

2.0

STRATEGY





2.1 MISSION

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- PRODUCTION OF HIGH VALUE ADDED METAL PRODUCTS FOR THE FUEL AND ENERGY, TRANSPORTATION, CONSTRUCTION AND OTHER INDUSTRIES, WHICH BEST SATISFY CLIENT DEMAND BY OFFERING AN OPTIMAL PRICE-TO-PERFORMANCE RATIO





2.2 VISION

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- OMK IS A MANUFACTURER OF HIGH VALUE ADDED METAL PRODUCTS
- OMK IS THE LARGEST PRODUCER OF STANDARD PARTS AND AN INTEGRATED SUPPLIER OF PRODUCTS AND SOLUTIONS FOR RUSSIAN FUEL AND ENERGY INDUSTRY COMPANIES
- OMK HAS ASSEMBLED THE BEST TEAM OF PROFESSIONALS AMONG METALLURGICAL COMPANIES IN RUSSIA





2.0 PRIMARY AREAS FOR OMK'S DEVELOPMENT

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In 2016, as it has done over the past several years, OMK continued to implement its chosen strategy, aimed at expanding the company and strengthening its position in the industry.

Our objective is to become the key supplier of integrated solutions for the oil and gas industry and the most efficient metals business in Russia. This model is based on the expansion of our own modern products, including import-substitution products, which meet the strictest requirements of current and prospective customers.

To this end, we are working on the following priority areas:

- 1 Improving operational efficiency**
 - Further expanding the production system
 - Eliminating bottlenecks
 - Searching for reserves to reduce costs
 - Applying an integrated approach: we pay significant attention to environmental protection, occupational safety, and improving working conditions
- 2 Creating a new business model**
 - Integrating products and facilities
 - Developing and using synergies
 - Certifying production facilities according to leading international standards
- 3 Employing critical risk management**
- 4 Expanding the product line**
 - Reaching new segments
 - Developing production – modernization and retooling





2014 OMK BUSINESS PRINCIPLES

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1 HIGH-TECH FOCUS

- We invest in developing high-tech products

2 RELIABILITY

- We procure raw materials and components by establishing mutually profitable long-term relationships with suppliers that offer an optimum price-quality ratio
- We develop reliable long-term relationships with consumers, using a long-term formula pricing system that ensures reliable company revenue
- We have a predictable order filling chain – from raw materials to delivery of the product to the consumer – with minimum process losses
- We comply with ISO social and environmental standards

3 SYNERGY

- We develop efficient cooperation between divisions

4 OPERATIONAL LEADERSHIP

- Operational efficiency is the main driver of OMK's future development

5 INVESTMENT LEADERSHIP

- Our investment policy is aimed at earning maximum profit or covering unacceptable risks
- We develop manufacturing of products that are in demand
- We implement an import-substitution programme

6 OMK EMPLOYEES ARE OUR PRIORITY

- Human capital is our most important asset
- We create teams of professionals first and invest further resources second
- Employee safety is the company's priority

7 SOLVENCY

- We always meet our obligations to creditors
- We maintain a reliable company debt-to-income ratio (debt/EBITDA), which ensures that we can reliably meet our obligations and are attractive to creditors

8 PRIORITY OF BUSINESS MODEL OVER PRODUCT

9 SAFETY AND ENVIRONMENT

- We are creating safe working conditions for staff and contractors and are constantly striving to reduce the environmental impact of our operations.

10 CORPORATE RESPONSIBILITY

- The company complies unwaveringly with all legal requirements and adheres to the principles of ethical behaviour in its interactions with internal and external interested parties, following the principles of accountability and transparency in our operations



