal includes waste steel generated from within metal-processing plants and steel mills through edge trimming and rejects.

*Sections:* Blooms or billets that are hot-rolled in a rolling mill to manufacture rounds, squares, bands, among other structural shapes, L, U, T or I shapes. Sections can also be produced by welding together pieces of flat products. Sections can be used for a wide variety of purposes in the construction, engineering and transport industries.

*Semi-finished steel:* Steel shapes (for example, blooms, billets or slabs) that later are rolled into finished products such as beams, bars or sheet.

*Sheet steel:* Thin, flat-rolled steel created in a hot-strip mill by rolling a cast slab flat while maintaining the side dimensions. The malleable steel lengthens to several thousand feet as it is squeezed by the rolling mill. The most common differences among steel bars, strip, plate and sheet are merely their physical dimensions of width and gauge (thickness).

*Sintering:* A process that combines iron-bearing particles into small chunks. Initially, these materials are too fine to withstand the air currents of the smelting process in the blast furnace and could be thrown away. The iron is now conserved in sinter as the chunks of sinter are heavier and therefore can be charged into the blast furnace.

*Slab:* The most common type of semi-finished steel. Traditional slabs measure 13-35 centimeters thick, 75-300 centimeters wide and are usually about 6-12 meters long, while the output of the recently developed thin slab casters is approximately five centimeters thick. After casting, slabs are sent to the hot-strip mill to be rolled into coiled sheet and plate products.

*Special steel:* Alloyed steel produced by the addition of various metals (e.g., manganese) in small quantities during the steel-making process to improve mechanical properties such as strength and resistance to stress. Special steels are intermediary products between standard steel grades and stainless steel alloys (with a high content of nickel and

chrome). Special steel products are typically used as long products (e.g., special bar quality, bearing steel, tool steel and high-speed steel).



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*Tailings:* Material rejected from a mine after the valuable minerals have been recovered.

*Welded mesh:* Cold-rolled or drawn wire cuts of certain length welded together at specified distances in longitudinal and traverse directions into sheets of rectangular shapes.

*Wire rod:* Round, semi-finished steel that is rolled from a billet and coiled for further processing. Wire rod is commonly drawn into wire or used to tie bundles. Wire rod rolling mills (rolling facilities) can run as fast as 6,000 meters per minute.

**Item 11. Quantitative and Qualitative Disclosures about Market Risk**

In the normal course of business, our financial position is routinely subject to a variety of risks. We are exposed to market risks associated with foreign currency exchange rates, interest rates and commodity prices. We are also subject to the risks associated with the business environment in which we operate, including the collectibility of accounts receivable.

We do not enter into hedging transactions to manage the risks specified above.

We do not hold or issue derivative financial instruments for trading purposes.

**Currency Risk**

The functional currencies for our main Russian and European subsidiaries are the Russian ruble and euro, respectively. The U.S. dollar is the functional currency of our other main international operations. Our reporting currency is the Russian ruble.

In the past we entered into forward transactions to buy U.S. dollars for euros to hedge our exposure to movements in foreign currency exchange rates arising in relation to euro-denominated accounts receivable of our trading subsidiaries. These derivatives were not designated as hedging contracts for accounting purposes. As of December 31, 2016, we did not have any forward transactions.

We are exposed to movements in the U.S. dollar and euro exchange rates relative to the Russian ruble, our reporting currency. The following table sets forth our monetary assets and liabilities by currency as of December 31, 2016.

|                                | U.S. Dollar                     | Euro |
|--------------------------------|---------------------------------|------|
|                                | (In millions of Russian rubles) |      |
| <b>Non-current assets</b>      |                                 |      |
| Long-term financial assets     |                                 |      |
| <b>Current assets</b>          |                                 |      |
| Receivables                    | 225                             | 534  |
| Shor-term financial assets     | 156                             | 353  |
| Cash and cash equivalents      | 69                              | 181  |
| <b>Long-term liabilities</b>   |                                 |      |
| Long-term loans and borrowings |                                 | (38) |

|                                    |           |          |
|------------------------------------|-----------|----------|
| Long-term payables                 |           |          |
| Long-term finance lease liability  |           |          |
| <b>Short-term liabilities</b>      | (124,281) | (23,766) |
| Short-term loans and borrowings    | (113,327) | (22,817) |
| Short-term payables                | (9,433)   | (838)    |
| Short-term finance lease liability | (1,521)   | (111)    |

**Table of Contents****Interest Rate Risk**

Interest rate risk is the risk that changes in floating interest rates will adversely impact our financial results. As of December 31, 2016, 2015 and 2014, the shares of the borrowings with floating rates in the total amount of the borrowings were 91% (including MosPrime 0.1%, the CBR key rate 62%, LIBOR, EURIBOR and others 29%), 53% (including MosPrime 0.2%, the CBR key rate 14%, LIBOR, EURIBOR and others 39%) and 39% (including MosPrime 12%, LIBOR, EURIBOR and others 27%), respectively.

We have not entered into transactions designed to hedge against interest rate risks, which may exist in connection with our current or future indebtedness. We monitor the market and assess our options for hedging interest rate risks and may enter into such arrangements in the future.

We manage interest rate risk through analysis of current interest rates. If there are significant changes in market interest rates management may consider refinancing of a particular financial instrument on more favorable terms.

The table below demonstrates our sensitivity to change of floating rates which management believes is an appropriate measure of the current market conditions.

|             | Increase/decrease in MosPrime and the CBR key rate (%) | Effect on profit before tax (In millions of Russian rubles) | Increase/decrease in LIBOR (%) | Effect on profit before tax (In millions of Russian rubles) | Increase/decrease in EURIBOR (%) | Effect on profit before tax (In millions of Russian rubles) |
|-------------|--|---|--------------------------------|---|----------------------------------|---|
| <b>2014</b> |  |   |                                |   |                                  |   |
|             | +9.32%   | 4,395   | +0.02%                         | 12  | +0.07%                           | 13  |
|             | 9.32%  | (4,395)   | 0.02%                          | (12)  | 0.07%                            | (13)  |
| <b>2015</b> |  |   |                                |   |                                  |   |
|             | +6%  | 3,312   | +0.5%                          | 662   | +0.25%                           | 62  |
|             | 5%   | (2,760)   | 0.12%                          | (159)   | 0.25%                            | (62)  |
| <b>2016</b> |  |   |                                |   |                                  |   |
|             | +2%  | 4,943   | +0.6%                          | 736   | +0.12%                           | 28  |
|             | 4%   | (9,887)   | 0.08%                          | (98)  | 0.08%                            | (19)  |

**Commodity Price Risk**

In the normal course of our business, we are primarily exposed to market risk of price fluctuations related to the purchase, production and sale of steel products, coal, coke and other products.

We do not use commodity derivatives or long-term fixed-price sales contracts to manage our commodity price risks.

**Equity Price Risk**

We also have minor investments in shares of Russian companies that are not publicly traded and, accordingly, their market values are not available. We consider that it is not practicable for us to estimate the fair values of these investments because we have not yet obtained or developed the valuation models necessary to make the estimates, and

the cost of obtaining an independent valuation is believed by management to be excessive considering the significance of the investments. Accordingly, these investments are omitted from the risk information disclosure presented herein.

We do not use derivative instruments or any other arrangements to manage our equity price risks.

**Table of Contents****Item 12. Description of Securities Other than Equity Securities****Depository Fees and Charges**

Our common American Depositary Shares, or common ADSs, each representing two common shares, are traded on the NYSE under the symbol MTL. The common ADSs are evidenced by common American Depositary Receipts, or common ADRs, issued by Deutsche Bank Trust Company Americas, as depositary ( **DBTCA** ) under the Deposit Agreement, dated as of July 27, 2004, among Mechel PAO, Deutsche Bank Trust Company Americas, and holders and beneficial owners of common ADSs, as amended on May 21, 2007, May 19, 2008 and December 21, 2015.

Common ADS holders are required to pay the following service fees to DBTCA:

| <b>Service</b>  | <b>Fees (In U.S. dollars)</b> |
|---|-------------------------------|
| Issuance of common ADSs   | Up to \$0.05 per common ADS   |
| Cancellation of common ADSs   | Up to \$0.05 per common ADS   |
| Distribution of cash dividends or other cash distributions  | Up to \$0.02 per common ADS   |
| Distribution of common ADSs pursuant to (1) stock dividends, free stock distributions or (2) exercises of rights to purchase additional common ADSs or distribution of proceeds thereof | Up to \$0.05 per common ADS   |
| Distribution of securities other than common ADSs or rights to purchase additional common ADSs or the distribution of proceeds thereof  | Up to \$0.05 per common ADS   |
| Common ADR transfer, combination or split-up fee  | \$1.50 per transfer           |
| Share register inspection annual fee  | \$0.01 per common ADS         |
| Operation and maintenance annual fee  | \$0.02 per common ADS*        |

\* This fee, when combined with the fees for cash distributions, shall not exceed \$0.02 per common ADS per year. Our preferred American Depositary Shares, or preferred ADSs, each representing one-half of a preferred share, are traded on the NYSE under the symbol MTL PR. The preferred ADSs are evidenced by preferred American Depositary Receipts, or preferred ADRs, issued by DBTCA under the Deposit Agreement, dated as of May 12, 2010, among Mechel PAO, Deutsche Bank Trust Company Americas, and holders and beneficial owners of preferred ADSs. Preferred ADS holders are required to pay the following service fees to DBTCA:

| <b>Service</b>  | <b>Fees (In U.S. dollars)</b>  |
|---|--------------------------------|
| Issuance of preferred ADSs  | Up to \$0.05 per preferred ADS |
| Cancellation of preferred ADSs  | Up to \$0.05 per preferred ADS |
| Distribution of cash dividends or other cash distributions  | Up to \$0.02 per preferred ADS |
| Distribution of preferred ADSs pursuant to (1) stock dividends, free stock distributions or (2) exercises of rights to purchase additional preferred ADSs or distribution of proceeds thereof | Up to \$0.05 per preferred ADS |
| Distribution of securities other than preferred ADSs or rights to purchase additional preferred ADSs or the distribution of proceeds thereof  | Up to \$0.05 per preferred ADS |
| Preferred ADR transfer, combination or split-up fee   | \$1.50 per transfer            |
| Share register inspection annual fee  | \$0.01 per preferred ADS       |
| Operation and maintenance annual fee  | \$0.02 per preferred ADS*      |

\* This fee, when combined with the fees for cash distributions, shall not exceed \$0.02 per preferred ADS per year. In addition, holders of ADSs may also be charged for the following expenses: (1) taxes and governmental charges; (2) cable, telex and facsimile transmission and delivery charges; (3) transfer or registration fees of the Russian share registrar; (4) fees or charges of DBTCA for conversion of foreign currency into U.S. dollars; and (5) expenses of DBTCA in connection with the issuance of definitive certificates.

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Holders of ADSs are responsible for any taxes or other governmental charges payable on their ADSs or on the deposited securities underlying the ADSs. DBTCA may refuse to transfer the ADSs or to allow holders to withdraw the deposited securities underlying their ADSs until such payment is made, or it may deduct the amount of taxes owed from any payments to ADS holders. It may also sell deposited securities, by public or private sale, to pay any taxes owed. ADS holders will remain liable if the proceeds of the sale are not enough to pay the taxes. If DBTCA sells deposited securities, it will, if appropriate, reduce the number of ADSs to reflect the sale and pay to ADS holders any proceeds, or send to ADS holders any property, remaining after it has paid the taxes.

***Depository Payments for 2014, 2015 and 2016***

In consideration for its appointment as depository, DBTCA agreed to reimburse us for costs of the maintenance of our ADS programs and of ADS-programs related investor relations activities. For the years ended December 31, 2014, 2015 and 2016, DBTCA reimbursed us \$2.489 million, \$1.778 million and \$826 thousand, respectively, in regard to our common ADS-program. In 2010, DBTCA had also paid us upfront \$2.494 million in regard to our 5-year preferred ADS-program. For the years ended December 31, 2015 and 2016, DBTCA reimbursed us \$419 thousand and \$234 thousand, respectively, in regard to our preferred ADS-program.

In addition, for the years ended December 31, 2014, 2015 and 2016, DBTCA made the following payments on our behalf in relation to our ADS programs:

| <b>Category</b>                    | <b>Payment (In U.S. dollars)</b>       |                |                |
|------------------------------------|--|----------------|----------------|
|                                    | <b>For the Year Ended December 31,</b> |                |                |
|                                    | <b>2014</b>                            | <b>2015</b>    | <b>2016</b>    |
| NYSE listing fees                  | 83,140                                 | 91,888         | 150,189        |
| Proxy solicitation expenses        |  |                | 178,010        |
| ADS holder identification expenses | 15,300                                 |                | 9,000          |
| Full targeting project             |  |                |                |
| Perception study                   |  |                |                |
| BD corporate                       | 11,000                                 | 11,000         |                |
| <b>Total</b>                       | <b>109,440</b>                         | <b>102,888</b> | <b>337,199</b> |

In addition, DBTCA waived the cost of various ADR program-related support services that it provided to us in 2014, 2015 and 2016. DBTCA had valued these services at \$412,500 per annum for common ADSs when DBTCA was re-appointed in 2014 and \$160,000 per annum for preferred ADSs when DBTCA was appointed in 2015. The volume of the costs that DBTCA agrees to waive may vary depending on the depository receipt program size within particular year. Under certain circumstances, including early termination of the appointment of DBTCA, we would be required to repay to DBTCA some or all of the payments made to us or on our behalf (including fees waived by it) since its appointment.

**Table of Contents****PART II****Item 13. Defaults, Dividend Arrearages and Delinquencies**

As of April 26, 2017, we did not pay amounts due in respect of principal and interest under certain of our loan agreements and several of our lease agreements and were in breach of certain financial and non-financial covenants under our credit facilities. See Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Restrictive Covenants and Item 3. Key Information Risk Factors Risks Relating to Our Financial Condition and Financial Reporting Our failure to comply with the payment and other obligations in our credit facilities caused some of our creditors to accelerate amounts due under their loan agreements and such failure, or like failure in the future, may cause the acceleration of our other outstanding debt, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects, Item 3. Key Information Risk Factors Risks Relating to Our Financial Condition and Financial Reporting If we are unable to restructure all of our indebtedness or fail to comply with the new terms of the restructured indebtedness, our lenders may claim for accelerated repayment, which could lead to cross-default under other borrowings and have a material adverse effect on our business, financial condition, results of operations and prospects, Item 3. Key Information Risk Factors Risks Relating to Our Financial Condition and Financial Reporting We have a substantial amount of outstanding indebtedness with restrictive financial covenants and most shares and assets in our subsidiaries are pledged and Item 3. Key Information Risk Factors Risks Relating to Our Financial Condition and Financial Reporting We have not fulfilled our payment obligations under several of the group's lease agreements and a number of the respective lessors have required the return of the leased assets, which may materially adversely affect our business, financial condition, results of operations and prospects.

The table below summarizes the payment defaults, cross-defaults and other covenant breaches under our main facility agreements:

|   | <b>Non-payment of<br/>principal or interest<br/>(yes/no)</b> | <b>Cross-default<br/>(yes/no)</b> | <b>Breach of financial<br/>covenants<sup>(1)</sup><br/>(yes/no)</b> | <b>Breach of non-<br/>financial covenants<sup>(1)</sup><br/>(yes/no)</b> |
|---|--|-----------------------------------|---|--|
| VTB Bank  | no   | yes                               | no  | yes  |
| Sberbank  | no   | yes                               | no  | yes  |
| Gazprombank   | no   | yes                               | no  | yes  |
| Pre-Export Facilities<br>from a Syndicate of<br>Banks | yes  | yes                               | yes   | yes  |
| Universal Rolling Mill<br>Facility Agreement          | yes  | yes                               | yes   | yes  |
| Vnesheconombank                                       | yes  | no                                | no  | yes  |
| Other <sup>(2)</sup>                                  | yes  | yes                               | yes   | yes  |

(1) The breaches provided in this table are as of December 31, 2016.

(2) Includes other loan agreements and lease agreements.

The failure to pay the scheduled principal and interest amounts, as well as the breach of financial and other covenants in our loan agreements, which were not remedied by us or waived by our creditors, permit the creditors under those loan agreements to accelerate the payment of principal and interest under those loan agreements, as well as trigger



cross-default provisions under a number of other facilities, permitting the respective lenders under such other facilities to accelerate the payment of principal and interest under their loans.

The failure to pay amounts due, the non-compliance with financial and non-financial covenants and the triggering of the cross-default provisions resulted in the reclassification of our group's long-term debt into short-term liabilities in the amount of RUB 260,653 million as of December 31, 2016.

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In addition, several of our group companies have failed to fulfill payment obligations as well as other terms and conditions under the lease agreements. As a result, the long-term finance lease liability of RUB 6,904 million was reclassified to short-term finance lease liabilities as of December 31, 2016.

**Payment Defaults**

The sections below summarize details of payment defaults under our main credit facilities, including principal amounts outstanding as of April 26, 2017, as well as briefly describe outstanding amounts under certain lease agreements with respect to which we have failed to meet payment obligations. Figures included in these sections are subject to change, including as a result of reconciliation with creditors, changes in exchange rates, additional charges invoiced, default interest and/or other penalty accruals, ongoing restructuring negotiations or any present or future proceedings (including litigations and arbitrations described in Item 8. Financial Information Litigation Debt litigation ) related to our indebtedness or to our restructuring plans. Consequently, the figures stated herein do not constitute an acknowledgement of any obligation on our part to pay such amounts.

As of April 26, 2017, the total amount in default for failure to pay principal or interest under our credit facilities and several of our lease agreements was approximately 87.2 billion rubles. Conversion from U.S. dollars and euros into rubles is made using the CBR exchange rate on April 26, 2017. The amounts provided below do not include various fines, surcharges and penalty fees, unless otherwise noted.

***Pre-Export Facilities from a Syndicate of Banks***

Pre-Export Facility Agreements for Yakutugol and Southern Kuzbass Coal Company from a syndicate of banks coordinated by ING Bank N.V., Société Générale and VTB Capital Plc the principal amount outstanding was \$1.0 billion (approximately 56.1 billion rubles), including overdue principal in the amount of \$1.0 billion (approximately 56.1 billion rubles). In addition, the amount of overdue interest was \$108.0 million (approximately 6.0 billion rubles).

***Universal Rolling Mill Facility Agreement***

Facility Agreement for Chelyabinsk Metallurgical Plant from BNP Paribas, Gazprombank and UniCredit the principal amount outstanding was \$154.9 million and 154.7 million (in aggregate approximately 18.1 billion rubles), including overdue principal in the amount of \$84.5 million and 66.3 million (in aggregate approximately 8.7 billion rubles). In addition, the amount of overdue interest was \$13.0 million and 3.0 million (in aggregate approximately 911.8 million rubles).

***Vnesheconombank***

Facility Agreements for Elgaugol from Vnesheconombank the principal amount outstanding was \$167.3 million (approximately 9.3 billion rubles), including overdue principal in the amount of \$146.4 million (approximately 8.2 billion rubles). In addition, the amount of overdue interest was \$10.1 million (approximately 563.2 million rubles).

***Leasing***

All overdue debt under our lease agreements amounted to 308.6 million rubles, including overdue lease payments to Sberbank Leasing AO and Caterpillar Financial OOO in the amount of 56.9 million rubles and \$4.4 million (approximately 243.1 million rubles), respectively.

**Item 14. *Material Modifications to the Rights of Security Holders and Use of Proceeds***

None.

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**Table of Contents****Item 15. Controls and Procedures****(a) Disclosure Controls and Procedures**

As required by Rules 13a-15f and 15d-15f under the Securities Exchange Act of 1934, management has evaluated, with the participation of our chief executive officer and chief financial officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Disclosure controls and procedures refer to controls and other procedures designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the Securities and Exchange Commission. Disclosure controls and procedures include, without limitation, controls and other procedures designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported to management, including our chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding our required disclosure. In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply its judgment in evaluating and implementing possible controls and procedures.

As described below, a material weakness was identified in our internal control over financial reporting. Exchange Act Rule 12b-2 (17 CFR 240.12b-2) and Rule 1-02 of Regulation S-X (17 CFR 210.1-02) define a material weakness as a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis. As a result of the material weakness, our chief executive officer and chief financial officer have concluded that, as of December 31, 2016, the end of the period covered by this report, our disclosure controls and procedures were not effective at a reasonable assurance level.

**(b) Management's Annual Report on Internal Control over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting.

Internal control over financial reporting refers to a process designed by, or under the supervision of, our chief executive officer and chief financial officer and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS, and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and members of our Board of Directors; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a

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timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process, and it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

Our management evaluated the effectiveness of our internal control over financial reporting as of December 31, 2016 using the framework set forth in the report of the Treadway Commission's Committee of Sponsoring Organizations (COSO), Internal Control - Integrated Framework (2013).

As a result of management's evaluation of our internal control over financial reporting, management identified a material weakness in our internal control. Specifically, we failed to operate effective controls over the IFRS financial statements close process. As a result, several misstatements, material in the aggregate, in the consolidated financial statements resulting from errors in the underlying data prepared by subsidiaries and manual calculations were identified and then corrected. This material weakness relates to the operating effectiveness of internal controls over the IFRS financial statements close process and affects certain significant accounts, presentation and disclosure in the consolidated financial statements.

As a result of this material weakness, management has concluded that our internal control over financial reporting was ineffective as of December 31, 2016.

Ernst & Young LLC, an independent registered public accounting firm, has audited our consolidated financial statements and has also issued an attestation report on the effectiveness of our internal controls over financial reporting as of December 31, 2016, which contains an adverse opinion on the effectiveness of internal controls over financial reporting.

**(c) Report of Independent Registered Public Accounting Firm**

The Shareholders and the Board of Directors of Mechel PAO

We have audited Mechel PAO and subsidiaries (hereinafter referred to as the **Group**) internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework), (the COSO criteria). The Group's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those

policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable

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assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management's assessment (Item 15 (b) Management's Annual Report on Internal Control over Financial Reporting):

The Group's management did not operate effective internal controls over the preparation and review of the Group's IFRS consolidated financial statements and IFRS transformation process.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2016 consolidated financial statements of the Group. This material weakness was considered in determining the nature, timing and extent of audit tests applied in our audit of the 2016 consolidated financial statements, and this report does not affect our report dated April 26, 2017, which expressed an unqualified opinion on those financial statements that included an explanatory paragraph regarding the Group's ability to continue as a going concern.

In our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, the Group has not maintained effective internal control over financial reporting as of December 31, 2016, based on the COSO criteria.

/s/ Ernst & Young LLC

Moscow, Russia

April 26, 2017

**(d) Remediation Activities and Changes in Internal Control over Financial Reporting**  
***Remediation Activities Being Undertaken***

In order to remedy this material weakness, we plan to continue improving formalization and detailed description of the processes and controls, as well as strengthening review controls over the financial information provided for the purposes of IFRS transformation at the level of each legal entity. We also plan to closer align local GAAP and Group IFRS accounting policies and allow more time for review controls as well as increase the degree of automation in the IFRS financial statements close process. We will conduct trainings for accounting professionals as well as continue recruiting qualified employees. We are also taking steps to modify the review controls over the information submitted by our subsidiaries in areas, where errors were detected.



***Changes in Internal Control over Financial Reporting***

We undertook the following efforts in 2016 to address a material weakness, identified by us in 2015 that we have determined to be a material change in our internal control over financial reporting:

*We failed to operate effective controls related to the computation of deferred income taxes.*

In order to remediate this material weakness, we have performed the following actions:

implemented changes in the format of information used in deferred tax calculations at the subsidiary level, as well as included additional checks in order to detect errors at an early stage of the deferred tax calculation process;

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implemented automation of certain steps of the deferred tax calculation process;

prepared detailed instructions for the completion of reporting forms pertaining to the deferred tax calculation process; and

conducted trainings for accounting and tax professionals.

Except for the remediation efforts undertaken as described herein, there have been no material changes in our internal control over financial reporting identified in the evaluation required by Rule 13a-15 or Rule 15d-15 of the Exchange Act that occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 16A. Audit Committee Financial Expert**

Our Board of Directors has determined that Vladimir Korovkin, chairman of our Audit Committee, is an audit committee financial expert. Mr. Korovkin is independent in accordance with SEC Rule 10A-3. For a description of Mr. Korovkin's experience, see Item 6. Directors, Senior Management and Employees – Directors and Executive Officers.

**Item 16B. Code of Ethics**

We have adopted a code of business conduct and ethics that applies to our directors, officers and employees. It is available at [www.mechel.com](http://www.mechel.com) and [www.mechel.ru](http://www.mechel.ru). Hard copies of our code of business conduct and ethics are available free of charge to any person upon request. In order to request a hard copy, please send an inquiry to [ir@mechel.com](mailto:ir@mechel.com) indicating postal address to which the hard copies should be sent and a contact person. No amendments were made to our code of business conduct and ethics in 2016.

**Item 16C. Principal Accountant Fees and Services**

Ernst & Young LLC has served as our independent registered public accountants for each of the fiscal years in the three year period ended December 31, 2016, for which audited financial statements appear in this Annual Report on Form 20-F. The following table presents the aggregate fees for professional services and other services rendered by Ernst & Young LLC in 2016 and 2015, respectively.

|                    | <b>Year Ended December 31,</b>                     |              |
|--------------------|--|--------------|
|                    | <b>2016</b>  | <b>2015</b>  |
|                    | <b>(In millions of Russian rubles, net of VAT)</b> |              |
| Audit Fees         | 128.4  | 120.0        |
| Audit-related Fees | 2.8  | 3.3          |
| Tax Fees           | 0.6  | 2.6          |
| Other Fees         |  |              |
| <b>Total</b>       | <b>131.8</b>                                       | <b>125.9</b> |

**Audit Fees**

The amount of audit fees includes fees necessary to perform an audit or interim review in accordance with the standards of the Public Company Accounting Oversight Board (United States) and services that generally only the independent auditor can reasonably provide, such as comfort letters, statutory audits, attestation services and consents and assistance with, and review of, documents filed with the SEC.

**Audit-related Fees**

This category usually includes assurance and related services that are typically performed by the independent auditor. More specifically, these services could include, among others, employee benefit plan audits, IT-related audits, consultation concerning financial accounting and reporting standards.

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**Tax Fees**

Tax services include, among others, tax consultation related to proposed and consummated transactions, restructuring, personal taxation and general tax consultation.

**Other Fees**

Other fees include subscription, consultancy and training fees.

**Audit Committee Pre-Approval Policies and Procedures**

The Sarbanes-Oxley Act of 2002 required that we implement a pre-approval process for all engagements with our independent public accountants. In compliance with Sarbanes-Oxley requirements pertaining to auditor independence, our Audit Committee pre-approves the engagement terms and fees of Ernst & Young LLC for all audit and non-audit services, including tax services. All audit, audit-related and tax services rendered by Ernst & Young LLC in 2016 were approved by the Audit Committee before Ernst & Young LLC was engaged for such services. No services of any kind were approved pursuant to a waiver permitted pursuant to 17 CFR 210.2-01(c)(7)(i)(C).

**Item 16D. *Exemptions from the Listing Standards for Audit Committees***

None.

**Item 16E. *Purchases of Equity Securities by the Issuer and Affiliated Purchasers***

We did not repurchase any of our shares, GDSs or ADSs in 2016.

**Item 16F. *Change in Registrant's Certifying Accountant***

Not applicable.

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**Item 16G. Corporate Governance**

The NYSE permits us to follow certain home country corporate governance practices, which differ from those required for U.S. companies under the NYSE Listed Company Manual. The following table sets forth the most important differences between the NYSE corporate governance requirements for U.S. companies under the NYSE Listed Company Manual Section 303A and our current practices.

**NYSE Corporate Governance Rules for U.S. Companies**

A majority of directors must be independent, as determined by the board. (Section 303A.01 and 02).

Non-management directors must meet at regularly scheduled executive sessions without management. (Section 303A.03).

Listed companies must have a nominating/corporate governance and a compensation committee, each composed entirely of independent directors and having a written charter specifying the committee's purpose and responsibilities, as well as annual performance evaluation of the committee. (Section 303A.04 and 05).

Listed companies must have an audit committee that satisfies the requirements of Rule 10A-3 under the Exchange Act. (Section 303A.06).

Audit committee must have a minimum of three members and have a written charter specifying the committee's purpose, an annual performance evaluation and its duties and responsibilities. (Section 303A.07(a) and(b)).

Listed companies must have an internal audit function. (Section 303A.07(c)).

Shareholders must be given the opportunity to vote on all equity compensation plans and material revisions thereto. (Section 303A.08).

Listed companies must adopt and disclose corporate governance guidelines. (Section 303A.09).

**Our Corporate Governance Practices**

We comply with this requirement, although it is not required for foreign private issuers like Mechel.

Our Bylaw on the Board of Directors, which is posted in the Corporate Governance section of our corporate website, provides that before each meeting of the board of directors, independent directors shall hold a consultation in the absence of management.

We have a Committee on Appointments and Remuneration, which has four independent members. The Bylaw on Appointments and Remuneration Committee of the Board of Directors is posted in the Corporate Governance section of our corporate website.

We comply with this requirement.

Our Audit Committee has three members. The Bylaw on the Audit Committee of the Board of Directors is posted in the Corporate Governance section of our corporate website.

We have an Internal Audit Department. The summary of the Bylaw on the Internal Audit Department is posted in the Corporate Governance section of our corporate website.

As a Russian company, we are subject to the mandatory requirements of the Russian Joint-Stock Companies Law. The items on which shareholders can vote cannot be altered.

Our corporate governance guidelines are reflected in our various corporate documents, such as the Bylaw on the Board of Directors and the Code of Corporate Governance, all of which are posted in the Corporate Governance section of our website.

Listed companies must adopt and disclose a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers. (Section 303A.10). Our Code of Business Conduct and Ethics is posted in the Corporate Governance section of our website.

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**PART III**

**Item 17. *Financial Statements***

See instead Item 18. Financial Statements.

**Item 18. *Financial Statements***

The following financial statements, together with the report of Ernst & Young LLC, are filed as part of this annual report on Form 20-F.

|   |      |
|---|------|
| <u>Index to the Consolidated Financial Statements</u>   | F-2  |
| <u>Report of Independent Registered Public Accounting Firm</u>  | F-3  |
| <u>Consolidated Statement of Profit (Loss) and Other Comprehensive Income (Loss) for the years ended December 31, 2016, 2015 and 2014</u> | F-4  |
| <u>Consolidated Statement of Financial Position as of December 31, 2016 and 2015</u>  | F-6  |
| <u>Consolidated Statement of Changes in Equity for the years ended December 31, 2016, 2015 and 2014</u>                                   | F-7  |
| <u>Consolidated Statement of Cash Flows for the years ended December 31, 2016, 2015 and 2014</u>  | F-10 |
| <u>Notes to the Consolidated Financial Statements</u>   | F-12 |

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| No. | Description   |
|-----|---|
| 1.1 | Charter of Mechel PAO (new version) registered on March 17, 2016 (English translation) is incorporated herein by reference to Exhibit 1.1 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.  |
| 4.1 | Amendment Agreement No. 4 dated April 10, 2013 to Facility Agreement No. 2640 dated December 27, 2010 by and between VTB Bank (open joint stock company) and Mechel OAO (English translation) is incorporated herein by reference to Exhibit 4.1 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.                     |
| 4.2 | Amendment Agreement No. 5 dated February 7, 2014 to Facility Agreement No. 2640 dated December 27, 2010 by and between VTB Bank (open joint stock company) and Mechel OAO (English translation) is incorporated herein by reference to Exhibit 4.2 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.                   |
| 4.3 | Non-Revolving Loan Facility Agreement No. 5593 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.3 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.   |
| 4.4 | Amending Agreement No. 1 dated December 5, 2012 to Non-Revolving Loan Facility Agreement No. 5593 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.4 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.    |
| 4.5 | Novation Agreement No. 5593 dated December 5, 2012 to Non-Revolving Loan Facility Agreement No. 5593 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.5 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F. |
| 4.6 | Amending Agreement No. 2 dated August 9, 2013 to Non-Revolving Loan Facility Agreement No. 5593 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.6 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.      |
| 4.7 | Amending Agreement No. 3 dated September 27, 2013 to Non-Revolving Loan Facility Agreement No. 5593 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.7 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended                                   |



December 31, 2013, on Form 20-F.

- 4.8 Amending Agreement No. 4 dated December 19, 2013 to Non-Revolver Loan Facility Agreement No. 5593 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.8 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.

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| <b>No.</b> | <b>Description</b>  |
|------------|---|
| 4.9        | Non-Revolving Loan Facility Agreement No. 5594 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.9 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.   |
| 4.10       | Amending Agreement No. 1 dated December 27, 2012 to Non-Revolving Loan Facility Agreement No. 5594 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.10 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.  |
| 4.11       | Amending Agreement No. 2 dated March 4, 2013 to Non-Revolving Loan Facility Agreement No. 5594 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.11 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.      |
| 4.12       | Novation Agreement No. 5594 dated March 4, 2013 to Non-Revolving Loan Facility Agreement No. 5594 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.12 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.   |
| 4.13       | Amending Agreement No. 3 dated August 9, 2013 to Non-Revolving Loan Facility Agreement No. 5594 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.13 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.     |
| 4.14       | Amending Agreement No. 4 dated September 27, 2013 to Non-Revolving Loan Facility Agreement No. 5594 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.14 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F. |
| 4.15       | Amending Agreement No. 5 dated December 19, 2013 to Non-Revolving Loan Facility Agreement No. 5594 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.15 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.  |
| 4.16       | Non-Revolving Loan Facility Agreement No. 8507 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.16 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.  |
| 4.17       | Novation Agreement No. 8507 dated October 9, 2012 to Non-Revolving Loan Facility Agreement No. 8507 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.17 to the Annual Report   |

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filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.

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| <b>No.</b> | <b>Description</b>   |
|------------|--|
| 4.18       | Amending Agreement No. 1 dated December 27, 2012 to Non-Revolver Loan Facility Agreement No. 8507 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.18 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.  |
| 4.19       | Amending Agreement No. 2 dated August 9, 2013 to Non-Revolver Loan Facility Agreement No. 8507 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.19 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.     |
| 4.20       | Amending Agreement No. 3 dated September 27, 2013 to Non-Revolver Loan Facility Agreement No. 8507 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.20 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F. |
| 4.21       | Amending Agreement No. 4 dated December 19, 2013 to Non-Revolver Loan Facility Agreement No. 8507 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.21 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.  |
| 4.22       | Non-Revolver Loan Facility Agreement No. 8508 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.22 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.  |
| 4.23       | Novation Agreement No. 8508 dated October 9, 2012 to Non-Revolver Loan Facility Agreement No. 8508 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.23 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F. |
| 4.24       | Amending Agreement No. 1 dated December 27, 2012 to Non-Revolver Loan Facility Agreement No. 8508 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.24 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.  |
| 4.25       | Amending Agreement No. 2 dated August 9, 2013 to Non-Revolver Loan Facility Agreement No. 8508 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.25 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.     |
| 4.26       | Amending Agreement No. 3 dated September 27, 2013 to Non-Revolver Loan Facility Agreement No. 8508 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of   |

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Russia (English translation) is incorporated herein by reference to Exhibit 4.26 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.

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| No.  | Description  |
|------|--|
| 4.27 | Amending Agreement No. 4 dated December 19, 2013 to Non-Revolver Loan Facility Agreement No. 8508 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.27 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.  |
| 4.28 | Amendment and Restatement Agreement dated December 4, 2012 made between Southern Kuzbass Coal Company Open Joint Stock Company and the Mandated Lead Arrangers, the Original Lenders, the New Lenders, the Facility Agent, the Security Agent, the Joint & Several Creditor, the Original Special Rate Providers and the Special Rate Agent is incorporated herein by reference to Exhibit 4.28 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F. |
| 4.29 | Amendment Agreement dated December 3, 2013 made between Southern Kuzbass Coal Company Open Joint Stock Company and the Facility Agent is incorporated herein by reference to Exhibit 4.29 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.   |
| 4.30 | Amendment and Restatement Agreement dated December 4, 2012 made between OJSHC Yakutugol and the Mandated Lead Arrangers, the Original Lenders, the New Lenders, the Facility Agent, the Security Agent, the Joint & Several Creditor, the Original Special Rate Providers and the Special Rate Agent is incorporated herein by reference to Exhibit 4.30 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.  |
| 4.31 | Amendment Agreement dated December 3, 2013 made between OJSHC Yakutugol and the Facility Agent is incorporated herein by reference to Exhibit 4.31 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.  |
| 4.32 | Credit Facility Agreement No. 110100/1400 dated March 12, 2014 between the State Corporation Bank for Development and Foreign Economic Affairs (Vnesheconombank) and the Elgaugol OOO (English translation) is incorporated herein by reference to Exhibit 4.32 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.   |
| 4.33 | Credit Facility Agreement No. 110100/1401 dated March 12, 2014 between the State Corporation Bank for Development and Foreign Economic Affairs (Vnesheconombank) and the Elgaugol OOO (English translation) is incorporated herein by reference to Exhibit 4.33 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.   |
| 4.34 | Amendment Agreement No. 6 dated May 14, 2014 to Facility Agreement No. 2640 dated December 27, 2010 by and between VTB Bank (open joint stock company) and Mechel OAO (English translation) is incorporated herein by reference to Exhibit 4.34 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2013, on Form 20-F.   |
| 4.35 |  |

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Amending Agreement No. 5 dated October 31, 2014 to Non-Revolving Loan Facility Agreement No. 5593 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.35 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2014, on Form 20-F.

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| No.  | Description   |
|------|---|
| 4.36 | Amending Agreement No. 6 dated October 31, 2014 to Non-Revolving Loan Facility Agreement No. 5594 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.36 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2014, on Form 20-F.   |
| 4.37 | Amending Agreement No. 5 dated October 31, 2014 to Non-Revolving Loan Facility Agreement No. 8507 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.37 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2014, on Form 20-F.   |
| 4.38 | Amending Agreement No. 5 dated October 31, 2014 to Non-Revolving Loan Facility Agreement No. 8508 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.38 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2014, on Form 20-F.   |
| 4.39 | Facilities Agreement dated September 15, 2010 made between Chelyabinsk Metallurgical Plant OAO and BNP Paribas S.A. is incorporated herein by reference to Exhibit 4.39 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.  |
| 4.40 | Deed of Amendment between Chelyabinsk Metallurgical Plant OAO and BNP Paribas S.A. dated March 6, 2012; Deed of Amendment between Chelyabinsk Metallurgical Plant OAO and BNP Paribas S.A. dated June 21, 2013; Deed of Amendment between Chelyabinsk Metallurgical Plant OAO and BNP Paribas S.A. dated June 21, 2013 is incorporated herein by reference to Exhibit 4.40 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.   |
| 4.41 | Additional Agreement No. 7 dated September 9, 2015 to Credit Agreement No. 2640 dated December 27, 2010 between VTB Bank (Public Joint Stock Company) and Mechel Open Joint Stock Company (English translation) is incorporated herein by reference to Exhibit 4.41 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.  |
| 4.42 | Amicable Agreement dated December 18, 2015 to Non-Revolving Credit Facility Agreement No. 5593 dated October 9, 2012 and Novation Agreement No. 5593 dated December 5, 2012 between Southern Kuzbass Coal Company OAO and Sberbank PJSC (English translation); Additional Agreement No. 7 dated March 4, 2016 to Non-Revolving Credit Facility Agreement No. 5593 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.42 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F. |
| 4.43 | Amicable Agreement dated December 18, 2015 to Non-Revolving Credit Facility Agreement No. 5594 dated October 9, 2012 and Novation Agreement No. 5594 dated March 4, 2013 between Southern Kuzbass Coal Company OAO and Sberbank PJSC (English translation); Additional Agreement No. 8  |



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dated March 4, 2016 to Non-Revolver Credit Facility Agreement No. 5594 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.43 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.

