Financial review

Statement of operations

In its full-year financial results for 2018, EVRAZ reported an increase of 18.6% year-on-year in consolidated revenues, which were US$12,836 million compared with US$10,827 million in 2017. This performance was driven mostly by an upswing in prices for vanadium and steel products amid more favourable market trends.

EVRAZ consolidated EBITDA amounted to US$3,777 million in the period, compared with US$2,624 million in 2017, boosting the EBITDA margin from 24.2% to 29.4% and free cash flow to US$1,940 million. The improvement is primarily attributable to higher vanadium and steel product prices, lower expenses in US dollar terms because of the effect that rouble weakening had on costs in 2018 versus 2017, as well as the impact of cost-cutting initiatives on efficiency. This was partly offset by an increase in prices for raw and auxilliary materials, including scrap, electrodes and ferroalloys.

The Steel segment's revenues (including inter-segment) climbed by 14.7% year-on-year to US$8,879 million, or 62.2% of the Group's total before elimination. The growth was mainly attributable to higher revenues from sales of vanadium products, which rose by 111.4% year-on-year, 124.6% increase was attributed to surges in average sales prices. Ongoing vanadium production restrictions together with China's new high-strength rebar standard and strong global demand from steelmakers has severely affected stockpiles and pushed up price indices. Sales of steel products also increased by 5.8% due to higher sales prices, primarily for finished products.

The Steel, North America segment's revenues increased by 38.6% year-on-year. Prices and volume went up by 22.6% and 14.4%, respectively. The key drivers of this growth were improved demand across product segments, particularly for tubular products driven by recovery in oil prices and drilling activity and the start of new major pipelines construction in Canada and the US.

The Coal segment's revenues grew by 5.6% year-on-year, supported largely by higher sales volumes, which were up 4.8% due to stable demand and improved productivity at the Raspadskaya-Koksovaya mine.

In 2018, the Steel segment's EBITDA rose due to an increase in steel and vanadium prices; lower expenses in US dollar terms due to the effect that rouble weakening had on costs; and the impact of cost-cutting initiatives implemented in the period. This was partly offset by an increase in prices for raw and auxilliary materials, including scrap, electrodes and ferroalloys.

The increase in volume and metal spreads of the Steel, North America segment's was more than offset by the effect of tariffs and duties on Canadian large-diameter and line pipe sales into the US, as well as due to operational challenges at EVRAZ Regina facility that resulted in lower EBITDA.

The Coal segment's EBITDA declined slightly year-on-year mainly due to higher cost per tonne amid more complex geological conditions, rise in auxiliary materials prices and higher involvement of contractors. This was partly offset by sales prices rising in line with global benchmarks; the impact of cost-cutting initiatives; and lower expenses in US dollar terms as a result of the effect that rouble weakening had on costs.

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

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EVRAZ consolidated EBITDA improved amid higher vanadium and steel product prices, lower expenses in US dollar terms as well as the impact of cost-cutting initiatives on efficiency.

Nikolay Ivanov
Chief Financial Officer

Revenues, *US$ million*

Segment	2018	2017	Change	Change, %
Steel	8,879	7,743	1,136	14.7
Steel, North America	2,583	1,864	719	38.6
Coal	2,337	2,214	123	5.6
Other operations	472	462	10	2.2
Eliminations	(1,435)	(1,456)	21	(1.4)
Total	**12,836**	**10,827**	**2,009**	**18.6**

Revenues by region, *US$ million*

Region	2018	2017	Change	Change, %
Russia	4,564	4,255	309	7.3
Americas	3,009	2,201	808	36.7
Asia	2,716	2,162	554	25.6
Europe	1,426	1,128	298	26.4
CIS (excl. Russia)	936	812	124	15.3
Africa and rest of the world	185	269	(84)	(31.2)
Total	**12,836**	**10,827**	**2,009**	**18.6**

EBITDA, *US$ million*

Segment	2018	2017	Change	Change, %
Steel	2,672	1,483	1,189	80.2
Steel, North America	14	58	(44)	(75.9)
Coal	1,218	1,226	(8)	(0.7)
Other operations	17	21	(4)	(19.0)
Unallocated	(135)	(131)	(4)	3.1
Eliminations	(9)	(33)	24	(72.7)
Total	**3,777**	**2,624**	**1,153**	**43.9**

For the definition of EBITDA, please refer to page 261.

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

Effect of Group’s cost-cutting initiatives in 2018, *US$ million*

Improving yields and raw material costs, including	**132**
Improving yields and raw material costs of Urals and Siberia divisions	74
Various improvements at coal washing plants and mines	15
Improving yields and raw material costs of North American assets and vanadium operations	43
Increasing productivity and cost effectiveness	**132**
Others, including	**9**
Reduction of general and administrative (G&A) costs and non-G&A headcount	9
Total	**273**

In 2018, selling and distribution expenses increased by 41.3%, mostly due to increased freight costs, tariffs imposed on steel exports to US customers of EVRAZ North America and higher sales volumes, partly offset by the weakening of the rouble. General and administrative expenses edged up by 1.1% due to wage indexation, partly offset by the effect that rouble depreciation had on costs.