2.0 BUSINESS MODEL

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Divisions >	Raw materials >	OMK Group assets – redistribution and integration >	Finished products
<p>LARGE DIAMETER PIPE DIVISION</p>	Slabs	TPM 5000 > Sheet > EPWS 4 >	Large diameter pipes Hot-rolled wide sheet
<p>OIL AND GAS PIPE DIVISION</p>	Scrap	Casting and Rolling Mill > Roll > EPWS 1 ² > EPWS 2 > EPWS 3 > EPWS 5 >	Oil and gas pipes Water and gas pipes Casing pipes Shaped pipes Hot-rolled sheet
<p>APP DIVISION</p>	Roll	Pipe production >	Oil and gas pipes Water and gas pipes Shaped pipes
<p>RAILWAY WHEELS DIVISION</p>	Scrap, Cast iron	Steel Works > Wheel rolling plant >	Railway wheels
<p>CMW DIVISION</p>	Blanks	Section rolling mill > Automotive spring shop >	Springs Rolled sections
<p>TRUBODETAL DIVISION</p>	Pipes, components, sheet steel	Trubodetal >	Pipeline fittings
<p>BVP DIVISION</p>	Scrap, rolled stock	Blagoveshchensk Valves Plant >	Pipeline valves

CLIENTS

² EPWS1 is a new shop for production and finishing of pipes



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The situation in the sectors where OMK operates remains difficult: major pipeline projects are being delayed, demand continues to fall, and difficult new challenges are arising. Nevertheless, in 2016 OMK undertook a number of projects aimed at putting the company's long-term strategy into practice, specifically: expanding existing production, developing new, in-demand products, and improving efficiency.

PRODUCTION SYSTEM

The businesses within United Metallurgical Company completed an annual production system audit cycle in accordance with the method employed by the Japanese company Toyota. According to the results, all OMK plants have made progress in comparison with the first audit conducted a year ago.

VSW received the highest score. For this, the plant was awarded a bronze medal for developing its production system according to the Toyota principles, becoming the first metals company in the world to be honoured with this award. The acknowledgement of VSW's achievements by the Japanese company once again confirmed the plant's operating efficiency and the high quality of its products.





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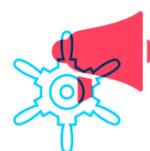
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MANAGEMENT

To improve the efficiency of the core business and concentrate on new projects, last year OMK sold off non-core and unprofitable businesses and assets.

- The company sold an American asset, the OMK Tube welded pipe production plant and associated finishing shops in Houston, USA, to the South Korean company SeAH Steel. The business had faced falling sales from late 2014 onwards due to the drop in oil prices and the decrease in oil production in the US. In view of the changes in market conditions and the continuing uncertainty on the US pipe market, we made the logical decision to sell the asset.
- OMK also sold the Baltic metals terminal in the port of Ust-Luga.



PIPES

- Construction of a new tubing production section and a casing finishing centre began at VSW, which will enable the company to enter the segment of diameters exceeding 245 mm.
- A project was implemented at VSW to construct a section for the application of polyurethane foam insulation to 219–1,067 mm diameter pipes.
- VSW launched production of complex pipes for the Nord Stream 2 project, pipes resistant to hydrogen sulphide cracking made of grade 13KhFA steel, and high-strength pipes with monolayer coating
- In response to market demand, VSW began production of thin-walled pipes, 51 mm in diameter with wall thickness of 2.5 mm, made of carbon steels in accordance with GOST 10705-80. A batch of pipes was shipped to a customer, who confirmed the high quality of the product.
- In line with the plan to expand the product range, the production of grade 05KhGB steel oil and gas pipes and tubes (including 159-mm-diameter pipes), casings of strength group 'L', and round and hollow sections made of grade C345 steel was developed.
- VSW began production of several new types of hollow sections, including some made of S235JRH steel in accordance with DIN 10219. Around 1,800 tonnes of these products were sold to non-CIS countries.





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PIPELINE VALVES

- OMK launched a project to localize in Russia the production of special-purpose ball valves for the gas industry up to 1,400 mm in diameter and designed for pressure up to 42 MPa. These are currently imported. For this purpose, the Ural Special Valves Plant (UZSA) was founded and commissioned in close cooperation with the Trubodetal plant at its industrial site, following the company principle of developing synergies between businesses and improving efficiency. The full-cycle production of ball valves for special conditions is planned for 2018–2019, with maximum localization over the subsequent few years.
- The Blagoveshchensk Valves Plant developed new sizes of wellhead valves and sixth-generation downhole pressure safety valves with increased capacity. The plant is constantly optimizing the existing designs of wedge gate valves and check valves to improve their specifications.