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| <b>No.</b> | <b>Description</b>   |
|------------|--|
| 4.44       | Amicable Agreement dated December 18, 2015 to Non-Revolver Credit Facility Agreement No. 8507 dated October 9, 2012 and Novation Agreement No. 8507 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank PJSC (English translation); Additional Agreement No. 6 dated March 4, 2016 to Non-Revolver Credit Facility Agreement No. 8507 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.44 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F. |
| 4.45       | Amicable Agreement dated December 18, 2015 to Non-Revolver Credit Facility Agreement No. 8508 dated October 9, 2012 and Novation Agreement No. 8508 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank PJSC (English translation); Additional Agreement No. 6 dated March 4, 2016 to Non-Revolver Credit Facility Agreement No. 8508 dated October 9, 2012 between Southern Kuzbass Coal Company OAO and Sberbank of Russia (English translation) is incorporated herein by reference to Exhibit 4.45 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F. |
| 4.46       | Additional agreement No. 2 dated August 20, 2015 to Credit Facility Agreement No. 226/12-B dated April 27, 2012 between Joint Stock Holding Company Yakutugol and Gazprombank (Joint Stock Company) (English translation) is incorporated herein by reference to Exhibit 4.46 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.   |
| 4.47       | Additional agreement No. 1 dated December 25, 2015 to Additional Agreement No. 2 to Credit Facility Agreement No. 226/12-B dated April 27, 2012 between Joint Stock Holding Company Yakutugol and Gazprombank (Joint Stock Company) (English translation) is incorporated herein by reference to Exhibit 4.47 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.   |
| 4.48       | Additional agreement No. 2 dated August 20, 2015 to Credit Facility Agreement No. 227/12-B dated April 27, 2012 between Southern Kuzbass Coal Company Open Joint Stock Company and Gazprombank (Joint Stock Company) (English translation) is incorporated herein by reference to Exhibit 4.48 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.  |
| 4.49       | Additional agreement No. 1 dated December 24, 2015 to Additional Agreement No. 2 to Credit Facility Agreement No. 227/12-B dated April 27, 2012 between Southern Kuzbass Coal Company Open Joint Stock Company and Gazprombank (Joint Stock Company) (English translation) is incorporated herein by reference to Exhibit 4.49 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.  |
| 4.50       | Additional agreement No. 1 dated August 28, 2015 to Credit Facility Agreement No. 84/13-B dated April 26, 2013 between Southern Kuzbass Coal Company Open Joint Stock Company and Gazprombank (Joint Stock Company) (English translation) is incorporated herein by reference to Exhibit 4.50 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.   |

- 4.51 Additional agreement No. 1 dated December 25, 2015 to Additional Agreement No. 1 to Credit Facility Agreement No. 84/13-B dated April 26, 2013 between Southern Kuzbass Coal Company Open Joint Stock Company and Gazprombank (Joint Stock Company) (English translation) is incorporated herein by reference to Exhibit 4.51 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.

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| <b>No.</b> | <b>Description</b>   |
|------------|--|
| 4.52       | Additional agreement No. 1 dated August 28, 2015 to Credit Facility Agreement No. 85/13-B dated April 26, 2013 between Joint Stock Holding Company Yakutugol and Gazprombank (Joint Stock Company) (English translation) is incorporated herein by reference to Exhibit 4.52 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.  |
| 4.53       | Additional agreement No. 1 dated December 25, 2015 to Additional Agreement No. 1 to Credit Facility Agreement No. 85/13-B dated April 26, 2013 between Joint Stock Holding Company Yakutugol and Gazprombank (Joint Stock Company) (English translation) is incorporated herein by reference to Exhibit 4.53 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.  |
| 4.54       | Additional Agreement No. 8 dated March 31, 2016 on amendment of certain terms and conditions of Non-Revolving Credit Facility Agreement No. 5593 dated October 09, 2012 and Additional Agreement No. 7 dated March 04, 2016 to Non-Revolving Credit Facility Agreement No. 5593 dated October 09, 2012 between Southern Kuzbass PAO and Sberbank PJSC (English translation) is incorporated herein by reference to Exhibit 4.54 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F. |
| 4.55       | Additional Agreement No. 9 dated March 31, 2016 on amendment of certain terms and conditions of Non-Revolving Credit Facility Agreement No. 5594 dated October 09, 2012 and Additional Agreement No. 8 dated March 04, 2016 to Non-Revolving Credit Facility Agreement No. 5594 dated October 09, 2012 between Southern Kuzbass PAO and Sberbank PJSC (English translation) is incorporated herein by reference to Exhibit 4.55 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F. |
| 4.56       | Additional Agreement No. 7 dated March 31, 2016 on amendment of certain terms and conditions of Non-Revolving Credit Facility Agreement No. 8507 dated October 09, 2012 and Additional Agreement No. 6 dated March 04, 2016 to Non-Revolving Credit Facility Agreement No. 8507 dated October 09, 2012 between Southern Kuzbass PAO and Sberbank PJSC (English translation) is incorporated herein by reference to Exhibit 4.56 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F. |
| 4.57       | Additional Agreement No. 7 dated March 31, 2016 on amendment of certain terms and conditions of Non-Revolving Credit Facility Agreement No. 8508 dated October 09, 2012 and Additional Agreement No. 6 dated March 04, 2016 to Non-Revolving Credit Facility Agreement No. 8508 dated October 09, 2012 between Southern Kuzbass PAO and Sberbank PJSC (English translation) is incorporated herein by reference to Exhibit 4.57 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F. |
| 4.58       | Amicable Agreement dated April 13, 2016 to Non-Revolving Credit Facility Agreement No. 5593 dated October 9, 2012 and Novation Agreement No. 5593 dated December 5, 2012 between Southern Kuzbass PAO and Sberbank PJSC (English translation) is incorporated herein by reference to Exhibit 4.58 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.   |
| 4.59       | Amicable Agreement dated April 13, 2016 to Non-Revolving Credit Facility Agreement No. 5594 dated October 9, 2012 and Novation Agreement No. 5594 dated March 4, 2013 between Southern Kuzbass   |

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PAO and Sberbank PJSC (English translation) is incorporated herein by reference to Exhibit 4.59 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F.

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| <b>No.</b> | <b>Description</b>  |
|------------|---|
| 4.60       | Amicable Agreement dated April 13, 2016 to Non-Revolving Credit Facility Agreement No. 8507 dated October 9, 2012 and Novation Agreement No. 8507 dated October 9, 2012 between Southern Kuzbass PAO and Sberbank PJSC (English translation) is incorporated herein by reference to Exhibit 4.60 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F. |
| 4.61       | Amicable Agreement dated April 13, 2016 to Non-Revolving Credit Facility Agreement No. 8508 dated October 9, 2012 and Novation Agreement No. 8508 dated October 9, 2012 between Southern Kuzbass PAO and Sberbank PJSC (English translation) is incorporated herein by reference to Exhibit 4.61 to the Annual Report filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2015, on Form 20-F. |
| 4.62       | Supplemental Agreement No. 8 dated December 23, 2016 to Credit Agreement No. 2640 dated December 27, 2010 between VTB Bank (Public Joint Stock Company) and Mechel Public Joint Stock Company (English translation).  |
| 4.63       | Supplemental Agreement No. 11 dated December 9, 2016 to Non-Revolving Credit Facility Agreement No. 5593 dated October 9, 2012 between Southern Kuzbass PAO and Sberbank PJSC (English translation).  |
| 4.64       | Supplemental Agreement No. 12 dated December 9, 2016 to Non-Revolving Credit Facility Agreement No. 5594 dated October 9, 2012 between Southern Kuzbass PAO and Sberbank PJSC (English translation).  |
| 4.65       | Supplemental Agreement No. 10 dated December 9, 2016 to Non-Revolving Credit Facility Agreement No. 8507 dated October 9, 2012 between Southern Kuzbass PAO and Sberbank PJSC (English translation).  |
| 4.66       | Supplemental Agreement No. 10 dated December 9, 2016 to Non-Revolving Credit Facility Agreement No. 8508 dated October 9, 2012 between Southern Kuzbass PAO and Sberbank PJSC (English translation).  |
| 4.67       | Supplemental Agreement No. 3 dated June 15, 2016 to Credit Facility Agreement No. 226/12-B dated April 27, 2012 between Joint Stock Holding Company Yakutugol and Gazprombank (Joint-Stock Company) (English translation).  |
| 4.68       | Supplemental Agreement No. 4 dated December 28, 2016 to Credit Facility Agreement No. 226/12-B dated April 27, 2012 between Joint Stock Holding Company Yakutugol and Gazprombank (Joint-Stock Company) (English translation).  |
| 4.69       | Supplemental Agreement No. 3 dated June 16, 2016 to Credit Facility Agreement No. 227/12-B dated April 27, 2012 between Southern Kuzbass PAO and Gazprombank (Joint-Stock Company) (English translation).   |
| 4.70       | Supplemental Agreement No. 4 dated December 28, 2016 to Credit Facility Agreement No. 227/12-B dated April 27, 2012 between Southern Kuzbass PAO and Gazprombank (Joint-Stock Company) (English translation).   |
| 4.71       | Supplemental Agreement No. 2 dated June 16, 2016 to Credit Facility Agreement No. 84/13-B dated April 26, 2013 between Southern Kuzbass PAO and Gazprombank (Joint-Stock Company) (English translation).  |

translation).

- 4.72 Supplemental Agreement No. 3 dated December 28, 2016 to Credit Facility Agreement No. 84/13-B dated April 26, 2013 between Southern Kuzbass PAO and Gazprombank (Joint-Stock Company) (English translation).

**Table of Contents****Exhibit**

| <b>No.</b> | <b>Description</b>  |
|------------|---|
| 4.73       | Supplemental Agreement No. 2 dated June 15, 2016 to Credit Facility Agreement No. 85/13-B dated April 26, 2013 between Joint Stock Holding Company Yakutugol and Gazprombank (Joint-Stock Company) (English translation).     |
| 4.74       | Supplemental Agreement No. 3 dated December 28, 2016 to Credit Facility Agreement No. 85/13-B dated April 26, 2013 between Joint Stock Holding Company Yakutugol and Gazprombank (Joint-Stock Company) (English translation). |
| 4.75       | Supplemental Agreement No. 5 dated April 6, 2017 to Credit Facility Agreement No. 226/12-B dated April 27, 2012 between Joint Stock Holding Company Yakutugol and Gazprombank (Joint-Stock Company) (English translation).    |
| 4.76       | Supplemental Agreement No. 5 dated April 6, 2017 to Credit Facility Agreement No. 227/12-B dated April 27, 2012 between Southern Kuzbass PAO and Gazprombank (Joint-Stock Company) (English translation).                     |
| 4.77       | Supplemental Agreement No. 4 dated April 6, 2017 to Credit Facility Agreement No. 84/13-B dated April 26, 2013 between Southern Kuzbass PAO and Gazprombank (Joint-Stock Company) (English translation).                      |
| 4.78       | Supplemental Agreement No. 4 dated April 6, 2017 to Credit Facility Agreement No. 85/13-B dated April 26, 2013 between Joint Stock Holding Company Yakutugol and Gazprombank (Joint-Stock Company) (English translation).     |
| 8.1        | Key subsidiaries of Mechel.   |
| 12.1       | Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 12.2       | Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.   |
| 13.1       | Certification by the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 13.2       | Certification by the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |

We hereby agree to furnish to the Securities and Exchange Commission, upon its request, copies of any instruments defining the rights of holders of long-term debt issued by Mechel or any of its consolidated subsidiaries.



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**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

MECHEL PAO

By: /s/ OLEG V. KORZHOV  
Name: Oleg V. Korzhov  
Title: *Chief Executive Officer*

Date: April 26, 2017

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**CONSOLIDATED FINANCIAL STATEMENTS**

for the year ended December 31, 2016

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of

Mechel PAO

We have audited the accompanying consolidated statements of financial position of Mechel PAO, a public joint stock company, and subsidiaries (hereinafter referred to as the Group ) as of December 31, 2016 and 2015, and the related consolidated statements of profit (loss) and other comprehensive income (loss), changes in equity, and cash flows for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Group s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 2016 and 2015, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

The accompanying consolidated financial statements have been prepared assuming that the Group will continue as a going concern. As discussed in Note 4 to the financial statements, the Group has significant debt that it does not have the ability to repay without its refinancing or restructuring, and has not complied with certain covenants of its major loan agreements with banks. These conditions raise substantial doubt about the Group s ability to continue as a going concern. Management s plans in regard to these matters are also described in Note 4. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Group s internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated April 26, 2017 expressed an adverse opinion thereon.

/s/ Ernst & Young LLC

Moscow, Russia

April 26, 2017

**Table of Contents****MECHEL PAO****Consolidated statement of profit (loss) and other comprehensive income (loss) for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

|   | Notes | Year ended<br>December 31,<br>2016 | Year ended<br>December 31,<br>2015 | Year ended<br>December 31,<br>2014 |
|---|-------|------------------------------------|------------------------------------|------------------------------------|
| <b>Continuing operations</b>  |       |                                    |                                    |                                    |
| Revenue   | 27    | 276,009                            | 253,141                            | 243,992                            |
| Cost of goods sold  |       | (146,322)                          | (151,334)                          | (153,057)                          |
| <b>Gross profit</b>   | 27    | <b>129,687</b>                     | <b>101,807</b>                     | <b>90,935</b>                      |
| Selling and distribution expenses   |       | (56,233)                           | (51,117)                           | (55,661)                           |
| Loss on write-off of property, plant and equipment  |       | (1,953)                            | (691)                              | (661)                              |
| Impairment of goodwill and other non-current assets   | 18    | (5,202)                            | (1,460)                            | (7,996)                            |
| Allowance for doubtful accounts   | 12    | (758)                              | (1,507)                            | (3,797)                            |
| Taxes other than income taxes   |       | (5,913)                            | (5,853)                            | (6,469)                            |
| Administrative and other operating expenses   | 26.1  | (18,791)                           | (17,300)                           | (16,315)                           |
| Other operating income  | 26.3  | 1,853                              | 373                                | 871                                |
| <b>Total selling, distribution and operating income and (expenses), net</b>   |       | <b>(86,997)</b>                    | <b>(77,555)</b>                    | <b>(90,028)</b>                    |
| <b>Operating profit</b>   |       | <b>42,690</b>                      | <b>24,252</b>                      | <b>907</b>                         |
| Finance income  | 26.4  | 1,176                              | 183                                | 107                                |
| Finance costs including fines and penalties on overdue loans and borrowings and finance leases payments of RUB 6,013 million, RUB 19,167 million and RUB 1,829 million for the periods ended December 31, 2016, 2015 and 2014, respectively | 26.5  | (54,240)                           | (60,452)                           | (28,110)                           |
| Foreign exchange gain (loss), net   |       | 25,947                             | (71,106)                           | (103,176)                          |
| Share of (loss) profit of associates, net of provision  | 8     | (17)                               |                                    | 7                                  |
| Other income  | 26.6  | 598                                | 342                                | 664                                |
| Other expenses  | 26.6  | (2,003)                            | (347)                              | (1,486)                            |
| <b>Total other income and (expense), net</b>  |       | <b>(28,539)</b>                    | <b>(131,380)</b>                   | <b>(131,994)</b>                   |
| <b>Income (loss) before tax from continuing operations</b>  |       | <b>14,151</b>                      | <b>(107,128)</b>                   | <b>(131,087)</b>                   |
| Income tax (expense) benefit  | 20    | (4,893)                            | (8,322)                            | 8,822                              |

|  |    |              |                  |                  |
|--|----|--------------|------------------|------------------|
| <b>Income (loss) for the year from continuing operations</b>           |    | <b>9,258</b> | <b>(115,450)</b> | <b>(122,265)</b> |
| <b>Discontinued operations</b>   |    |              |                  |                  |
| (Loss) profit after tax for the year from discontinued operations, net | 16 | (426)        | 822              | (11,702)         |
| <b>Profit (loss) for the year</b>                                      |    | <b>8,832</b> | <b>(114,628)</b> | <b>(133,967)</b> |
| <b>Attributable to:</b>  |    |              |                  |                  |
| Equity shareholders of Mechel PAO                                      |    | 7,126        | (115,163)        | (132,704)        |
| Non-controlling interests  |    | 1,706        | 535              | (1,263)          |

*See accompanying notes to the consolidated financial statements.*

**Table of Contents****MECHEL PAO****Consolidated statement of profit (loss) and other comprehensive income (loss) for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

|  | Notes | Year ended<br>December 31,<br>2016 | Year ended<br>December 31,<br>2015 | Year ended<br>December 31,<br>2014 |
|--|-------|------------------------------------|------------------------------------|------------------------------------|
| <b>Other comprehensive income</b>  |       |                                    |                                    |                                    |
| <i>Other comprehensive income to be reclassified to profit or loss in subsequent periods, net of income tax:</i>   |       |                                    |                                    |                                    |
| Exchange differences on translation of foreign operations  |       | 430                                | 295                                | 1,170                              |
| Net (loss) gain on available for sale financial assets   |       | (1)                                | 8                                  | 2                                  |
| <i>Other comprehensive loss not to be reclassified to profit or loss in subsequent periods, net of income tax:</i> |       |                                    |                                    |                                    |
| Re-measurement losses on defined benefit plans   | 23    | (23)                               | (194)                              | (127)                              |
| <b>Other comprehensive income for the year, net of tax</b>   |       | <b>407</b>                         | <b>101</b>                         | <b>1,043</b>                       |
| <b>Total comprehensive income (loss) for the year, net of tax</b>  |       | <b>9,239</b>                       | <b>(114,527)</b>                   | <b>(132,924)</b>                   |
| <b>Attributable to:</b>  |       |                                    |                                    |                                    |
| Equity shareholders of Mechel PAO  |       | 7,529                              | (115,064)                          | (131,675)                          |
| Non-controlling interests  |       | 1,710                              | 537                                | (1,249)                            |
| <b>Earnings (loss) per share</b>   |       |                                    |                                    |                                    |
| Weighted average number of common shares   | 25    | 416,270,745                        | 416,270,745                        | 416,270,745                        |
| Basic and diluted, profit (loss) for the year attributable to ordinary equity holders of the parent                | 25    | 17.12                              | (276.65)                           | (318.79)                           |
| Earnings (loss) per share from continuing operations (Russian rubles per share), basic and diluted                 | 25    | 17.99                              | (278.44)                           | (289.96)                           |
| (Loss) earnings per share from discontinued operations (Russian rubles per share)                                  | 25    | (0.87)                             | 1.79                               | (28.83)                            |
| <i>See accompanying notes to the consolidated financial statements.</i>  |       |                                    |                                    |                                    |

**Table of Contents****MECHEL PAO****Consolidated statement of financial position as of December 31, 2016***(All amounts are in millions of Russian rubles)*

|   | Notes  | December 31,<br>2016 | December 31,<br>2015 |
|---|--------|----------------------|----------------------|
| <b>Assets</b>   |        |                      |                      |
| <b>Current assets</b>   |        |                      |                      |
| Cash and cash equivalents   | 11     | 1,689                | 3,079                |
| Trade and other receivables   | 12     | 19,054               | 16,013               |
| Inventories   | 14     | 35,227               | 35,189               |
| Income tax receivables  |        | 686                  | 603                  |
| Other current financial assets  |        | 167                  | 45                   |
| Other current assets  | 15     | 6,942                | 8,191                |
| <b>Total current assets</b>   |        | <b>63,765</b>        | <b>63,120</b>        |
| <b>Non-current assets</b>   |        |                      |                      |
| Property, plant and equipment   | 17, 18 | 204,353              | 215,844              |
| Mineral licenses  | 19     | 36,099               | 38,517               |
| Non-current financial assets  |        | 235                  | 194                  |
| Investments in associates   | 8      | 265                  | 284                  |
| Deferred tax assets   | 20     | 1,502                | 1,492                |
| Goodwill  | 18, 19 | 18,355               | 21,378               |
| Other non-current assets  | 15     | 891                  | 1,243                |
| <b>Total non-current assets</b>   |        | <b>261,700</b>       | <b>278,952</b>       |
| <b>Total assets</b>   |        | <b>325,465</b>       | <b>342,072</b>       |
| <b>Equity and liabilities</b>   |        |                      |                      |
| <b>Current liabilities</b>  |        |                      |                      |
| Interest-bearing loans and borrowings, including interest payable, fines and penalties on overdue amounts of RUB 38,594 million and RUB 47,475 million as of December 31, 2016 and 2015, respectively | 10.1   | 434,165              | 491,674              |
| Trade and other payables  | 21     | 40,985               | 54,602               |
| Advances received   |        | 3,815                | 3,492                |
| Provisions  | 22     | 3,496                | 2,532                |
| Pension obligations   | 23     | 944                  | 1,120                |
| Finance lease liabilities   | 28     | 10,175               | 13,507               |
| Income tax payable  |        | 2,552                | 5,549                |
| Taxes and similar charges payable other than income tax   | 24     | 9,195                | 8,034                |



|   |      |                  |                  |
|---|------|------------------|------------------|
| Other current liabilities                                       |      | 19               | 26               |
| <b>Total current liabilities</b>                                |      | <b>505,346</b>   | <b>580,536</b>   |
| <b>Non-current liabilities</b>                                  |      |                  |                  |
| Interest-bearing loans and borrowings                           | 10.1 | 11,644           | 4,308            |
| Provisions  | 22   | 3,420            | 3,439            |
| Pension obligations   | 23   | 3,501            | 3,746            |
| Finance lease liabilities                                       | 28   | 421              | 481              |
| Deferred tax liabilities  | 20   | 16,282           | 11,090           |
| Other non-current liabilities                                   |      | 159              | 189              |
| Other non-current financial liabilities                         | 6    | 36,740           |                  |
| Income tax payables   |      | 540              | 137              |
| <b>Total non-current liabilities</b>                            |      | <b>72,707</b>    | <b>23,390</b>    |
| <b>Total liabilities</b>  |      | <b>578,053</b>   | <b>603,926</b>   |
| <b>Equity</b>   |      |                  |                  |
| Common shares   | 25   | 4,163            | 4,163            |
| Preferred shares  | 25   | 833              | 833              |
| Additional paid-in capital                                      | 25   | 28,326           | 28,322           |
| Accumulated other comprehensive income                          |      | 848              | 445              |
| Accumulated deficit   |      | (294,444)        | (301,565)        |
| <b>Equity attributable to equity shareholders of Mechel PAO</b> |      | <b>(260,274)</b> | <b>(267,802)</b> |
| Non-controlling interests                                       | 6, 7 | 7,686            | 5,948            |
| <b>Total equity</b>   |      | <b>(252,588)</b> | <b>(261,854)</b> |
| <b>Total equity and liabilities</b>                             |      | <b>325,465</b>   | <b>342,072</b>   |

*See accompanying notes to the consolidated financial statements.*

**Table of Contents****MECHEL PAO****Consolidated statement of changes in equity for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless shares numbers)*

|  | Notes | Common shares      |              | Attributable to equity holders of the parent |                            |                               | Equity attributable to other shareholders |                                |                  | Total equity   |                                 |
|--|-------|--------------------|--------------|--|----------------------------|-------------------------------|---|--------------------------------|------------------|----------------|---------------------------------|
|  |       | Shares<br>Quantity | Amount       | Shares<br>Quantity                           | Preferred shares<br>Amount | Additional<br>paid-in capital | Accumulated<br>deficit                    | comprehensive<br>(loss) income | Mechel<br>PAO    |                | Non-<br>controlling<br>interest |
|  |       |                    |              |  |                            |                               |   |                                |                  |                |                                 |
| <b>of January 1, 2014</b>  |       | <b>416,270,745</b> | <b>4,163</b> | <b>83,254,149</b>                            | <b>833</b>                 | <b>25,591</b>                 | <b>(53,564)</b>                           | <b>(11)</b>                    | <b>(22,988)</b>  | <b>9,500</b>   | <b>(13,488)</b>                 |
| Loss for the period  |       |                    |              |  |                            |                               | (132,704)                                 |                                | (132,704)        | (1,263)        | (133,967)                       |
| Other comprehensive income (loss)                                |       |                    |              |  |                            |                               |   |                                |                  |                |                                 |
| Net gain on available-for-sale financial assets                  |       |                    |              |  |                            |                               |   | 2                              | 2                |                |                                 |
| Actuarial measurement losses on defined benefit plans            | 23    |                    |              |  |                            |                               |   | (141)                          | (141)            | 14             | (127)                           |
| Exchange rate differences from translation of foreign operations |       |                    |              |  |                            |                               |   | 1,168                          | 1,168            |                | 1,168                           |
| <b>Total comprehensive income (loss)</b>                         |       |                    |              |  |                            |                               | <b>(132,704)</b>                          | <b>1,029</b>                   | <b>(131,675)</b> | <b>(1,249)</b> | <b>(132,924)</b>                |
| Dividends declared to shareholders of Mechel OAO                 | 25    |                    |              |  |                            |                               | (4)                                       |                                | (4)              |                | (4)                             |
| Dividends declared to non-controlling interest                   | 25    |                    |              |  |                            |                               |   |                                |                  | (2)            | (2)                             |
| Disposal of non-controlling interest                             | 6     |                    |              |  |                            | 1                             |   |                                | 1                | 4              | 6                               |
| <b>of December 31, 2016</b>                                      |       | <b>416,270,745</b> | <b>4,163</b> | <b>83,254,149</b>                            | <b>833</b>                 | <b>25,592</b>                 | <b>(186,272)</b>                          | <b>1,018</b>                   | <b>(154,666)</b> | <b>8,253</b>   | <b>(146,411)</b>                |

*See accompanying notes to the consolidated financial statements.*

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## MECHEL PAO

## Consolidated statement of changes in equity for the year ended December 31, 2016 (continued)

(All amounts are in millions of Russian rubles, unless shares numbers)

|  | Notes | Common shares      |        | Attributable to equity holders of the parent |        |                                  | Equity attributable to other shareholders |                  |               | Non-controlling interest | Total equity |
|--|-------|--------------------|--------|--|--------|----------------------------------|---|------------------|---------------|--------------------------|--------------|
|  |       | Shares<br>Quantity | Amount | Shares<br>Quantity                           | Amount | Additional<br>paid-in<br>capital | Accumulated<br>deficit                    | Income<br>(loss) | Mechel<br>PAO |                          |              |
| As of January 1, 2015  |       | 416,270,745        | 4,163  | 83,254,149                                   | 833    | 25,592                           | (186,272)                                 | 1,018            | (154,666)     | 8,253                    | (146,4       |
| Net (loss) profit for the period   |       |                    |        |  |        |                                  | (115,163)                                 |                  | (115,163)     | 535                      | (114,6       |
| Other comprehensive income (loss)  |       |                    |        |  |        |                                  |   |                  |               |                          |              |
| Gain on available-for-sale financial assets  |       |                    |        |  |        |                                  |   | 8                | 8             |                          |              |
| Measurement losses on defined benefit plans  | 23    |                    |        |  |        |                                  |   | (196)            | (196)         | 2                        | (1           |
| Exchange differences on translation of foreign operations                            |       |                    |        |  |        |                                  |   | 287              | 287           |                          | 2            |
| <b>Total comprehensive (loss) income for the period</b>                              |       |                    |        |  |        |                                  | (115,163)                                 | 99               | (115,064)     | 537                      | (114,5       |
| Transfer of cumulative translation adjustment to disposal of discontinued operations | 16    |                    |        |  |        |                                  |   | (798)            | (798)         |                          | (7           |
| Transfer of actuarial gains (losses) due to disposal of discontinued operations      | 16    |                    |        |  |        |                                  | (126)                                     | 126              |               |                          |              |
| Dividends declared to shareholders of Mechel OAO                                     | 25    |                    |        |  |        |                                  | (4)                                       |                  | (4)           |                          |              |
| Dividends declared to non-controlling interest                                       | 25    |                    |        |  |        |                                  |   |                  |               |                          |              |
| Acquisition of non-controlling interest  | 6, 25 |                    |        |  |        | 2,730                            |   |                  | 2,730         | (2,842)                  | (1           |

of December 31,

|   |             |       |            |     |        |           |     |           |       |        |
|---|-------------|-------|------------|-----|--------|-----------|-----|-----------|-------|--------|
| 5 | 416,270,745 | 4,163 | 83,254,149 | 833 | 28,322 | (301,565) | 445 | (267,802) | 5,948 | (261,8 |
|---|-------------|-------|------------|-----|--------|-----------|-----|-----------|-------|--------|

*See accompanying notes to the consolidated financial statements.*

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## MECHEL PAO

## Consolidated statement of changes in equity for the year ended December 31, 2016 (continued)

(All amounts are in millions of Russian rubles, unless shares numbers)

|   | Notes | Attributable to equity holders of the parent |                  | Equity attributable to other shareholders |                     |                            |                     |                           | Total equity     |                          |                  |
|---|-------|--|------------------|---|---------------------|----------------------------|---------------------|---------------------------|------------------|--------------------------|------------------|
|   |       | Common shares                                | Preferred shares | Additional paid-in capital                | Accumulated deficit | Accumulated income (loss)  | Mechel PAO          | Non-controlling interest  |                  |                          |                  |
|   |       | Shares<br>Quantity                           | Amount           | Shares<br>Quantity                        | Amount              | Additional paid-in capital | Accumulated deficit | Accumulated income (loss) | Mechel PAO       | Non-controlling interest | Total equity     |
| <b>As of January 1, 2016</b>                                |       | <b>416,270,745</b>                           | <b>4,163</b>     | <b>83,254,149</b>                         | <b>833</b>          | <b>28,322</b>              | <b>(301,565)</b>    | <b>445</b>                | <b>(267,802)</b> | <b>5,948</b>             | <b>(261,854)</b> |
| Profit for the period                                       |       |  |                  |   |                     |                            | 7,126               |                           | 7,126            | 1,706                    | 8,832            |
| <i>Other comprehensive income (loss)</i>                    |       |  |                  |   |                     |                            |                     |                           |                  |                          |                  |
| Net loss on available for sale financial assets             |       |  |                  |   |                     |                            |                     | (1)                       | (1)              |                          | (1)              |
| Re-measurement losses on defined benefit plans              | 23    |  |                  |   |                     |                            |                     | (23)                      | (23)             |                          | (23)             |
| Exchange differences on translation of foreign operations   |       |  |                  |   |                     |                            |                     | 427                       | 427              | 4                        | 431              |
| <b>Total comprehensive income for the year</b>              |       |  |                  |   |                     |                            | <b>7,126</b>        | <b>403</b>                | <b>7,529</b>     | <b>1,710</b>             | <b>9,239</b>     |
| Reversal of unclaimed declared dividends to non-controlling |       |  |                  |   |                     |                            |                     |                           |                  | 35                       | 35               |

interest upon  
expiration of  
limitation period

|   |       |  |  |  |   |     |  |     |     |     |
|---|-------|--|--|--|---|-----|--|-----|-----|-----|
| Dividends<br>declared to<br>shareholders<br>of Mechel PAO | 25    |  |  |  |   | (5) |  | (5) |     | (5) |
| Dividends<br>declared to<br>non-controlling<br>interest   | 25    |  |  |  |   |     |  |     | (3) | (3) |
| Acquisition of<br>non-controlling<br>interest             | 6, 25 |  |  |  | 4 |     |  | 4   | (4) | 0   |

**As of  
December 31,  
2016**

**416,270,745 4,163 83,254,149 833 28,326 (294,444) 848 (260,274) 7,686 (252,588)**

*See accompanying notes to the consolidated financial statements.*

**Table of Contents****MECHEL PAO****Consolidated statement of cash flows for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

|   |              | <b>Year ended December 31,</b> |                  |                  |
|---|--------------|--------------------------------|------------------|------------------|
|   | <b>Notes</b> | <b>2016</b>                    | <b>2015</b>      | <b>2014</b>      |
| <b>Cash flows from operating activities</b>   |              |                                |                  |                  |
| <b>Net profit (loss)</b>  |              | <b>8,832</b>                   | <b>(114,628)</b> | <b>(133,967)</b> |
| Loss (profit) from discontinuing operations, net of income tax  |              | 426                            | (822)            | 11,702           |
| Net profit (loss) from continuing operations  |              | 9,258                          | (115,450)        | (122,265)        |
| <i>Adjustments to reconcile net profit (loss) from continuing operations to net cash provided by operating activities:</i>  |              |                                |                  |                  |
| Depreciation  |              | 11,813                         | 12,397           | 12,639           |
| Depletion and amortization  |              | 1,901                          | 1,688            | 1,790            |
| Foreign exchange (gain) loss  |              | (25,947)                       | 71,106           | 103,176          |
| Deferred income taxes   | 20           | 5,104                          | 7,946            | (15,525)         |
| Allowance for doubtful accounts   | 12           | 758                            | 1,507            | 3,797            |
| Write-off of accounts receivable  | 26.1         | 113                            | 247              | 185              |
| Write-off of taxes receivable   |              |                                |                  | 1,605            |
| Write-off of inventories to net realisable value  | 14           | 364                            | 1,003            | 394              |
| Revision in estimated cash flows of rehabilitation provision  | 26.3         | (375)                          | (47)             | (236)            |
| Loss on write-off of property, plant and equipment  | 26.1         | 1,953                          | 691              | 661              |
| Impairment of goodwill and non-current assets   | 18           | 5,202                          | 1,460            | 7,996            |
| Loss on sale of property, plant and equipment   |              | 57                             | 102              | 85               |
| Gain on sale of investments   | 26.6         | (186)                          |                  | (483)            |
| Gain on write-off of accounts payable with expired legal term   | 26.6         | (115)                          | (222)            | (37)             |
| Curtailment and rereasurement of pension obligations  | 26.3         | (325)                          | (142)            | (58)             |
| Pension service cost and actuarial loss, other related expenses   | 23           | 154                            | 192              | 52               |
| Finance income  | 26.4         | (1,176)                        | (183)            | (107)            |
| Finance costs including fines and penalties on overdue loans and borrowings and finance leases payments of RUB 6,013 million, RUB 19,167 million and RUB 1,829 million for the periods ended December 31, 2016, 2015 and 2014, respectively | 26.5         | 54,240                         | 60,452           | 28,110           |
| VEB commissions write-off   | 15           | 1,411                          |                  |                  |
| Provision for non-recoverable advances to pension funds   | 26.6         | 408                            |                  |                  |
| Other   |              | (70)                           | 480              | 1,492            |
| <i>Changes in working capital items:</i>  |              |                                |                  |                  |
| Trade and other receivables   |              | (5,542)                        | 4,597            | 2,130            |
| Inventories   |              | (1,070)                        | 1,873            | 14,565           |
| Trade and other payables  |              | (4,259)                        | (8,125)          | (1,710)          |
| Advances received   |              | 588                            | (664)            | 62               |
| Taxes payable and other current liabilities   |              | 2,368                          | (1,465)          | 8,771            |
| Other current assets  |              | (883)                          | 997              | (822)            |

|   |               |               |               |
|---|---------------|---------------|---------------|
| Income taxes paid                                   | (2,101)       | (1,437)       | (2,509)       |
| Net operating cash flows of discontinued operations | (436)         | (136)         | (745)         |
| <b>Net cash provided by operating activities</b>    | <b>53,207</b> | <b>38,867</b> | <b>43,013</b> |

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**Table of Contents****MECHEL PAO****Consolidated statement of cash flows for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

|  | Notes    | Year ended December 31, |                 |                 |
|--|----------|-------------------------|-----------------|-----------------|
|  |          | 2016                    | 2015            | 2014            |
| <b>Cash flows from investing activities</b>                                      |          |                         |                 |                 |
| Proceeds from disposal of securities   |          |                         | 143             | 538             |
| Loans issued and other investments   |          | (133)                   | (6)             | (36)            |
| Interest received  |          | 128                     | 25              | 22              |
| Royalty payments associated with disposal of Bluestone                           | 16, 26.6 | 103                     | 101             |                 |
| Proceeds from disposal of other subsidiaries                                     |          | 145                     | 76              | 632             |
| Purchases of available for sale securities                                       |          | (4)                     |                 | (113)           |
| Proceeds from loans issued   |          | 31                      | 15              | 151             |
| Proceeds from disposals of property, plant and equipment                         |          | 285                     | 405             | 830             |
| Purchases of property, plant and equipment                                       |          | (4,742)                 | (5,076)         | (11,365)        |
| Purchases of mineral licenses and other related payments                         |          |                         | (71)            |                 |
| Interest paid, capitalized   |          | (782)                   | (830)           | (5,141)         |
| Net investing cash flows of discontinued operations                              |          |                         |                 | (12)            |
| <b>Net cash used in investing activities</b>                                     |          | <b>(4,969)</b>          | <b>(5,218)</b>  | <b>(14,494)</b> |
| <b>Cash flows from financing activities</b>                                      |          |                         |                 |                 |
| Proceeds from borrowings   |          | 4,002                   | 13,875          | 64,469          |
| Repayment of borrowings  |          | (42,322)                | (11,896)        | (77,761)        |
| Dividends paid   |          | (5)                     | (4)             | (4)             |
| Dividends paid to non-controlling interest                                       |          | (2)                     | (1)             | (6)             |
| Interest paid  |          | (33,872)                | (28,910)        | (14,963)        |
| Acquisition of non-controlling interest in subsidiaries                          |          |                         | (1)             | (1,425)         |
| Proceeds from sale of 49% share in Elga coal complex, with put-option granted    | 6        | 34,300                  |                 |                 |
| Repayment of obligations under finance lease                                     |          | (3,238)                 | (2,677)         | (1,863)         |
| Sale leaseback proceeds  |          |                         |                 | 675             |
| Net financing cash flows of discontinued operations                              |          |                         |                 | (105)           |
| Deferred consideration paid for the acquisition of subsidiaries in prior periods |          | (4,732)                 | (4,819)         | (3,223)         |
| <b>Net cash used in financing activities</b>                                     |          | <b>(45,869)</b>         | <b>(34,433)</b> | <b>(34,206)</b> |
| Effect of exchange rate changes on cash and cash equivalents                     |          | (1,807)                 | 331             | 901             |
| <b>Net increase (decrease) in cash and cash equivalents</b>                      |          | <b>562</b>              | <b>(453)</b>    | <b>(4,786)</b>  |
| Cash and cash equivalents at the beginning of period                             | 11       | 3,079                   | 4,074           | 8,979           |

|   |    |              |              |              |
|---|----|--------------|--------------|--------------|
| <b>Cash and cash equivalents net of overdrafts at the beginning of period</b> | 11 | <b>891</b>   | <b>1,344</b> | <b>6,130</b> |
| Cash and cash equivalents at the end of period                                | 11 | 1,689        | 3,079        | 4,074        |
| <b>Cash and cash equivalents net of overdrafts at the end of period</b>       | 11 | <b>1,453</b> | <b>891</b>   | <b>1,344</b> |

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**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)***1. Corporate information****(a) Information**

Mechel PAO (Mechel, formerly Mechel OAO and Mechel Steel Group OAO) was incorporated on March 19, 2003, under the laws of the Russian Federation in connection with a reorganization to serve as a holding company for various steel and mining companies owned by two individual shareholders (the Controlling Shareholders). The Controlling Shareholders, directly or through their associates, either acquired existing companies or established new companies, at varying dates from 1995 through March 19, 2003, which were contributed to Mechel after its formation. The formation of Mechel and contribution of the subsidiaries' shares into Mechel's capital represents a reorganization of entities under common control, and accordingly, has been accounted for in a manner similar to a pooling for the periods presented. During 2006, one of the Controlling Shareholders sold all his Mechel's stock to the other Controlling Shareholder, Igor Zyuzin, the ultimate controlling party. In accordance with the changes in the Civil Code of the Russian Federation Mechel has registered changes in its Charter on March 17, 2016 and changed its corporate name from Mechel OAO to Mechel PAO. The registered office is located at Krasnoarmeyskaya St. 1, Moscow 125167, Russian Federation. Mechel and its subsidiaries are collectively referred to herein as the Group. Set forth below is a summary of the Group's primary subsidiaries:

| <b>Name of subsidiary</b>              | <b>Registered in</b> | <b>Core business</b>      | <b>Date control acquired / date of incorporation (*)</b> | <b>Interest in voting stock held by the Group at December 31, 2016</b> |
|--|----------------------|---------------------------|--|--|
| Southern Kuzbass Coal Company (SKCC)   | Russia               | Coal mining               | January 1999   | 96.6%  |
| Chelyabinsk Metallurgical Plant (CMP)  | Russia               | Steel products            | December 2001  | 94.2%  |
| Vyartsilya Metal Products Plant (VMPP) | Russia               | Steel products            | May 2002   | 93.3%  |
| Beloretsk Metallurgical Plant (BMP)    | Russia               | Steel products            | June 2002  | 94.8%  |
| Urals Stampings Plant (USP)            | Russia               | Steel products            | April 2003   | 93.8%  |
| Korshunov Mining Plant (KMP)           | Russia               | Iron ore mining           | October 2003   | 90.0%  |
| Mechel Nemunas (MN)                    | Lithuania            | Steel products            | October 2003   | 100.0%   |
| Mechel Energo                          | Russia               | Power generation and sale | February 2004  | 100.0%   |
| Port Posiet                            | Russia               | Transshipment             | February 2004  | 97.6%  |

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|  |        |                             |              |        |
|--|--------|-----------------------------|--------------|--------|
| Izhstal                                | Russia | Steel products              | May 2004     | 90.0%  |
| Port Kambarka                          | Russia | Transshipment               | April 2005   | 90.4%  |
| Mechel Service                         | Russia | Trading                     | May 2005     | 100.0% |
| Mechel Coke                            | Russia | Coke production             | June 2006    | 100.0% |
| Moscow Coke and Gas Plant<br>(Moskoks) | Russia | Coke production             | October 2006 | 99.5%  |
| Southern Kuzbass Power Plant<br>(SKPP) | Russia | Power generation            | April 2007   | 98.3%  |
| Kuzbass Power Sales Company<br>(KPSC)  | Russia | Electricity<br>distribution | June 2007    | 72.1%  |
| Bratsk Ferroalloy Plant (BFP)          | Russia | Ferrosilicon<br>production  | August 2007  | 100.0% |

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**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

| <b>Name of subsidiary</b>                                    | <b>Registered in</b> | <b>Core business</b>    | <b>Date control acquired / date of incorporation (*)</b> | <b>Interest in voting stock held by the Group at December 31, 2016</b> |
|--|----------------------|-------------------------|--|--|
| Yakutugol  | Russia               | Coal mining             | October 2007   | 100.0%   |
| Port Temryuk   | Russia               | Transshipment           | March 2008   | 100.0%   |
| Mechel Carbon AG   | Switzerland          | Trading                 | April 2008   | 100.0%   |
| HBL Holding GmbH (HBL)                                       | Germany              | Trading                 | September 2008   | 100.0%   |
| Mechel Service Stahlhandel Austria GmbH and its subsidiaries | Austria              | Trading                 | September 2012   | 100.0%   |
| Elgaugol   | Russia               | Coal mining             | August 2013  | 51.0%**  |
| Elga-road  | Russia               | Railroad transportation | January 2016   | 51.0%**  |

\* Date, when a control interest was acquired or a new company established.