Foreign exchange gains amounted to US$361 million and were primarily related to intra-group loans denominated in roubles payable among Russian and non-russian subsidiaries. The depreciation of the Russian rouble against the US dollar in 2018 led to exchange gains mainly recognised in the income statements of EVRAZ plc and East Metals A.G., which were not offset by the exchange losses recognised in the income statements or the equity of the Russian subsidiaries.

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

	2018	2017	Change, %
Steel segment			
Revenues	8,879	7,743	14.7
Cost of sales	(5,613)	(5,795)	(3.1)
Gross profit	3,266	1,948	67.7
Steel, North America segment			
Revenues	2,583	1,864	38.6
Cost of sales	(2,215)	(1,656)	33.8
Gross profit	368	208	76.9
Coal segment			
Revenues	2,337	2,214	5.6
Cost of sales	(1,042)	(973)	7.1
Gross profit	1,295	1,241	4.4
Other operations – *gross profit*	15	104	(85.6)
Unallocated – *gross profit*	(8)	(8)	–
Eliminations – *gross profit*	(111)	(151)	(26.5)
Total	**4,825**	**3,342**	**44.4**

Interest expenses incurred by the Group decreased, mainly due to the gradual reduction in total debt and the refinancing of existing indebtedness at more favourable terms during the reporting period. Gains on financial assets and liabilities amounted to US$13 million and were mostly related to gains on hedging instruments.

A net loss of US$10 million on disposal groups classified as held for sale was caused by the disposal in March 2018 of EVRAZ DMZ, which was sold to a third party for a cash consideration of US$35 million. The Group recognised a US$10 million loss on the subsidiary's sale, including US$60 million of cumulative exchange losses reclassified from other comprehensive income to the consolidated statement of operations. The result was included as a loss on disposal groups classified as held for sale on the consolidated statement of operations.

For the reporting period, the Group had a current income tax expense of US$679 million, compared with US$484 million a year earlier. The change reflects the Group's better operating results and taxes withheld on dividends distributed within the Group.

Gross profit, expenses and results, *US$ million*

	2018	2017	Change	Change, %
Gross profit	**4,825**	**3,342**	**1,483**	**44.4**
Selling and distribution costs	(1,013)	(717)	(296)	41.3
General and administrative expenses	(546)	(540)	(6)	1.1
Impairment of assets	(30)	12	(42)	n/a
Foreign-exchange gains/(losses), net	361	(54)	415	n/a
Other operating income and expenses, net	(69)	(57)	(12)	21.1
Profit from operations	**3,528**	**1,986**	**1,542**	**77.6**
Interest expense, net	(341)	(423)	82	(19.4)
Share of losses of joint ventures and associates	9	11	(2)	(18.2)
Gain/(loss) on financial assets or liabilities, net	13	(57)	70	n/a
Loss on disposal groups classified as held for sale, net	(10)	(360)	350	(97.2)
Other non-operating gains/(losses), net	2	(2)	4	n/a
Profit before tax	**3,201**	**1,155**	**2,046**	**n/a**
Income tax benefit/(expense)	(731)	(396)	(335)	84.6
Net profit	**2,470**	**759**	**1,711**	**n/a**

Cash flow, *US$ million*

	2018	2017	Change	Change, %
Cash flows from operating activities before changes in working capital	3,063	2,111	952	45.1
Changes in working capital	(430)	(154)	(276)	n/a
Net cash flows from operating activities	**2,633**	**1,957**	**676**	**34.5**
Short-term deposits at banks, including interest	11	7	4	57.1
Purchases of property, plant and equipment and intangible assets	(521)	(595)	74	(12.4)
Proceeds from sale of disposal groups classified as held for sale, net of transaction costs	52	412	(360)	(87.4)
Other investing activities	80	9	71	n/a
Net cash flows used in investing activities	**(378)**	**(167)**	**(211)**	**n/a**
Net cash flows used in financing activities	**(2,606)**	**(1,479)**	**(1,127)**	**76.2**
Including dividends paid	(1,556)	(430)	(1,126)	n/a
Effect of foreign-exchange rate changes on cash and cash equivalents	(48)	(2)	(46)	n/a
Net decrease in cash and cash equivalents	**(399)**	**309**	**(708)**	**n/a**