PIPELINE FITTINGS

- To meet customers' needs, the Trubodetal plant built and commissioned a section for the application of internal anti-corrosion coating on small- and medium-diameter pipeline parts.

RAILWAY WHEELS

- As part of its programme to improve efficiency, OMK signed a contract with Metalloinvest to supply steel billets for solid railway wheels. The 455-mm-diameter round cast billets will be produced at the Ural Steel complex owned by Metalloinvest and shipped to VSW. The contract runs until the end of 2027.
- During 2015 and 2016, VSW prepared to transition from the use of its own open-hearth billets to continuously cast billets. Test lots of wheels were produced, the required certification was conducted, and the installation of modern saw complexes continues.

SPRINGS

- Chusovoy Metallurgical Works retooled its equipment. Technical, marketing and pre-sales work was done to enter the market with its own Springer brand of springs for foreign vehicles
- As part of the localization programme, agreements were reached with world leaders in automobile manufacturing to supply test lots of Chusovoy springs to Ford Motors, BPW and Hyundai Motors assembly lines.
- Fifty-one new types of spring product were launched, including 16 for automotive plants and 31 for foreign vehicles.

STEEL

- OMK continues to develop new applications for its steel and to seek out customers for this type of product. One step forward in fulfilling this strategy was obtaining a TUV certificate, making it possible to supply S275N and S355N sheets after normalizing rolling in accordance with European standard EN 10025-3 for export orders from customers in construction and heavy industry.

Key projects focused on expanding production and developing new products with improved properties, and were implemented at VSW and the Trubodetal plant.

MAIN INVESTMENT PROJECTS IN 2016:

VSW:

- Constructing a high-tech finishing centre for casings 139.7–426.0 mm in diameter for the oil and gas sector
- Organizing a section for producing tubing, casings, and oil and gas pipes and tubes 60–178 mm in diameter
- Renovating the fifth tube section to expand the product line and increase production volumes
- Constructing VSW's own shop for the application of internal anti-corrosion coatings for 114–530 mm pipes in the third pipe section
- Purchasing a coupling sleeve machine complex
- Modernizing the wheel rolling section's preparation shop

Trubodetal

- Organizing the production of 57–630-mm-diameter pipeline fittings with internal anti-corrosion coating
- Modernizing the production of stamped and welded pipeline parts to conform to altered technical requirements





2.7 INVESTMENT AND R&D

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PRIMARY AREAS FOR R&D IN 2016:

- Launching the production of wheels made of continuous cast steel billets
- Optimizing the chemical composition of steels for the manufacture of rolled stock on the Thick Plate Mill 5000 and at the Casting and Rolling Mill
- A package of operations to increase the output of the Casting and Rolling Mill
- Reducing the content of non-metallic inclusions in steel
- Developing new types of threaded couplings
- Optimizing conditions for heat-treating pipes with high-frequency current

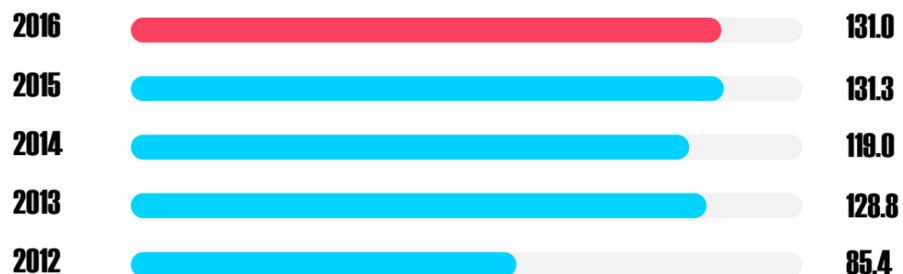
6.0

Investment (RUB billion)



131.0

R&D expenditure (RUB million)





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LARGE DIAMETER PIPES

OMK will strive to retain its substantial share of the Russian large diameter pipe market in the near future. Pipes will continue to be shipped for international projects (Nord Stream 2). There are plans to participate in pipeline projects for Gazprom (Power of Siberia, North European Gas Pipeline, etc.), Transneft and oil companies, and to supply large diameter pipes for workover and operating needs.