\*\* In 2016, the Group sold 49% stakes in Elgaugol and Elga-road to Gazprombank. Simultaneously with this transaction, the Group granted to Gazprombank a put option to sell 49% stakes in these companies to the Group. The transaction in fact represents a financial liability, and these entities are consolidated based on 100% ownership (Note 6, 10.4).

**(b) Business**

The Group operates in three business segments: steel (comprising steel and steel products), mining (comprising coal, iron ore and coke) and power (comprising electricity (generation and transportation) and heat power generation), and conducts operations in Russia, Kazakhstan and Europe. The Group sells its products within Russia and foreign markets. Through acquisitions, the Group has added various businesses to explore new opportunities and build an integrated Group of steel, mining, ferroalloy and power companies. The Group operates in a highly competitive and cyclical industry; any local or global downturn in the industries may have an adverse effect on the Group's results of operations and financial condition. While the Group will utilize funds from operations, it expects to continue to rely on operating cash flow and long term debt to finance major investment projects, focus on restructuring of the loan portfolio and other financing sources for its capital needs. As discussed in Notes 4 and 5, management believes that the Group will secure adequate financing.

## **2. Basis of preparation of the consolidated financial statements**

### **(a) Basis of preparation**

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

The consolidated financial statements have been prepared on a historical cost basis, except for specific financial assets and liabilities that have been measured at fair value.

Russian associates and subsidiaries of the Group maintain their books and records in Russian rubles and prepare accounting reports in accordance with the accounting principles and practices mandated by Russian Accounting Standards (RAS). Foreign subsidiaries and associates maintain their books and records in different foreign functional currencies and prepare accounting reports in accordance with generally accepted accounting principles (GAAP) in various jurisdictions. The financial statements and accounting reports for the Group and its

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**MECHEL PAO**

**Notes to the consolidated financial statements for the year ended December 31, 2016**

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

subsidiaries and associates for the purposes of preparation of the consolidated financial statements in accordance with IFRS have been translated and adjusted on the basis of the respective standalone RAS or other GAAP financial statements.

The accompanying consolidated financial statements differ from the financial statements issued for the RAS and other GAAP purposes in that they reflect certain adjustments, not recorded in the statutory books, which are appropriate to present the financial position, results of operations and cash flows in accordance with IFRS. The principal adjustments relate to: (1) purchase accounting; (2) recognition of interest expense and certain operating expenses; (3) valuation and depreciation of property, plant and equipment and mineral licenses; (4) defined benefit plans and other long-term benefits; (5) foreign currency translation; (6) deferred income taxes; (7) accounting for tax penalties, uncertainties and contingencies, (8) revenue recognition; (9) valuation allowances for unrecoverable assets, and (10) recording investments at fair value.

The consolidated financial statements of the Group comply with the Russian Federal Law No. 208 *On Consolidated Financial Statements* (Law 208-FZ ), which was adopted on July 27, 2010. The Law 208-FZ provides the legal basis for certain entities to prepare the financial statements in accordance with IFRS as issued by the IASB and subsequently endorsed for use in the Russian Federation. As of December 31, 2016, all currently effective standards and interpretations issued by the IASB have been endorsed for use in Russia. The consolidated financial statements are presented in millions of Russian rubles, except when otherwise indicated.

**(b) Basis of consolidation**

The consolidated financial statements comprise the financial statements of the Group and its subsidiaries for the year ended December 31, 2016. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if, and only if, the Group has:

Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee);

Exposure, or rights, to variable returns from its involvement with the investee;

The ability to use its power over the investee to affect its returns.

Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Assets, liabilities, income and expenses of a subsidiary acquired or disposed of during

the year are included in the consolidated financial statements from the date the Group gains control until the date the Group ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income (loss) (OCI) are attributed to the equity holders of the parent of the Group and to the non-controlling interests, even if this results in the non-controlling interests having a deficit balance. When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction.



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**MECHEL PAO**

**Notes to the consolidated financial statements for the year ended December 31, 2016**

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

If the Group loses control over a subsidiary, it derecognises the related assets (including goodwill), liabilities, non-controlling interest and other components of equity, while any resultant gain or loss is recognised in the consolidated statement of profit (loss) and other comprehensive income (loss). Any investment retained is recognised at fair value.

**3. Summary of significant accounting policies**

**(a) Business combinations and goodwill**

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the Group elects whether to measure the non-controlling interests in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred and included in administrative expenses.

When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as of the acquisition date.

Any contingent consideration to be transferred by the acquirer will be recognised at fair value at the acquisition date. Contingent consideration classified as an asset or liability that is a financial instrument and within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*, is measured at fair value with the changes in fair value recognised in the consolidated statement of profit (loss) and other comprehensive income (loss).

Goodwill is initially measured at cost (being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interests) and any previous interest held over the net identifiable assets acquired and liabilities assumed. If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the Group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognised at the acquisition date. If the reassessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognised in the consolidated statement of profit (loss) and other comprehensive income (loss).

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill has been allocated to a cash-generating unit (CGU) and part of the operation within that unit is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss on disposal. Goodwill disposed in these circumstances is measured based on the relative values of the disposed operation and the portion of the cash-generating unit retained.

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**MECHEL PAO**

**Notes to the consolidated financial statements for the year ended December 31, 2016**

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

**(b) Investments in associates**

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

The considerations made in determining significant influence are similar to those necessary to determine control over subsidiaries.

The Group's investments in its associate are accounted for using the equity method.

Under the equity method, the investment in an associate is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the Group's share of net assets of the associate since the acquisition date. Goodwill relating to the associate is included in the carrying amount of the investment and is not tested for impairment separately.

The consolidated statement of profit (loss) and other comprehensive income (loss) reflects the Group's share of the results of operations of the associate. Any change in OCI of those investees is presented as part of the Group's OCI. In addition, when there has been a change recognised directly in the equity of the associate, the Group recognises its share of any changes, when applicable, in the statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

The aggregate of the Group's share of profit or loss of an associate is shown on the face of the consolidated statement of profit (loss) and other comprehensive income (loss) outside operating profit and represents profit or loss after tax and non-controlling interests in the subsidiaries of the associate.

The financial statements of the associate are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

After application of the equity method, the Group determines whether it is necessary to recognise an impairment loss on its investment in its associate. At each reporting date, the Group determines whether there is objective evidence that the investment in the associate is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value, and then recognises the loss as *Share of profit of an associate* in the consolidated statement of profit (loss) and other comprehensive income (loss).

Upon loss of significant influence over the associate, the Group measures and recognises any retained investment at its fair value. Any difference between the carrying amount of the associate upon loss of significant influence and the fair value of the retained investment and proceeds from disposal is recognised in the consolidated statement of profit (loss) and other comprehensive income (loss).

**(c) Current versus non-current classification**

The Group presents assets and liabilities in the consolidated statement of financial position based on current/non-current classification. An asset is current when it is:

Expected to be realised or intended to be sold or consumed in the normal operating cycle;

Held primarily for the purpose of trading;

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**MECHEL PAO**

**Notes to the consolidated financial statements for the year ended December 31, 2016**

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

Expected to be realised within twelve months after the reporting period; or

Cash or cash equivalent unless restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

All other assets are classified as non-current.

A liability is current when:

It is expected to be settled in the normal operating cycle;

It is held primarily for the purpose of trading;

It is due to be settled within twelve months after the reporting period; or

There is no unconditional right to defer the settlement of the liability for at least twelve months after the reporting period.

The Group classifies all other liabilities as non-current. Deferred tax assets and liabilities are classified as non-current assets and liabilities.

**(d) Fair value measurement**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

In the principal market for the asset or liability; or

In the absence of a principal market, in the most advantageous market for the asset or liability.  
The principal or the most advantageous market must be accessible by the Group.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Level 1 quoted (unadjusted) market prices in active markets for identical assets or liabilities;

Level 2 valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable;

Level 3 valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

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**MECHEL PAO**

**Notes to the consolidated financial statements for the year ended December 31, 2016**

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

For assets and liabilities that are recognised in the financial statements at fair value on a recurring basis, the Group determines whether transfers have occurred between levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

**(e) Revenue recognition**

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured, regardless of when the payment is received. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding discounts, rebates, and sales taxes or duty.

Revenues are inflows from sales of goods that constitute ongoing major operations of the Group and are reported as such in the consolidated statement of profit (loss) and other comprehensive income (loss). Inflows from incidental and peripheral operations are considered gains and are included, net of related costs, in other income in the consolidated statement of profit (loss) and other comprehensive income (loss).

The following criteria are also applicable to other specific revenue transactions:

*Sales of goods*

Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer. Revenue from the sale of goods is measured at the fair value of the consideration received or receivable, net of returns and allowances, trade discounts, associated sales taxes (VAT) and export duties.

*Principal vs agent arrangements*

The Group is involved in re-selling goods and services produced or rendered by other entities. Revenues are reported based on the gross amount billed to the customer when the Group has earned revenue as a principal from the sale of goods or services, or the net amount retained (that is, the amount billed to the customer reduced by the amount billed by the supplier) when the Group has earned a commission or fee as an agent.

*Shipping and handling costs*

The Group classifies all amounts billed to customers in a sale transaction and related to shipping and handling as part of sales revenue and all related shipping and handling costs as selling and distribution expenses when the Group is acting as a principal in accordance with the requirements of IAS 18 *Revenue*.

*Sales of power*

In the Power segment (Note 27), revenue is recognised based on unit of power measure (kilowatts) delivered to customers, since at that point revenue recognition criteria are met. The billings are usually done on a monthly basis, several days after each month end.

*Interest income*

For all financial instruments measured at amortised cost interest income is recorded using the effective interest rate (EIR). The EIR is the rate that exactly discounts the estimated future cash receipts over the expected



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life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset. Interest income is included in finance income in the consolidated statement of profit (loss) and other comprehensive income (loss).

**(f) Taxes**

*Current income tax*

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the reporting date in the countries where the Group operates and generates taxable income.

*Uncertain tax positions*

The Group's policy is to comply fully with the applicable tax regulations in the jurisdictions in which its operations are subject to income taxes. The Group's estimates of current income tax expense and liabilities are calculated assuming that all tax computations filed by the Group's subsidiaries will be subject to a review or audit by the relevant tax authorities. The Group and the relevant tax authorities may have different interpretations of how regulations should be applied to actual transactions. Such uncertain tax positions are accounted for in accordance with IAS 12 *Income Taxes* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The Group applies single most likely outcome method of uncertain tax positions estimation.

*Deferred tax*

Deferred tax is provided using the liability method on temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

When the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint arrangements, when the timing of the reversal of the temporary differences

can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, the carry forward of unused tax credits and any unused tax losses. Deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised, except:

When the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint arrangements, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

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The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are re-assessed at each reporting date and are recognised to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred tax relating to items recognised outside profit or loss is recognised in correlation to the underlying transaction either in OCI or directly in equity.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Tax benefits acquired as part of a business combination, but not satisfying the criteria for separate recognition at that date, are recognised subsequently if new information about facts and circumstances change. The adjustment is either treated as a reduction in goodwill (as long as it does not exceed goodwill) if it was incurred during the measurement period or recognised in profit or loss.

**(g) Foreign currencies**

The Group's consolidated financial statements are presented in Russian rubles to comply with the Law 208-FZ. Russian rubles is also the parent company's functional currency.

For each entity, the Group determines the functional currency and items included in the financial statements of each entity are measured using that functional currency. The functional currencies of the main Russian and European subsidiaries of the Group are the Russian ruble and euro, respectively. The U.S. dollar is the functional currency of the other main international operations of the Group. The Group uses the direct method of consolidation and on disposal of a foreign operation, the gain or loss that is reclassified to profit or loss reflects the amount that arises from using this method.

**(i) Transactions and balances**

Transactions in foreign currencies are initially recorded by the Group's entities at their respective functional currency spot rates at the date the transaction first qualifies for recognition. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency spot rates of exchange at the reporting date. Differences arising on settlement or translation of monetary items are recognised in profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

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The following table presents the exchange rates for the functional and operating currencies at various subsidiaries, other than the presentation currency:

| Currency    | Rates at          |                   |                   | Average exchange rates* |                   |                   |
|-------------|-------------------|-------------------|-------------------|-------------------------|-------------------|-------------------|
|             | December 31, 2016 | December 31, 2015 | December 31, 2014 | December 31, 2016       | December 31, 2015 | December 31, 2014 |
| U.S. dollar | 60.66             | 72.88             | 56.26             | 67.03                   | 60.96             | 38.42             |
| Euro        | 63.81             | 79.70             | 68.34             | 74.23                   | 67.78             | 50.82             |

*(\*) Exchange rates shown in Russian rubles for one local currency unit.*

The majority of the balances and operations not already denominated in the presentation currency were denominated in the U.S. dollar and euro. The Russian ruble is not a convertible currency outside the territory of Russia. Official exchange rates are determined daily by the Central Bank of Russia ( CBR ) and are generally considered to be a reasonable approximation of market rates.

**(ii) Group companies**

On consolidation, the assets and liabilities of foreign operations are translated into rubles at the rate of exchange prevailing at the reporting date and their statements of profit (loss) and other comprehensive income (loss) are translated at the weighted average exchange rate for the period. The exchange differences arising on translation for consolidation are recognised in OCI. On disposal of a foreign operation, the component of OCI relating to that particular foreign operation is recognised in profit or loss.

Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operation and translated at the spot rate of exchange at the reporting date.

**(h) Non-current assets held for sale and discontinued operations**

The Group classifies non-current assets (or disposal group) as held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. Such non-current assets (or disposal group) classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

The criteria for held for sale classification is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups). For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active program to locate a buyer and complete the plan must have been initiated.

Property, plant and equipment and intangible assets are not depreciated or amortised once classified as held for sale.

Assets and liabilities classified as held for sale are presented separately as current items in the statement of financial position.

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A disposal group qualifies as discontinued operation if it is a component of an entity that either has been disposed of, or is classified as held for sale, and:

Represents a separate major line of business or geographical area of operations;

Is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or

Is a subsidiary acquired exclusively with a view to resale.

Discontinued operations are excluded from the results of continuing operations and are presented as a single amount as profit or loss after tax from discontinued operations in the consolidated statement of profit (loss) and other comprehensive income (loss).

Additional disclosures are provided in Note 16. All other notes to the financial statements include amounts for continuing operations, unless otherwise mentioned.

**(i) Mineral licenses**

Mineral licenses acquired separately are measured on initial recognition at cost. The cost of mineral licenses acquired in a business combination is their fair value at the date of acquisition. Mineral licenses are amortized under a unit of production basis over proved and probable reserves of the relevant area.

In order to calculate proved and probable reserves, estimates and assumptions are used about a range of geological, technical and economic factors, including but not limited to quantities, grades, production techniques, recovery rates, production costs, transport costs, commodity demand, commodity prices and exchange rates. There are numerous uncertainties inherent in estimating proved and probable reserves, and assumptions that are valid at the time of estimation may change significantly when new information becomes available.

The Group established a policy, according to which internal mining engineers review proved and probable reserves annually. This policy does not change the Group's approach to the measurement of proved and probable reserves as of their acquisition dates as part of business combinations that involve independent mining engineers. The Group's proved and probable reserve estimates as of the reporting date were made by internal mining engineers and the majority of the assumptions underlying these estimates had been previously reviewed and verified by independent mining engineers.

**(j) Property, plant and equipment**

Property, plant and equipment and construction in progress are stated at cost, net of accumulated depreciation and accumulated impairment losses, if any. The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bringing the asset into operation, the initial estimate of the rehabilitation provision, and, for qualifying assets (where relevant), borrowing costs and other costs incurred in connection with the borrowings. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

When significant parts of property, plant and equipment are required to be replaced at intervals, the Group depreciates them separately based on their specific useful lives. Likewise, when a major inspection is performed, its cost is recognised in the carrying amount of the property, plant and equipment as a replacement if the recognition criteria are satisfied. Where a separately depreciated asset, or part of an asset, is replaced, the



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expenditure is capitalised. Where part of the asset was not separately considered as a component and therefore not depreciated separately, the replacement value is used to estimate the carrying amount of the replaced asset(s) which is immediately written off. All other repair and maintenance costs are recognised in the consolidated statement of profit (loss) and other comprehensive income (loss) as incurred.

The capitalised value of a finance lease is also included in property, plant and equipment. The present value of the expected cost for the rehabilitation of an asset after its use is included in the cost of the respective asset if the recognition criteria for a provision are met.

Inventories planned to be used for construction and spare parts with useful lives over one year are recorded within property, plant and equipment.

*Mining assets and processing plant and equipment*

Mining assets and processing plant and equipment are those assets, including construction in progress, which are intended to be used only for the needs of a certain mine or field, and upon full extraction exhausting of the reserves of such mine or the field, these assets cannot be further used for any other purpose without a capital reconstruction.

Items of production mines are stated at cost, less accumulated depletion and accumulated impairment losses, if any.

Costs of developing new underground mines are capitalized. Underground development costs, which are costs incurred to make the mineral physically accessible, include costs to prepare property for shafts, driving main entries for ventilation, haulage, personnel, construction of airshafts, roof protection and other facilities. Additionally, interest expense subject to allocation to the cost of developing mining properties and to constructing new facilities is capitalized until assets are ready for their intended use.

Exploration and evaluation activity involves the search for mineral resources, the determination of technical feasibility and the assessment of commercial viability of identified proved and probable reserves. Once the legal right to explore has been acquired, exploration and evaluation expenditure is charged to profit or loss as incurred, unless the Group concludes that a future economic benefit is more likely than not to be realized.

Stripping costs incurred in the development phase of a mine, before the production phase commences, are capitalized as part of cost of constructing the mine. The capitalization of development stripping costs ceases when the mine is commissioned and ready for use as intended by management. Stripping costs undertaken during the production phase of mine are charged to profit and loss as cost of goods sold as incurred.

When mining assets and processing plant and equipment are placed in production, the applicable capitalized costs, including mine development costs, are depleted using the unit-of-production method at the ratio of tonnes of mineral mined or processed to the estimated proved and probable mineral reserves that are expected to be mined during the estimated lives of the mines. The unit-of-production method is used for the underground mine development structure

costs as their useful lives coincide with the estimated lives of mines, provided that all repairs and maintenance are timely carried out.

A decision to abandon, reduce or expand activity on a specific mine is based upon many factors, including general and specific assessments of mineral reserves, anticipated future mineral prices, anticipated costs of

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developing and operating a producing mine, the expiration date of mineral licenses, and the likelihood that the Group will continue exploration on the mine. Based on the results at the conclusion of each phase of an exploration program, properties that are not economically feasible for production are re-evaluated to determine if future exploration is warranted and that carrying values are appropriate. The ultimate recovery of these costs depends on the discovery and development of economic ore reserves or the sale of the companies owning such mineral rights.

*Other property, plant and equipment*

Capitalized production costs for internally developed assets include material, direct labor costs, and allocated material and manufacturing overhead costs. When construction activities are performed over an extended period, borrowing costs incurred in connection with the borrowing of funds are capitalized. Construction-in-progress and equipment held for installation are not depreciated until the constructed or installed asset is substantially ready for its intended use.

Property, plant and equipment (apart from railway of the Elga coal deposit) are depreciated using the straight-line method. Upon sale or retirement, the acquisition or production cost and related accumulated depreciation are removed from the consolidated statement of financial position and any gain or loss is included in the consolidated statement of profit (loss) and other comprehensive income (loss).

The following useful lives are used as a basis for calculating depreciation:

| <b>Category of asset</b>          | <b>Useful economic<br/>lives<br/>estimates,<br/>years</b> |
|-----------------------------------|---|
| Buildings and constructions       | 5-85  |
| Operating machinery and equipment | 2-30  |
| Transportation vehicles           | 2-25  |
| Other equipment                   | 2-15  |

**(k) Leases**

The determination of whether an arrangement is (or contains) a lease is based on the substance of the arrangement at the inception of the lease. The arrangement is, or contains, a lease if fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset or assets, even if that right is not explicitly specified in an arrangement.

A lease is classified at the inception date as a finance lease or an operating lease. A lease that transfers substantially all the risks and rewards incidental to ownership to the Group is classified as a finance lease.

Finance leases are capitalised at the commencement of the lease at the inception date fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognised in finance costs in the consolidated statement of profit (loss) and other comprehensive income (loss).

A leased asset is depreciated over the useful life of the asset. However, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset and the lease term.

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An operating lease is a lease other than a finance lease. Operating lease payments are recognised as an operating expense in the consolidated statement of profit (loss) and other comprehensive income (loss) on a straight-line basis over the lease term.

**(l) Borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale (a qualifying asset) are capitalised as part of the cost of the respective asset. Borrowing costs consist of interest including exchange differences arising from foreign currency borrowings and other costs that an entity incurs in connection with the borrowing of funds.

Where funds are borrowed specifically to finance a project, the amount capitalised represents the actual borrowing costs incurred. Where the funds used to finance a project form part of general borrowings, the amount capitalised is calculated using a weighted average of rates applicable to relevant general borrowings of the Group during the period.

According to IAS 23 *Borrowing Costs*, borrowing costs may include exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs. Foreign exchange differences on borrowings directly attributable to the acquisition, construction or production of a qualifying asset are considered by the Group to be eligible for capitalization in the amount of difference between actual amount of interest costs and potential amount of interest costs calculated using a weighted average of rates applicable to ruble-nominated borrowings of the Group during the period. All other borrowing costs are recognised in the consolidated statement of profit (loss) and other comprehensive income (loss) in the period in which they are incurred.

**(m) Intangible assets**

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses.

Intangible assets with determinable useful lives are amortized using the straight-line method over their estimated period of benefit, ranging from two to sixteen years.

**(n) Financial instruments – initial recognition and subsequent measurement**

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

**(i) Financial assets**

*Initial recognition and measurement*

Financial assets are classified, at initial recognition, as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale (AFS) financial assets, or as derivatives. All financial assets are recognised initially at fair value plus, in the case of financial assets not recorded at fair value through profit or loss, transaction costs that are attributable to the acquisition of the financial asset.

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Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) are recognised on the trade date, i.e., the date that the Group commits to purchase or sell the asset.

*Subsequent measurement*

For purposes of subsequent measurement, financial assets are classified in four categories:

Financial assets at fair value through profit or loss;

Loans and receivables;

Held-to-maturity investments;

AFS financial assets.

*Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. Financial assets at fair value through profit or loss are carried in the statement of financial position at fair value with net changes in fair value presented as finance costs (negative net changes in fair value) or finance income (positive net changes in fair value) in the consolidated statement of profit (loss) and other comprehensive income (loss).

*Loans and receivables*

This category is the most relevant to the Group. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the effective interest rate (EIR) method, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included in finance income in the consolidated statement of profit (loss) and other comprehensive income (loss). The losses arising from impairment are recognised in the consolidated statement of profit (loss) and other comprehensive income (loss) in finance costs for loans and in other operating expenses for receivables.

This category generally applies to trade and other receivables (Note 12).

*AFS financial assets*

AFS financial assets include equity investments and debt securities. Equity investments classified as AFS are those that are neither classified as held for trading nor designated at fair value through profit or loss. Debt securities in this category are those that are intended to be held for an indefinite period of time and that may be sold in response to needs for liquidity or in response to changes in the market conditions.

After initial measurement, AFS financial assets are subsequently measured at fair value with unrealised gains or losses recognised in OCI and credited in the AFS reserve until the investment is derecognised, at which time, the cumulative gain or loss is recognised in other operating income, or the investment is determined to be impaired, when the cumulative loss is reclassified from the AFS reserve to the consolidated statement of profit (loss) and other comprehensive income (loss) in finance costs. Interest earned whilst holding AFS financial assets is reported as interest income using the EIR method.



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*Derecognition*

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is primarily derecognised (i.e., removed from the Group's consolidated statement of financial position) when:

The rights to receive cash flows from the asset have expired; or

The Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a pass-through arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

***Impairment of financial assets***

Further disclosures relating to impairment of financial assets are also provided in the following notes:

Financial assets – Note 10.

Trade and other receivables – Note 12.

The Group assesses, at each reporting date, whether there is objective evidence that a financial asset or a group of financial assets is impaired. An impairment exists if one or more events that has occurred since the initial recognition of the asset (an incurred loss event), has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and observable data indicating that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

*Financial assets carried at amortised cost*

For financial assets carried at amortised cost, the Group first assesses whether impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and

collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

**(ii) Financial liabilities**

*Initial recognition and measurement*

Financial liabilities are classified, at initial recognition, as financial liabilities at fair value through profit or loss, loans and borrowings, payables, or as derivatives.

All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings and payables, net of directly attributable transaction costs.

The Group's financial liabilities include trade and other payables, loans and borrowings including bank overdrafts, financial guarantee contracts and derivative financial instruments.

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*Subsequent measurement*

The measurement of financial liabilities depends on their classification, as described below:

*Financial liabilities at fair value through profit or loss*

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss.

Financial liabilities are classified as held for trading if they are incurred for the purpose of repurchasing in the near term. Gains or losses on liabilities held for trading are recognised in the consolidated statement of profit (loss) and other comprehensive income (loss).

Financial liabilities designated upon initial recognition at fair value through profit or loss are designated at the initial date of recognition, and only if the criteria in IAS 39 *Financial Instruments Recognition and Measurement* are satisfied.

*Loans and borrowings*

This is the category most relevant to the Group. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the EIR method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the EIR amortisation process. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as finance costs in the consolidated statement of profit (loss) and other comprehensive income (loss). This category generally applies to interest-bearing loans and borrowings (Note 10).

*Financial guarantee contracts*

Financial guarantee contracts issued by the Group are those contracts that require a payment to be made to reimburse the holder for a loss it incurs because the specified debtor fails to make a payment when due in accordance with the terms of a debt instrument. Financial guarantee contracts are recognised initially as a liability at fair value, adjusted for transaction costs that are directly attributable to the issuance of the guarantee. Subsequently, the liability is measured at the higher of the best estimate of the expenditure required to settle the present obligation at the reporting date and the amount recognised less cumulative amortisation.

*Put Options Written on Non-controlling Interests*

The Group initially measures a financial liability at the present value of the redemption amount in the parent's consolidated financial statements for written puts on non-controlling interest, therefore when the Group grants non-controlling interests a put option to sell part or all of their interests in a subsidiary during a certain period, on the

date of grant, the non-controlling interests are classified as a financial liability. The Group remeasures the financial liability at the end of each reporting period based on the estimated present value of the consideration to be transferred upon the exercise of the put option. The respective finance cost is recognised in the consolidated statement of profit (loss) and other comprehensive income (loss) within finance costs.

*Derecognition*

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially

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different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the consolidated statement of profit (loss) and other comprehensive income (loss).

**(o) Derivative financial instruments**

The Group uses derivative financial instruments, such as cross currency swap and cross currency option. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative.

For the years ended December 31, 2016, 2015 and 2014, the Group did not have any derivatives designated as hedging instruments.

**(p) Inventories**

Inventories are measured at the lower of cost or net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

The cost of inventories is determined under the weighted average cost method, and includes all costs in bringing the inventory to its present location and condition. The elements of costs include direct material, labor and allocable material and manufacturing overhead.

Costs of production in process and finished goods include the purchase costs of raw materials and conversion costs such as direct labor and allocation of fixed and variable production overheads. Raw materials are valued at a purchase cost inclusive of freight and other shipping costs.

Coal and iron ore inventory costs include direct labor, supplies, depreciation of equipment, depletion of mining assets and amortization of licenses to use mineral reserves, mine operating overheads and other related costs. Operating overheads are charged to expenses in the periods when the production is temporarily paused or abnormally low.

**(q) Impairment of non-current assets**

Further disclosures relating to impairment of non-current assets are also provided in the following notes:

Intangible assets Note 19.

Impairment of goodwill and other non-current assets Note 18.

The Group assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or CGU's fair value less costs of disposal and its value in use. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. When the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. The Group's CGUs represent single entities with one component of business in each case. As of December 31, 2016, the Group performed the impairment testing for the following number of CGUs by segments: Steel 8, Mining 7 and Power 2.

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In assessing value in use, the Group uses assumptions that include estimates regarding the discount rates, growth rates and expected changes in selling prices, sales volumes and operating costs, as well as capital expenditures and working capital requirements during the forecasted period. The estimated future cash flows expected to be generated by the asset, when the quoted market prices are not available, are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. The growth rates are based on the Group's growth forecasts, which are largely in line with industry trends. Changes in selling prices and direct costs are based on historical experience and expectations of future changes in the market. In determining fair value less costs of disposal, recent market transactions are taken into account.

The Group bases its impairment calculation on detailed budgets and forecast calculations, which are prepared separately for each of the Group's CGUs to which the individual assets are allocated. These budgets and forecast calculations generally cover a period of five years. A long-term growth rate is calculated and applied to project future cash flows after the fifth year.

For CGUs involved in mining activity future cash flows include estimates of recoverable minerals that will be obtained from proved and probable reserves, mineral prices (considering current and historical prices, price trends and other related factors), production levels, capital and reclamation costs, all based on the life of mine models prepared by the Group's engineers.

Impairment losses of continuing operations are recognised in the consolidated statement of profit (loss) and other comprehensive income (loss) in expense categories consistent with the function of the impaired asset.

For assets excluding goodwill, an assessment is made at each reporting date to determine whether there is an indication that previously recognised impairment losses no longer exist or have decreased. If such indication exists, the Group estimates the asset's or CGU's recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the consolidated statement of profit (loss) and other comprehensive income (loss) unless the asset is carried at a revalued amount, in which case, the reversal is treated as a revaluation increase.

Goodwill is tested for impairment annually as of December 31, and when circumstances indicate that the carrying value may be impaired.

Impairment is determined for goodwill by assessing the recoverable amount of each CGU to which the goodwill relates. When the recoverable amount of the CGU is less than its carrying amount, an impairment loss is recognised. Impairment losses relating to goodwill cannot be reversed in future periods.

**(r) Cash and cash equivalents**

Cash and cash equivalents in the statement of financial position comprise cash at banks and on hand and short-term deposits with a maturity of three months or less, which are subject to an insignificant risk of changes in value.

For the purpose of the consolidated statement of cash flows, cash and cash equivalents consist of cash and short-term deposits, as defined above, net of outstanding bank overdrafts as they are considered an integral part of the Group's cash management.



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**Notes to the consolidated financial statements for the year ended December 31, 2016**

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

**(s) Provisions**

*General*

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation including legal or tax proceedings obligations and a reliable estimate can be made of the amount of the obligation. The expense relating to a provision is presented in the consolidated statement of profit (loss) and other comprehensive income (loss).

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, when appropriate, the risks specific to the liability. When discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

*Rehabilitation provision*

Mine rehabilitation costs will be incurred by the Group either while operating, or at the end of the operating life of the Group's facilities and mine properties. The Group assesses its mine rehabilitation provision at each reporting date. The Group recognises a rehabilitation provision where it has a legal and constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of obligation can be made. The nature of these restoration activities includes: dismantling and removing structures; rehabilitating mines and tailings dams; dismantling operating facilities; closing plant and waste sites; and restoring, reclaiming and revegetating affected areas.

The obligation generally arises when the asset is installed or the ground/environment is disturbed at the mining operation's location. When the liability is initially recognised, the present value of the estimated costs is capitalised by increasing the carrying amount of the related mining assets to the extent that it was incurred as a result of the development/construction of the mine.

Changes in the estimated timing of rehabilitation or changes to the estimated future costs are dealt with prospectively by recognising an adjustment to the rehabilitation provision and a corresponding adjustment to the asset to which it relates, if the initial estimate was originally recognised as part of an asset measured in accordance with IAS 16

*Property, Plant and Equipment.*

Any reduction in the rehabilitation provision and, therefore, any deduction from the asset to which it relates, may not exceed the carrying amount of that asset. If it does, any excess over the carrying value is taken immediately to the consolidated statement of profit (loss) and other comprehensive income (loss).

Over time, the discounted liability is increased for the change in present value based on the discount rates that reflect current market assessments and the risks specific to the liability. The periodic unwinding of the discount is recognised in the consolidated statement of profit (loss) and other comprehensive income (loss) as part of finance costs.

For closed sites, changes to estimated costs are recognised immediately in the consolidated statement of profit (loss) and other comprehensive income (loss).

*Environmental expenditures and liabilities*

Environmental expenditures that relate to current or future revenues are expensed or capitalised as appropriate. Expenditures that relate to an existing condition caused by past operations and do not contribute to

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current or future earnings are expensed. Liabilities for environmental costs are recognised when a clean-up is probable and the associated costs can be reliably estimated. Generally, the timing of recognition of these provisions coincides with the commitment to a formal plan of action or, if earlier, on divestment or on closure of inactive sites. The amount recognised is the best estimate of the expenditure required. Where the liability will not be settled for a number of years, the amount recognised is the present value of the estimated future expenditure.

**(t) Pensions and other post-employment benefits**

*Defined benefit pension and other post-retirement plans*

The Group has a number of defined benefit pension plans and other long-term benefits that cover the majority of production employees.

Benefits under these plans are primarily based upon years of service and average earnings. The Group accounts for the cost of defined benefit plans and other long-term benefits using the projected unit credit method. Under this method, the cost of providing pensions is charged to the consolidated statement of profit (loss) and other comprehensive income (loss), so as to attribute the total pension cost over the service lives of employees in accordance with the benefit formula of the plan.

The Group's obligation in respect of defined retirement benefit plans and other long-term benefits is calculated separately for each defined benefit plan and other long-term benefit plan by discounting the amounts of future benefits that employees have already earned through their service in the current and prior periods. The discount rate applied represents the yield at the year end on highly rated long-term bonds.

Where there is a change in actuarial assumptions, the resulting actuarial gains and losses are recognised directly in the statement of comprehensive income.

For unfunded plans, the Group recognizes a pension liability, which is equal to the projected benefit obligation. For funded plans, the Group offsets the fair value of the plan assets with the projected benefit obligations and recognizes the net amount of pension liability. The market value of plan assets is measured at each reporting date.

*State pension fund*

The Group's Russian subsidiaries are legally obligated to make defined contributions to the Russian Pension Fund, managed by the Russian Federation Social Security (a defined contribution plan financed on a pay-as-you-go basis). The Group's contributions to the Russian Pension Fund relating to defined contribution plans are charged to income in the year, to which they relate.

**(u) Significant accounting judgments, estimates and assumptions**

The preparation of the consolidated financial statements requires management to make judgments, estimates and assumptions that affect the reported carrying amounts of assets and liabilities, and disclosure of contingent assets and liabilities as of the date of the financial statements, and the amounts of revenues and expenses recognised during the reporting period. Estimates and assumptions are continually evaluated and are based on the Group's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results could differ from those estimates. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

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**Notes to the consolidated financial statements for the year ended December 31, 2016**

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

*Judgments*

In the process of applying the Group's accounting policies, management has made the following judgments, which have the most significant effect on the amount recognised in the consolidated financial statements.

***Abandoned activity***

As of January 1, 2014, Southern Urals Nickel Plant ( SUNP ) was recognised as abandoned activity according to a decision to close SUNP without sale. In July 2013, the Group received an approval from the governmental authorities to abandon the industrial complex. The closure of SUNP is aligned with the revised strategy aimed at restructuring the Group's assets and development of its core businesses. During 2014-2015, the works related to closure of the plant were ongoing. Starting the fourth quarter of 2016, the Group stopped liquidation activities (Note 16); therefore the Group presents the results of SUNP as discontinued operations in the consolidated statement of profit (loss) and other comprehensive income (loss) for the nine months ended September 30, 2016 and prior periods and as continued operations from the fourth quarter of 2016.

***Capitalization of interest related to the Elga Coal Deposit and Railway Construction***

In 2013 and 2014, Elgaugol OOO ( Elgaugol ) and the Russian State Corporation Bank for Development and Foreign Economic Affairs ( VEB ) signed credit agreements for financing of the Elga coal project approved by the VEB's Supervisory Board in September 2013. The use of proceeds under these facilities is limited to the development of the Elga coal project. Borrowing costs under these VEB facilities that are directly attributable to the construction of the Elga coal project are capitalized. Borrowing costs consist of interest including exchange differences arising from revaluation of foreign currency borrowings and other costs that the Group incurs in connection with the debt servicing.