Calculation of free cash flow, *US$ million*

	2018	2017	Change	Change, %
EBITDA	3,777	2,624	1,153	43.9
EBITDA excluding non-cash items	**3,773**	**2,627**	**1,146**	**43.6**
Changes in working capital	(430)	(154)	(276)	n/a
Income tax accrued	(683)	(485)	(198)	40.8
Social and social infrastructure maintenance expenses	(27)	(31)	4	(12.9)
Net cash flows from operating activities	**2,633**	**1,957**	**676**	**34.5**
Interest and similar payments	(298)	(453)	155	(34.2)
Capital expenditures, including recorded in financing activities and non-cash transactions	(527)	(603)	76	(12.6)
Proceeds from sale of disposal groups classified as held for sale, net of transaction costs	52	412	(360)	(87.4)
Other cash flows from investing activities	80	9	71	n/a
Free cash flow	**1,940**	**1,322**	**618**	**46.7**

In 2018, net cash flows from operating activities climbed by 34.5% year-on-year. Free cash flow for the period was US$1,940 million.

For the definition of free cash flow, please refer to page 261.

CAPEX and key projects

In 2018, EVRAZ capital expenditures fell to US$527 million, compared with US$603 million a year earlier, as EVRAZ NTMK finished implementing two main projects, the construction of blast furnace No. 7 (first pig iron was obtained in Q1 2018) and the grinding ball mill (first ball was produced in Q1 2018), amid the weakening of the rouble exchange rate against the US dollar. EVRAZ North America also started to implement two projects to reduce costs that are scheduled to be completed in 2019.

Capital expenditures (including those recognised in financing activities) for 2018 in millions of US dollars can be summarised as follows.

Capital expenditures in 2018, *US$ million*

Steel segment	
Blast furnace No. 7 construction at EVRAZ NTMK The project aim is to maintain stable pig iron production volumes during the capital repair of blast furnace No. 6 in 2018-19.	48
Wheel resurfacing capacity expansion at EVRAZ NTMK The project aim is to expand wheel resurfacing capacity to balance production capacity in 2019-22 and increase production volumes.	10
Grinding ball mill construction at EVRAZ NTMK The project aim is to construct a new grinding ball mill that can make the grinding balls of hardness category five.	5
Steel, North America segment	
EVRAZ Pueblo seamless threading The project aim is to in-source seamless threading and coupling process from third-party providers to improve cost competitiveness.	15
EVRAZ Red Deer heat treatment The project aim is to develop heat treatment capability to access a higher margin market.	13
Coal segment	
Access and development of reserves in the Uskovskaya mine's seam No. 48 The project aim is to prepare the reserves in seam No. 48 for mining.	20
Access and development of reserves in the Esaulskaya mine's seam No. 29a The project aim is to relocate mining operations from seam No. 26 to seam No. 29a.	5
Other development projects	51
Maintenance	360
Total	**527**

Financing and liquidity

EVRAZ began 2018 with total debt of US$5,432 million. The Group used the cash flows it generated during the period to reduce its debt and completed several transactions to manage its maturity profile.

In February, EVRAZ repaid US$500 million in loans, comprising US$200 million from Alfa Bank due in 2019, US$200 million from Alfa Bank due in 2023 and US$100 million from Sberbank due in 2020. The Group financed these repayments with a combination of its cash balances and a new five-year, US$300 million term loan from Alfa Bank. These transactions helped to improve the repayment schedule in terms of loan tenures and reduce interest charges.

Between April and June, to reduce its interest charges, the Group completed an early repayment of its outstanding loans to VTB with principal amounts of US$495 million using cash accumulated on the balance sheet.

These actions, together with scheduled bank loan repayments and changes in credit line balances, reduced total debt by US$794 million to US$4,638 million as at 31 December 2018.

In 2018, EVRAZ made four dividend payments to its shareholders totalling US$1,556 million.

During the reporting period, net debt decreased by US$395 million to US$3,571 million, compared with US$3,966 million as at 31 December 2017. Interest expense accrued in respect of loans, bonds and notes amounted to US$322 million in 2018, compared with US$394 million in 2017. The lower interest expense was mainly due to a reduction of total debt by early repayments.

The strong market trends seen in 2018 drove significant growth of EBITDA and free cash flow generation. This helped to substantially improve the Group's major leverage metric, the ratio of net debt to EBITDA, which fell to 0.9 times as at 31 December 2018, compared with 1.5 times as at 31 December 2017.

As at 31 December 2018, debt with financial maintenance covenants comprised various bilateral facilities with a total outstanding principal of around US$1,061 million. Maintenance covenants under these facilities include two key ratios calculated using EVRAZ plc's consolidated financials: a maximum net leverage and a minimum EBITDA interest cover. As at 31 December 2018, EVRAZ was in full compliance with its financial covenants.

As at 31 December 2018, cash amounted to US$1,067 million, while short-term loans and the current portion of long-term loans stood at US$377 million. Cash-on-hand and committed credit facilities are sufficient to cover all of EVRAZ refinancing requirements for 2019 and 2020.