MANAGEMENT

In 2016, Vyksa Steel Works started implementing an automatic execution system. A contract for the project was signed with Danieli Automation, Italy. In four years' time, all VSW pipe facilities and the railway wheel rolling facility will be equipped with high-tech manufacturing execution tools. This will make VSW's order fulfilment more reliable and guarantee the quality of our product thereby helping meet customers' most stringent requirements.



SMALL AND MEDIUM DIAMETER PIPES

With respect to the highly competitive markets for water and gas pipes and hollow sections, OMK's objective is to maintain its existing position. The basis of this strategy is to meet the challenge of leading in terms of costs, and to take advantage of the capabilities of upgraded equipment.

Over the next three to five years, the range of medium and large diameter pipes is due to be expanded at production facilities, and there are plans to develop technology for thin-walled pipe production (using the capabilities of the Casting and Rolling Mill in the production of rolls with wall thickness of 1.0–1.3 mm), which will make it possible to reach new niche markets for these products. The supply of pipes for heavy industry, liquefied natural gas plant projects, and structural steel, including for unique structures (high-rise buildings, airports, stadiums, etc.), looks promising.

In the oil and gas pipes and tubes segment, the plan is to maintain OMK's current market position in the threaded and line pipes segments and to expand its product lines in the OCTG, oil and gas pipes and tubes, and casings segments. In addition, action will be taken to increase the share of high-strength threaded pipes in the shipments portfolio, as well as pipes with premium and semi-premium threading, and to differentiate grades of steel, coatings, and combinations thereof for different regions and fields.





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RAILWAY WHEELS

The switch to continuously cast billets guarantees steady fulfilment of orders, however complex, and the production of wheel products that meet the latest standards and demanding requirements of customers, including foreign customers. Work is under way to develop and introduce new products with improved consumer properties.



PIPELINE VALVES

We intend to develop our technical competencies and capabilities as regards integrated supplies of pipeline fittings and valves, and to increase the sales volumes of high-margin types of pipeline valve by developing promising new designs and technologies.



PIPELINE FITTINGS

With increasing competition from new manufacturers of pipeline fittings, the objective of the Trubodetal plant is to maintain its share of the Russian market at the current level, and to increase exports.



SPRINGS

Chusovoy Metallurgical Works continues to develop its own unique brand of springs for foreign vehicles. The plant will also continue to implement the localization programme for this type of production. Further market recovery, as well as an increase in the share of orders for small leaf springs, is expected.





2.0 RISK OVERVIEW

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	General				
Increasing competition due to the emergence of new manufacturers on the market	Tubular goods	railway wheels	pipeline fittings	pipeline valves	
Decreasing market capacity in Russia and the CIS	Tubular goods	railway wheels	automotive springs		
Stricter requirements in standards and specifications	Tubular goods	railway wheels	pipeline fittings	pipeline valves	
Rising prices for raw materials	Tubular goods	railway wheels	pipeline fittings	pipeline valves	automotive springs
Decreasing consumer buying power and rethinking of investment programmes	Tubular goods	railway wheels	pipeline fittings	pipeline valves	automotive springs

Specific	
Aggressive pricing policy of foreign competitors	Railway wheels
Environmental risks due to retention of open-hearth steel production	Railway wheels
Introduction of stricter requirements in European standards on painting of wheels by the manufacturer	Railway wheels
Counterfeit products	Pipeline valves



2016 MARKET OVERVIEW

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OMK products for the oil and gas, transport and other important industries are in demand worldwide. The company supplies pipes and tubes, railway wheels and automotive springs to more than 30 countries. Russia and the CIS are, however, the key markets for OMK.