***Railway depreciation method***

In 2015, the Group commences to depreciate the railway of the Elga coal deposit using units of production method. In applying the units of production method, depreciation is normally calculated based on produced and delivered tonnes in the period as a percentage of total expected tonnes to be produced and delivered in current and future periods over the Elga coal deposit life cycle. The Group's analysis has shown that the consumption of the economic benefits of the asset is linked to production and delivery of coal. The Group assesses the total or ultimate railway capacity in tonnes at least at each financial year end and, if expectations differ from previous estimates, the changes will be accounted for as a change in an accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

***DEMP property complex***

On June 25, 2016, by the decree of the Council of Ministers of the self-proclaimed People's Republic of Donetsk, the State Enterprise Yuzovsky metallurgical plant was established on the basis of the property complex of the Group's subsidiary Donetsk Electrometallurgical Plant (DEMP). The Group's ability to manage and control the assets of the DEMP property complex is restricted by this decree. The Group concluded that the assets included in the DEMP's property complex do not meet the recognition criteria and derecognized these assets in the consolidated financial statements.

The DEMP's assets were fully impaired based on the results of impairment tests as of January 1, 2014 and December 31, 2014 due to conservation of production since 2013. The loss of control over the assets of nil carrying value has no impact on the financial result for the year ended December 31, 2016.

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**Notes to the consolidated financial statements for the year ended December 31, 2016**

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

***Principal vs agent arrangements***

The Group makes significant judgment on gross or net revenue recognition. The Group evaluates the relevant facts and circumstances and takes into consideration the following factors in determining whether to recognize revenue on a gross basis:

The Group has the primary responsibility for providing the goods or services to the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer;

The Group has inventory risk before or after the customer order, during shipping or on return;

The Group has latitude in establishing prices, either directly or indirectly, for example by providing additional goods or services; and

The Group bears the customer's credit risk for the amount receivable from the customer. Otherwise, revenues are reported net when the Group performs as an agent or a broker without assuming the risks and rewards of ownership of goods. The evaluations of these factors, which at times can be contradictory, are subject to significant judgment and subjectivity. In the situation when the Group acts as a supplier and as a buyer with the same counterparty, the Group analyzes the respective purchase and sales agreements to identify whether these transactions were concluded in contemplation with each other and, therefore, should be combined for accounting purposes deferring the revenue recognition to the point when the earnings process has culminated.

***Estimates and assumptions***

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are described below or in the related accounting policy note. The Group based its assumptions and estimates on parameters available when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market change or circumstances arising beyond the control of the Group.

In particular, the Group has identified a number of areas where significant estimates and assumptions are required. Further information on each of these areas and how they impact the various accounting policies are described with the associated accounting policy note within the related qualitative and quantitative note as described below.

***Deferred tax assets and uncertain tax positions***

Deferred tax assets are recognised for unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Significant management judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and the level of future taxable profits and the existence of taxable temporary differences (Note 20). Various factors are considered to assess the probability of the future utilization of deferred tax assets, including past operating results, operational plans, expiration of tax losses carried forward, and tax planning strategies. If actual results differ from these estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected. In the event that the assessment of future utilization of deferred tax assets must be reduced, this reduction will be recognised in the consolidated statement of profit (loss) and other comprehensive income (loss).



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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

***Impairment of property, plant and equipment and other non-current assets***

The Group assesses at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the Group makes an estimate of the asset's recoverable amount. An impairment exists when the carrying value of an asset or CGU exceeds its recoverable amount, which is the higher of its fair value less costs of disposal and its value in use. The fair value less costs of disposal calculation is based on available data from binding sales transactions, conducted at arm's length for similar assets or observable market prices less incremental costs for disposing of the asset. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the assets.

Impairment is based on a large number of factors, such as changes in current competitive conditions, expectations of growth in the industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, and other changes in circumstances that indicate that impairment exists. The determination of the recoverable amount of a cash-generating unit involves the use of estimates by management. Methods used to determine the value in use include discounted cash flow-based methods, which require the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. These estimates, including the methodologies used, may have a material impact on the value in use and, ultimately, the amount of any impairment (Note 18).

***Impairment of goodwill***

The Group determines whether goodwill is impaired at least on an annual basis and when circumstances indicate that the carrying value may be impaired. This requires an estimation of the value in use of the cash generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. More details of the assumptions used in estimating the value in use of the cash-generating units to which goodwill is allocated are provided in Note 18.

***Useful lives of items of property, plant and equipment***

The Group assesses the remaining useful lives of items of property, plant and equipment at least at each financial year end and, if expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. These estimates may have a material impact on the amount of the carrying values of property, plant and equipment and on depreciation expense for the period.

***Mineral reserves***

Mineral reserves and the associated mine plans are a material factor in the Group's computation of a depletion charge. Estimation of reserves involves some degree of uncertainty. The uncertainty depends mainly on the amount of reliable geological and engineering data available at the time of the estimate and the interpretation of this data, which also requires use of subjective judgment and development of assumptions. Mine plans are periodically updated which can have a material impact on the depletion charge for the period. More details are provided in Note 3(i).

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***Fair value of financial instruments***

Where the fair value of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, their fair value is determined using valuation techniques, including discounted cash flow models. The inputs to these models are taken from observable markets where possible, but when this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments (Note 9).

***Provisions***

The Group is subject to various legal proceedings, disputes and claims, including regulatory discussions related to the Group's business, licenses, tax positions and the outcomes are subject to significant uncertainty. Management evaluates, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Unanticipated events or changes in these factors may require the Group to increase or decrease the amount recorded or to be recorded for a matter that has not been previously recorded because it was not considered probable (Note 22).

***Pensions and other post-employment benefits***

The cost of defined benefit pension plans and other post-employment benefits and the present value of the pension obligation are determined using actuarial valuations. An actuarial valuation involves making various assumptions which may differ from actual developments in the future. These include the determination of the discount rate, future salary increases, mortality rates and future pension increases. Due to the complexity of the valuation, the underlying assumptions and its long-term nature, a defined benefit obligation and other long-term benefit plans are highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date. More details are provided in Note 23.

***Rehabilitation provisions***

The Group reviews rehabilitation provisions at each reporting date and adjusts them to reflect the current best estimate. Rehabilitation provisions are recognised in the period in which they arise and are stated at the best estimate of the present value of estimated future costs. These estimates require extensive judgment about the nature, cost and timing of the work to be completed, and may change with future changes to costs, environmental laws and regulations and remediation practices. Changes in the estimated timing of rehabilitation or changes to the estimated future costs are dealt with prospectively by recognizing an adjustment to the rehabilitation provision and a corresponding adjustment to the asset to which it relates, if the initial estimate was originally recognised as part of an asset measured in accordance with IAS 16 *Property, Plant and Equipment* (Note 17).

***Impairment of financial assets***

The Group makes allowances for doubtful receivables to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of an allowance for doubtful accounts, management bases its estimates on the current overall economic conditions, the ageing of accounts receivable balances, historical write-off experience, customer creditworthiness and changes in payment terms. Changes in the economy, industry or specific customer conditions may require adjustments to the allowance for doubtful accounts recorded in the consolidated financial statements.

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***Determining net realizable value of inventories***

The Group makes write-downs for obsolete and slow-moving raw materials and spare parts. In addition, finished goods of the Group are carried at net realizable value (Note 14). Estimates of net realizable value of finished goods are based on the most reliable evidence available at the time the estimates are made. These estimates take into consideration fluctuations of price or cost directly relating to events occurring subsequent to the end of the reporting period to the extent that such events confirm conditions existing at the end of the period.

For other judgments, estimates and assumptions and details refer to:

Mineral licenses (Note 3(i));

Property, plant and equipment (Note 3(j));

Recovery of deferred tax assets (Note 3(f));

Non-current assets held for sale and discontinued operations (Note 3(h));

Inventories (Note 3(p));

Impairment of non-current assets (Note 3(q));

Pensions and other post-employment benefits (Note 3(t));

Provisions (Note 3(s));

Fair value measurement (Note 3(d)).

**(v) Reclassifications**

Certain reclassifications have been made to the prior periods consolidated financial statements to conform to the current year presentation. Such reclassifications affect the presentation of certain items in the consolidated statement of financial position, consolidated statement of profit (loss) and other comprehensive income (loss) and consolidated statement of cash flows and have no impact on net income or equity.

**(w) New and amended standards and interpretations**

The Group applied for the first time certain standards and amendments, which are effective for annual periods beginning on or after January 1, 2016. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective. The nature and the effect of these changes are described below.

***Amendments to IAS 1 Disclosure Initiative***

The amendments to IAS 1 *Presentation of Financial Statements* clarify existing IAS 1 requirements:

The materiality requirements in IAS 1;

The requirements that apply when additional subtotals are presented in the statement of financial position and the statements of profit or loss and OCI;

That specific line items in the statements of profit or loss and OCI and the statement of financial position may be disaggregated;

That entities have flexibility as to the order in which they present the notes to financial statements;

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That the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, and classified between those items that will or will not be subsequently reclassified to profit or loss.

***Amendments to IFRS 11 Accounting for Acquisitions of Interests in Joint Operations***

The amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business, must apply the relevant IFRS 3 principles for business combinations accounting. The amendments also clarify that a previously held interest in a joint operation is not remeasured on the acquisition of an additional interest in the same joint operation while joint control is retained. In addition, a scope exclusion has been added to IFRS 11 to specify that the amendments do not apply when the parties sharing joint control, including the reporting entity, are under common control of the same ultimate controlling party. The amendments apply to both the acquisition of the initial interest in a joint operation and the acquisition of any additional interests in the same joint operation and are prospectively effective for annual periods beginning on or after January 1, 2016, with early adoption permitted.

***Amendments to IAS 16 and IAS 38 Clarification of Acceptable Methods of Depreciation and Amortisation***

The amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets.

***Amendments to IFRS 10, IFRS 12 and IAS 28 Investment Entities: Applying the Consolidation Exemption***

The amendments address issues that have arisen in applying the investment entities exception under IFRS 10 *Consolidated Financial Statements*. The amendments to IFRS 10 clarify that the exemption from presenting consolidated financial statements applies to a parent entity that is a subsidiary of an investment entity, when the investment entity measures all of its subsidiaries at fair value. Furthermore, the amendments to IFRS 10 clarify that only a subsidiary of an investment entity that is not an investment entity itself and that provides support services to the investment entity is consolidated. All other subsidiaries of an investment entity are measured at fair value. The amendments to IAS 28 *Investments in Associates and Joint Ventures* allow the investor, when applying the equity method, to retain the fair value measurement applied by the investment entity associate or joint venture to its interests in subsidiaries. These amendments are applied retrospectively. The adoption of the amendments do not have significant impact on the Group as the Group does not apply the consolidation exception.

***Amendments to IAS 27 Equity Method in Separate Financial Statements***

The amendments allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements. Entities already applying IFRS and electing to change to the equity method in its separate financial statements will have to apply that change retrospectively.

***Annual improvements to IFRSs 2010-2012 cycle***

The amendments relate to IFRS 2 *Share-based Payment*, IFRS 3 *Business Combinations*, IFRS 8 *Operating Segments*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*, IAS 24 *Related Party Disclosures*.

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**Notes to the consolidated financial statements for the year ended December 31, 2016**

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***Annual improvements to IFRSs 2012-2014 cycle***

The amendments relate to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, IFRS 7 *Financial Instruments: Disclosures*, IAS 19 *Employee Benefits*, IAS 34 *Interim Financial Reporting*.

The amendments and improvements described above had no significant impact on the financial position and performance of the Group or the disclosures in the consolidated financial statements.

**Standards issued but not effective**

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Group's financial statements are discussed below. The Group intends to adopt these standards, if applicable, when they become effective.

***Annual improvements to IFRS 2014-2016 cycle (issued in December 2016)***

This annual improvements package amended three standards:

*IFRS 1 First-time Adoption of International Financial Reporting Standards*. Short-term exemptions in paragraphs E3-E7 of IFRS 1 were deleted, because they have now served their intended purpose.

*IAS 28 Investments in Associates and Joint Ventures*. The amendment clarified that the election to measure at fair value through profit or loss an investment in an associate or a joint venture that is held by an entity that is a venture capital organisation, or other qualifying entity, is available for each investment in an associate or joint venture on an investment-by-investment basis, upon initial recognition.

*IFRS 12 Disclosure of Interests in Other Entities*. The amendment clarified the scope of the standard by specifying that the disclosure requirements in the standard, except for those in paragraphs B10-B16, apply to an entity's interests in a subsidiary, a joint venture or an associate that are classified as held for sale, as held for distribution or as discontinued operations in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

The amendments described above had no significant impact on the financial position and performance of the Group or the disclosures in the consolidated financial statements. The Group has not early adopted any other standard, interpretation or amendment that has been issued but is not yet effective.

The Group is in the process of assessing of impact of the adoption of the pronouncements listed below on the Group's consolidated financial statements:

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Amendments to IAS 7 *Disclosure Initiative* effective for annual periods beginning on or after January 1, 2017;

Amendments to IAS 12 *Recognition of Deferred Tax Assets for Unrealised Losses* January 1, 2017;

Amendments to IAS 40 *Transfers of Investment Property* January 1, 2018;

Amendments to IFRS 2 *Classification and Measurement of Share-based Payment Transactions* January 1, 2018;

Amendments to IFRS 4 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts* January 1, 2018;

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Annual improvements to IFRSs 2014-2016 cycle January 1, 2018;

IFRS 9 *Financial Instruments* January 1, 2018;

IFRS 15 *Revenue from Contracts with Customers* January 1, 2018;

IFRIC 22 *Foreign Currency Transactions and Advance Consideration* January 1, 2018;

IFRS 16 *Leases* January 1, 2019.

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments*. The final version of IFRS 9 replaces IAS 39 *Financial Instruments: Recognition and Measurement*, and all previous versions of IFRS 9. IFRS 9 brings together the requirements for the classification and measurement, impairment and hedge accounting of financial instruments. In respect of impairment, IFRS 9 replaces the incurred loss model used in IAS 39 with a new expected credit loss model that will require a more timely recognition of expected credit losses. The standard is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

In January 2016, the IASB issued IFRS 16 *Leases*. IFRS 16 eliminates the classification of leases as either operating leases or finance leases and establishes a single lessee accounting model. The most significant effect of the new requirements for the lessee will be an increase in lease assets and financial liabilities. The new standard replaces the previous leases standard, IAS 17 *Leases*, and the related interpretations.

The Group plans to apply IFRS 16 and IFRS 9 starting from the respective effective dates. The Group is currently assessing the impact of the standards on the consolidated financial statements.

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers*. IFRS 15 establishes a single framework for revenue recognition and contains requirements for related disclosures. The new standard supersedes IAS 18 *Revenue*, IAS 11 *Construction Contracts*, and the related interpretations on revenue recognition. The standard is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

IFRS 15 establishes a five-step model to account revenue arising from contracts with customers. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

IFRS 15 provides presentation and disclosure requirements, which are more detailed than under the current IFRS. The presentation requirements represent a significant change from current practice and increase the volume and level of details of disclosures required in the Group's consolidated financial statements. The Group expects to adopt the new

standard from January 1, 2018 retrospectively. During 2016, the Group performed a preliminary assessment of IFRS 15, which is subject to a change arising from a more detailed ongoing analysis. In 2017, further review of contracts will be undertaken at all businesses. Furthermore, the Group is considering the clarification issued by the IASB in an exposure draft in April 2016 and will monitor any further developments.

#### **4. Going concern**

The current economic environment and economic conditions in the major segments of the Group's operations create uncertainty about the level of demand for the Group's products, the pricing of major products mined or manufactured by the Group, operation and financial results, the availability of free cash flow for repayment or ability to refinance and restructure current liabilities.

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

As of December 31, 2016, the Group's total liabilities exceeded total assets by RUB 252,588 million.

In 2016, the Group was in the process of debt restructuring, while as of December 31, 2016, this process was not finalized with respect to the Group's credit facilities with the foreign banks and lenders other than Gazprombank, Sberbank, VTB, Gazprombank Leasing, Sberbank Leasing, VTB Leasing, Moscow Commercial Bank and therefore the Group was not in compliance with the payment schedules under certain credit facilities and a number of financial and non-financial covenants contained in the Group's loan agreements totaling to RUB 427,350 million. As of December 31, 2016, the Group's short-term debt was RUB 434,165 million, including RUB 260,653 million of long-term debt classified as short-term debt as no debt restructuring was finalized with respect to the Group's credit portfolio and cross-default provisions, and RUB 21,678 million of fines and penalties accrued on overdue debt and overdue interest. As of the date of approval of the consolidated financial statements, these breaches constitute an event of default and, as a result, the lenders may request accelerated repayment of a substantial portion of the Group's debt. The Group does not have the resources to enable it to comply with such accelerated repayment requests immediately. However, during 2016 and through the date of approval of the consolidated statements, the restructuring agreements have been signed with the major creditors of the Group, including Gazprombank, Sberbank, VTB, Gazprombank Leasing, Sberbank Leasing, VTB Leasing, Moscow Commercial Bank and other banks (see Note 29). The Group successfully restructured the ruble-denominated bonds in 2016. It will pursue to reach the restructuring agreements with other lenders, including pre-export facility creditors, ECA-covered loans creditors and Vnesheconombank (VEB).

The management has concluded that the existing uncertainty about the Group's availability of free cash flow for repayment or ability to refinance and restructure current liabilities described above represents a material uncertainty that casts significant doubt upon the Group's ability to continue as a going concern. Based on management's plans and actions undertaken as noted herein, management believes that the Group will achieve restructuring with all of its lenders and secure adequate financing to continue in operational existence for the foreseeable future. The management's strategy includes enhancement of crude steel production, increase in sales of the major steel products as well as diversifying products range into specialty products, rails and beams targeting higher marginal market niches. Together with the further development of the Group's mining assets providing additional volumes of high-grade coking coal both to the Russian consumers and to exports markets the Group expects it to result in increase in profitability. The Group's detailed monthly operational plans include further optimization of the costs structure and on-going control over the production costs and commercial expenses.

The consolidated financial statements have been prepared assuming that the Group will continue as a going concern. Accordingly, the consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, the amounts and classification of liabilities or any other adjustments that might result in the Group being unable to continue as a going concern.

**5. Capital management**

The equity capital of the Group was formed by injecting shares of its operating subsidiaries into Mechel PAO. This together with obtaining profits allowed the Group to raise debt to finance major investment projects as well as to acquire new companies. Although it has always been the Group's priority to create and grow the shareholders' value, during the past few years, the Group has become more focused on managing its debt, which has been the major source for expansion and growth.

Metals and mining industry is known for its capital intensive investment cycle requiring secure long-term financing. In 2012-2015, high price volatility on the coal seaborne market and metal market resulted in the decrease in the Group's operating profit, impairments of non-current assets. Devaluation of the national currency (Russian ruble) affected the amount of foreign exchange losses and increase in cost of financing on local and

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

foreign debt markets. These facts became the major reason for the losses incurred by the Group in the past and resulted in a negative equity. At the meantime the amount of the total Group's debt denominated in U.S. dollar decreased from \$2,963 million (RUB 96,989 million at exchange rate as of December 31, 2013) at the end of 2013 to \$1,772 million (RUB 107,499 million at exchange rate as of December 31, 2016) at the end of 2016, which is a result of partial repayment of U.S. dollar-denominated debt, conversion of U.S. dollar-denominated debt into RUB-denominated loans during the restructuring process.

Given current economic circumstances and the amount of debt, the Group's primary objective is to focus on resolving the debt issues through a long-term restructuring of the loan portfolio and bringing down both cost of financing and actual interest payments as well as use of all available free cash flow for repayment of debt. The Group's long-term policy is to maintain a strong capital base to maintain investor, creditor and market confidence and to sustain future development of the business. The Group's management constantly monitors profitability and leverage ratios. The Group's capital management has always been based on a number of covenants, of which Net Debt to EBITDA and EBITDA to Net Interest Expense are the main indicators the management uses for control. The level of dividends are monitored by the Board of Directors of the Group.

The Group was required to comply with the following ratios under the most significant loan agreements as of December 31, 2016<sup>1</sup>:

| <b>Restrictive covenant</b>                       | <b>Requirement</b>              | <b>Actual as of<br/>December 31, 2016</b> |
|---|---------------------------------|---|
| Mechel's EBITDA to Net Interest Expense           | Shall not be less than 1.25:1.0 | 1.36:1.0                                  |
| Mechel's EBITDA to Consolidated Financial Expense | Shall not be less than 1.25:1.0 | 1.28:1.0                                  |
| Mechel's Net Debt to EBITDA                       | Shall not exceed 9.00:1.0       | 7.18:1.0                                  |
| Mechel's Total Debt to EBITDA                     | Shall not exceed 7.50:1.0       | 7.48:1.0                                  |

The Group was required to comply with the following ratios under the most significant loan agreements as of December 31, 2015:

| <b>Restrictive covenant</b>                       | <b>Requirement</b>              | <b>Actual as of<br/>December 31, 2015</b> |
|---|---------------------------------|---|
| Mechel's EBITDA to Net Interest Expense           | Shall not be less than 1.15:1.0 | 0.8:1.0                                   |
| Mechel's EBITDA to Consolidated Financial Expense | Shall not be less than 0.9:1.0  | 0.8:1.0                                   |
| Mechel's Net Debt to EBITDA                       | Not exceed 9.75:1.0             | 11.2:1.0                                  |
| Mechel's Total Debt to EBITDA                     | Not exceed 9.5:1.0              | 11.2:1.0                                  |

In 2012-2015, following a sudden fall of the commodity markets the Group violated most of such covenants and defaulted on major credit facilities of interest and debt payments. Limited free cash flow available for debt service

forced the Group to start negotiations with creditors about review of schedule of the debt maturity profile. Current restructuring arrangements with major creditors are aimed at rescheduling repayment of principal, gradual amortization and decrease in interest payments by partial capitalization.

Cost of debt is also important in the Group's capital management. Throughout the restructuring process, the Group changed the floating interest rates dependent on the Russian money market (Mosprime rate) by the key rate of the Central Bank of Russia, which is less volatile and better represents the cost of funds by the local banks from the Central Bank of Russia in the Russian economy. The management believes that it

<sup>1</sup> Detailed information in respect of restrictive covenant calculations is presented in Note 10.1.



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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

will allow the Group to avoid sudden splashes in the cost of debt due to temporary demand/supply fluctuations. In 2016, under the restructuring agreements, the outstanding balance of U.S. dollar-denominated long-term loans was partially converted from U.S. dollar into Russian ruble, which will allow to reduce the cost of foreign currency fluctuations. On the foreign currency indebtedness, the Group's finance cost is based on the floating LIBOR/EURIBOR, which remains comparatively low.

The main goal for the Group is to achieve long-term restructuring of the loan portfolio with a grace period for repayment of debts and gradual amortization, which will permit to restore working capital, improve efficiency of operations and provide ability to sustain full service of debt in accordance with newly agreed repayment schedules as well as use of all available free cash flow for repayment of debt through cash sweep mechanism, which stipulates that all available cash flow above agreed minimum level shall be used for earlier repayment of debts to major creditors.

In June 2016, a 49% stake in the Elga coal complex (OOO Elgaugol, Elga-road OOO and Mecheltrans Vostok OOO) was sold to Gazprombank by exercising an option held by Gazprombank for a total consideration of RUB 34,300 million. All proceeds received from the sale of the shares were used for repayment of the Group's debt assigned from Sberbank to Gazprombank, and to repay overdue payment to Sberbank. Simultaneously with the sale of a 49% stake a put option in respect of this stake was granted to Gazprombank (see Note 6).

The objectives, policies and processes for managing capital during the years ended December 31, 2016 and 2015 are not changed.

**6. Business combinations and changes in non-controlling interests**

There were no new business combinations in the years ended December 31, 2014, 2015 and 2016.

On December 22, 2011, the Group acquired 100% of the shares of Daveze Ltd, which held 100% of ownership interest in DEMP, a steel plant located in Donetsk, Ukraine, for a consideration of \$537,000 thousand (RUB 17,058 million at exchange rate as of December 22, 2011) to be paid in monthly installments during the period from December 2011 until December 2018. The Group continues to pay monthly installments and disclosed the respective payments in the consolidated statement of cash flows within cash outflows from financing activities. The reclassifications of prior periods' amounts have been made to conform to the current year presentation.

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

The following table summarizes changes in non-controlling interests for the years ended December 31, 2016, 2015 and 2014:

|   |              |
|---|--------------|
| <b>Balance at January 1, 2014</b>   | <b>9,500</b> |
| Effect from disposal of subsidiaries  | 4            |
| Dividends declared to non-controlling interest  | (2)          |
| Loss for the period   | (1,263)      |
| Other comprehensive income/(loss)   | 14           |
| <b>Balance at December 31, 2014</b>   | <b>8,253</b> |
| Change of non-controlling interest in existing subsidiaries by the Group (Note 25)                        | (2,842)      |
| Profit for the period   | 535          |
| Other comprehensive income/(loss)   | 2            |
| <b>Balance at December 31, 2015</b>   | <b>5,948</b> |
| Acquisition of non-controlling interest in existing subsidiaries by the Group                             | (4)          |
| Reversal of unclaimed declared dividends to non-controlling interest upon expiration of limitation period | 35           |
| Dividends declared to non-controlling interest  | (3)          |
| Profit for the period   | 1,706        |
| Other comprehensive income/(loss)   | 4            |
| <b>Balance at December 31, 2016</b>   | <b>7,686</b> |

In June 2016, 49% share in the Elga coal complex was sold to Gazprombank by exercising an option held by Gazprombank for a total consideration of RUB 34,300 million. The Group sold to Gazprombank upon its request a 49% stake in Elgaugol OOO, the owner of the subsoil license for the Elga coal deposit, a 49% stake in Elga-road, the owner of the Ulak-Elga rail line, which had been contributed to the registered capital of this newly established company in March 2016, a 49% stake in Mecheltrans Vostok OOO, the rail line's transportation operator (collectively, the target companies).

Simultaneously with the sale of a 49% stake in the target companies a put option with fixed price and annual interest at the key rate of the Central Bank of Russia + 2% was granted to Gazprombank to sell the stake (in full or in part) in the target companies to the Group within three years following a five-year grace period or in case of a breach of conditions stipulated by such agreement. This allowed the Group to retain control over 100% of shares and therefore this transaction in fact represents a financial liability. Put options are signed by Yakutugol and Mechel-Trans OOO (sellers of the stakes in target companies) and are guaranteed by Mechel Mining AO and SKCC. If the Group fails to perform under these put options Gazprombank has the right to buy out (call option) the remaining stakes owned by the Group in the target companies and a 100% stake in Mechel Port Vanino. A 1.99% stake in each of the target

companies is pledged in favor of Gazprombank as a security for the call option.

For accounting of this financial liability see Note 10.4.

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**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)***7. Material partly-owned subsidiaries**

Financial information of subsidiaries that have material non-controlling interests is provided below.

Proportion of equity interest held by non-controlling interests:

| <b>Name</b>                              | <b>At December 31,<br/>2016</b> | <b>At December 31,<br/>2015</b> |
|--|---------------------------------|---------------------------------|
| SKCC and subsidiaries*                   | 3.4%                            | 3.4%                            |
| Kuzbass Power Sales Company<br>(KPSC)    | 27.9%                           | 27.9%                           |
| Chelyabinsk Metallurgical Plant<br>(CMP) | 5.9%                            | 5.9%                            |
| Southern Urals Nickel Plant (SUNP)       | 15.9%                           | 15.9%                           |
| Beloretsk Metallurgical Plant (BMP)      | 8.6%                            | 8.6%                            |
| Korshunov Mining Plant (KMP)             | 10.0%                           | 10.0%                           |
| Urals Stampings Plant (USP)              | 6.2%                            | 6.2%                            |
| Izhstal                                  | 10.0%                           | 10.0%                           |

\* Hereinafter SKCC and subsidiaries are represented by Southern Kuzbass Coal Company (SKCC), Tomusinsky Open Pit Mine (TOPM), Tomusinsky Energoupravlenie.

The summarised financial information of these subsidiaries is provided below. This information is based on amounts before inter-company eliminations. SUNP was recognized as abandoned operations activity according to a decision to close SUNP without sale (Note 16) for the nine months of 2016, and years ended December 31, 2015 and 2014. Therefore, SUNP's results for the nine months period ended September 30, 2016, and for the years ended December 31, 2015 and 2014 are not disclosed in summarised statements of profit and loss below. The SUNP's results for the fourth quarter of 2016 are disclosed in summarised statements of profit or loss below. Profit allocated to SUNP non-controlling interest was RUB 19 million, RUB 80 million and RUB 301 million for the years ended December 31, 2016, 2015 and 2014, respectively. The SUNP's non-controlling interest is disclosed in statements of financial position as of December 31, 2016 and 2015 (see below).

Summarised statements of profit and other comprehensive income for 2016:

| <b>SKCC<br/>and<br/>subsidiaries</b> | <b>KPSC</b> | <b>CMP</b> | <b>SUNP</b> | <b>BMP</b> | <b>KMP</b> | <b>USP</b> | <b>Izhstal</b> |
|--------------------------------------|-------------|------------|-------------|------------|------------|------------|----------------|
|--------------------------------------|-------------|------------|-------------|------------|------------|------------|----------------|

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|   |              |            |               |            |           |              |              |            |
|---|--------------|------------|---------------|------------|-----------|--------------|--------------|------------|
| Revenue   | 27,171       | 20,695     | 107,119       | 16         | 22,718    | 8,782        | 12,471       | 14,357     |
| Cost of goods sold                                      | (18,115)     | (10,518)   | (84,441)      | (8)        | (20,311)  | (6,064)      | (9,908)      | (12,456)   |
| Total selling, distribution and operating expenses, net | (6,284)      | (9,865)    | (11,261)      | 13         | (1,746)   | (3,029)      | (1,035)      | (1,254)    |
| Total other income and (expense), net                   | 3,995        | 274        | 1,209         | 530        | (640)     | 2,742        | 756          | (476)      |
| <b>Profit before tax</b>                                | <b>6,767</b> | <b>586</b> | <b>12,626</b> | <b>551</b> | <b>21</b> | <b>2,431</b> | <b>2,284</b> | <b>171</b> |
| Income tax (expense) benefit                            | (592)        | (128)      | 297           | (27)       | 29        | 25           | (170)        | 266        |
| <b>Profit for the year from continuing operations</b>   | <b>6,175</b> | <b>458</b> | <b>12,923</b> | <b>524</b> | <b>50</b> | <b>2,456</b> | <b>2,114</b> | <b>437</b> |
| <b>Total comprehensive income</b>                       | <b>6,175</b> | <b>458</b> | <b>12,923</b> | <b>524</b> | <b>50</b> | <b>2,456</b> | <b>2,114</b> | <b>437</b> |
| Attributable to non-controlling interests               | 241          | 128        | 757           | 83         | 4         | 245          | 132          | 44         |
| Dividends paid to non-controlling interests             |              |            |               |            |           |              |              |            |

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**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

Summarised statements of profit (loss) and other comprehensive income (loss) for 2015:

|  | <b>SKCC<br/>and<br/>subsidiaries</b> | <b>KPSC</b> | <b>CMP</b>   | <b>BMP</b>   | <b>KMP</b>   | <b>USP</b>   | <b>Izhstal</b> |
|--|--------------------------------------|-------------|--------------|--------------|--------------|--------------|----------------|
| Revenue  | 31,169                               | 20,723      | 96,126       | 23,605       | 7,784        | 12,591       | 9,902          |
| Cost of goods sold   | (19,842)                             | (11,268)    | (78,995)     | (21,518)     | (6,400)      | (9,663)      | (8,589)        |
| Total selling, distribution and operating expenses, net      | (6,281)                              | (8,924)     | (6,421)      | (1,991)      | (3,031)      | (3,207)      | 5,097          |
| Total other income and (expense), net                        | (27,950)                             | 167         | (9,078)      | 1,702        | 2,768        | 993          | (1,552)        |
| <b>(Loss) profit before tax</b>                              | <b>(22,904)</b>                      | <b>698</b>  | <b>1,632</b> | <b>1,798</b> | <b>1,121</b> | <b>714</b>   | <b>4,858</b>   |
| Income tax (expense) benefit                                 | (3,432)                              | (141)       | 665          | 37           | 26           | 298          | (730)          |
| <b>(Loss) profit for the year from continuing operations</b> | <b>(26,336)</b>                      | <b>557</b>  | <b>2,297</b> | <b>1,835</b> | <b>1,147</b> | <b>1,012</b> | <b>4,128</b>   |
| <b>Total comprehensive (loss) income</b>                     | <b>(26,336)</b>                      | <b>557</b>  | <b>2,297</b> | <b>1,835</b> | <b>1,147</b> | <b>1,012</b> | <b>4,128</b>   |
| Attributable to non-controlling interests                    | (565)                                | 155         | 135          | 157          | 114          | 63           | 413            |
| Dividends paid to non-controlling interests                  | 2                                    |             |              |              |              |              |                |

Summarised statements of profit (loss) and other comprehensive income (loss) for 2014:

|   | <b>SKCC<br/>and<br/>subsidiaries</b> | <b>KPSC</b> | <b>CMP</b>     | <b>BMP</b>   | <b>KMP</b>   | <b>USP</b>   | <b>Izhstal</b> |
|---|--------------------------------------|-------------|----------------|--------------|--------------|--------------|----------------|
| Revenue   | 26,584                               | 19,037      | 87,866         | 22,253       | 9,688        | 12,792       | 9,131          |
| Cost of sales   | (18,835)                             | (9,737)     | (72,198)       | (20,094)     | (6,301)      | (9,997)      | (8,964)        |
| Total selling, distribution and operating expenses, net | (7,614)                              | (8,920)     | (6,553)        | (2,007)      | (3,256)      | (1,373)      | (7,460)        |
| Total other income and (expense), net                   | (37,837)                             | 150         | (10,236)       | 1,111        | 2,562        | 1,096        | (1,745)        |
| <b>(Loss) profit before tax</b>                         | <b>(37,702)</b>                      | <b>530</b>  | <b>(1,121)</b> | <b>1,263</b> | <b>2,693</b> | <b>2,518</b> | <b>(9,038)</b> |
| Income tax (expense) benefit                            | 2,921                                | (114)       | (1,213)        | 50           | (58)         | 64           | 819            |

|  |                 |            |                |              |              |              |                |
|--|-----------------|------------|----------------|--------------|--------------|--------------|----------------|
| <b>(Loss) profit for the year from continuing operations</b> | <b>(34,781)</b> | <b>416</b> | <b>(2,334)</b> | <b>1,313</b> | <b>2,635</b> | <b>2,582</b> | <b>(8,219)</b> |
| <b>Total comprehensive (loss) income</b>                     | <b>(34,781)</b> | <b>416</b> | <b>(2,334)</b> | <b>1,313</b> | <b>2,635</b> | <b>2,582</b> | <b>(8,219)</b> |
| Attributable to non-controlling interests                    | (1,263)         | 116        | (137)          | 112          | 262          | 161          | (822)          |
| Dividends paid to non-controlling interests                  |                 |            |                |              |              |              |                |

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**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

Summarised statements of financial position as of December 31, 2016:

|                         | <b>SKCC<br/>and<br/>subsidiaries</b> | <b>KPSC</b>    | <b>CMP</b>      | <b>SUNP</b>    | <b>BMP</b>     | <b>KMP</b>      | <b>USP</b>      | <b>Izhstal</b> |
|-------------------------|--------------------------------------|----------------|-----------------|----------------|----------------|-----------------|-----------------|----------------|
| Current assets          | 29,513                               | 3,666          | 36,533          | 3,150          | 7,367          | 9,905           | 9,768           | 3,490          |
| Non-current assets      | 89,689                               | 3,586          | 83,378          | 3,841          | 8,010          | 22,165          | 15,197          | 5,526          |
| Current liabilities     | (138,268)                            | (3,025)        | (92,371)        | (230)          | (6,291)        | (1,951)         | (7,700)         | (8,165)        |
| Non-current liabilities | (3,778)                              | (104)          | (5,562)         | (181)          | (130)          | (799)           | (80)            | (5,372)        |
| <b>Total equity</b>     | <b>22,844</b>                        | <b>(4,123)</b> | <b>(21,978)</b> | <b>(6,580)</b> | <b>(8,956)</b> | <b>(29,320)</b> | <b>(17,185)</b> | <b>4,521</b>   |

**Attributable to:**

|                          |        |         |          |         |         |          |          |       |
|--------------------------|--------|---------|----------|---------|---------|----------|----------|-------|
| Equity holders of parent | 22,492 | (2,974) | (20,690) | (5,534) | (8,190) | (26,401) | (16,113) | 4,069 |
| Non-controlling interest | 352    | (1,149) | (1,288)  | (1,046) | (766)   | (2,919)  | (1,072)  | 452   |

Summarised statements of financial position as of December 31, 2015:

|                         | <b>SKCC<br/>and<br/>subsidiaries</b> | <b>KPSC</b>    | <b>CMP</b>     | <b>SUNP</b>    | <b>BMP</b>     | <b>KMP</b>      | <b>USP</b>      | <b>Izhstal</b> |
|-------------------------|--------------------------------------|----------------|----------------|----------------|----------------|-----------------|-----------------|----------------|
| Current assets          | 81,248                               | 5,095          | 46,932         | 4,646          | 11,479         | 18,357          | 14,611          | 2,961          |
| Non-current assets      | 61,713                               | 1,235          | 61,183         | 2,345          | 3,449          | 11,961          | 7,437           | 5,972          |
| Current liabilities     | (168,615)                            | (2,559)        | (96,666)       | (318)          | (5,891)        | (2,622)         | (6,935)         | (11,678)       |
| Non-current liabilities | (3,355)                              | (107)          | (2,678)        | (211)          | (143)          | (873)           | (48)            | (2,209)        |
| <b>Total equity</b>     | <b>29,009</b>                        | <b>(3,664)</b> | <b>(8,771)</b> | <b>(6,462)</b> | <b>(8,894)</b> | <b>(26,823)</b> | <b>(15,065)</b> | <b>4,954</b>   |

**Attributable to:**

|                          |        |         |         |         |         |          |          |       |
|--------------------------|--------|---------|---------|---------|---------|----------|----------|-------|
| Equity holders of parent | 28,433 | (2,643) | (8,257) | (5,434) | (8,133) | (24,153) | (14,126) | 4,459 |
| Non-controlling interest | 576    | (1,021) | (514)   | (1,028) | (761)   | (2,670)  | (939)    | 495   |

Summarised cash flow information for the year ended December 31, 2016:

| <b>SKCC<br/>and</b> | <b>KPSC</b> | <b>CMP</b> | <b>SUNP</b> | <b>BMP</b> | <b>KMP</b> | <b>USP</b> | <b>Izhstal</b> |
|---------------------|-------------|------------|-------------|------------|------------|------------|----------------|
|---------------------|-------------|------------|-------------|------------|------------|------------|----------------|



|  | <b>subsidiaries</b> |            |            |       |           |       |           |          |
|--|---------------------|------------|------------|-------|-----------|-------|-----------|----------|
| Operating  | 14,923              | 707        | 14,900     | 806   | (491)     | 86    | 2,119     | 987      |
| Investing  | 25,989              | (554)      | (8,035)    | (806) | 398       | 310   | (1,226)   | (33)     |
| Financing  | (41,114)            | 200        | (6,418)    |       | 151       | (396) | (839)     | (949)    |
| <b>(Decrease) increase in cash and cash equivalents, net</b> | <b>(202)</b>        | <b>353</b> | <b>447</b> |       | <b>58</b> |       | <b>54</b> | <b>5</b> |

Summarised cash flow information for the year ended December 31, 2015:

|  | <b>SKCC and subsidiaries</b> |            |              |            |             |                |           |  |
|--|------------------------------|------------|--------------|------------|-------------|----------------|-----------|--|
|  | <b>KPSC</b>                  | <b>CMP</b> | <b>BMP</b>   | <b>KMP</b> | <b>USP</b>  | <b>Izhstal</b> |           |  |
| Operating  | 11,513                       | 924        | 2,586        | 1,622      | (2,123)     | 1,926          | 803       |  |
| Investing  | (7,894)                      | (584)      | (12,368)     | 622        | 2,352       | (3,782)        | (34)      |  |
| Financing  | (3,464)                      | (21)       | 9,482        | (2,090)    | (274)       | 1,557          | (756)     |  |
| <b>Increase (decrease) in cash and cash equivalents, net</b> | <b>155</b>                   | <b>319</b> | <b>(300)</b> | <b>154</b> | <b>(45)</b> | <b>(299)</b>   | <b>13</b> |  |

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Summarised cash flow information for the year ended December 31, 2014:

|  | <b>SKCC<br/>and<br/>subsidiaries</b> | <b>KPSC</b>  | <b>CMP</b> | <b>BMP</b>  | <b>KMP</b> | <b>USP</b> | <b>Izhstal</b> |
|--|--------------------------------------|--------------|------------|-------------|------------|------------|----------------|
| Operating  | 12,980                               | (497)        | 15,544     | 2,163       | 6,351      | 1,569      | (12)           |
| Investing  | (12,038)                             | (375)        | (17,492)   | (1,581)     | (6,347)    | (1,981)    | (49)           |
| Financing  | (3,901)                              | 401          | 2,370      | (668)       | (8)        | 750        | 29             |
| <b>Increase (decrease) in cash and cash equivalents, net</b> | <b>(2,959)</b>                       | <b>(471)</b> | <b>422</b> | <b>(86)</b> | <b>(4)</b> | <b>338</b> | <b>(32)</b>    |

**8. Investments in associates**

Investments in associates are comprised of:

| <b>Investee</b>                        | <b>Percent of shares held at</b> |                          | <b>Investment carrying value at</b> |                          |
|--|----------------------------------|--------------------------|-------------------------------------|--------------------------|
|  | <b>December 31, 2016</b>         | <b>December 31, 2015</b> | <b>December 31, 2016</b>            | <b>December 31, 2015</b> |
| Mechel Somani Carbon (Mining segment)  | 51.0%                            | 51.0%                    |                                     | 45                       |
| TPTU (Mining segment)                  | 40.0%                            | 40.0%                    | 175                                 | 157                      |
| TRMZ (Mining segment)                  | 25.0%                            | 25.0%                    | 90                                  | 82                       |
| <b>Total investments in associates</b> |                                  |                          | <b>265</b>                          | <b>284</b>               |

Mechel Somani Carbon Private Limited shares are owned by Mechel Carbon AG. The core business is distribution of metallurgical coals on the Indian market. Despite the ownership of 51% of Mechel Somani Carbon shares the Group cannot exercise control over the company. As of December 31, 2016, the Group recognized a provision of RUB 42 million for this investment.

TPTU (Tomusinskiy Transportation Management Center) shares are owned by SKCC. The core business is provision of transportation services both to the Group's subsidiaries and third parties.

TRMZ (Tomusinskiy Auto Repair Shop) shares are owned by SKCC. TRMZ provides repair services to the Group's subsidiaries.

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Table of Contents**MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

The following table shows movements in the investments in associates:

|   | <b>Mechel Somani<br/>Carbon Private<br/>Limited (Mining<br/>segment)</b> | <b>TPTU<br/>(Mining<br/>segment)</b> | <b>TRMZ<br/>(Mining<br/>segment)</b> | <b>BWS<br/>Bewehrungsstahl<br/>GmbH<br/>(Austria)<br/>(Steel<br/>segment)</b> | <b>Total</b> |
|---|--|--------------------------------------|--------------------------------------|---|--------------|
| <b>January 1, 2014</b>                  | <b>17</b>  | <b>148</b>                           | <b>79</b>                            | <b>7</b>  | <b>251</b>   |
| Share of profit (loss)                  | 6  | 7                                    | 1                                    | (7)   | 7            |
| Disposal of investments                 |  |                                      |                                      | (1)   | (1)          |
| Exchange differences                    | 16   |                                      |                                      | 1   | 17           |
| <b>December 31, 2014</b>                | <b>39</b>  | <b>155</b>                           | <b>80</b>                            |   | <b>274</b>   |
| Share of (loss) profit                  | (5)  | 2                                    | 3                                    |   |              |
| Exchange differences                    | 10   |                                      |                                      |   | 10           |
| <b>December 31, 2015</b>                | <b>44</b>  | <b>157</b>                           | <b>83</b>                            |   | <b>284</b>   |
| Share of (loss) profit                  |  | 18                                   | 7                                    |   | 25           |
| Provision for impairment of investments | (42)   |                                      |                                      |   | (42)         |
| Exchange differences                    | (2)  |                                      |                                      |   | (2)          |
| <b>December 31, 2016</b>                |  | <b>175</b>                           | <b>90</b>                            |   | <b>265</b>   |

**9. Fair value measurement**

Set out below is a comparison by class of the carrying amounts and fair value of the Group's financial instruments that are carried in the consolidated financial statements:

|  | <b>Level</b> | <b>December 31, 2016</b>   |                       | <b>December 31, 2015</b>   |                       |
|--|--------------|----------------------------|-----------------------|----------------------------|-----------------------|
|  |              | <b>Carrying<br/>amount</b> | <b>Fair<br/>value</b> | <b>Carrying<br/>amount</b> | <b>Fair<br/>value</b> |
| <b>Financial liabilities</b>           |              |                            |                       |                            |                       |
| Interest-bearing loans and borrowings: |              |                            |                       |                            |                       |
| Floating rate loans                    | 3            | 407,015                    | 357,782               | 255,931                    | 220,225               |

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|   |   |                |                |                |                |
|---|---|----------------|----------------|----------------|----------------|
| Bonds   | 1 | 14,717         | 12,740         | 16,684         | 13,398         |
| Fixed rate loans                                    | 3 | 24,077         | 23,105         | 223,367        | 190,108        |
| Other non-current financial liabilities (Note 10.4) | 3 | 36,198         | 25,772         |                |                |
| <b>Total</b>  |   | <b>482,007</b> | <b>419,399</b> | <b>495,982</b> | <b>423,731</b> |

Management assessed that the fair values of cash and short-term deposits, trade receivables, trade payables, finance lease liabilities, bank overdrafts and other current liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments.

The fair value of the financial assets and liabilities is included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

The following methods and assumptions were used to estimate the fair values:

*Long-term loans and borrowings, other non-current liabilities:* the fair values of other non-current liabilities are based on the present value of the anticipated cash flows and approximate carrying value.

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

*Derivatives:* the fair value of derivative financial instruments, including embedded derivatives, is based on quoted market prices. Where no price information is available from a quoted market source, alternative market mechanisms or recent comparable transactions, fair value is estimated based on the Group's views on relevant future prices, net of valuation allowances to accommodate liquidity, modelling and other risks implicit in such estimates. Option-based derivatives are valued using Black-Scholes models and Monte-Carlo simulations. The derivative financial instruments are recorded at their fair value at each reporting date. There are no such financial instruments as of December 31, 2016.

The movement of financial instruments measured at the fair value using unobservable inputs (Level 2 and 3) is presented below:

|   | <b>Contingent<br/>consideration<br/>Drilling Program<br/>Level 3</b> | <b>Swap<br/>transactions<br/>Level 2</b> | <b>Option<br/>Level 2</b> |
|---|--|--|---------------------------|
| <b>January 1, 2014</b>                            | <b>907</b>   | <b>408</b>                               | <b>415</b>                |
| Remeasurement recognised in OCI                   | 689  |  |                           |
| Loss on contingent consideration<br>remeasurement | 85   |  |                           |
| Disposal/termination                              |  | (408)                                    | (415)                     |
| <b>December 31, 2014</b>                          | <b>1,681</b>   |  |                           |
| Disposal/termination                              | (1,681)  |  |                           |
| <b>December 31, 2015</b>                          |  |  |                           |
| Initial recognition                               |  |  |                           |
| Remeasurement gain/loss                           |  |  |                           |
| <b>December 31, 2016</b>                          |  |  |                           |

The contingent consideration resulted from the acquisition of Bluestone and its subsidiaries (the BCG Companies) and measured at fair value is represented by the Drilling Program contingent consideration, which was calculated using estimated tonnage of coal in-place determined by the independent appraiser. The present value of this liability was determined using an 8% discount rate, stated in the agreement for actual settlement of contingent obligation, which represents the estimate of the amount that would have been paid if the Group had settled the liability at the balance sheet date. The contingent consideration was released on the date of transfer of the BCG Companies' shares on February 12, 2015.



**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)***10. Financial assets and financial liabilities****10.1 Financial liabilities: interest-bearing loans and borrowings**

The Group has the following principal and interest amounts outstanding for interest-bearing loans and bonds:

|  | December 31, 2016 |                            | December 31, 2015 |                            |
|--|-------------------|----------------------------|-------------------|----------------------------|
|  | Interest rate     | Amount of outstanding debt | Interest rate     | Amount of outstanding debt |
| <b>Short-term borrowings and current portion of long-term debt</b>       |                   |                            |                   |                            |
| <b>In Russian rubles</b>   |                   |                            |                   |                            |
| Banks and financial institutions   | 9.8-14.5          | 3,458                      | 9.4-16.0          | 8,239                      |
| Corporate lenders  | 6.7               | 64                         | 6.7               | 65                         |
| Weighted average interest rate for the period                            |                   | 13.9%                      |                   | 12.9%                      |
| <b>In U.S. dollars</b>   |                   |                            |                   |                            |
| Banks and financial institutions   | 8.0               | 154                        | 8.0               | 310                        |
| Weighted average interest rate for the period                            |                   | 8.0%                       |                   | 8.0%                       |
| <b>In euro</b>   |                   |                            |                   |                            |
| Banks and financial institutions   | 2.8               | 114                        | 8.3               | 3,591                      |
| Corporate lenders  |                   |                            | 2.8               | 182                        |
| Weighted average interest rate for the period                            |                   | 2.8%                       |                   | 8.3%                       |
| Current portion of long-term debt  |                   | 391,781                    |                   | 431,812                    |
| Interest payable   |                   | 16,916                     |                   | 27,269                     |
| Fines and penalties on overdue amounts                                   |                   | 21,678                     |                   | 20,206                     |
| <b>Total short-term borrowings and current portion of long-term debt</b> |                   | <b>434,165</b>             |                   | <b>491,674</b>             |

|                          | December 31, 2016 |                            | December 31, 2015 |                            |
|--------------------------|-------------------|----------------------------|-------------------|----------------------------|
|                          | Interest rate     | Amount of outstanding debt | Interest rate     | Amount of outstanding debt |
| <b>Long-term debt</b>    |                   |                            |                   |                            |
| <b>In Russian rubles</b> |                   |                            |                   |                            |



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|  |          |               |           |              |
|--|----------|---------------|-----------|--------------|
| Banks and financial institutions               | 5.0-15.0 | 258,855       | 10.1-17.0 | 134,786      |
| Bonds issue                                    | 8.0-15.0 | 14,365        | 2.0-15.0  | 16,551       |
| Corporate lenders                              | 6.7      | 5             | 6.7       | 5            |
| Weighted average interest rate for the period  |          | 12.5%         |           | 12.9%        |
| <b>In U.S. dollars</b>                         |          |               |           |              |
| Banks and financial institutions               | 2.2-8.2  | 107,346       | 1.8-8.0   | 260,212      |
| Weighted average interest rate for the period  |          | 8.2%          |           | 8.0%         |
| <b>In euro</b>                                 |          |               |           |              |
| Banks and financial institutions               | 0.8-7.3  | 22,854        | 0.8-5.7   | 24,566       |
| Weighted average interest rate for the period  |          | 4.5%          |           | 4.5%         |
| Current part of long-term loans and borrowings |          | (391,781)     |           | (431,812)    |
| <b>Total long-term debt</b>                    |          | <b>11,644</b> |           | <b>4,308</b> |

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Aggregate scheduled maturities of the debt outstanding as of December 31, 2016, were as follows:

|                             |                |
|-----------------------------|----------------|
| <b>Payable by</b>           |                |
| On demand (current portion) | 427,400        |
| 2017 (current portion)      | 6,764          |
| 2018                        | 3,161          |
| 2019                        | 3,572          |
| 2020                        | 2,921          |
| 2021                        | 1,991          |
| Thereafter                  |                |
| <b>Total</b>                | <b>445,809</b> |

The unused portion under all credit facilities as of December 31, 2016 and 2015 was RUB 373 million and RUB 409 million, respectively.

The outstanding balances of principal amount of short-term and long-term debt by denominated currencies and major banks as of December 31, 2016 and 2015 were as follows:

| <b>Short-term and long-term debt</b> | <b>December 31,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--------------------------------------|------------------------------|------------------------------|
| <b>Russian ruble-denominated</b>     |                              |                              |
| Gazprombank                          | 153,614                      | 33,639                       |
| VTB                                  | 71,711                       | 70,415                       |
| Sberbank                             | 31,106                       | 32,141                       |
| Bonds                                | 14,365                       | 16,551                       |
| Uralsib                              | 3,116                        | 3,331                        |
| Eurasian Development Bank            | 1,227                        | 1,767                        |
| Raiffeisen Bank                      | 490                          | 897                          |
| Other                                | 1,119                        | 905                          |
| <b>Total</b>                         | <b>276,748</b>               | <b>159,646</b>               |
| <b>U.S. dollar-denominated</b>       |                              |                              |
| Pre-export facility                  | 60,898                       | 72,881                       |
| Sberbank                             | 21,811                       | 56,609                       |

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|  |                |                |
|--|----------------|----------------|
| VEB  | 10,147         | 12,192         |
| BNP  | 9,251          | 10,955         |
| MCB  | 5,041          | 6,311          |
| Gazprombank  |                | 101,156        |
| Other  | 351            | 418            |
| <b>Total</b>   | <b>107,499</b> | <b>260,522</b> |
| <b>Euro-denominated</b>                                    |                |                |
| BNP  | 9,460          | 11,505         |
| VTB  | 3,214          | 4,098          |
| BNL  | 2,736          | 3,364          |
| UniCredit Bank (former Bayerische<br>Hypo-und-Vereinsbank) | 2,723          | 3,345          |
| ING Bank   | 1,997          | 2,461          |
| Raiffeisen Bank  | 381            | 475            |
| Other  | 2,457          | 3,091          |
| <b>Total</b>   | <b>22,968</b>  | <b>28,339</b>  |
| <b>Total short-term and long-term debt</b>                 | <b>407,215</b> | <b>448,507</b> |

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**MECHEL PAO**

**Notes to the consolidated financial statements for the year ended December 31, 2016**

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

**(a) Pre-export facility agreement**

As of December 31, 2016, pre-export facility agreement (represented by the syndicate of banks – CJSC UniCredit Bank, Caterpillar Financial, ING Bank N.V. and other) bears interest at 1M LIBOR plus 5.5% p.a. (or 7.5% p.a. if payments are overdue). The outstanding balances as of December 31, 2016 and 2015 were RUB 60,898 million (\$1,003,964 thousand at exchange rate as of December 31, 2016) and RUB 72,881 million (\$999,970 thousand at exchange rate as of December 31, 2015), respectively.

As of December 31, 2016, the Group's overdue principal amount and overdue interest on pre-export facility agreement amounted to RUB 60,897 million and RUB 7,123 million, respectively, as of December 31, 2015 – RUB 38,049 million and RUB 3,857 million, respectively.

As of December 31, 2016, the Group was in the process of negotiation with the syndicate of banks in order to reach the restructuring agreements for the pre-export credit facility.

The fines and penalties on overdue amounts of RUB 20 million and RUB 28 million were recorded in interest-bearing loans and borrowings in the consolidated statement of financial position as of December 31, 2016 and 2015, respectively. The amount of RUB 427 million and RUB 165 million was recorded as finance costs in the consolidated statements of profit (loss) and other comprehensive income (loss) for the year ended December 31, 2016 and 2015, respectively.

**(b) VTB facilities**

In December 2016, the Group signed amendments to the restructuring agreements providing with an extension of the repayment grace period until April 2020 and the final maturity until April 2022 for the credit facilities of Mechel PAO, CMP, SKCC and Yakutugol in the total amount of RUB 71,711 million. The extension of the grace period was subject to certain conditions such as guarantees on a full amount from Mechel PAO and CMP which shall be provided till March 31, 2017 and compliance with covenants set by the agreements (in case of breach of covenants the grace period is moved to April 2017 and the final maturity – to April 2020). Interest rate under the restructured agreements is set at the level of the key rate of the Central Bank of Russia plus 1.5% starting from April 2016 (subject to increase to 2.35% through January 6, 2018, and 2.99% afterwards if certain conditions are not met). In April 2017, the conditions were met resulting in the extended repayment grace period until 2020 and the final maturity until 2022 (see Note 29). Fines and penalties accrued prior to the restructuring date (December 23, 2016) were waived according to the restructured agreements (apart from the most significant amount of penalties accrued on credit facility of Mechel PAO – see details below).

The outstanding balances of the ruble-denominated facilities as of December 31, 2016 and 2015 were RUB 71,711 million and RUB 70,415 million, respectively, bearing interest at 11.5% p.a.

During 2010-2015, VTB provided euro-denominated loans to the Group, bearing interest at 5.3%-7.3% p.a. In December 2016, the Group signed the prolongation agreement providing with the final maturity until April 2022 for the euro-denominated credit facility of MCAG in the amount of RUB 2,812 million. The outstanding balances as of December 31, 2016 and 2015 were RUB 3,214 million and RUB 4,098 million, respectively.

As of December 31, 2016, there was no overdue principal amount and overdue interest on VTB credit facilities, as of December 31, 2015, the Group's overdue principal amount was RUB 45 million. The fines and penalties on overdue amounts of RUB 10,597<sup>2</sup> million and RUB 10,689 million were recorded in interest-bearing loans and borrowings in the consolidated statement of financial position as of December 31, 2016 and 2015,

<sup>2</sup> According to the restructuring terms, after the Group pays RUB 895 million by equal quarterly instalments within 36 months after October 13, 2015, penalties in the amount of RUB 9,761 million are to be cancelled.

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

respectively. The amount of RUB 184 million and RUB 9,704 million was recorded as finance costs in the consolidated statements of profit (loss) and other comprehensive income (loss) for the year ended December 31, 2016 and 2015, respectively.

**(c) Gazprombank facilities**

In 2015, the Group signed restructuring agreements (became effective in 2016) providing with an extension of the repayment grace period until April 2017 and the final maturity until April 2020 for the credit facilities of SKCC, Yakutugol, CMP, Mechel Service, Mechel-Energo, BMP, Port Posiet, Mechel Coke and USP in the total amount of RUB 150,809 million as of December 31, 2016. The repayment grace period and final maturity may be extended until April 2020 and April 2022, respectively, if certain conditions are met. In April 2017, the conditions were met resulting in the extended repayment grace period until 2020 and the final maturity until 2022 (see Note 29). Interest rate under the restructured agreements is set at the level of the Central Bank of Russia rate plus 1.5% since the effective date of the restructuring (subject to increase to 3.5% if certain conditions are not met). The extended grace period, final maturity and interest rate set in April 2017 were subject to similar terms with Sberbank and VTB. The restructuring under SKCC and Yakutugol U.S. dollar-denominated credit facilities became effective in January-March 2016. The restructuring under CMP, Mechel Service, Mechel-Energo, BMP, Port Posiet, Mechel Coke, SKCC and USP ruble-denominated credit facilities became effective in June 2016.

During 2011-2015, Gazprombank provided ruble-denominated long-term and short-term loans to the Group bearing interest at 9.8%-11.5% p.a. with the outstanding balance RUB 33,639 million as of December 31, 2015. During 2009-2013, Gazprombank provided dollar-denominated long-term loans to the Group bearing interest at 5.9%-7.5% p.a. The outstanding balance of U.S. dollar-denominated debt as of December 31, 2015 was RUB 101,156 million (\$1,387,930 thousand at exchange rate as of December 31, 2015) and it was converted from U.S. dollar into Russian ruble based on market exchange rate at the date of the conversion during the restructuring in 2016. Upon the conversion, the outstanding loan balances as of December 31, 2016 was RUB 153,614 million.

As of December 31, 2016, there was no overdue principal amount and overdue interest on Gazprombank credit facilities. As of December 31, 2015, the Group's overdue principal amount and overdue interest amounted to RUB 36,308 million and RUB 11,362 million, respectively. The fines and penalties on overdue amounts of RUB 7,450 million and RUB 6,026 million were recorded in interest-bearing loans and borrowings in the consolidated statement of financial position as of December 31, 2016 and 2015, respectively. The amount of RUB 2,031 million and RUB 5,179 million was recorded as finance costs in the consolidated statements of profit (loss) and other comprehensive income (loss) for the year ended December 31, 2016 and 2015, respectively.

**(d) Sberbank facilities**

In 2016, the Group signed restructuring agreements and amicable settlements agreement approved by the courts with Sberbank. Those agreements provided with an extension of the repayment grace period until April 2017 and the final maturity until April 2020 for credit facilities in the amount of RUB 51,103 million of CMP, SKCC and MTAG. The repayment grace period and final maturity may be extended until January 2020 and April 2022, respectively, if certain conditions such as cross pledges between facilities and cross guarantees are met. In April 2017, the conditions were met resulting in the extended repayment grace period until 2020 and the final maturity until 2022 (see Note 29). For the credit facilities of CMP, Izhstal, BFP, KMP, Yakutugol and SKCC in the amount of RUB 1,814 million the final maturity was determined to be October 2017. Interest rate under the restructured agreements is set at the level of the Central Bank of Russia rate plus 1.5% (subject to increase to 3.5% if certain conditions are not met) and in U.S. dollars at a rate 3M LIBOR + 7% starting from April 2016. According to the restructuring agreements, fines and penalties were fixed at RUB 1.7 billion (at exchange rate as of December 31, 2015).

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

The outstanding balances of the ruble-denominated facilities as of December 31, 2016 and 2015 were RUB 31,106 million and RUB 32,141 million, respectively, bearing interest at 11.5% p.a. The outstanding balances of the dollar-denominated facilities as of December 31, 2016 and 2015 were RUB 21,811 million (\$359,587 thousand at exchange rate as of December 31, 2016) and RUB 56,609 million (\$776,715 thousand at exchange rate as of December 31, 2015), respectively, bearing interest at 7.9% p.a. The outstanding balances decreased due to repayment of credit facilities from cash received from the sale of a 49% stake in the Elga coal complex to Gazprombank and entering into a put option agreement (see Note 6).

As of December 31, 2016, there were no overdue principal amount and overdue interest on Sberbank credit facilities. As of December 31, 2015, the Group's overdue principal amount and overdue interest amounted to RUB 65,778 million and RUB 5,770 million, respectively.

The fines and penalties on overdue amounts of RUB 2,311 million and RUB 2,681 million were recorded in interest-bearing loans and borrowings in the consolidated statement of financial position as of December 31, 2016 and 2015, respectively. The amount of RUB 2,244 million and RUB 2,699 million was recorded as finance costs in the consolidated statements of profit (loss) and other comprehensive income (loss) for the year ended December 31, 2016 and 2015, respectively.

**(e) VEB facility**

The Elgaugol's outstanding balances under VEB credit facility as of December 31, 2016 and 2015 were RUB 10,147 million (\$167,288 thousand at exchange rate as of December 31, 2016) and RUB 12,192 million (\$167,288 thousand at exchange rate as of December 31, 2015), respectively, bearing interest at 8.0% p.a. As of December 31, 2016, the Group's overdue principal amount and overdue interest payable on VEB credit facilities amounted to RUB 8,882 million (\$146,438 thousand at exchange rate as of December 31, 2016) and RUB 374 million (\$6,163 thousand at exchange rate as of December 31, 2016), respectively, as of December 31, 2015 RUB 10,673 million (\$146,438 thousand at exchange rate as of December 31, 2015) and RUB 246 million (\$3,369 thousand at exchange rate as of December 31, 2015). The use of proceeds under the facility is limited to the development of the Elga coal project.

As of December 31, 2016, the Group was in process of negotiation with VEB in order to reach restructuring agreements for the VEB facility.

The fines and penalties on overdue amounts of RUB 24 million and RUB 18 million were recorded in interest-bearing loans and borrowings in the consolidated statement of financial position as of December 31, 2016 and 2015, respectively. The amount of RUB 10 million and RUB 9 million was recorded as finance costs in the consolidated statements of profit (loss) and other comprehensive income (loss) for the year ended December 31, 2016 and 2015, respectively.



**(f) Bonds**

On July 30, 2009, Mechel PAO issued 5,000,000 ruble-denominated bonds in an aggregate principal amount of RUB 5,000 million. The interest rate for the current coupon period amounted to 13.0% p.a. The maturity date is July 15, 2021. The balance outstanding as of December 31, 2016 was RUB 1,638 million. In July 2016, bonds were restructured and according to the restructuring terms RUB 317 million were classified as current debt and RUB 1,321 million were classified as long-term debt as of December 31, 2016. According to the new payment schedule, the amount of RUB 317 million should be paid in 2017, RUB 352 million in 2018-2020 and RUB 265 million in 2021.

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

On September 7, 2010, Mechel PAO issued two 5,000,000 ruble-denominated bonds in an aggregate principal amount of RUB 10,000 million. The interest rate for the current coupon period amounted to 15.0% p.a. The maturity date is February 25, 2020. The balance outstanding as of December 31, 2016 was RUB 3,914 million, including RUB 764 million classified as short-term debt and RUB 3,150 million classified as long-term debt. According to the new payment schedule, the amount of RUB 764 million should be paid in 2017, RUB 1,005 million in 2018, RUB 1,406 million in 2019, and the final payment in the amount of RUB 739 million should be made in 2020.

On February 22, 2011, Mechel PAO made two issues of 5,000,000 ruble-denominated bonds each in an aggregate principal amount of RUB 10,000 million. The interest rate for the current coupon period amounted to 8.0% p.a. The maturity date is February 9, 2021. The option to demand early redemption of the bonds was replaced with the novation agreement approved at the general meeting of bondholders on August 4, 2016. The balance outstanding as of December 31, 2016 was RUB 820 million and is classified as long-term debt that should be paid in 2021.

On June 9, 2011, Mechel PAO made two issues of 5,000,000 ruble-denominated bonds each in an aggregate principal amount of RUB 10,000 million. The interest rate for the current coupon period amounted to 13.5% p.a. The maturity date is May 27, 2021. The balance outstanding as of December 31, 2016 was RUB 5,110 million. In June 2016, bonds were restructured and according to the restructuring terms, RUB 1,066 million were classified as current debt and RUB 4,044 million were classified as long-term debt as of December 31, 2016. According to the new payment schedule, the amount of RUB 1,066 million should be paid in 2017, RUB 1,138 million in 2018, RUB 1,152 million in 2019, RUB 1,168 million in 2020 and RUB 586 million in 2021.

On June 14, 2011, Mechel PAO issued 5,000,000 ruble-denominated bonds in an aggregate principal amount of RUB 5,000 million. The interest rate for the current coupon period amounted to 13.5% p.a. The maturity date is June 1, 2021. The balance outstanding as of December 31, 2016 was RUB 2,883 million. In July 2016, bonds were restructured and according to the restructuring terms, RUB 616 million were classified as current debt and RUB 2,267 million were classified as long-term debt as of December 31, 2016. According to the new payment schedule, the amount of RUB 616 million should be paid in 2017, RUB 648 million in 2018-2020 and RUB 323 million in 2021.

**(g) Other loans**

Other loans represent Russian ruble, U.S. dollar and euro-denominated long-term and short-term loans bearing interest at 0.8%-15% p.a. The outstanding balance under other loan agreements amounted to RUB 40,350 million and RUB 48,825 million as of December 31, 2016 and 2015, respectively.

As of December 31, 2016, the Group was in process of negotiation with other banks (such as BNP, BNL, ING, Raiffeisen Bank and other international banks) in order to reach restructuring agreements for the related credit facilities.

As of December 31, 2016, the Group's overdue principal amount and overdue interest on other loans amounted to RUB 11,447 million and RUB 1,120 million, respectively, as of December 31, 2015 – RUB 10,436 million and RUB 735 million, respectively. The fines and penalties on overdue amounts of RUB 1,276 million and RUB 764 million were recorded in interest-bearing loans and borrowings in the consolidated statement of financial position as of December 31, 2016 and 2015, respectively. The amount of RUB 642 million and RUB 769 million was recorded as finance costs in the consolidated statements of profit (loss) and other

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

comprehensive income (loss) for the year ended December 31, 2016 and 2015, respectively. The amount of RUB 36 million of waived fines and penalties (due to the restructuring of MCB credit facilities) was recorded as finance income in the consolidated statements of profit (loss) and other comprehensive income (loss) for the year ended December 31, 2016.

In 2010-2016, the Group signed revolving credit agreements for working capital financing up to RUB 3,914 million with several banks. These revolving credit lines allow the Group to withdraw, repay and re-draw in the agreed amounts, timing and number of times until the arrangement expires. Borrowings bear interest at 5.3-14.5% p.a.

**(h) Pledges**

In order to secure bank financings, the Group pledged shares in certain key subsidiaries, including 100% 1 share of Yakutugol, 75% + 4 shares of SKCC, 91.66% of CMP, 50% + 2 shares of common shares of BMP, 80% + 3 shares of KMP, 62.5% of Mechel Mining, 80% 5 shares of USP, 33.33% + 1 share of common shares of Izhstal, 25% + 1 share of Port Posiet, 50.99% of Elgaugol, 25% of registered capital of Mecheltrans, 100% of registered capital of Fincom-invest OOO, 25% of BFP, 25% of Mechel Temryuk, 1.99% of Mecheltrans Vostok OOO, 1.99% of Elga-road as of December 31, 2016.

As of December 31, 2016 and 2015, the carrying value of property, plant and equipment pledged under the loan agreements amounted to RUB 117,047 million and RUB 33,510 million, respectively (Note 18). Carrying value of inventories pledged under the loan agreements amounted to RUB 3,668 million and RUB 4,037 million as of December 31, 2016 and 2015, respectively. Accounts receivable pledged as of December 31, 2016 and 2015 amounted to RUB 238 million and RUB 273 million, respectively. Additionally, CMP pledged its rights to receive future payments (revenue) related to the contract with OJSC Russian Railways in the amount of RUB 6,066 million (\$100 million).<sup>3</sup>

**(i) Covenants**

The Group's loan agreements contain a number of covenants and restrictions, which include, but are not limited to, financial ratios, minimum value of shareholders' equity and certain cross-default provisions. The covenants also include, among other restrictions, limitations on: (1) raising of additional borrowings; (2) amount of dividends in common and preferred shares; and (3) amounts that can be spent for capital expenditures, new investments and acquisitions. Covenant breaches if not waived generally permit lenders to demand accelerated repayment of principal and interest.

CMP's accounts receivable from OJSC Russian Railways as of December 31, 2016 amounted to RUB 1,166 million.

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The Group was required to comply with the following ratios under the most significant loan agreements as of December 31, 2016<sup>4</sup>:

| <b>Restrictive covenant</b>                       | <b>Requirement</b>              | <b>Actual as of<br/>December 31,<br/>2016</b> |
|---|---------------------------------|---|
| Mechel's EBITDA to Net Interest Expense           | Shall not be less than 1.25:1.0 | 1.36:1.0                                      |
| Mechel's EBITDA to Consolidated Financial Expense | Shall not be less than 1.25:1.0 | 1.28:1.0                                      |
| Mechel's Net Debt to EBITDA                       | Shall not exceed 9.00:1.0       | 7.18:1.0                                      |
| Mechel's Total Debt to EBITDA                     | Shall not exceed 7.50:1.0       | 7.48:1.0                                      |

As of December 31, 2016, the Group was in compliance with major Group's restrictive financial covenants under the restructured loan agreements with the Russian state banks (Gazprombank, Sberbank and VTB). However, the Group was not in compliance with covenants contained in the loan agreements with foreign banks (such as Net Borrowings to EBITDA ratio, EBITDA to Net Interest Expense ratio and targeted amount of Adjusted Shareholder's Equity). There was a default on payments of principal and interest in the amount of RUB 81,226 million and RUB 8,617 million, respectively, which is represented primarily by the default of the pre-export facility agreement (Note 10.1(a)) and ECA-covered loans (represented by the credit facilities of BNP, BNL, ING, Raiffeisen Bank and other international banks - Note 10.1(g)). As a result, the long-term debt of RUB 260,653 million was reclassified to short-term liabilities as of December 31, 2016.

**10.2 Financial instruments risk management objectives and policies**

The Group is exposed to foreign currency risk, credit risk and liquidity risk. Management reviews and agrees policies for managing each of these risks, which are summarised below.

*Liquidity risk*

Liquidity risk is the risk that arises when the maturity of assets and liabilities does not match. An unmatched position potentially enhances profitability, but can also increase the risk of losses. The Company has procedures with the object of minimizing such losses such as maintaining sufficient cash and other highly liquid current assets to meet its liabilities as and when they fall due.

As of December 31, 2016, the Group was in breach of a number of financial covenants contained in the Group's loan agreements, which led to cross-defaults under other loan and finance lease agreements, permitting the respective lenders under such other facilities to accelerate the payment of principal and interest under their loans.

The following tables show the remaining contractual maturities at the reporting date of the Group's non-derivative financial liabilities, which are based on contractual undiscounted cash flows (including interest payment computed using contractual rates, or if floating, based on rates current at the reporting date) and the earliest the Group can be required to pay.

- <sup>4</sup> Net Debt and Total Debt are calculated according to the respective definitions set by the credit agreements. Generally, Total Debt includes outstanding loans, finance lease, bonds and other financial liability balances; Net Debt is equal to Total Debt less cash and cash equivalents, and excludes Net Debt of Elgaugol (set by the VEB credit facility).

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|   | <b>Maturity</b>  |                          |   |  |  |                              | <b>Total</b>   |
|---|------------------|--------------------------|---|--|--|------------------------------|----------------|
|   | <b>On demand</b> | <b>Within<br/>1 year</b> | <b>More than<br/>1 year<br/>but<br/>less than<br/>2 years</b> | <b>More than<br/>2 years<br/>but<br/>less than<br/>3 years</b> | <b>More than<br/>3 years<br/>but<br/>less than<br/>4 years</b> | <b>More than<br/>4 years</b> |                |
| <b>At December 31, 2016</b>             |                  |                          |   |  |  |                              |                |
| Loans and borrowings, including         |                  |                          |   |  |  |                              |                |
| interest payable                        | 428,597          | 8,496                    | 4,688   | 4,648  | 3,593  | 2,455                        | <b>452,477</b> |
| Finance lease liabilities               | 7,857            | 4,456                    | 280   | 106  | 83   | 61                           | <b>12,843</b>  |
| Trade and other payables                | 435              | 37,231                   | 448   | 181  |  |                              | <b>38,295</b>  |
| Other non-current financial liabilities |                  |                          |   |  |  | 60,475                       | <b>60,475</b>  |

|                                 | <b>Maturity</b>      |                          |   |  |  |                              | <b>Total</b>   |
|---------------------------------|----------------------|--------------------------|---|--|--|------------------------------|----------------|
|                                 | <b>On<br/>demand</b> | <b>Within<br/>1 year</b> | <b>More than<br/>1 year<br/>but<br/>less than<br/>2 years</b> | <b>More than<br/>2 years<br/>but<br/>less than<br/>3 years</b> | <b>More than<br/>3 years<br/>but<br/>less than<br/>4 years</b> | <b>More than<br/>4 years</b> |                |
| <b>At December 31, 2015</b>     |                      |                          |   |  |  |                              |                |
| Loans and borrowings, including |                      |                          |   |  |  |                              |                |
| interest payable                | 472,159              | 23,385                   | 1,542   | 1,754  | 2,187  | 986                          | <b>502,013</b> |
| Finance lease liabilities       | 10,534               | 6,469                    | 360   | 169  | 20   | 1                            | <b>17,553</b>  |
| Trade and other payables        | 1,038                | 50,200                   | 15  |  |  |                              | <b>51,253</b>  |
| <i>Credit risk</i>              |                      |                          |   |  |  |                              |                |

Credit risk arises when a failure by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the reporting date.

The Group is exposed to credit risk from its operating activities (primarily trade receivables) and from its financing activities, including deposits with banks and financial institutions, foreign exchange transactions and other financial instruments.

Customer credit risk is managed by each subsidiary subject to the Group's established policy, procedures and control relating to customer credit risk management. Credit quality of a customer is assessed and individual credit limits are defined in accordance with this assessment. Outstanding customer receivables are regularly monitored.



The contractual credit period for sales of goods is varied from 30 to 60 days on average. No interest is charged on trade receivables.

An impairment analysis is performed at each reporting date on an individual basis for major clients. In addition, a large number of minor receivables are grouped into homogenous groups and assessed for impairment collectively. The calculation is based on actual incurred historical data.

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The maximum exposure to credit risk arising from the Group's financial assets is presented as follows:

|  | <b>December 31,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--|------------------------------|------------------------------|
| Restricted cash (excluding cash on hand) | 24                           | 62                           |
| Trade and other receivables              | 19,121                       | 16,033                       |
| Other financial assets                   | 415                          | 303                          |
| <i>Promissory notes</i>                  | 208                          | 218                          |
| <i>Loans issued</i>                      | 61                           | 72                           |
| <i>Bonds</i>                             | 13                           | 13                           |
| <i>Deposits</i>                          | 133                          |                              |
| <b>Total</b>                             | <b>19,560</b>                | <b>16,398</b>                |

*Foreign currency risk*

Foreign currency risk is the risk that the value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. This risk arises when commercial transactions and recognised assets and liabilities are denominated in a currency different from the Group's functional currency.

The Group undertakes transactions denominated in foreign currencies and consequently is exposed to foreign currency risk. Approximately 21% of the Group's sales are denominated in U.S. dollars and 12% of the Group's sales are denominated in euro, 27% of the Group's borrowings are denominated in U.S. dollars and 6% of the Group's borrowings are denominated in euro. The Group does not have formal arrangements to mitigate foreign currency risk. However, management of the Group believes that the foreign currency risk is partly mitigated for the Group by the situation where approximately 33% of total sales of the Group are denominated in U.S. dollars and euro that reduces negative impact of changes in exchange rates for the Group's borrowings and purchases denominated in foreign currencies, mostly in U.S. dollars. The Group does not currently use derivative instruments to manage exchange rate exposures.

The Group's exposure at the reporting date to foreign currency risk arising from recognised assets and liabilities denominated in a currency other than the functional currency of the entity to which they relate to is set out in the table below:

|   | <b>December 31,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---|------------------------------|------------------------------|
| <b>Assets and liabilities denominated in U.S. dollars</b> |                              |                              |

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|                                    |                  |                  |
|------------------------------------|------------------|------------------|
| <b>Current assets</b>              | <b>225</b>       | <b>2,549</b>     |
| Receivables                        | 156              | 1,399            |
| Cash and cash equivalents          | 69               | 1,150            |
| <b>Current liabilities</b>         | <b>(124,281)</b> | <b>(301,442)</b> |
| Short-term loans and borrowings    | (113,327)        | (279,905)        |
| Short-term payables                | (9,433)          | (19,405)         |
| Short-term finance lease liability | (1,521)          | (2,132)          |

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## MECHEL PAO

## Notes to the consolidated financial statements for the year ended December 31, 2016

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

|   | December 31,<br>2016 | December 31,<br>2015 |
|---|----------------------|----------------------|
| <b>Assets and liabilities denominated in euro</b> |                      |                      |
| <b>Current assets</b>                             | <b>534</b>           | <b>3,096</b>         |
| Receivables                                       | 353                  | 1,939                |
| Cash and cash equivalents                         | 181                  | 1,157                |
| <b>Non-current liabilities</b>                    | <b>(38)</b>          | <b>(97)</b>          |
| Long-term loans and borrowings                    | (38)                 | (64)                 |
| Long-term finance lease liability                 |                      | (33)                 |
| <b>Current liabilities</b>                        | <b>(23,766)</b>      | <b>(30,705)</b>      |
| Short-term loans and borrowings                   | (22,817)             | (28,544)             |
| Short-term payables                               | (838)                | (1,936)              |
| Short-term finance lease liability                | (111)                | (225)                |
|   | <b>December 31,</b>  | <b>December 31,</b>  |
| <b>Currency exchange rates</b>                    | <b>2016</b>          | <b>2015</b>          |
| U.S. dollar                                       | 60.6569              | 72.8827              |
| Euro  | 63.8111              | 79.6972              |

*Sensitivity analysis*

The table below demonstrates the Group's sensitivity to a devaluation of the Russian ruble against U.S. dollar and euro which management believes is an appropriate measure in the current market conditions and which would impact its operations:

|      | Change in<br>U.S. dollar to<br>Russian ruble<br>exchange<br>rate | Effect on profit<br>before tax | Change in<br>Euro to<br>Russian ruble<br>exchange<br>rate | Effect on profit<br>before tax |
|------|--|--------------------------------|---|--------------------------------|
| 2014 |  |                                |   |                                |
|      | +30%   | 68,671                         | +30%  | 7,070                          |
|      | -30%   | (68,671)                       | -30%  | (7,070)                        |
| 2015 |  |                                |   |                                |
|      | +40%   | 119,557                        | +40%  | 11,082                         |
|      | -15%   | (44,834)                       | -15%  | (4,156)                        |
| 2016 |  |                                |   |                                |
|      | +20%   | 24,811                         | +20%  | 4,654                          |

|  |      |          |      |         |
|--|------|----------|------|---------|
|  | -20% | (24,811) | -20% | (4,654) |
|--|------|----------|------|---------|

*Interest rate risk*

Interest rate risk is the risk that changes in floating interest rates will adversely impact the financial results of the Group. As of December 31, 2016 and 2015, the shares of the borrowings with floating rates in the total amount of the borrowings were 91% (incl. Mosprime 0.1%, key rate of the Central Bank of Russia 62%, LIBOR, EURIBOR and others 29%) and 53% (incl. Mosprime 0.2%, key rate of the Central Bank of Russia 14%, LIBOR, EURIBOR and others 39%), respectively.

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The table below demonstrates the Group's sensitivity to change of floating rates.

|             | <b>Increase/<br/>decrease in<br/>MosPrime and<br/>Central<br/>Bank<br/>of Russia<br/>rate<br/>(%)</b> | <b>Effect on profit<br/>before tax</b> | <b>Increase/<br/>decrease in<br/>LIBOR (%)</b> | <b>Effect on profit<br/>before<br/>tax</b> | <b>Increase/<br/>decrease in<br/>EURIBOR (%)</b> | <b>Effect on profit<br/>before<br/>tax</b> |
|-------------|---|--|--|--|--|--|
| <b>2014</b> |   |  |  |  |  |  |
|             | +9.32%  | 4,395                                  | +0.02%   | 12   | +0.07%   | 13   |
|             | -9.32%  | (4,395)                                | -0.02%   | (12)                                       | -0.07%   | (13)                                       |
| <b>2015</b> |   |  |  |  |  |  |
|             | +6%   | 3,312                                  | +0.5%  | 662  | +0.25%   | 62   |
|             | -5%   | (2,760)                                | -0.12%   | (159)                                      | -0.25%   | (62)                                       |
| <b>2016</b> |   |  |  |  |  |  |
|             | +2%   | 4,943                                  | +0.6%  | 736  | +0.12%   | 28   |
|             | -4%   | (9,887)                                | -0.08%   | (98)                                       | -0.08%   | (19)                                       |

**10.3 Other current financial assets**

In November 2011, the owners of the former Estar metallurgical plants and the Group entered into a loan agreement pursuant to which a loan of \$944,530 thousand (RUB 28,433 million at exchange rate as of November 10, 2011) was granted by the Group. The loan consists of several tranches which bear interest at the range of 1-8.5% p.a. To secure the loan, shares in the major former Estar metallurgical plants (or shares in parent companies of such metallurgical plants) were pledged. The proceeds from this loan were used by the former Estar metallurgical plants to repay most of the accounts receivable owed to the Group. According to the loan agreement, in the event that the loan is not repaid at maturity (September 30, 2012), the Group was entitled to enforce the pledge over the pledged former Estar metallurgical plants assets and thereby take control of these assets subject to approval from the Russian Federal Antimonopoly Service.

In September 2012, the Group extended the term of the loan for additional nine months from October 1, 2012, the pledges and guarantees remained the same. From September through December 2012, the loan was partially repaid in the amount of \$213,360 thousand (RUB 6,654 million at the average rate for the period from September till December 2012). To make this repayment, the owners of the former Estar metallurgical plants used the proceeds received by them from the Group for the sale of Cognor and proceeds under a security deposit, as discussed further below. During

the year ended December 31, 2013, \$5,000 thousand (RUB 154 million at exchange rate as of March 19, 2013) were repaid and the owners of the former Estar metallurgical plants returned the security deposit paid by the Group in the end of 2012 for the acquisition of some assets pledged under the loan agreement.

The Group evaluates the recoverability of the loan amount based on the fair value of the pledged assets which, as of December 31, 2016, 2015 and 2014, was RUB nil. This resulted in a \$830,288 thousand (RUB 50,320 million at exchange rate as of December 31, 2016), \$830,421 thousand (RUB 60,620 million at exchange rate as of December 31, 2015) and \$832,013 thousand (RUB 46,742 million at exchange rate as of December 31, 2014) provision for doubtful accounts under this loan as of December 31, 2016, 2015 and 2014, respectively. The Group has not taken possession of assets provided as collateral because these entities are under the bankruptcy procedure and burdened with substantial amount of debt.

**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)***10.4 Other non-current financial liabilities**

As of December 31, 2016, the Group recognized other non-current financial liabilities under the put option of Gazprombank (see Note 6) in the amount of RUB 36,198 million (estimated at present value of the consideration to be transferred upon the exercise of the put option discounted at an interest rate of 12%). The respective finance cost was recognized in the consolidated statement of profit (loss) and other comprehensive income (loss) (Note 26.5).

**11. Cash and cash equivalents**

|  | December 31,<br>2016 | December 31,<br>2015 |
|--|----------------------|----------------------|
| <b>Cash and cash equivalents from continuing operations:</b> |                      |                      |
| Cash on hand   | 8                    | 8                    |
| Cash at banks, including                                     |                      |                      |
| in Russian rubles  | 683                  | 628                  |
| in U.S. dollars  | 482                  | 1,150                |
| in euro  | 404                  | 1,157                |
| in other currencies  | 109                  | 135                  |
| Other cash and cash equivalents                              | 3                    | 1                    |
| <b>Total cash and cash equivalents</b>                       | <b>1,689</b>         | <b>3,079</b>         |

For the purpose of the statement of cash flows, bank overdrafts are deducted from cash and cash equivalents in the amount of RUB 236 million and RUB 2,188 million as of December 31, 2016 and 2015, respectively.

As of December 31, 2016 and 2015, the Group did not have any short-term deposits with original maturities of less than 90 days.

As of December 31, 2016 and 2015, the amount of RUB 24 million and RUB 62 million, respectively, was restricted for use by regulatory requirements.

As of December 31, 2016 and 2015, the Group had available RUB 373 million and RUB 409 million, respectively, of undrawn committed borrowing facilities.

**12. Trade and other receivables**



|  | <b>December 31,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--|------------------------------|------------------------------|
| Trade receivables, including             | 24,325                       | 26,895                       |
| domestic customers                       | 20,436                       | 22,342                       |
| foreign customers                        | 3,889                        | 4,553                        |
| Other receivables*                       | 28,670                       | 29,336                       |
| <b>Total trade and other receivables</b> | <b>52,995</b>                | <b>56,231</b>                |
| Less allowance for doubtful accounts*    | (33,941)                     | (40,218)                     |
| <b>Total accounts receivable, net</b>    | <b>19,054</b>                | <b>16,013</b>                |

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As of December 31, 2016 and 2015, the ageing analysis of trade receivables were as follows:

|   | <b>December 31,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---|------------------------------|------------------------------|
| <b>Total receivables</b>                | <b>52,995</b>                | <b>56,231</b>                |
| <b>Past due but not impaired</b>        |                              |                              |
| <30 days                                | 2,739                        | 2,338                        |
| 30-60 days                              | 528                          | 661                          |
| 61-90 days                              | 201                          | 241                          |
| 91-180 days                             | 476                          | 248                          |
| 181-365 days                            | 362                          | 327                          |
| >1 year                                 | 183                          | 615                          |
| <b>Total past due, but not impaired</b> | <b>4,489</b>                 | <b>4,430</b>                 |

Receivables that were past due but not impaired amounted to RUB 4,489 million and RUB 4,430 million as of December 31, 2016 and 2015, respectively. Based on past experience, management believes that no allowance is necessary in respect of receivables that were past due but not impaired as there has not been a significant change in credit quality and the balances are still considered fully recoverable. The Group does not hold any collateral over these balances.

The movements in the allowance for doubtful accounts on trade and other receivables were as follows:

|  |                 |
|--|-----------------|
|  | <b>Total</b>    |
| <b>At January 1, 2014</b>                              | <b>(27,362)</b> |
| Charge for the year                                    | (3,203)         |
| Utilised/unused amounts reversed                       |                 |
| Disposal of subsidiaries                               | 153             |
| Reclassified in assets of disposal group held for sale | 9               |
| Exchange rate difference                               | (8,479)         |
| <b>At December 31, 2014</b>                            | <b>(38,882)</b> |
| Charge for the year                                    | (1,152)         |
| Utilised/unused amounts reversed                       | 261             |

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|  |                 |
|--|-----------------|
| Disposal of subsidiaries                               | 10              |
| Reclassified in assets of disposal group held for sale | 25              |
| Exchange rate difference                               | (480)           |
| <b>At December 31, 2015</b>                            | <b>(40,218)</b> |
| Charge for the year                                    | (613)           |
| Utilised/unused amounts reversed                       | 6,637           |
| Reclassified in assets of disposal group held for sale | 11              |
| Exchange rate difference                               | 242             |
| <b>At December 31, 2016</b>                            | <b>(33,941)</b> |

As of December 31, 2016, 2015 and 2014, receivables from related parties in the amount of RUB 24,539 million, RUB 24,035 million and RUB 24,254 million, respectively, are included into Other receivables. The amounts are fully covered by the allowance (Note 13(b)).

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## MECHEL PAO

## Notes to the consolidated financial statements for the year ended December 31, 2016

*(All amounts are in millions of Russian rubles, unless stated otherwise)***13. Related party disclosures**

Note 1 provides information about the Group's structure, including details of the subsidiaries and the holding company. The following table provides the total amount of transactions that have been entered into with the related parties in 2016, 2015 and 2014.

|   | 2016       |            |                        | 2015       |            |                        | 2014       |            |                        |
|---|------------|------------|------------------------|------------|------------|------------------------|------------|------------|------------------------|
|   | Purchases  | Sales      | Other loss<br>(income) | Purchases  | Sales      | Other loss<br>(income) | Purchases  | Sales      | Other loss<br>(income) |
| Associates  | 200        | 117        | (11)                   | 199        | 80         | 28                     | 284        | 91         | (2)                    |
| Controlling shareholders and entities under control of the Group's Controlling shareholders | 278        | 45         | 41                     | 261        | 37         | (23)                   | 94         | 25         | 133                    |
| <b>Total</b>  | <b>478</b> | <b>162</b> | <b>30</b>              | <b>460</b> | <b>117</b> | <b>5</b>               | <b>378</b> | <b>116</b> | <b>131</b>             |

As of December 31, 2016 and 2015, the Group had the following balances in settlement with related parties:

|   | December 31, 2016   |                |                              | December 31, 2015   |                |                              |
|---|---------------------|----------------|------------------------------|---------------------|----------------|------------------------------|
|   | Receivables<br>from | Payables<br>to | Total<br>outstanding,<br>net | Receivables<br>from | Payables<br>to | Total<br>outstanding,<br>net |
| Associates  | 33                  | (55)           | (22)                         | 8                   | (50)           | (42)                         |
| Controlling shareholders and entities under control of the Group's Controlling shareholders | 70                  | (37)           | 33                           | 88                  | (28)           | 60                           |
| <b>Total</b>  | <b>103</b>          | <b>(92)</b>    | <b>11</b>                    | <b>96</b>           | <b>(78)</b>    | <b>18</b>                    |

**(a) Transactions with the associates**

The Group's associates provide to the Group's subsidiaries transportation and auto repair services. During the years ended December 31, 2016, 2015 and 2014, the Group purchased from its associates transportation services in the amount of RUB 114 million, RUB 105 million and RUB 166 million, respectively, and repair services in the amount of RUB 86 million, RUB 94 million and RUB 86 million, respectively.

**(b) Controlling shareholders and entities under control of the Group s Controlling shareholders**

As of December 31, 2016 and 2015, the amounts of accounts receivable fully covered by the allowance included amounts receivable of RUB 24,539 million and RUB 24,035 million, respectively, described below. In December 2013, the Group, related party (an entity wholly owned by the Controlling Shareholder) and the former Estar metallurgical plants signed an assignment agreement. Under that agreement, the Group assigned to its related party the right to collect amounts due from the former Estar metallurgical plants, and the related party is to repay this amount to the Group through November 2017.

The outstanding cash balance in Coalmetsbank was RUB 200 million and RUB 1,580 million as of December 31, 2016 and December 31, 2015, respectively.

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

**(c) Compensation to key management personnel**

The total compensation to key management personnel was included in general and administrative expenses in the consolidated statement of profit (loss) and other comprehensive income (loss) and consisted of the short-term employee benefits in the amount of RUB 543 million, RUB 481 million and RUB 291 in the years ended December 31, 2016, 2015 and 2014, respectively. There are no share-based payments to key management personnel. The Group's directors and executive officers are also provided with voluntary medical insurance and the use of wireless services.

**14. Inventories**

|  | <b>December 31, 2016</b> | <b>December 31, 2015</b> |
|--|--------------------------|--------------------------|
| Raw materials  | 13,666                   | 11,496                   |
| Work in progress   | 5,654                    | 5,769                    |
| Finished goods and goods for resale                                    | 15,907                   | 17,924                   |
| <b>Total inventories at the lower of cost and net realizable value</b> | <b>35,227</b>            | <b>35,189</b>            |

During 2016, RUB 364 million (2015: RUB 1,003 million, 2014: RUB 1,360 million) was recognised as an expense within cost of goods sold for inventories carried at net realisable value. The amount of inventories recognised as an expense during the period was RUB 95,019 million for 2016 (2015: RUB 100,577 million, 2014: RUB 99,934 million).

**15. Other current and non-current assets**

|   | <b>December 31, 2016</b> | <b>December 31, 2015</b> |
|---|--------------------------|--------------------------|
| <b>Other current assets</b>                       |                          |                          |
| Prepayments and advances                          | 3,873                    | 3,545                    |
| Input VAT and other taxes recoverable             | 3,000                    | 2,976                    |
| Other current assets                              | 69                       | 1,670                    |
| <b>Total prepayments and other current assets</b> | <b>6,942</b>             | <b>8,191</b>             |

|   | December 31, 2016 | December 31, 2015 |
|---|-------------------|-------------------|
| <b>Other non-current assets</b>           |                   |                   |
| Deferred assets from sale and lease back  | 306               | 339               |
| Advance payment to non state pension fund |                   | 462               |
| Other non-current assets                  | 585               | 442               |
| <b>Total other non-current assets</b>     | <b>891</b>        | <b>1,243</b>      |

The other current assets as of December 31, 2015 reflect the upfront fee in the amount of RUB 1,411 million paid in 2014 to VEB for the opening of the credit line. As of December 31, 2016, the provision for the VEB's commission was recorded due to uncertainty in further financing.

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

Generally in Russia, VAT related to sales is payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred on purchases may be reclaimed, subject to certain restrictions, against VAT related to sales.

As of December 31, 2015, advance payment to non state pension fund (Mechel Fund) of RUB 462 million was made by Yakutugol based on terms of the agreed pension benefit program. On June 1, 2016, the advance payment in the amount of RUB 408 million was fully provided for due to revocation of the fund's license by the Central Bank and existing uncertainty of its recoverability (Note 23).

Provision for advances issued of RUB 185 million, RUB 355 million and RUB 595 million was included in Allowance for doubtful accounts in the consolidated statement of profit (loss) and other comprehensive income (loss) for the years ended December 31, 2016, 2015 and 2014.

**16. Discontinued operations****BCG Companies**

In December 2014, the Group entered into an agreement with a third party to sell 100% of the shares of the BCG Companies. The binding agreement was signed on February 12, 2015. The total consideration for the sale of the BCG Companies under the shares sale agreement consists of: (1) an immediate cash payment of \$5,000 thousand (RUB 330 million at exchange rate of 66.0585 RUB/USD as of February 12, 2015); (2) future royalty payments on coal mined and sold in the amount of 3.00 U.S. dollars (RUB 198.2 at exchange rate of 66.0585 RUB/USD as of February 12, 2015) per short ton, capped at \$150,000 thousand (RUB 9,909 million at exchange rate of 66.0585 RUB/USD as of February 12, 2015); (3) a portion of a sale price in case of any future sale of the BCG Companies and/or its assets, amounting to 12.5% or 10% of the total consideration if the sale transaction closed within, respectively, five or ten years of the sale to the buyer. The fair value of future royalty payments and portion of selling price in case of future resale of the BCG Companies was assessed by the Group as RUB nil at the date of sale.

During 2016, the Group received royalty payments on coal mined and sold in the amount of \$1.8 million (RUB 121 million at the year average exchange rate of 67.04 RUB/USD) (Note 26.6).

The contingent consideration arising upon the acquisition of the BCG Companies of \$29,936 thousand (RUB 1,681 million at exchange rate as of December 31, 2014 and RUB 1,977 million at exchange rate of 66.0585 RUB/USD as of February 12, 2015), which depends on the results of additional geological researches of reserves (Drilling Program), was released on the date of transfer of shares of February 12, 2015. The Group incurred expenses of \$3,415 thousand (RUB 226 million at exchange rate of 66.0585 RUB/USD as of February 12, 2015) related to consulting services from third party banks in connection with the sale. The disposal of the BCG Companies is aligned with the revised strategy aimed at restructuring the Group's assets and development of its core businesses.



The results of operations of BCG Companies are included in the consolidated financial statements as discontinued operations for the period ended December 31, 2014.

Following the classification of the BCG Companies as held for sale, the fair value less costs to sell of net assets was determined in accordance with requirements of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. As a result, the impairment loss of RUB 11,653 million was recognised as a loss on discontinued operations for the year ended December 31, 2014 (including RUB 669 million related to Property, plant and equipment and RUB 10,934 million related to Mineral licenses and RUB 50 million related to other assets).

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**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

The results of the BCG Companies presented as discontinued operations in the consolidated statements of profit (loss) and other comprehensive income (loss) were as follows:

|  | <b>2015</b> | <b>2014</b>     |
|--|-------------|-----------------|
| Revenue  |             | 389             |
| Cost of goods sold   |             | (629)           |
| <b>Gross profit</b>  |             | <b>(240)</b>    |
| Selling and distribution expenses  |             | (10)            |
| Administrative and other operation expenses  |             | (864)           |
| Other operating income   |             | (207)           |
| Finance costs  |             | (146)           |
| Total other income (expense), net  | (34)        | 64              |
| Impairment loss recognised on the remeasurement to fair value less costs to sell         |             | (11,653)        |
| <b>Loss before tax from discontinued operations</b>                                      | <b>(34)</b> | <b>(13,056)</b> |
| <b>Tax benefit</b>   |             |                 |
| Related to current pre-tax profit (loss)   |             | (85)            |
| Transfer of cumulative translation adjustment due to disposal of discontinued operations | 798         |                 |
| <b>Profit (loss) for the year from discontinued operations</b>                           | <b>764</b>  | <b>(13,141)</b> |

The major classes of assets and liabilities of the BCG Companies classified as held for sale were as follows:

|                               | <b>At February 12, 2015</b> | <b>At December 31, 2014</b> |
|-------------------------------|-----------------------------|-----------------------------|
| <b>Assets</b>                 |                             |                             |
| Cash and cash equivalents     |                             | 91                          |
| Trade and other receivables   | 139                         | 118                         |
| Other current assets          | 251                         | 212                         |
| Other non-current assets      | 2,263                       | 1,919                       |
| Property, plant and equipment | 428                         | 363                         |
| Mineral licenses              | 7,065                       | 5,993                       |

|  |               |              |
|--|---------------|--------------|
| <b>Assets of disposal group<br/>classified as held for sale</b>      | <b>10,146</b> | <b>8,696</b> |
| <b>Liabilities</b>   |               |              |
| Trade and other payables   | 2,297         | 2,026        |
| Provisions   | 845           | 716          |
| Pension obligations  | 3,650         | 3,097        |
| Interest-bearing loans and<br>borrowings                             | 727           | 617          |
| Other non-current liabilities  | 555           | 470          |
| <b>Liabilities of disposal group<br/>classified as held for sale</b> | <b>8,074</b>  | <b>6,926</b> |
| <b>Net assets directly associated<br/>with disposal group</b>        | <b>2,072</b>  | <b>1,770</b> |

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**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

The net cash flows incurred by the BCG Companies were as follows:

|                         | <b>For the period from<br/>January 1 till<br/>February 12,<br/>2015</b> | <b>For the year ended<br/>December 31, 2014</b> |
|-------------------------|---|---|
| Operating               | (91)  | (738)   |
| Investing               |   | (17)  |
| Financing               |   | (105)   |
| <b>Net cash outflow</b> | <b>(91)</b>   | <b>(860)</b>                                    |

**SUNP**

On 25 May 2013, according to the decision on the closure of the plant the Group approved the plan of staff curtailment. The number of SUNP's personnel was reduced to 274 workers as of January 1, 2014. As of December 31, 2014, the number of personnel increased to 315 workers due to cease of third parties security services and redirection of these functions to SUNP's internal employees as part of the Group's efforts to reduce SUNP's costs.

The impairment of property, plant and equipment and nickel mineral license of RUB 2,600 million as of January 1, 2014 was recognised to reduce the carrying amount of the assets and liabilities of SUNP to their realizable value. The impairment of goodwill in the amount of RUB 184 million was recognised as of January 1, 2014.

Starting the fourth quarter of 2016, the Group stopped liquidation activities on SUNP and the company was involved into operations other than ferronickel production, its current income and expenses, gains and losses are not significant to the Group. The Group presents the results of SUNP as discontinued operations in the consolidated statement of profit (loss) and other comprehensive income (loss) for the nine months ended September 30, 2016 and as continued operations starting the fourth quarter of 2016.

The results of SUNP presented as discontinued operations in the consolidated statement of profit (loss) and other comprehensive income (loss) were as follows for the periods ended:

|                    | <b>December 31,<br/>2016</b> | <b>December 31,<br/>2015</b> | <b>December 31,<br/>2014</b> |
|--------------------|------------------------------|------------------------------|------------------------------|
| Revenue            | 53                           | 69                           | 66                           |
| Cost of goods sold | (49)                         | (51)                         | (45)                         |

|   |              |           |              |
|---|--------------|-----------|--------------|
| <b>Gross profit</b>   | <b>4</b>     | <b>18</b> | <b>21</b>    |
| Selling and distribution expenses                                   |              |           | (1)          |
| Administrative and other operating expenses                         | (73)         | (115)     | (133)        |
| Other operating (expenses)/income                                   | (102)        | 31        | 296          |
| Finance costs   | (15)         | (30)      | (32)         |
| Other (expenses)/income   | (240)        | 154       | 1,288        |
| <b>(Loss) profit for the year from discontinued operations, net</b> | <b>(426)</b> | <b>58</b> | <b>1,439</b> |

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**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)***17. Property, plant and equipment**

|  | Land construction | Buildings and<br>operating<br>machinery<br>equipment | Transportation<br>vehicles | Other<br>equipment | Construction-<br>in-progress | Mining<br>plant<br>equipment | Railway<br>Ulak-Elga | Total          |
|--|-------------------|--|----------------------------|--------------------|------------------------------|------------------------------|----------------------|----------------|
| <b>Cost</b>  |                   |  |                            |                    |                              |                              |                      |                |
| <b>At January 1,<br/>2014</b>  | <b>3,210</b>      | <b>64,226</b>  | <b>107,481</b>             | <b>29,810</b>      | <b>1,331</b>                 | <b>109,730</b>               | <b>15,193</b>        | <b>330,981</b> |
| Additions  |                   | 786  | 2,467                      | 137                | 13                           | 19,794                       | 488                  | 23,685         |
| Assets of<br>disposal group<br>held for sale /<br>discontinued<br>operations | (130)             | (99)   | (13,496)                   | (254)              | (33)                         | (93)                         | (1,579)              | (15,684)       |
| Change in<br>rehabilitation<br>provision                                     |                   | (225)  |                            |                    |                              |                              | (496)                | (721)          |
| Transfers  | 3                 | 8,249  | 15,523                     | 1,814              | 49                           | (25,627)                     | (11)                 |                |
| Disposals  | (318)             | (1,205)  | (3,192)                    | (705)              | (203)                        | (1,308)                      | (129)                | (7,060)        |
| Exchange<br>differences  | 357               | 1,845  | 6,159                      | 100                | 142                          | 42                           | 643                  | 9,288          |
| <b>At<br/>December 31,<br/>2014</b>  | <b>3,122</b>      | <b>73,577</b>  | <b>114,942</b>             | <b>30,902</b>      | <b>1,299</b>                 | <b>102,538</b>               | <b>14,109</b>        | <b>340,489</b> |
| Additions  |                   | 417  | 1,052                      | 508                | 29                           | 4,249                        | 719                  | 6,974          |
| Change in<br>rehabilitation<br>provision                                     |                   | 49   |                            |                    |                              |                              | 232                  | 281            |
| Transfers  | 59                | 4,886  | 1,607                      | 171                | 24                           | (78,565)                     | 14                   | 71,804         |
| Disposals  | (10)              | (474)  | (3,196)                    | (1,170)            | (156)                        | (1,378)                      | (156)                | (6,540)        |
| Exchange<br>differences  | 142               | (190)  | (174)                      | (12)               | 40                           | (8)                          |                      | (202)          |
| <b>At<br/>December 31,<br/>2015</b>  | <b>3,313</b>      | <b>78,265</b>  | <b>114,231</b>             | <b>30,399</b>      | <b>1,236</b>                 | <b>26,836</b>                | <b>14,918</b>        | <b>341,002</b> |
| Additions  |                   | 504  | 1,428                      | 549                | 25                           | 5,027                        | 542                  | 8,075          |

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|                                    |              |               |                |               |            |               |               |               |                |
|------------------------------------|--------------|---------------|----------------|---------------|------------|---------------|---------------|---------------|----------------|
| Change in rehabilitation provision |              | 346           |                |               |            |               | (212)         |               | 134            |
| Transfers                          | 1            | 2,435         | 2,610          | 180           | (209)      | (8,393)       | 389           | 2,987         |                |
| Disposals                          | (75)         | (3,050)       | (3,266)        | (1,717)       | (169)      | (2,330)       | (536)         |               | (11,143)       |
| Exchange differences               | (190)        | (841)         | (675)          | (120)         | (61)       | (6)           | (1)           |               | (1,894)        |
| <b>At December 31, 2016</b>        | <b>3,049</b> | <b>77,659</b> | <b>114,328</b> | <b>29,291</b> | <b>822</b> | <b>21,134</b> | <b>15,100</b> | <b>74,791</b> | <b>336,174</b> |

**Depreciation and impairment**

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|  | Land         | Buildings and<br>construction | Operating<br>machinery<br>and equipment | Transportation<br>vehicles | Other<br>equipment | Construction-<br>in-progress | Mining<br>plant<br>and<br>equipment | Railway<br>Ulak-Elga | Total            |
|--|--------------|-------------------------------|---|----------------------------|--------------------|------------------------------|-------------------------------------|----------------------|------------------|
| <b>At January 1,<br/>2014</b>                | <b>(98)</b>  | <b>(24,141)</b>               | <b>(63,885)</b>                         | <b>(11,749)</b>            | <b>(903)</b>       | <b>(47)</b>                  | <b>(3,905)</b>                      |                      | <b>(104,728)</b> |
| Depreciation<br>charge                       |              | (4,593)                       | (7,693)                                 | (2,718)                    | (170)              |                              | (227)                               |                      | (15,401)         |
| Disposals                                    |              | 395                           | 2,650                                   | 565                        | 186                |                              | 126                                 |                      | 3,922            |
| Assets of<br>disposal group<br>held for sale | 109          | 88                            | 12,756                                  | 245                        | 28                 | 81                           | 1,345                               |                      | 14,652           |
| Impairment                                   | (124)        | (2,414)                       | (5,345)                                 | (82)                       | (15)               | (16)                         |                                     |                      | (7,996)          |
| Exchange<br>differences                      | (17)         | (245)                         | (5,605)                                 | (69)                       | (105)              | (35)                         | (563)                               |                      | (6,639)          |
| <b>At<br/>December 31,<br/>2014</b>          | <b>(130)</b> | <b>(30,910)</b>               | <b>(67,122)</b>                         | <b>(13,808)</b>            | <b>(979)</b>       | <b>(17)</b>                  | <b>(3,224)</b>                      |                      | <b>(116,190)</b> |
| Depreciation<br>charge                       |              | (5,008)                       | (5,627)                                 | (2,745)                    | (56)               |                              | (218)                               | (334)                | (13,988)         |
| Disposals                                    | 9            | 396                           | 2,619                                   | 1,092                      | 146                | 16                           | 54                                  |                      | 4,332            |
| Reversal of<br>impairment/<br>(impairment)   | 67           | (485)                         | 1,331                                   | 6                          | (4)                | (931)                        |                                     |                      | (16)             |
| Exchange<br>differences                      | (5)          | 430                           | 280                                     | 39                         | (40)               |                              |                                     |                      | 704              |
| <b>At<br/>December 31,<br/>2015</b>          | <b>(59)</b>  | <b>(35,577)</b>               | <b>(68,519)</b>                         | <b>(15,416)</b>            | <b>(933)</b>       | <b>(932)</b>                 | <b>(3,388)</b>                      | <b>(334)</b>         | <b>(125,158)</b> |
| Depreciation<br>charge                       |              | (3,774)                       | (7,760)                                 | (2,613)                    | (50)               |                              | (133)                               | (247)                | (14,577)         |
| Disposals                                    |              | 3,160                         | 3,045                                   | 1,272                      | 198                | 238                          | 437                                 |                      | 8,350            |
| Impairment                                   | (224)        | (260)                         | (215)                                   | (98)                       |                    | (887)                        | (16)                                |                      | (1,700)          |
| Exchange<br>differences                      | 32           | 546                           | 550                                     | 86                         | 52                 | (1)                          | (1)                                 |                      | 1,264            |
| <b>At<br/>December 31,</b>                   | <b>(251)</b> | <b>(35,905)</b>               | <b>(72,899)</b>                         | <b>(16,769)</b>            | <b>(733)</b>       | <b>(1,582)</b>               | <b>(3,101)</b>                      | <b>(581)</b>         | <b>(131,821)</b> |



**2016****Net book value**

|                               |              |               |               |               |            |                |               |  |                |
|-------------------------------|--------------|---------------|---------------|---------------|------------|----------------|---------------|--|----------------|
| <b>At January 1,<br/>2014</b> | <b>3,112</b> | <b>40,085</b> | <b>43,596</b> | <b>18,061</b> | <b>428</b> | <b>109,683</b> | <b>11,288</b> |  | <b>226,253</b> |
|-------------------------------|--------------|---------------|---------------|---------------|------------|----------------|---------------|--|----------------|

|                                     |              |               |               |               |            |                |               |  |                |
|-------------------------------------|--------------|---------------|---------------|---------------|------------|----------------|---------------|--|----------------|
| <b>At<br/>December 31,<br/>2014</b> | <b>2,992</b> | <b>42,667</b> | <b>47,820</b> | <b>17,094</b> | <b>320</b> | <b>102,521</b> | <b>10,885</b> |  | <b>224,299</b> |
|-------------------------------------|--------------|---------------|---------------|---------------|------------|----------------|---------------|--|----------------|

|                                     |              |               |               |               |            |               |               |               |                |
|-------------------------------------|--------------|---------------|---------------|---------------|------------|---------------|---------------|---------------|----------------|
| <b>At<br/>December 31,<br/>2015</b> | <b>3,254</b> | <b>42,688</b> | <b>45,712</b> | <b>14,983</b> | <b>303</b> | <b>25,904</b> | <b>11,530</b> | <b>71,470</b> | <b>215,844</b> |
|-------------------------------------|--------------|---------------|---------------|---------------|------------|---------------|---------------|---------------|----------------|

|                                     |              |               |               |               |           |               |               |               |                |
|-------------------------------------|--------------|---------------|---------------|---------------|-----------|---------------|---------------|---------------|----------------|
| <b>At<br/>December 31,<br/>2016</b> | <b>2,798</b> | <b>41,754</b> | <b>41,429</b> | <b>12,522</b> | <b>89</b> | <b>19,552</b> | <b>11,999</b> | <b>74,210</b> | <b>204,353</b> |
|-------------------------------------|--------------|---------------|---------------|---------------|-----------|---------------|---------------|---------------|----------------|

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According to the results of the impairment analysis of non-current assets, impairment losses of RUB 1,700 million, RUB 16 million and RUB 7,996 million were recognized by the Group for the years ended December 31, 2016, 2015 and 2014, respectively (Note 18).

**Assets under construction**

As of December 31, 2016 and 2015, construction-in-progress included advances issued for acquisition of property, plant and equipment in the amounts of RUB 430 million and RUB 544 million, respectively.

In 2015, the Group transferred the railway from the Elga coal deposit to Ulak station from Construction-in-progress in the amount of RUB 71,804 million, put it into exploitation and commenced its depreciation.

**Property pledged to the bank as security**

Certain property, plant and equipment have been pledged to secure bank loans and borrowings granted to the Group:

|                | <b>December 31,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|----------------|------------------------------|------------------------------|
| Net book value | 117,047                      | 33,510                       |

**Finance leases**

The Group leases machinery and equipment and transport under a number of finance lease agreements. At the end of the term of the lease, the Group obtains ownership of the assets or has an option to purchase leased assets at a redemption price.

|  | <b>December 31,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--|------------------------------|------------------------------|
| Net book value operating machinery and equipment | 2,825                        | 4,253                        |
| Net book value transportation vehicles           | 9,265                        | 12,332                       |

Additions of machinery and equipment and transport under finance lease during the year ended December 31, 2016 amounted to RUB 386 million.

**Capitalised borrowing costs**

The amount of borrowing costs capitalised during the year ended December 31, 2016 was RUB 1,015 million (2015: RUB 1,954 million, 2014: RUB 9,254 million). The rate used to determine the amount of borrowing costs eligible for capitalisation was 10.28% (2015: 15.02%, 2014: 12.04%), which is the average rate of the borrowings.

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

**18. Impairment of goodwill and other non-current assets**

As of December 31, 2016 and 2015, the Group performed an impairment analysis of goodwill and other non-current assets on the level of cash generating units (CGU). For each CGU the Group considers the relationship between market capitalization and its book value, among other factors, when reviewing for indicators of impairment. Goodwill acquired through business combinations has been allocated to CGUs for impairment testing as follows (before impairment write-downs):

| <b>Cash generating units</b>    | <b>Segment</b> | <b>Goodwill</b>          |                          |
|---------------------------------|----------------|--------------------------|--------------------------|
|                                 |                | <b>December 31, 2016</b> | <b>December 31, 2015</b> |
| Yakutugol                       | Mining         | 13,399                   | 13,399                   |
| Bratsk Ferroalloy Plant         | Steel          | 2,930                    | 2,930                    |
| Southern Kuzbass Power Plant    | Power          | 2,382                    | 3,827                    |
| Kuzbass Power Sales Company     | Power          | 1,026                    | 1,026                    |
| Port Posiet                     | Mining         | 756                      | 756                      |
| Chelyabinsk Metallurgical Plant | Steel          | 580                      | 672                      |
| Southern Kuzbass Coal Company   | Mining         | 143                      | 143                      |
| Mechel Temryuk                  | Mining         | 69                       | 69                       |
| <b>Total</b>                    |                | <b>21,285</b>            | <b>22,822</b>            |

As of December 31, 2016 and 2015, the recoverable amount of CGUs was determined based on value in use. The material assumptions that drive the value in use are represented by projected prices, sales volumes, discount rates. Some of these assumptions materially deviate from the Group's historical results primarily due to the market downturns and economic slowdowns in the recent years in Russia. All these material assumptions are based on the Group's projections and are subject to risk and uncertainty.

The forecasted period for non-mining subsidiaries of the Group was assumed to be five years to reach stabilized cash flows. As of December 31, 2016 the value beyond the forecasted period was based on the terminal growth rates of 2%-4%. For mining subsidiaries of the Group the forecasted period was based on the remaining life of the mines.

Discount rates used in the impairment test for goodwill and non-current assets were estimated in nominal terms on the weighted average cost of capital basis. Inflation and discount rates, range of discount rates, estimated for each year for the forecasted period, were as follows:

| <b>For the year ended December 31, 2015</b> | <b>2016</b> | <b>Forecast period, years</b> |             |             |             |
|---|-------------|-------------------------------|-------------|-------------|-------------|
|   |             | <b>2017</b>                   | <b>2018</b> | <b>2019</b> | <b>2020</b> |

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|   |             |             |             |             |             |
|---|-------------|-------------|-------------|-------------|-------------|
| Inflation rate in Russia                    | 7.5%        | 5.6%        | 5.2%        | 4.6%        | 4.3%        |
| Inflation rate in Europeans countries       | 2.6%        | 2.6%        | 2.4%        | 2.3%        | 2.3%        |
| Discount rate, %                            | 8.5%-18.9%  | 8.5%-18.9%  | 8.5%-18.9%  | 8.5%-18.9%  | 8.5%-18.9%  |
| <b>For the year ended December 31, 2016</b> | <b>2017</b> | <b>2018</b> | <b>2019</b> | <b>2020</b> | <b>2021</b> |
| Inflation rate in Russia                    | 5.1%        | 4.0%        | 4.0%        | 4.0%        | 4.0%        |
| Inflation rate in Europeans countries       | 3.3%        | 3.1%        | 3.1%        | 3.1%        | 3.0%        |
| Discount rate, %                            | 8.9%-19.0%  | 8.9%-19.0%  | 8.9%-19.0%  | 8.9%-19.0%  | 8.9%-19.0%  |

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

For CGUs which cash flows relate to mineral assets, future cash flows include estimates of recoverable minerals that will be obtained from proved and probable reserves, mineral prices (considering current and historical prices, price trends and other related factors), production levels, capital and reclamation costs, all based on the life of mine models prepared by the Group's engineers. The Group believes that the values assigned to key assumptions and estimates represent the most realistic assessment of future trends.

**Impairment of goodwill**

According to the results of the impairment analysis of goodwill, an impairment loss as of December 31, 2016 was recognized in the following CGU:

|                               | <b>Impairment loss<br/>on goodwill at<br/>December 31,<br/>2016</b> |
|-------------------------------|---|
| <b>Cash generating units</b>  |   |
| Bratsk Ferroalloy Plant (BFP) | 2,930   |
| <b>Total</b>                  | <b>2,930</b>  |

Impairment of goodwill at BFP was recognized due to the changes in expectations of long-term prices for ferrosilicon and in forecasted production volumes accompanied by increased forecasted costs..

According to the results of the impairment analysis of goodwill, an impairment loss as of December 31, 2015 was recognised in the following CGUs:

|                                     | <b>Impairment loss<br/>on goodwill at<br/>December 31,<br/>2015</b> |
|-------------------------------------|---|
| <b>Cash generating units</b>        |   |
| Southern Kuzbass Power Plant (SKPP) | 1,444   |
| <b>Total</b>                        | <b>1,444</b>  |

Impairment of goodwill at Southern Kuzbass Power Plant (SKPP) was identified due to change in structure of raw materials and usage of steam coal instead of lean grade coal with low oxidation rate from SKCC. The remaining carrying value of the goodwill of SKPP was RUB 2,383 million as of December 31, 2015.

**Impairment of non-current assets**

According to the results of the impairment analysis, impairment of non-current assets was identified for the following CGUs as of December 31, 2016:

|                               | <b>Impairment loss<br/>on non-current<br/>assets identified as<br/>a result of<br/>impairment<br/>tests<br/>at<br/>December 31,<br/>2016</b> |
|-------------------------------|--|
| <b>Cash generating units</b>  |  |
| Bratsk Ferroalloy Plant (BFP) | 697  |
| Mechel Service Romania        | 203  |
| <b>Total</b>                  | <b>900</b>   |

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The carrying value of individual items of the assets for the respective entities was impaired due to inability to generate economic benefits:

|                                      | <b>Impairment loss<br/>on<br/>non-current<br/>assets<br/>identified<br/>for individual<br/>items of assets at<br/>December 31,<br/>2016</b> |
|--------------------------------------|---|
| <b>Subsidiaries</b>                  |   |
| Yakutugol                            | 572   |
| Port Temryuk                         | 389   |
| Southern Kuzbass Coal Company (SKCC) | 277   |
| Maritime Cargo Shipping.             | 98  |
| Cognor                               | 36  |
| <b>Total</b>                         | <b>1,372</b>  |

According to the results of the impairment analysis, impairment of non-current assets was identified for the following CGUs as of December 31, 2015:

|                              | <b>Impairment loss<br/>on<br/>non-current<br/>assets<br/>at<br/>December 31,<br/>2015</b> |
|------------------------------|---|
| <b>Cash generating units</b> |   |
| Mechel Materials             | 5,982   |
| <b>Total</b>                 | <b>5,982</b>  |

The carrying value of property, plant and equipment related to grinding mixing complex at Mechel Materials was written down to RUB nil as of December 31, 2015 due to unfavorable market conditions including decline in



production volume of construction industry, cut-off of subsidy in related industries and forecasts of slow market recovery in the future.

According to the results of the impairment analysis, reversal of previously recognised impairment loss of non-current assets was identified for the following CGUs as of December 31, 2015:

|                              | <b>Reversal of<br/>previously<br/>recognised<br/>impairment loss of<br/>non-current<br/>assets<br/>at<br/>December 31,<br/>2015</b> |
|------------------------------|---|
| <b>Cash generating units</b> |   |
| Izhstal                      | 5,966   |
| <b>Total</b>                 | <b>5,966</b>  |

Based on the comparison of carrying value and recoverable value of Izhstal, as of December 31, 2015, excess of recoverable value over its carrying value was identified; therefore reversal of previously recorded impairment loss as of December 31, 2014 was recognised in the amount of RUB 5,966 million due to optimization of product lines in favor of high value added long products and hardware and devaluation of ruble to U.S. dollar, which positively affected Izhstal's margin. The carrying value of property, plant and equipment of Izhstal after reversal of impairment loss was RUB 5,966 million as of December 31, 2015.

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**MECHEL PAO**

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**Sensitivity analysis**

Reasonably possible change in key assumptions used in calculations of value in use could impact recoverable amount which was most sensitive to the growth of discount rate, cash flows growth rates after the forecasted period and change in operational profit due to changes in sales and extraction volumes, sales prices and costs.

Based on the sensitivity analysis carried out as of December 31, 2016, a 5% decrease in future planned revenues would trigger impairment of goodwill of RUB 1,026 million, property, plant and equipment of RUB 644 million at KPSC, additional impairment of property, plant and equipment at BFP of RUB 1,363 million and impairment of property, plant and equipment of RUB 1,996 million at Izhstal.

For the cash-generating units, which were not impaired in the reporting period and for which the reasonably possible changes could lead to impairment, the recoverable amounts would become equal to their carrying amounts if the assumptions used to measure the recoverable amounts changed by the following percentages: decrease in sales prices by 3.7% at Izhstal, decrease in sales prices by 1.3% at KPSC.

The recoverable amounts of KPSC and Izhstal based on key assumptions exceed the carrying amounts by RUB 3,403 million and by RUB 5,405 million, respectively.

Effects of reasonably possible changes in other key assumptions used in recoverable amount of CGUs as of December 31, 2016 do not lead to excess of carrying value over recoverable value.

Based on the sensitivity analysis carried out as of December 31, 2015, a 1% decrease in cash flows growth rate after the forecasted future and a 1% increase in discount rate would trigger additional impairment of goodwill at SKPP in the amount of RUB 188 million and RUB 286 million, respectively. A 5% decrease in future planned revenues would trigger additional impairment of goodwill at SKPP of RUB 1,721 million, impairment of goodwill of RUB 1,026 million, property, plant and equipment of RUB 630 million at KPSC and property, plant and equipment of RUB 383 million at BFP and would allow to reverse RUB 5,732 million of previously recorded impairment of Izhstal which is less than the full reversal recorded by the Group by RUB 235 million.

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|  | <b>Goodwill</b> | <b>Mineral licenses</b> |
|--|-----------------|-------------------------|
| <b>Cost</b>  |                 |                         |
| <b>At January 1, 2014</b>  | <b>32,781</b>   | <b>126,680</b>          |
| Assets of disposal group held for sale / discontinued operations |                 | (122,002)               |
| Exchange differences   | 682             | 51,034                  |
| <b>At December 31, 2014</b>                                      | <b>33,463</b>   | <b>55,712</b>           |
| Additions  |                 | 71                      |
| Disposal   | (88)            |                         |
| Exchange differences   | (174)           |                         |
| <b>At December 31, 2015</b>                                      | <b>33,201</b>   | <b>55,783</b>           |
| Additions  |                 |                         |
| Disposal   |                 |                         |
| Exchange differences   | (2,286)         |                         |
| <b>At December 31, 2016</b>                                      | <b>30,915</b>   | <b>55,783</b>           |
| <b>Amortisation and impairment</b>                               |                 |                         |
| <b>At January 1, 2014</b>  | <b>(10,261)</b> | <b>(74,953)</b>         |
| Depletion  |                 | (1,759)                 |
| Assets of disposal group held for sale / discontinued operations |                 | 105,075                 |
| Exchange differences   | (505)           | (43,953)                |
| <b>At December 31, 2014</b>                                      | <b>(10,766)</b> | <b>(15,590)</b>         |
| Impairment   | (1,444)         |                         |
| Depletion  |                 | (1,676)                 |
| Disposal   | 88              |                         |
| Exchange differences   | 299             |                         |
| <b>At December 31, 2015</b>                                      | <b>(11,823)</b> | <b>(17,266)</b>         |
| Impairment   | (2,930)         | (572)                   |
| Depletion  |                 | (1,846)                 |

|                             |                 |                 |
|-----------------------------|-----------------|-----------------|
| Disposal                    |                 |                 |
| Exchange differences        | 2,193           |                 |
| <b>At December 31, 2016</b> | <b>(12,560)</b> | <b>(19,684)</b> |
| <b>Net book value</b>       |                 |                 |
| <b>At January 1, 2014</b>   | <b>22,520</b>   | <b>51,727</b>   |
| <b>At December 31, 2014</b> | <b>22,697</b>   | <b>40,122</b>   |
| <b>At December 31, 2015</b> | <b>21,378</b>   | <b>38,517</b>   |
| <b>At December 31, 2016</b> | <b>18,355</b>   | <b>36,099</b>   |

Most of the existing mineral licenses (97%) relate to coal mines and were recorded upon acquisition of mining subsidiaries.

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The carrying values of the mineral licenses were reduced proportionate to the depletion of the respective mineral reserves at each deposit related to mining and production of reserves adjusted for the reserves re-measurement and purchase accounting effects. Reduction in carrying values of the mineral licenses is included in the depletion charge for the period within the Cost of goods sold in the consolidated statement of profit (loss) and other comprehensive income (loss). No residual value is assumed in the mineral license valuation.

To determine the value of the mineral licenses as of December 31, 2016, the Group used quantities of underlying mineral assets, production data and other factors, including economic viability and any new exploration data.

The Group's mining segment production activities are located within Russia. The Group's mineral reserves and deposits are situated on the land belonging to government and regional authorities. Mining minerals require a subsoil license from the state authorities with respect to identified mineral deposits. The Group obtains licenses from such authorities and pays certain taxes to explore and produce from these deposits. These licenses expire up to 2037, with the most significant licenses expiring between 2019 and 2024, and management believes that they may be extended at the initiative of the Group without substantial cost. Management intends to extend such licenses for deposits expected to remain productive subsequent to their license expiry dates.

As of December 31, 2016 and 2015, the Group performed an impairment analysis of goodwill (Note 18).

**20. Income tax**

The major components of income tax (expense) benefit for the years ended December 31, 2016, 2015 and 2014 are:

| <b>Recognised in profit or loss</b>   | <b>2016</b>    | <b>2015</b>    | <b>2014</b>  |
|---|----------------|----------------|--------------|
| <i>Current income tax</i>   |                |                |              |
| Current income tax charge   | (555)          | (361)          | (396)        |
| Adjustments in respect of income tax related to previous years, including income tax penalties and changes in uncertain income tax position | 766            | (15)           | (6,307)      |
| <i>Deferred tax</i>   |                |                |              |
| Relating to origination and reversal of temporary differences   | (5,104)        | (7,946)        | 15,525       |
| <b>Income tax (expense) benefit reported in the consolidated statement of profit (loss) and other comprehensive income (loss)</b>           | <b>(4,893)</b> | <b>(8,322)</b> | <b>8,822</b> |

In January 2013, the Group created the consolidated group of taxpayers in accordance with the Tax code of the Russian Federation, under the Federal law of the Russian Federation of November 16, 2011 No. 321-FZ. The

existence of the consolidated group of taxpayers is subject to compliance with several conditions stated in the Tax code of the Russian Federation. The Group believes that these conditions were met as of December 31, 2016 and 2015. As of January 1, 2013, the consolidated group of taxpayers consisted of 16 subsidiaries of the Group, together with Mechel PAO, which is the responsible taxpayer under the agreement. As of January 1, 2014, the number of subsidiaries included in the consolidated group of taxpayers increased to 20 participants and did not change as of December 31, 2015 and 2016.

For subsidiaries which are not included in the consolidated group of taxpayers, income taxes are calculated on an individual subsidiary basis. Deferred income tax assets and liabilities are recognised in the accompanying consolidated financial statements in the amount determined by the Group in accordance with IAS 12 *Income Taxes*.

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

During 2013-2016, income tax was calculated at 20% of taxable profit in Russia, at 10.8% in Switzerland, at 16% in Romania, at 15% in Lithuania, at 20% in Kazakhstan and at 18% in Ukraine. The Group's subsidiaries incorporated in British Virgin Islands are exempt from profit tax. Amendments in the tax legislation of the United Kingdom resulted in the decrease in tax rate from 21% since April 1, 2014 to 20% since April 1, 2015.

The reconciliation between the income tax (expense) benefit computed by applying the Russian enacted statutory tax rates to the income from continuing operations before tax and non-controlling interest, to the income tax (expense) benefit reported in the financial statements is as follows:

|  | <b>2016</b>    | <b>2015</b>    | <b>2014</b>  |
|--|----------------|----------------|--------------|
| <b>Profit (loss) before tax from continuing operations</b>   | 14,151         | (107,128)      | (131,087)    |
| Income tax (expense) benefit at statutory income tax rate of 20%   | (2,830)        | 21,426         | 26,217       |
| <i>Adjustments:</i>  |                |                |              |
| Adjustments in respect of income tax related to previous years, including income tax penalties and changes in uncertain income tax position. | 766            | (15)           | (6,307)      |
| Unrecognized current year tax losses and write-off of previously recognized asset on tax losses  | 513            | (19,822)       | 286          |
| Non-deductible expenses for tax purposes   | (1,317)        | (4,341)        | (7,318)      |
| Non-deductible interest expense  | (1,055)        | (2,588)        | (3,815)      |
| Non-deductible penalties on breach of credit agreements  | (1,152)        | (3,025)        |              |
| Effect of different tax rates in foreign jurisdictions   | 182            | 26             | (37)         |
| Effect of the disposal of subsidiaries   |                | 17             | (204)        |
| <b>At the effective income tax rate of 34.6% (7.8% in 2015, 6.7% in 2014)</b>  | <b>(4,893)</b> | <b>(8,322)</b> | <b>8,822</b> |
| <b>Income tax (expense) benefit reported in the consolidated statement of profit (loss) and other comprehensive income (loss)</b>            | <b>(4,893)</b> | <b>(8,322)</b> | <b>8,822</b> |

The deferred tax balances were calculated by applying the currently enacted statutory tax rate in each jurisdiction applicable to the period in which the temporary differences between the carrying amounts and tax base (both in respective local currencies) of assets and liabilities are expected to reverse.

On January 9, 2014, the Group failed to sustain its position in the court with respect to the income tax claims in the amount of RUB 3,977 million, including penalties and fines. The Group recognized this income tax as income tax expense in the amount of RUB 3,666 million included in the line Adjustments in respect of current income tax of previous years and penalty in the amount of RUB 311 million included in line Tax penalties and interest in the income

tax reconciliation in 2014. During 2016, the Group delayed payments and new payment schedule agreed by the tax authorities was signed in December 2016. As of December 31, 2016, the outstanding amount payable was RUB 2,160 million (not overdue) including long-term part RUB 540 million.



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The amounts reported in the accompanying consolidated financial statements consisted of the following:

|   | January 1, 2014 | Tax benefit<br>(expense) during<br>the period<br>recognised<br>in<br>profit or<br>loss | Foreign currency<br>translation<br>effect | December 31, 2014 |
|---|-----------------|--|---|-------------------|
| <b>Deferred tax assets</b>                    |                 |  |   |                   |
| Property, plant and equipment                 | 786             | 23   | 11  | 820               |
| Rehabilitation provision                      | 214             | 9  |   | 223               |
| Inventory                                     | 140             | (33)   | 18  | 125               |
| Accounts receivable                           | 63              | 125  | 2   | 190               |
| Bad debt allowance                            | 461             | 250  | 47  | 758               |
| Loans & borrowings                            | 9               | 3,417  | 2   | 3,428             |
| Finance lease liabilities                     | 2,077           | (445)  | 7   | 1,639             |
| Accounts payable and other liabilities        | 487             | 547  | 7   | 1,041             |
| Net operating loss carry-forwards             | 4,584           | 12,094   | 183                                       | 16,861            |
| Other   | 332             | (9)  | 5   | 328               |
| <b>Deferred tax liabilities</b>               |                 |  |   |                   |
| Property, plant and equipment                 | (14,628)        | (1,493)  | (359)                                     | (16,480)          |
| Mineral licenses                              | (8,341)         | 321  |   | (8,020)           |
| Rehabilitation provision                      | (17)            | (10)   |   | (27)              |
| Inventory                                     | (1,433)         | 471  | (8)                                       | (970)             |
| Accounts receivable                           | (89)            | 15   | (35)                                      | (109)             |
| Bad debt allowance                            | (229)           | 54   | (2)                                       | (177)             |
| Loans & borrowings                            | (1,129)         | 527  | (2)                                       | (604)             |
| Accounts payable and other liabilities        | (48)            | (34)   | 4   | (78)              |
| Other   | (197)           | (304)  | (62)                                      | (563)             |
| <b>Deferred tax assets (liabilities), net</b> | <b>(16,958)</b> | <b>15,525</b>  | <b>(182)</b>                              | <b>(1,615)</b>    |



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|   | January 1, 2015 | Tax<br>(expense) benefit<br>during the period<br>recognised<br>in<br>profit or<br>loss | Disposals of Foreign currency<br>subsidiaries translation effect | December 31,<br>2015 |
|---|-----------------|--|--|----------------------|
| <b>Deferred tax assets</b>                        |                 |  |  |                      |
| Property, plant and equipment                     | 820             | 265  | (30)   | 1,055                |
| Rehabilitation provision                          | 223             | 288  | (1)  | 510                  |
| Inventory   | 125             | (48)   | (4)  | 73                   |
| Accounts receivable                               | 190             | 79   | (11)   | 258                  |
| Bad debt allowance                                | 758             | 50   | (2)  | 854                  |
| Loans & borrowings                                | 3,428           | (3,205)  | 1  | 224                  |
| Finance lease liabilities                         | 1,639           | (133)  | 2  | 1,508                |
| Accounts payable and other<br>liabilities         | 1,041           | (279)  | 1  | 763                  |
| Net operating loss<br>carry-forwards              | 16,861          | (6,258)  | 3  | 10,611               |
| Other   | 328             | (4)  |  | 324                  |
| <b>Deferred tax liabilities</b>                   |                 |  |  |                      |
| Property, plant and equipment                     | (16,480)        | 308  | (27)   | (16,199)             |
| Mineral licenses                                  | (8,020)         | 319  |  | (7,701)              |
| Rehabilitation provision                          | (27)            | 19   |  | (8)                  |
| Inventory   | (970)           | 372  | (6)  | (604)                |
| Accounts receivable                               | (109)           | 62   |  | (47)                 |
| Bad debt allowance                                | (177)           |  |  | (177)                |
| Loans & borrowings                                | (604)           | 151  | (1)  | (454)                |
| Accounts payable and other<br>liabilities         | (78)            | (35)   |  | (113)                |
| Other   | (563)           | 103  | (15)   | (475)                |
| <b>Deferred tax assets<br/>(liabilities), net</b> | <b>(1,615)</b>  | <b>(7,946)</b>   | <b>(29)</b>  | <b>(9,598)</b>       |

**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

|   | January 1,<br>2016 | Tax (expense)<br>benefit during<br>the period<br>recognised in<br>profit or loss | Foreign<br>currency<br>translation<br>effect | December 31,<br>2016 |
|---|--------------------|--|--|----------------------|
| <b>Deferred tax assets</b>                    |                    |  |  |                      |
| Property, plant and equipment                 | 1,055              | (378)  |  | 677                  |
| Rehabilitation provision                      | 510                | 184  |  | 694                  |
| Inventory                                     | 73                 | 134  | (14)   | 193                  |
| Accounts receivable                           | 258                | (94)   | (4)  | 160                  |
| Bad debt allowance                            | 854                | (159)  | (24)   | 671                  |
| Loans & borrowings                            | 224                | (106)  |  | 118                  |
| Finance lease liabilities                     | 1,508              | (389)  | 2  | 1,121                |
| Accounts payable and other liabilities        | 763                | (70)   | 7  | 700                  |
| Net operating loss carry-forwards             | 10,611             | (5,807)  | (89)   | 4,715                |
| Other   | 324                | (264)  | (1)  | 59                   |
| <b>Deferred tax liabilities</b>               |                    |  |  |                      |
| Property, plant and equipment                 | (16,199)           | 497  | 37   | (15,665)             |
| Mineral licenses                              | (7,701)            | 485  |  | (7,216)              |
| Rehabilitation provision                      | (8)                | 1  |  | (7)                  |
| Inventory                                     | (604)              | (83)   | 3  | (684)                |
| Accounts receivable                           | (47)               | 41   |  | (6)                  |
| Bad debt allowance                            | (177)              | 59   |  | (118)                |
| Loans & borrowings                            | (454)              | 350  | 1  | (103)                |
| Accounts payable and other liabilities        | (113)              | 74   | 1  | (38)                 |
| Other   | (475)              | 421  | 3  | (51)                 |
| <b>Deferred tax assets (liabilities), net</b> | <b>(9,598)</b>     | <b>(5,104)</b>   | <b>(78)</b>                                  | <b>(14,780)</b>      |

**Recognised in the consolidated statement of financial position information**

|  | December 31, 2016 | December 31, 2015 |
|--|-------------------|-------------------|
| Deferred tax assets                      | 1,502             | 1,492             |
| Deferred tax liabilities                 | (16,282)          | (11,090)          |
| <b>Deferred tax liabilities,<br/>net</b> | <b>(14,780)</b>   | <b>(9,598)</b>    |

The Group offsets tax assets and liabilities if and only if it has a legally enforceable right to set off current tax assets and current tax liabilities and deferred tax assets and deferred tax liabilities relate to income taxes levied by the same tax authority.

For financial reporting purposes, the Group has not recognised deferred tax assets in the amount of RUB 38,068 million (2015: RUB 37,747 million) on losses in the amount of RUB 208,748 million (2015: RUB 201,624 million) that are available to carry forward against future taxable income of the subsidiaries in which the losses arose. Deferred tax assets have not been recognised in respect of these losses as it is not probable that future taxable profit will be available for utilization of such assets. Deferred tax assets on net operating loss carry forwards which are considered to be realized in the future, are mostly related to the Russian subsidiaries.

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

A deferred tax liability of approximately RUB 288 million and RUB 208 million as of December 31, 2016 and 2015, respectively, has not been recognised for temporary differences related to the Group's investment in foreign subsidiaries primarily as a result of unremitted earnings of consolidated subsidiaries, as it is the Group's intention, generally, to reinvest such earnings permanently.

Similarly, a deferred tax liability of nil as of December 31, 2016 (RUB 817 million as of December 31, 2015, respectively) has not been recognised for temporary difference related to unremitted earnings of consolidated domestic subsidiaries as management believes the Group has both the ability and intention to effect a tax-free reorganization or merger of major subsidiaries into Mechel. There are no income tax consequences attached to the payment of dividends by the Group to its shareholders.

Probable income tax risks of approximately RUB 162 million and RUB 1,136 million as of December 31, 2016 and 2015, respectively, have been recorded in the Group's consolidated financial statements. Possible income tax risks of approximately RUB 1,119 million and RUB 131 million as of December 31, 2016 and 2015, respectively, have not been recognised in the Group's consolidated financial statements. Probable tax risks decreased as a result of tax examinations for related periods and a lapse of the applicable statute of limitations. Increase in possible tax risks occurred due to tax positions taken during the current period.

**21. Trade and other payables**

|                                       | <b>December 31, 2016</b> | <b>December 31, 2015</b> |
|---------------------------------------|--------------------------|--------------------------|
| Trade payables                        | 21,335                   | 26,373                   |
| Other payables                        | 19,650                   | 28,229                   |
| <b>Total trade and other payables</b> | <b>40,985</b>            | <b>54,602</b>            |

Other payables include accruals for breach of contracts, payables for property, plant and equipment acquired, salaries payable, dividends payable and other.

|                                       | <b>December 31, 2016</b> | <b>December 31, 2015</b> |
|---------------------------------------|--------------------------|--------------------------|
| <b>Other payables</b>                 |                          |                          |
| Accounts payable for fixed assets     | 2,964                    | 3,593                    |
| Salaries payable                      | 1,475                    | 1,483                    |
| Accruals for breach of contract terms | 745                      | 1,281                    |
| Dividends payable, common shares      |                          | 36                       |

|              |               |               |
|--------------|---------------|---------------|
| Other        | 14,466        | 21,836        |
| <b>Total</b> | <b>19,650</b> | <b>28,229</b> |

The balance of other payables includes payables for the acquisition of DEMP of RUB 8,032 million and RUB 14,799 million as of December 31, 2016 and 2015, respectively.

**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)***22. Provisions**

|   | <b>Rehabilitation<br/>provision</b> | <b>Provisions for legal<br/>claims</b> | <b>Tax<br/>provisions</b> | <b>Other<br/>provisions</b> | <b>Total</b> |
|---|-------------------------------------|--|---------------------------|-----------------------------|--------------|
| <b>At January 1, 2014</b>   | <b>4,400</b>                        | <b>421</b>                             | <b>548</b>                | <b>465</b>                  | <b>5,834</b> |
| Arising during the year   | 284                                 | 1,006                                  | 41                        | 68                          | 1,399        |
| Utilized  |                                     | (160)                                  | (22)                      | (103)                       | (285)        |
| Revision in estimated cash flow                                     | 548                                 |  |                           |                             | 548          |
| Unused amounts reversed   |                                     | (178)                                  | (116)                     |                             | (294)        |
| Discount rate adjustment and imputed interest                       | (1,736)                             |  |                           |                             | (1,736)      |
| Liabilities of disposal group held for sale/Discontinued operations | (297)                               |  |                           | (213)                       | (510)        |
| Exchange rate differences   |                                     |  | 169                       | 3                           | 172          |
| <b>At December 31, 2014</b>   | <b>3,199</b>                        | <b>1,089</b>                           | <b>620</b>                | <b>220</b>                  | <b>5,128</b> |
| <b>Current</b>  | <b>201</b>                          | <b>1,089</b>                           | <b>620</b>                | <b>220</b>                  | <b>2,130</b> |
| <b>Non-current</b>  | <b>2,998</b>                        |  |                           |                             | <b>2,998</b> |
| Arising during the year   | 403                                 | 1,321                                  | 361                       | 27                          | 2,112        |
| Utilized  |                                     | (513)                                  | (504)                     | (81)                        | (1,098)      |
| Revision in estimated cash flow                                     | (1,027)                             |  |                           |                             | (1,027)      |
| Unused amounts reversed   |                                     | (325)                                  | (101)                     |                             | (426)        |
| Discount rate adjustment and imputed interest                       | 1,129                               |  |                           |                             | 1,129        |
| Exchange rate differences   |                                     |  | 104                       | 49                          | 153          |
| <b>At December 31, 2015</b>   | <b>3,704</b>                        | <b>1,572</b>                           | <b>480</b>                | <b>215</b>                  | <b>5,971</b> |
| <b>Current</b>  | <b>265</b>                          | <b>1,572</b>                           | <b>480</b>                | <b>215</b>                  | <b>2,532</b> |
| <b>Non-current</b>  | <b>3,439</b>                        |  |                           |                             | <b>3,439</b> |
| Arising during the year   | 256                                 | 533                                    | 413                       | 1,678                       | 2,880        |
| Utilized  | (52)                                | (885)                                  | (14)                      | (118)                       | (1,069)      |
| Revision in estimated cash flow                                     | (511)                               |  |                           |                             | (511)        |
| Unused amounts reversed   |                                     | (474)                                  | (31)                      |                             | (505)        |
| Discount rate adjustment and imputed interest                       | 281                                 |  |                           |                             | 281          |
| Exchange rate differences   |                                     |  | (88)                      | (43)                        | (131)        |



|                                 |              |            |            |              |              |
|---------------------------------|--------------|------------|------------|--------------|--------------|
| <b>At December 31, 2016</b>     | <b>3,678</b> | <b>746</b> | <b>760</b> | <b>1,732</b> | <b>6,916</b> |
| <b>Current</b>                  | <b>258</b>   | <b>746</b> | <b>760</b> | <b>1,732</b> | <b>3,496</b> |
| <b>Non-current</b>              | <b>3,420</b> |            |            |              | <b>3,420</b> |
| <i>Rehabilitation provision</i> |              |            |            |              |              |

The Group has numerous site rehabilitation provisions that it is required to perform under law or contract once an asset is permanently taken out of service. The main part of these obligations is not expected to be paid for many years, and will be funded from the general Group's resources at the time of removal. The Group's rehabilitation provisions primarily relate to its steel and mining production facilities with related landfills and dump areas and its mines.

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**MECHEL PAO**

**Notes to the consolidated financial statements for the year ended December 31, 2016**

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

*Provisions for legal claims*

The Group is subject to various lawsuits, claims and proceedings related to matters incidental to the business. Accruals of probable cash outflows have been made based on an assessment of a combination of litigation and settlement strategies. It is possible that results of operations in any future period could be materially affected by changes in assumptions or by the effectiveness of such strategies.

*Tax provisions*

Management believes that it has paid or accrued all applicable taxes. Where uncertainty exists, the Group has accrued tax liabilities based on management's best estimate of the probable outflow of resources embodying economic benefits, which will be required to settle these liabilities. In accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, the Group recorded RUB 760 million and RUB 480 million of other tax claims that management believes are probable as of December 31, 2016 and 2015, respectively.

The Group does not believe that any other material tax matters exist relating to the Group, including current pending or future governmental claims and demands, which would require adjustment to the accompanying financial statements in order for those statements not to be materially misstated or misleading as of December 31, 2016.

**23. Pensions and other post-employment benefit plans**

In addition to the state pension and social insurance required by the Russian legislation, the Group has a number of defined benefit occupational pension plans that cover the majority of production employees and some other postretirement benefit plans.

A number of the Group's companies provide their former employees with old age retirement pensions, which are conditional to the member qualifying for the state old age pension. Some employees are also eligible for an early retirement in accordance with the state pension regulations and specific coal industry rules (so-called territorial treaties), which also provide for certain post-retirement benefits in addition to old age pensions. Additionally, the Group voluntarily provides financial support, of a defined benefit nature, to its old age and disabled pensioners, who did not acquire any pension under the occupational pension program.

The Group also provides several types of long-term employee benefits such as death-in-service benefit and invalidity pension of a defined benefit nature. The Group may also provide the former employees with reimbursement of coal and wood used for heating purposes. In addition, one-time lump sum benefits are paid to employees of a number of the Group's companies upon retirement depending on the employment service with the Group and the salary level of an individual employee. All pension plans are unfunded until the qualifying event occurs.

Before the end of June 2016, the Group's entities contributed certain amounts of cash to non-state pension fund Mechel Fund, to invest pensions of its participants. Pursuant to the agreements between the Group and this non-state pension fund, under certain circumstances, assets from contributions were not effectively restricted from possible withdrawal by the employer. Based on this fact, these assets were not qualified as plan assets under IFRS and these pension plans were considered to be fully unfunded. On June 22, 2016, Mechel Fund stopped all operations after cancellation by the Russian regulator of its license for the activity on pension and pension insurance. In the second half of 2016, the Group voluntarily started to make settlements to new coming pensioners until the new pension fund would be selected by the Group.

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**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016**

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

As of December 31, 2016, there were 50,369 active participants under the defined benefit pension plans and other long-term benefit plans and 39,551 pensioners receiving monthly pensions or other regular financial support from these plans. As of December 31, 2015 and January 1, 2015, the related figures were 54,866 and 56,508 of active participants under the defined benefit pension plans and other long-term benefits and 39,201 and 40,574 pensioners receiving monthly pensions or other regular financial support from these plans, respectively. The majority of employees at the Group's major subsidiaries belong to the trade unions.

Actuarial valuation of pension and other post-employment and postretirement benefits for the major subsidiaries was performed in February 2017, with the measurement date of December 31, 2016. Members' census data as of that date was collected for all relevant business units of the Group.

Pension obligations and expenses determined by the Group are supported by an independent qualified actuary in accordance with the Projected Unit Credit method of calculation of actuarial present value of future liabilities.

As of December 31, 2016 the amount of pension obligations includes defined benefit obligations in the amount of RUB 3,640 million and other long-term benefits obligation in the amount of RUB 805 million (RUB 4,075 million and 791 million as of December 31, 2015, respectively).

Changes in the present value of the defined benefit obligations and other long-term benefits and fair value of plan assets for 2014 were as follows:

|  | <b>Pension<br/>obligation</b> | <b>Fair value of plan<br/>assets</b> | <b>Benefit liability</b> |
|--|-------------------------------|--------------------------------------|--------------------------|
| <b>January 1, 2014</b>   | <b>(4,353)</b>                | <b>183</b>                           | <b>(4,170)</b>           |
| Current service cost   | (148)                         |                                      | (148)                    |
| Net interest expense   | (315)                         | 13                                   | (302)                    |
| Curtailment / settlement loss  | 58                            |                                      | 58                       |
| Past service cost  | 96                            |                                      | 96                       |
| <b>Sub-total included in profit or loss</b>                          | <b>(309)</b>                  | <b>13</b>                            | <b>(296)</b>             |
| Benefit paid   | 251                           | (16)                                 | 235                      |
| Business combinations  | (17)                          |                                      | (17)                     |
| Exchange difference  | (370)                         | 96                                   | (274)                    |
| Actuarial changes arising from<br>changes in demographic assumptions | (285)                         |                                      | (285)                    |

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|   |                |            |                |
|---|----------------|------------|----------------|
| Actuarial changes arising from changes in financial assumptions | 229            |            | 229            |
| Experience adjustments  | 55             |            | 55             |
| <b>Sub-total included in OCI</b>                                | <b>(371)</b>   | <b>96</b>  | <b>(275)</b>   |
| Contributions by employer                                       |                | 6          | 6              |
| <b>December 31, 2014</b>  | <b>(4,799)</b> | <b>282</b> | <b>(4,517)</b> |

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Table of Contents**MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

Changes in the present value of the defined benefit obligations and other long-term benefits and fair value of plan assets for 2015 were as follows:

|  | <b>Pension<br/>obligation</b> | <b>Fair value of plan<br/>assets</b> | <b>Benefit liability</b> |
|--|-------------------------------|--------------------------------------|--------------------------|
| <b>January 1, 2015</b>   | <b>(4,799)</b>                | <b>282</b>                           | <b>(4,517)</b>           |
| Current service cost   | (167)                         |                                      | (167)                    |
| Net interest expense   | (418)                         | 5                                    | (413)                    |
| Curtailment / settlement gain  | 142                           |                                      | 142                      |
| Past service cost  | (25)                          |                                      | (25)                     |
| <b>Sub-total included in profit or loss</b>                          | <b>(468)</b>                  | <b>5</b>                             | <b>(463)</b>             |
| Benefit paid   | 432                           | (21)                                 | 411                      |
| Exchange difference  | (155)                         | 45                                   | (110)                    |
| Actuarial changes arising from<br>changes in demographic assumptions | 116                           |                                      | 116                      |
| Actuarial changes arising from<br>changes in financial assumptions   | (119)                         |                                      | (119)                    |
| Experience adjustments   | (191)                         |                                      | (191)                    |
| <b>Sub-total included in OCI</b>                                     | <b>(349)</b>                  | <b>45</b>                            | <b>(304)</b>             |
| Contributions by employer  |                               | 7                                    | 7                        |
| <b>December 31, 2015</b>   | <b>(5,184)</b>                | <b>318</b>                           | <b>(4,866)</b>           |

Changes in the present value of the pension obligations and other long-term benefits and fair value of plan assets for 2016 were as follows:

|                          | <b>Pension<br/>obligation</b> | <b>Fair value of plan<br/>assets</b> | <b>Benefit liability</b> |
|--------------------------|-------------------------------|--------------------------------------|--------------------------|
| <b>December 31, 2015</b> | <b>(5,184)</b>                | <b>318</b>                           | <b>(4,866)</b>           |

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|   |                |             |                |
|---|----------------|-------------|----------------|
| Current service cost  | (149)          |             | (149)          |
| Net interest expense  | (381)          | 13          | (368)          |
| Curtailment / settlement gain                                     | 272            |             | 272            |
| Remeasurement of pension obligations                              | 53             |             | 53             |
| Past service cost   | (5)            |             | (5)            |
| <b>Sub-total included in profit or loss</b>                       | <b>(210)</b>   | <b>13</b>   | <b>(197)</b>   |
| Benefit paid  | 357            | (16)        | 341            |
| Exchange difference   | 363            | (63)        | 300            |
| Actuarial changes arising from changes in demographic assumptions | 80             |             | 80             |
| Actuarial changes arising from changes in financial assumptions   | (397)          |             | (397)          |
| Experience adjustments  | 294            |             | 294            |
| <b>Sub-total included in OCI</b>                                  | <b>340</b>     | <b>(63)</b> | <b>277</b>     |
| <b>December 31, 2016</b>  | <b>(4,697)</b> | <b>252</b>  | <b>(4,445)</b> |

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Table of Contents**MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

Amounts of the pension obligations recognized in the consolidated statement of the financial position were as follows:

|                                      | <b>December 31, 2016</b> | <b>December 31, 2015</b> |
|--------------------------------------|--------------------------|--------------------------|
| Current liabilities                  | (944)                    | (1,120)                  |
| Non-current liabilities              | (3,501)                  | (3,746)                  |
| <b>Total net pension obligations</b> | <b>(4,445)</b>           | <b>(4,866)</b>           |

The plan asset allocation of the investment portfolio was as follows as of December 31, 2016 and 2015:

|                           | <b>December 31, 2016</b> | <b>December 31, 2015</b> |
|---------------------------|--------------------------|--------------------------|
| Debt instruments          | 142                      | 179                      |
| Equity instruments        | 64                       | 80                       |
| Cash and cash equivalents | 23                       | 29                       |
| Property                  | 9                        | 11                       |
| Other assets              | 14                       | 19                       |
| <b>Total plan assets</b>  | <b>252</b>               | <b>318</b>               |

The investment strategy employed by the Group includes an overall goal to attain a maximum investment return with a strong focus on limiting the amount of risk taken. The strategy is to invest with a medium- to long-term perspective while maintaining a level of liquidity through proper allocation of investment assets. Investment policies include rules to avoid concentrations of investments. The vast majority of plan assets are measured using quoted prices in active markets for identical assets (Level 1 assets). The investment portfolio is primarily comprised of debt and equity instruments. Real estate and other alternative investments asset can be included when these have favorable return and risk characteristics. Debt instruments include investment grade and high yield corporate and government bonds with fixed yield and mostly short- to medium maturities. Equity instruments include selected investments in equity securities listed on active exchange market. The valuation of debt and equity securities is determined using a market approach, and is based on an unadjusted quoted prices. The expected return on plan assets takes into account historical returns and the weighted average of estimated future long-term returns based on capital market assumptions for each asset category.

Staff reduction, curtailments and amendments of benefit programs at several entities lead to appropriate curtailment gains and past service costs in reporting periods. Most of the Group's entities have a practice of lump-sum financial support to former employees, so the risk of human longevity is less significant than in the case of life-long benefits. This risk is controlled by using rather conservative life expectancy tables. The risk of a significant fluctuation in



interest rates is offset by rather conservative actuarial assumptions in respect of discount rates. The Group does not identify the unusual, specific business plan or risk, as well as any significant risk concentrations. The Group performs sensitivity analysis calculating the whole defined benefit obligation and other long-term benefits obligation in different actuarial assumptions and comparing the results. There are no changes from the previous period in the methods and assumptions used in preparing the sensitivity analyses. The weighted average duration of the defined benefit obligation and other long-term benefits obligation is about 6 years at both reporting dates.

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The key actuarial assumptions used to determine benefit obligations were as follows as of December 31, 2016 and 2015:

|                                       | December 31, 2016 | December 31, 2015          |
|---------------------------------------|-------------------|----------------------------|
| <b>Discount rate</b>                  |                   |                            |
| Russian entities                      | 8.5%              | 9.70%                      |
| German entities                       | 1.50%             | 1.93%                      |
| Ukrainian entity                      | 11.10%            | varying from<br>9.6% to 8% |
| Austrian entities                     | 1.50%             | 2.0%                       |
| <b>Inflation rates</b>                |                   |                            |
| Russian entities                      | 5.00%             | 5.80%                      |
| Ukrainian entity                      | 8.60%             | 7.60%                      |
| <b>Expected return on plan assets</b> |                   |                            |
| Austrian entities                     | 4.70%             | 1.74%                      |
| <b>Rate of compensation increase</b>  |                   |                            |
| Russian entities                      | 6.00%             | 7.10%                      |
| German entities                       | 4.00%             | 4.00%                      |
| Ukrainian entity                      | 11.60%            | 10.60%                     |
| Austrian entities                     | 2.25%             | 2.25%                      |

The results of sensitivity analysis of pension benefit obligation for the Russian and Ukrainian entities as of December 31, 2016 and 2015 are presented below:

|                                      | 2016   | 2015   |
|--------------------------------------|--------|--------|
| <b>Discount rate</b>                 |        |        |
| 1% increase                          | -7.73% | -6.98% |
| 1% decrease                          | 9.13%  | 6.20%  |
| <b>Inflation rate</b>                |        |        |
| 1% increase                          | 5.93%  | 3.40%  |
| 1% decrease                          | -5.00% | -4.65% |
| <b>Rate of compensation increase</b> |        |        |
| 1% increase                          | 2.76%  | 2.18%  |
| 1% decrease                          | -2.51% | -4.09% |
| <b>Turnover rate</b>                 |        |        |
| 3% increase                          | -5.20% | -4.65% |
| 3% decrease                          | 7.07%  | 4.27%  |

The results of sensitivity analysis of pension benefit obligation for Austrian entities as of December 31, 2016 and 2015 are presented below:

|                      | <b>2016</b> | <b>2015</b> |
|----------------------|-------------|-------------|
| <b>Discount rate</b> |             |             |
| 1% increase          | -10.10%     | -9.90%      |
| 1% decrease          | 12.20%      | 11.90%      |

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The results of sensitivity analysis of pension benefit obligation for German entities as of December 31, 2016 and 2015 are presented below:

|                      | <b>2016</b> | <b>2015</b> |
|----------------------|-------------|-------------|
| <b>Discount rate</b> |             |             |
| 1% increase          | -12.00%     | -12.00%     |
| 1% decrease          | 18.00%      | 18.00%      |

The sensitivity analyses above have been determined based on a method that extrapolates the impact on the defined benefit obligation and other long-term benefits obligation as a result of reasonable changes in key assumptions occurring at the end of the reporting period. The sensitivity analyses are based on a change in a significant assumption, keeping all other assumptions constant. The sensitivity analysis may not be representative of an actual change in the defined benefit obligation and other long-term benefits obligation as it is unlikely that changes in assumptions would occur in isolation of one another. The same method has been applied for the sensitivity analysis as when calculation the recognised pension liability.

The following payments are expected contributions to the defined benefit plan and other long-term benefits in the future years:

|  | <b>December 31, 2016</b> |
|--|--------------------------|
| Within the next 12 months (next annual reporting period) | 944                      |
| Between 2 and 5 years                                    | 1,413                    |
| Between 5 and 10 years                                   | 1,376                    |
| Beyond 10 years  | 510                      |
| <b>Total expected payments</b>                           | <b>4,243</b>             |

**24. Taxes and similar charges payable (Other than Income Tax)**

|               | <b>December 31, 2016</b> | <b>December 31, 2015</b> |
|---------------|--------------------------|--------------------------|
| VAT payable   | 4,274                    | 2,364                    |
| Payroll taxes | 3,029                    | 3,622                    |
| Property tax  | 920                      | 696                      |

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|                        |              |              |
|------------------------|--------------|--------------|
| Land lease             | 342          | 478          |
| Mineral extraction tax | 277          | 172          |
| Land tax               | 223          | 557          |
| Other                  | 130          | 145          |
| <b>Total</b>           | <b>9,195</b> | <b>8,034</b> |

**25. Issued capital and reserves**

**Common shares**

The capital stock of Mechel PAO consists of 416,270,745 common shares, each with a nominal value of 10 Russian rubles, all of which are fully paid, issued and outstanding under the Russian law. The Group is authorized to issue an additional 81,698,341 common shares with a nominal value of 10 Russian rubles each.

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**MECHEL PAO**

**Notes to the consolidated financial statements for the year ended December 31, 2016**

*(All amounts are in millions of Russian rubles, unless stated otherwise)*

**Preferred shares**

On April 30, 2008 Mechel's Extraordinary Shareholders' Meeting adopted changes to its Charter, authorizing up to 138,756,915 preferred shares with a nominal value of 10 Russian rubles each (representing 25% of the Mechel PAO's share capital). Under the Russian law and the Mechel PAO's Charter, these stocks are non-cumulative and have no voting rights, except cases, stipulated by the law, including, dividends are not paid in the year. The dividend yield paid per one preferred share is also fixed by the Charter and amounts to 20% of the consolidated annual net profit of the Group under IFRS divided to 138,756,915 issued preferred stock.

**Distributions made and proposed**

In accordance with applicable legislation, Mechel and its subsidiaries can distribute all profits as dividends or transfer them to reserves. Dividends may only be declared from accumulated undistributed and unreserved earnings as shown in the statutory financial statements of both Russian and foreign Group's subsidiaries. Dividends from Russian companies are generally subject to a 13% withholding tax for residents (9% for the periods prior to 2015) and 15% for non-residents, which could be reduced or eliminated if paid to foreign owners under certain applicable double tax treaties.

Effective January 1, 2008, intercompany dividends may be subject to a withholding tax of 0% (if at the date of dividends declaration, the dividend-recipient Russian company held a controlling (over 50%) interest in the share capital of the company (Russian or foreign) of the dividend payer for a period over one year and the residence of the dividend distribution foreign company is not included into the Ministry of Finance offshore list. Herewith 0% tax rate is not applicable to the income received by foreign entities that are recognized as Russian residents in accordance with the Russian Tax Code.

On June 30, 2016, one of the Group's subsidiaries declared a dividend of RUB 2,525 thousand and Mechel declared a dividend of RUB 4,163 thousand to the holders of preferred shares for 2015. The dividends declared for 2015 were partially paid to the shareholders during the year ended December 31, 2016 in the amount of RUB 4,799 thousand.

On June 30, 2015, one of the Group's subsidiaries declared a dividend of RUB 380 thousand and Mechel declared a dividend of RUB 4,163 thousand to the holders of preferred shares for 2014. The dividends declared for 2014 were fully paid to the shareholders during the year ended December 31, 2015.

On June 30, 2014, one of the Group's subsidiaries declared a dividend of RUB 1,670 thousand and Mechel declared a dividend of RUB 4,163 thousand to the holders of preferred shares for 2013. The dividends declared for 2013 were partially paid to the shareholders in the amount of RUB 870 thousand as of December 31, 2014.

**Additional-paid-in-capital**

In 2015, additional-paid-in-capital was increased by RUB 2,730 million due to the acquisition of non-controlling interests of 22.95%, 0.04% and 0.39% in certain Group's subsidiaries with the carrying value of RUB 2,842 million.

Table of Contents**MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)***Earnings (loss) per share (EPS)**

Basic EPS is calculated by dividing the profit (loss) for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

|   | <b>2016</b>  | <b>2015</b>      | <b>2014</b>      |
|---|--------------|------------------|------------------|
| Net profit (loss) from continuing operations  | 9,258        | (115,450)        | (122,265)        |
| Less: net income (loss) from continuing operations attributable to non-controlling interests  | 1,771        | 458              | (1,564)          |
| <b>Net income (loss) attributable to ordinary equity holders from continuing operations</b>   | <b>7,487</b> | <b>(115,908)</b> | <b>(120,701)</b> |
| Net (loss) income from discontinued operations  | (426)        | 822              | (11,702)         |
| Less: net income from discontinued operations attributable to non-controlling interests       | (65)         | 77               | 301              |
| <b>Net profit (loss) attributable to ordinary equity holders from discontinued operations</b> | <b>(361)</b> | <b>745</b>       | <b>(12,003)</b>  |
| <b>Profit (loss) attributable to ordinary equity holders</b>                                  | <b>7,126</b> | <b>(115,163)</b> | <b>(132,704)</b> |

There were no dilutive securities issued as of December 31, 2016, 2015 and 2014.

|   | <b>2016</b>   | <b>2015</b>     | <b>2014</b>     |
|---|---------------|-----------------|-----------------|
| <b>Profit (loss) per share total (Russian rubles per share), including:</b> | <b>17.12</b>  | <b>(276.65)</b> | <b>(318.79)</b> |
| <i>from continuing operations (Russian rubles per share)</i>                | <i>17.99</i>  | <i>(278.44)</i> | <i>(289.96)</i> |
| <i>from discontinued operations (Russian rubles per share)</i>              | <i>(0.87)</i> | <i>1.79</i>     | <i>(28.83)</i>  |

**26. Other income/expenses****26.1 Administrative and other operating expenses**

General, administrative and other operating expenses are comprised of the following:



|   | <b>2016</b>   | <b>2015</b>   | <b>2014</b>   |
|---|---------------|---------------|---------------|
| Wages, salaries and social security costs           | 10,267        | 8,287         | 7,637         |
| Office expenses                                     | 1,397         | 1,333         | 1,274         |
| Pension costs                                       | 1,387         | 1,095         | 885           |
| Depreciation  | 716           | 690           | 1,033         |
| Audit and consulting services                       | 569           | 570           | 625           |
| Fines and penalties related to business contracts   | 487           | 236           | 275           |
| Social expenses                                     | 452           | 387           | 444           |
| Consumables   | 411           | 437           | 432           |
| Banking charges and services                        | 268           | 168           | 222           |
| Rent  | 259           | 259           | 242           |
| Business trips                                      | 136           | 165           | 154           |
| Write off of accounts receivable                    | 113           | 247           | 185           |
| Provision for legal claims, net                     | 59            | 996           | 656           |
| Loss from disposal of property, plant and equipment | 57            | 806           | 524           |
| Other   | 2,213         | 1,624         | 1,727         |
| <b>Total</b>  | <b>18,791</b> | <b>17,300</b> | <b>16,315</b> |

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**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)***26.2 Employee benefits expense**

Employee benefits expenses are comprised of the following:

|  | <b>2016</b>   | <b>2015</b>   | <b>2014</b>   |
|--|---------------|---------------|---------------|
| <b>Included in cost of sales</b>                               |               |               |               |
| Wages and salaries   | 19,806        | 19,867        | 20,083        |
| Social security costs  | 5,909         | 6,181         | 6,331         |
| Post-employment benefits                                       | 126           | 157           | 146           |
| <b>Included in selling and distribution expenses</b>           |               |               |               |
| Wages and salaries   | 4,029         | 3,966         | 3,928         |
| Social security costs  | 1,015         | 1,024         | 863           |
| Post-employment benefits                                       |               |               | 1             |
| <b>Included in administrative and other operating expenses</b> |               |               |               |
| Wages and salaries   | 9,510         | 7,631         | 6,976         |
| Social security costs  | 2,144         | 1,751         | 1,546         |
| <b>Total</b>   | <b>42,539</b> | <b>40,577</b> | <b>39,874</b> |

**26.3 Other operating income**

Other operating income is comprised of the following:

|  | <b>2016</b>  | <b>2015</b> | <b>2014</b> |
|--|--------------|-------------|-------------|
| Curtailment and remeasurement of pension obligations         | 392          | 142         | 58          |
| Revision in estimated cash flows of rehabilitation provision | 375          | 47          | 236         |
| Gain on fines and penalties related to business contracts    | 248          |             |             |
| Gain from sales of scrap materials                           | 190          | 184         | 20          |
| Insurance compensation                                       | 153          |             |             |
| Other operating income                                       | 495          |             | 557         |
| <b>Total</b>   | <b>1,853</b> | <b>373</b>  | <b>871</b>  |

Revision in estimated cash flows of rehabilitation provision relates to changes in the discount rate, in the planned volumes of works, change in costs of rehabilitation expenses and other reasons.

In 2016, the Group recognized curtailment gain on cancellation of the certain pension programs for workers of Yakutugol, Mechel-Remservice OOO. In 2015, the Group recognised curtailment gain on DEMP pension obligations due to mass layoffs of employees and decrease in salaries conditioned by the situation in Ukraine. In 2014, the Group recorded effect of defined benefits plans amendments at BMP and SKCC.

Table of Contents**MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)***26.4 Finance income**

Finance income is comprised of the following:

|  | <b>2016</b>  | <b>2015</b> | <b>2014</b> |
|--|--------------|-------------|-------------|
| Waiving of fines and penalties on loans and finance leases | 992          |             |             |
| Interest income from investments                           | 177          | 134         | 98          |
| Income from the discounting of financial instruments       | 7            | 49          | 9           |
| <b>Total</b>   | <b>1,176</b> | <b>183</b>  | <b>107</b>  |

Waiving of fines and penalties on loans and finance leases were recognised due to the debt restructuring primarily with Sberbank.

**26.5 Finance costs**

Finance costs are comprised of the following:

|   | <b>2016</b>     | <b>2015</b>     | <b>2014</b>     |
|---|-----------------|-----------------|-----------------|
| Interest on loans and borrowings  | (44,164)        | (38,664)        | (23,758)        |
| Fines and penalties on overdue loans and borrowing payments and overdue interest payments | (5,538)         | (18,525)        | (1,516)         |
| Finance charges payable under finance leases  | (1,500)         | (1,673)         | (1,816)         |
| Fines and penalties on overdue finance leases   | (475)           | (642)           | (313)           |
| <b>Total finance costs related to loans, borrowings and finance leases</b>                | <b>(51,677)</b> | <b>(59,504)</b> | <b>(27,403)</b> |
| Interest expenses under pension liabilities   | (368)           | (400)           | (297)           |
| Expenses related to discounting of financial instruments                                  | (1,956)         | (175)           | (154)           |
| Unwinding of discount on provisions   | (239)           | (373)           | (256)           |
| <b>Total</b>  | <b>(54,240)</b> | <b>(60,452)</b> | <b>(28,110)</b> |

The interest on loans and borrowings includes fines and penalties on overdue loans and borrowing payments and overdue interest payments of RUB 5,538 million, RUB 18,525 million and RUB 1,516 million for 2016, 2015 and 2014, respectively. The finance charges payable under finance leases includes fines and penalties on overdue finance

lease payments of RUB 475 million, RUB 642 million and RUB 313 million for 2016, 2015 and 2014, respectively. Expenses related to discounting of financial instruments include changes in the measurement of the non-current obligation related to put-option granted on non-controlling interests in the amount of RUB 1,898 million (2015: nil) (Note 6 and Note 10.4).

Table of Contents**MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)***26.6 Other income and other expenses**

Other income is comprised of the following:

|   | <b>2016</b> | <b>2015</b> | <b>2014</b> |
|---|-------------|-------------|-------------|
| Gain on final settlements from subsidiaries disposal occurred in previous years | 194         |             |             |
| Royalties associated with Bluestone disposal                                    | 121         |             |             |
| Gain on accounts payable with expired legal term                                | 115         | 222         | 37          |
| Dividends received  | 3           | 8           |             |
| Gain on sale of investments in equity securities                                |             |             | 483         |
| Gain on sales and purchases of foreign currencies                               |             |             | 143         |
| Other income  | 165         | 112         | 1           |
| <b>Total</b>  | <b>598</b>  | <b>342</b>  | <b>664</b>  |

Other expenses are comprised of the following:

|  | <b>2016</b>    | <b>2015</b>  | <b>2014</b>    |
|--|----------------|--------------|----------------|
| VEB commissions write off                              | (1,411)        |              |                |
| Provision on non-recoverable advances to pension funds | (408)          |              |                |
| Loss on sales and purchases of foreign currencies      | (130)          | (273)        |                |
| Loss on sale of investments in equity securities       | (8)            |              |                |
| Loss from disposal of subsidiaries                     |                | (19)         | (89)           |
| Loss on securities repurchase agreement                |                |              | (1,297)        |
| Other expenses   | (46)           | (55)         | (100)          |
| <b>Total</b>   | <b>(2,003)</b> | <b>(347)</b> | <b>(1,486)</b> |

In 2014, the Group recognised a loss of RUB 1,297 million related to the failure of counterparty to a securities repurchase agreement to return certain securities to the Group.

Gain (loss) on sale of investments occurred as a result of disposal of investments in equity securities to third parties in 2014-2016. Gain on accounts payable with expired legal term constitutes gain on the write-off of payable amounts that were written-off due to legal liquidation of the creditors or expiration of the statute of limitation.

**27. Segment information**

The Group's operations are presented in three business segments as follows:

Steel segment, comprising production and sales of semi-finished steel products, carbon and specialty long products, carbon and stainless flat products, value-added downstream metal products, including forgings, stampings, hardware, rails, barks and ferrosilicon;

Mining segment, comprising production and sales of coal (coking and steam) and middlings, coke and chemical products, and iron ore, which supplies raw materials to the Steel and Power segments and also sells substantial amounts of raw materials to third parties;

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

Power segment, comprising generation and sales of electricity and heat power, which supplies electricity and heat power to the Steel and Mining segments and also sells a portion of electricity and heat power to third parties.

These segments are combinations of subsidiaries and have separate management teams and offer different products and services.

The above three segments meet criteria for reportable segments. No operating segments have been aggregated to form the above reportable operating segments. Subsidiaries are consolidated by the segment to which they belong based on their products and by which they are managed. The Group's management evaluates performance of the segments based on segment revenues, gross margin and operating income (loss). Transfer prices between operating segments are on an arm's-length basis in a manner similar to transactions with third parties. The accounting policies used by the Group in reporting segments internally are the same as those used for preparation of consolidated financial statement and in the respective quantitative and qualitative notes of the financial statements therefore no reconciliation between segment information and consolidated assets, liabilities and operating results is performed.

| <b>Year ended December 31, 2016</b>                           | <b>Mining</b> | <b>Steel</b> | <b>Power</b> | <b>Adjustments and<br/>eliminations</b> | <b>Consolidated</b> |
|---|---------------|--------------|--------------|---|---------------------|
| Revenues from external customers                              | 89,647        | 161,639      | 24,723       |   | <b>276,009</b>      |
| Inter-segment revenues  | 31,907        | 7,254        | 15,903       | (55,064)                                |                     |
| Gross profit  | 76,515        | 42,148       | 11,578       | (554)                                   | <b>129,687</b>      |
| Gross margin, %   | 62.9          | 25.0         | 28.5         |   | <b>47.0</b>         |
| Depreciation and depletion                                    | (7,912)       | (5,435)      | (367)        |   | <b>(13,714)</b>     |
| Loss on write-off of property, plant and equipment            | (863)         | (1,089)      | (1)          |   | <b>(1,953)</b>      |
| Impairment of goodwill and non-current assets                 | (1,336)       | (3,866)      |              |   | <b>(5,202)</b>      |
| Operating profit  | 31,012        | 11,531       | 701          | (554)                                   | <b>42,690</b>       |
| Loss from associates  | (17)          |              |              |   | <b>(17)</b>         |
| Finance income  | 1,082         | 93           | 1            |   | <b>1,176</b>        |
| Intersegment finance income                                   | 1,401         | 2,141        | 53           | (3,595)                                 |                     |
| Finance cost  | (37,615)      | (16,015)     | (610)        |   | <b>(54,240)</b>     |
| Intersegment finance cost                                     | (1,731)       | (1,396)      | (468)        | 3,595                                   |                     |
| Loss after tax for the year from discontinued operations, net |               | (406)        | (20)         |   | <b>(426)</b>        |
| Profit (loss) for the year                                    | 2,309         | 7,455        | (378)        | (554)                                   | <b>8,832</b>        |
| Segment assets  | 210,028       | 104,550      | 10,887       |   | <b>325,465</b>      |
| Segment liabilities   | 375,938       | 191,058      | 11,057       |   | <b>578,053</b>      |
| Investments in associates                                     | 265           |              |              |   | <b>265</b>          |
| Goodwill  | 14,367        | 580          | 3,408        |   | <b>18,355</b>       |



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|                              |         |         |       |                |
|------------------------------|---------|---------|-------|----------------|
| Capital expenditures         | (3,958) | (1,206) | (360) | <b>(5,524)</b> |
| Income tax (expense) benefit | (5,019) | 265     | (139) | <b>(4,893)</b> |

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**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

| <b>Year ended December 31, 2015</b>                                    | <b>Mining</b> | <b>Steel</b> | <b>Power</b> | <b>Adjustments and<br/>eliminations</b> | <b>Consolidated</b> |
|--|---------------|--------------|--------------|---|---------------------|
| Revenues from external customers                                       | 80,632        | 146,032      | 26,477       |   | 253,141             |
| Inter-segment revenues   | 28,091        | 6,972        | 14,990       | (50,053)                                |                     |
| Gross profit   | 57,442        | 33,395       | 11,288       | (318)                                   | 101,807             |
| Gross margin, %  | 52.8          | 21.8         | 27.2         |   | 40.2                |
| Depreciation and depletion   | (9,106)       | (4,651)      | (328)        |   | (14,085)            |
| Loss on write-off of property, plant and equipment                     | (199)         | (492)        |              |   | (691)               |
| Impairment of goodwill and non-current assets                          |               | (16)         | (1,444)      |   | (1,460)             |
| Operating profit   | 16,004        | 8,527        | 39           | (318)                                   | 24,252              |
| Finance income   | 142           | 38           | 3            |   | 183                 |
| Intersegment finance income  | 887           | 307          | 53           | (1,247)                                 |                     |
| Finance cost   | (33,656)      | (24,767)     | (2,029)      |   | (60,452)            |
| Intersegment finance cost  | (225)         | (878)        | (144)        | 1,247                                   |                     |
| Profit (loss) after tax for the year from discontinued operations, net | 764           | 87           | (29)         |   | 822                 |
| Loss for the year  | (71,563)      | (40,626)     | (2,121)      | (318)                                   | (114,628)           |
| Segment assets   | 217,393       | 113,985      | 10,694       |   | 342,072             |
| Segment liabilities  | 375,153       | 216,771      | 12,002       |   | 603,926             |
| Investments in associates  | 284           |              |              |   | 284                 |
| Goodwill   | 14,367        | 3,603        | 3,408        |   | 21,378              |
| Capital expenditures   | (4,971)       | (520)        | (486)        |   | (5,977)             |
| Income tax (expense) benefit   | (5,630)       | (2,795)      | 103          |   | (8,322)             |
| <b>Year ended December 31, 2014</b>                                    | <b>Mining</b> | <b>Steel</b> | <b>Power</b> | <b>Adjustments and<br/>eliminations</b> | <b>Consolidated</b> |
| Revenues from external customers                                       | 79,509        | 138,660      | 25,823       |   | <b>243,992</b>      |
| Inter-segment revenues   | 21,049        | 8,207        | 13,731       | (42,987)                                |                     |
| Gross profit   | 49,123        | 31,382       | 10,339       | 91                                      | <b>90,935</b>       |
| Gross margin, %  | 48.9          | 21.4         | 26.1         |   | <b>37.3</b>         |
| Depreciation and depletion   | (8,747)       | (5,391)      | (291)        |   | <b>(14,429)</b>     |
| Loss on write-off of property, plant and equipment                     | (309)         | (242)        | (110)        |   | <b>(661)</b>        |
| Impairment of goodwill and non-current assets                          | 19            | (8,015)      |              |   | <b>(7,996)</b>      |
| Operating profit (loss)  | 1,718         | (1,318)      | 416          | 91                                      | <b>907</b>          |
| Income (loss) from associates  | 14            | (7)          |              |   | <b>7</b>            |

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|  |          |          |       |         |                  |
|--|----------|----------|-------|---------|------------------|
| Finance income   | 74       | 32       | 1     |         | <b>107</b>       |
| Intersegment finance income  | 704      | 358      | 46    | (1,108) |                  |
| Finance cost   | (14,852) | (12,296) | (962) |         | <b>(28,110)</b>  |
| Intersegment finance cost  | (183)    | (679)    | (246) | 1,108   |                  |
| Profit (loss) after tax for the year from discontinued operations, net | (13,141) | 1,468    | (29)  |         | <b>(11,702)</b>  |
| Loss for the year  | (87,758) | (45,765) | (535) | 91      | <b>(133,967)</b> |
| Capital expenditures   | (13,117) | (3,089)  | (300) |         | <b>(16,506)</b>  |
| Income tax benefit   | 8,435    | 374      | 13    |         | <b>8,822</b>     |

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Table of Contents**MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

The following table presents the Group's revenues segregated between domestic and export sales. Domestic represents sales by a subsidiary in the country in which it is located. This category is further divided between subsidiaries located in Russia and other countries. Export represents cross-border sales by a subsidiary regardless of its location.

|                      | <b>2016</b>    | <b>2015</b>    | <b>2014</b>    |
|----------------------|----------------|----------------|----------------|
| <b>Domestic</b>      |                |                |                |
| Russia               | 164,361        | 146,701        | 141,096        |
| Other                | 22,252         | 20,817         | 19,488         |
| <b>Total</b>         | <b>186,613</b> | <b>167,518</b> | <b>160,584</b> |
| Export               | 89,396         | 85,623         | 83,408         |
| <b>Total revenue</b> | <b>276,009</b> | <b>253,141</b> | <b>243,992</b> |

Allocation of total revenue by country is based on the location of the customer. The Group's total revenues from external customers by geographic area were as follows:

|               | <b>2016</b>    | <b>2015</b>    | <b>2014</b>    |
|---------------|----------------|----------------|----------------|
| Russia        | 164,412        | 146,754        | 141,179        |
| Asia          | 54,114         | 40,119         | 41,177         |
| Europe        | 34,126         | 39,019         | 34,233         |
| CIS           | 18,630         | 20,231         | 21,837         |
| Middle East   | 1,536          | 4,222          | 3,596          |
| USA           | 707            | 581            | 531            |
| Other regions | 2,484          | 2,215          | 1,439          |
| <b>Total</b>  | <b>276,009</b> | <b>253,141</b> | <b>243,992</b> |

The majority of the Group's non-current assets are located in Russia. The carrying amounts of property, plant and equipment pertaining to the Group's major operations were as follows:

|        | <b>December 31,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--------|------------------------------|------------------------------|
| Russia | 238,175                      | 250,868                      |

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|                |                |                |
|----------------|----------------|----------------|
| Germany        | 1,415          | 2,051          |
| Austria        | 581            | 780            |
| Czech Republic | 206            | 285            |
| Romania        | 40             | 266            |
| Other          | 35             | 111            |
| <b>Total</b>   | <b>240,452</b> | <b>254,361</b> |

Because of the significant number of customers, there are no individual external customers that generate sales greater than 10% of the Group's consolidated total revenue.

**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)*

The following table presents the breakdown of the Group's revenues from external customers by major products:

|                              | <b>2016</b>    | <b>2015</b>    | <b>2014</b>    |
|------------------------------|----------------|----------------|----------------|
| <b>Mining segment</b>        |                |                |                |
| Coal and middlings           | 75,258         | 64,186         | 62,385         |
| Coke and chemical products   | 11,330         | 11,756         | 10,849         |
| Iron ore concentrate         | 126            | 1,844          | 4,011          |
| Other                        | 2,933          | 2,846          | 2,264          |
| <b>Total</b>                 | <b>89,647</b>  | <b>80,632</b>  | <b>79,509</b>  |
| <b>Steel segment</b>         |                |                |                |
| Long steel products          | 89,575         | 73,853         | 71,064         |
| Hardware                     | 24,580         | 23,443         | 22,396         |
| Flat steel products          | 18,230         | 17,490         | 14,646         |
| Forgings and stampings       | 11,652         | 12,166         | 11,843         |
| Semi-finished steel products | 3,434          | 5,027          | 2,834          |
| Ferrosilicon                 | 3,368          | 3,528          | 2,713          |
| Steel pipes                  | 3,286          | 3,308          | 3,391          |
| Other                        | 7,514          | 7,217          | 9,773          |
| <b>Total</b>                 | <b>161,639</b> | <b>146,032</b> | <b>138,660</b> |
| <b>Power segment</b>         |                |                |                |
| Electricity                  | 22,527         | 24,524         | 23,628         |
| Other                        | 2,196          | 1,953          | 2,195          |
| <b>Total</b>                 | <b>24,723</b>  | <b>26,477</b>  | <b>25,823</b>  |
| <b>Total revenue</b>         | <b>276,009</b> | <b>253,141</b> | <b>243,992</b> |

**28. Commitments and contingencies***Commitments*

In the course of carrying out its operations and other activities, the Group and its subsidiaries enter into various agreements, which would require the Group to invest in or provide financing to specific projects or undertakings.

In management's opinion, these commitments are entered into under standard terms, which are representative of each specific project's potential and should not result in an unreasonable loss.

As of December 31, 2016 and 2015, the total Group's contractual commitments to acquire property, plant and equipment amounted to RUB 21,932 million and RUB 23,231 million, respectively. Included in the commitments related to acquisition of property, plant and equipment are amounts arising from various purchase agreements in respect of railway and related infrastructure facilities construction for the Elga project. The total amount of remaining commitments under the construction contracts as of December 31, 2016 and 2015 is equal to RUB 17,783 million and RUB 19,890 million, respectively.

**Table of Contents****MECHEL PAO****Notes to the consolidated financial statements for the year ended December 31, 2016***(All amounts are in millions of Russian rubles, unless stated otherwise)**Operating lease commitments*

The Group has entered into operating property and land leases with lease terms between 2016 and 2064. Property and land lease expenses amounted to RUB 1,829 million and RUB 1,792 million for the years ended December 31, 2016 and 2015, respectively. Future minimum rentals payable under non-cancellable operating leases as of December 31, 2016 are, as follows:

|   | <b>December 31, 2016</b> |
|---|--------------------------|
| Within one year                             | 1,870                    |
| After one year but not more than five years | 7,396                    |
| More than five years                        | 54,595                   |
| <b>Total rental payable</b>                 | <b>63,861</b>            |

The Group does not sublease the property leased under operating lease agreements.

*Finance lease commitments*

The Group has finance leases for various items of plant and machinery. The Group's obligations under finance leases are not secured. Future minimum lease payments under finance leases together with the present value of the net minimum lease payments were as follows:

|   | <b>Minimum payments</b>  |                          | <b>Present value of payments</b> |                          |
|---|--------------------------|--------------------------|----------------------------------|--------------------------|
|   | <b>December 31, 2016</b> | <b>December 31, 2015</b> | <b>December 31, 2016</b>         | <b>December 31, 2015</b> |
| Payable in 1 year                                 | 12,312                   | 17,004                   | 10,175                           | 13,507                   |
| Payable in 2 years                                | 280                      | 360                      | 225                              | 304                      |
| Payable in 3 years                                | 106                      | 169                      | 74                               | 157                      |
| Payable in 4 years                                | 83                       | 19                       | 64                               | 19                       |
| Payable in 5 years and thereafter                 | 61                       | 1                        | 58                               | 1                        |
| <b>Total minimum lease payment</b>                | <b>12,842</b>            | <b>17,553</b>            | <b>10,596</b>                    | <b>13,988</b>            |
| Less amounts representing finance charges         | (2,246)                  | (3,565)                  |                                  |                          |
| <b>Present value of finance lease liabilities</b> | <b>10,596</b>            | <b>13,988</b>            | <b>10,596</b>                    | <b>13,988</b>            |



|  |        |        |
|--|--------|--------|
| Current portion of finance lease liabilities     | 10,175 | 13,507 |
| Non-current portion of finance lease liabilities | 421    | 481    |

The discount rate used for the calculation of the present value of minimum lease payments equals the implicit rate for the lessor and varies on different groups of equipment from 10.4% p.a. to 11.4% p.a. (U.S. dollar-denominated contracts), from 5.7% p.a. to 16.4% p.a. (euro-denominated contracts) and from 6.2% p.a. to 15.3% p.a. (Russian ruble-denominated contracts). Interest expense charged to the consolidated statements of profit (loss) and other comprehensive income (loss) in 2016 and 2015 amounted to RUB 1,500 million and RUB 1,673 million, respectively.

The Group's finance lease contracts contain a number of covenants and restrictions, which include, but are not limited to, compliance with payment schedule and certain cross-default provisions. As of December 31, 2016 and 2015, the Group was not in compliance with all major Group's restrictive covenants. There was also a breach

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of restrictive covenants on overdue principal amount of RUB 417 million and RUB 3,523 million as of December 31, 2016 and 2015, respectively. As a result, the long-term finance lease liability of RUB 6,903 million and RUB 7,748 million was reclassified to short-term finance lease liabilities due to covenant violations as of December 31, 2016 and 2015, respectively.

The total amount of commitments under the signed lease contracts as of December 31, 2016 and 2015 is equal to RUB 103 million and nil, respectively.

**Contingencies**

*Legal claim contingency*

The Group's business activities expose it to a variety of lawsuits and claims which are monitored, assessed and contested on the ongoing basis. Where management believes that a lawsuit or another claim would result in the outflow of the economic benefits for the Group, a best estimate of such outflow is included in provisions in the consolidated financial statements (Note 22).

As of December 31, 2016, the management assesses the outflow as possible for the claims of Minmetals Engineering Co. Ltd to the Group. Minmetals Engineering Co. Ltd sued CMP for work performed of \$143,023 thousand (RUB 8,675 million at exchange rate as of December 31, 2016). CMP issued a claim to Minmetals Engineering Co. Ltd in the amount of \$57,568 thousand (RUB 3,492 million at exchange rate as of December 31, 2016) and 4,189 thousand euro (RUB 267 million at exchange rate as of December 31, 2016). The amount of an outflow of resources embodying economic benefits for this claim cannot be measured reliably.

*Guarantees*

As of December 31, 2016, the Group guaranteed the fulfillment of obligations to third parties for the total amount of RUB 56 million. These guarantees are given by the Group under promissory notes, which were transferred by endorsement.

*Environmental*

In the course of the Group's operations, the Group may be subject to environmental claims and legal proceedings. The quantification of environmental exposures requires an assessment of many factors, including changing laws and regulations, improvements in environmental technologies, the quality of information available related to specific sites, the assessment stage of each site investigation, preliminary findings and the length of time involved in remediation or settlement. Management does not believe that any pending environmental claims or proceedings will have a material adverse effect on its financial position and results of operations.

The Group estimated the total amount of capital investments to address environmental concerns at its various subsidiaries at RUB 647 million and RUB 644 million as of December 31, 2016 and 2015, respectively. These amounts are not accrued in the consolidated financial statements until actual capital investments are made.

Possible liabilities, which were identified by management as those that can be subject to potential claims from environmental authorities are not accrued in the consolidated financial statements. The amount of such liabilities was not significant.

*Taxation*

The Group is subject to taxation to the largest extent in Russia, and secondarily in other jurisdictions. The Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur

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frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that tax authorities are taking more assertive position in its interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of the taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

In Russia, generally tax declarations remain open and subject to inspection for a period of three years. The fact that a year has been reviewed does not close that year, or any tax declaration applicable to that year, from further review during the three-year period.

In the event that a taxpayer submits a revised tax declaration in which the stated amount of tax is less than the amount previously declared, tax audit of a taxpayer may be performed, but only with the respect to the changes in the tax declaration.

In other tax jurisdictions where the Group conducts operations or holds shares, taxes are generally charged on the income arising in that jurisdiction. In some jurisdictions agreements to avoid double taxation are signed between different jurisdictions; however, the risk of additional taxation exists, especially in respect of certain domiciles where some of the Group entities are located and which are considered to be tax havens.

The Russian transfer pricing legislation, which came into force on January 1, 2012, allows the Russian tax authority to apply transfer pricing adjustments and impose additional profits tax liabilities in respect of all controlled transactions if the transaction price differs from the market level of prices. The list of controlled transactions includes transactions performed with related parties and certain types of cross-border transactions. For domestic transactions the transfer pricing rules apply only if the amount of all transaction with related party exceeds RUB 1,000 million since 2014.

The tax audit on controlled transactions made in 2013 should have been commenced on or before December 31, 2015. In order to support the level of prices applied for the controlled transactions the Group should provide an evidence that prices of controlled transactions are based on market prices and to prepare the reports for submission to the Russian tax authorities. Otherwise, the Russian tax authorities have the right to challenge the prices determined by the Group for such transactions, and have the right to charge additional taxes, penalties and fines (tax liabilities).

In cases where the domestic transaction resulted in an accrual of additional tax liabilities for one party, another party could correspondingly adjust its profit tax liabilities according to the special notification issued by the authorized body in due course. The current Russian transfer pricing rules have considerably increased the compliance burden for the taxpayers compared to the transfer pricing rules which were in effect before 2012 due to, inter alia, shifting the burden of proof from the Russian tax authorities to the taxpayers. These rules are applicable not only to the transactions taking place in 2012 but also to the prior transactions with related parties if related income and expenses were recognised in 2012. Special transfer pricing rules apply to transactions with securities and derivatives.

Due to the uncertainty and absence of current practice of application of the current Russian transfer pricing legislation the Russian tax authorities may challenge the level of prices applied by the Group under the controlled transactions and accrue additional tax liabilities unless the Group is able to demonstrate the use of market prices with respect to the controlled transactions, and that there has been proper reporting to the Russian tax authorities, supported by appropriate available transfer pricing documentation.

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*(All amounts are in millions of Russian rubles, unless stated otherwise)*

The Group believes that it uses the market prices in controlled transactions and does not expect any claims of tax authorities related to the prices used in such transactions. However, due to the uncertainty and limited practice of the Russian legislation in the area of transfer pricing relevant tax claims may be raised which effect is currently impossible to estimate.

In addition, in November 2014, the legislation of the Russian Federation has been significantly revised in order to prevent the misuse of low-tax jurisdictions for tax avoidance in the Russian Federation. Changes in the legislation set out the rules for the taxation of income of a foreign organization recognized as a controlled foreign corporation. The foreign organization is recognized as a controlled foreign corporation, if it is not a tax resident of the Russian Federation and the share of the controlling Russian entities or individuals in the organization is more than 25%. The transition period provides for a gradual reduction in the amount of non-taxable income of the controlled corporation RUB 50 million, RUB 30 million and RUB 10 million for 2015, 2016, 2017 and further respectively. Russian tax law also provides for certain conditions, under which the income of controlled corporations qualifies as tax exempt. Starting 2016 the taxable income of the controlling party is increased by the undistributed profits of the controlled foreign corporation earned in the financial year ended prior to the reporting year provided that the financial year started on or after January 1, 2015.

Management believes that it has paid or accrued all taxes that are applicable. Where uncertainty exists, the Group has accrued tax liabilities based on management's best estimate of the probable outflow of resources embodying economic benefits, which will be required to settle these liabilities. In accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, the Group recorded RUB 760 million and RUB 480 million of other tax claims that management believes are probable, as of December 31, 2016 and 2015, respectively. In addition, income tax accrual was made under IAS 12 *Income Taxes* (Note 20). The Group does not believe that any other material tax matters exist relating to the Group, including current pending or future governmental claims and demands, which would require adjustment to the accompanying financial statements in order for those statements not to be materially misstated or misleading as of December 31, 2016.

Possible tax liabilities on taxes other than income tax, which were identified by management as those that can be subject to different interpretations of the tax law and regulations are not accrued in the consolidated financial statements. The amount of such liabilities was RUB 976 million and nil as of December 31, 2016 and 2015, respectively.

**29. Events after the reporting period**

The Group evaluated subsequent events for these consolidated financial statements through the date when the financial statements were issued, April 26, 2017.

*Call option agreement for preferred shares of the Group*

As a part of the restructuring requirement, in January 2017, the Group signed a call option agreement with VTB CAPITAL PLC (the Buyer) providing the Buyer with an option to acquire a 5% stake (6,937,846 preferred shares) of the preferred shares of the Group. In accordance with this agreement, the Group is obliged to exercise the option between April 1, 2017 to December 31, 2020 in one of the following ways: sell to the Buyer 5% of preferred shares of the Group at a price of 47.3682 rubles per share or to pay cash to the Buyer in the amount calculated as a difference between the weighted average market value of preferred shares for the last six months from the date of the call from the Buyer and the price of 47.3682 rubles per share or combination of these two option. Until the execution of the call option 6,937,846 preferred shares are pledged. In April 2017, VTB notified that the bank wants to exercise the option, but the Group has requested to extend the start day of the option period by 1 (one) year till April 1, 2018. Negotiations on amending the terms of the option are ongoing.

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*Confirmation of restructuring terms with the Russian state banks*

In April 2017, the Group's major lenders – Gazprombank, VTB and Sberbank – confirmed the restructuring terms under the relevant credit facilities including an extension of the repayment grace period until 2020 and the final maturity until 2022 and annual interest rate at the level of the key rate of the Central Bank of Russia plus 1.5% for ruble-denominated credit facilities and 3M LIBOR + 7% for U.S. dollar-denominated credit facilities.

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