GLOBAL STEEL MARKET

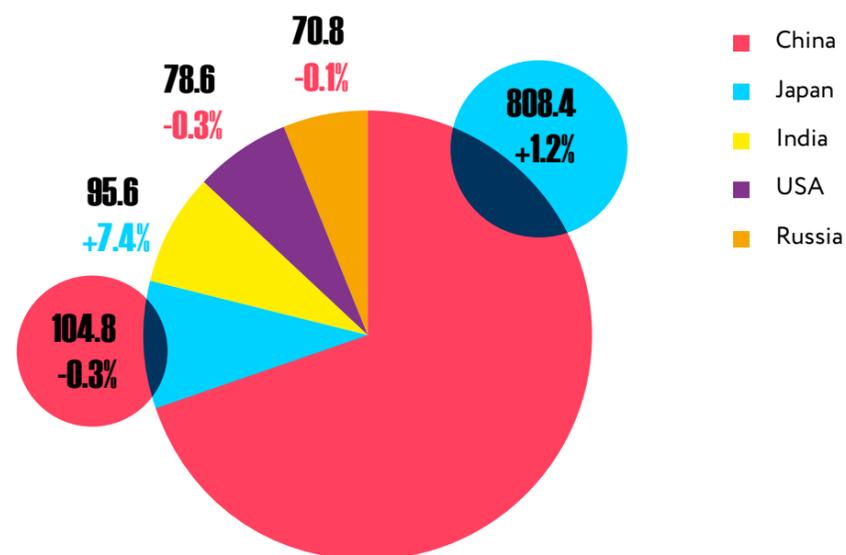
According to a report from the World Steel Association (worldsteel), total global steel production in 2016 was 1,628.5 million tonnes, 0.8% higher than the year before. Steel production decreased in Europe, America and Africa. On the other hand, it increased in the CIS nations, the Middle East, Asia and Oceania.

Russia was fifth in the ranking of nations with the highest production volumes, producing 70.8 million tonnes of steel (-0.1% in comparison with 2015); only the USA, India, Japan, and the undoubted leader, China, produced more.

World steel production in 2016³
(million tonnes)

1,628.5 +0.8%

Largest steel producers by country
(million tonnes)





2016 MARKET OVERVIEW

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DOMESTIC MARKETS

Pipes, fittings and pipeline valves

Pipes are OMK's key business, accounting for more than 80% of company revenues, so the situation on the domestic tubular goods market is decisive.

According to data from the Pipe Industry Development Fund, total pipe production in Russia was 10.3 million tonnes in 2016, 9% less than the year before, while pipe consumption fell by 10% in 2016 to 9.7 million tonnes. The main reason behind the shrinking of the Russian pipe market was the decrease in demand for large diameter pipes, down 35% in comparison with peak consumption in 2015, to 2.14 million tonnes. This is primarily explained by the decline in demand for large diameter pipes for the construction of new trunk pipelines in the Russian Federation.

Due to the increase in the length of oil and gas wells, the increase in drilling volumes, the maintenance of oil production levels, and the expansion of oil production in new territories with undeveloped infrastructure in 2016, consumption in the oil and gas pipes and tubes and OCTG segment increased by 2% to 3.1 million tonnes. But the biggest growth was seen in the heavy industry (industrial pipes) segment – up 9% to 189,000 tonnes.

The markets for pipeline fittings and pipeline valves fell in line with the pipe market for the same reason: the postponement of major projects and changes in the plans of strategic partners – oil and gas companies. In 2016, imports of pipe products increased by 19.5% compared with 2015, reaching 0.44 million tonnes.

Railway wheels

Demand for railway wheels showed some signs of reviving in Russia and the CIS and on the 1520 gauge market as a whole. But the situation is still difficult. The decrease in demand for the products of Russian manufacturers was driven by the increase in imports and the market share of Ukrainian wheels, despite the anti-dumping fines that were introduced in the Eurasian Economic Union at the beginning of the year at the initiative of the Eurasian Economic Commission (EEC).⁴

Springs

Chusovoy Metallurgical Works is the Russian leader in automotive spring production. The market for this type of product has decreased in recent years due to the slowdown of the economy as a whole, but certain positive signs were seen in 2016; in particular, freight haulage has experienced growth. Further market recovery, as well as an increase in the share of orders for small leaf springs, is expected in the future.

Pipe production in Russia in 2016⁵
(million tonnes)

10.3 -9%

Pipe consumption in Russia in 2016
(million tonnes)

9.7 -10%

Large diameter pipe consumption in Russia in 2016
(million tonnes)

2.14 -35%

⁴ Customs tariff regulations changed on 1 January 2016 due to Russia's decision to stop levying a 0% import duty on its trade with Ukraine. Russia now applies standard tariffs, similar to those on imports from outside the CIS, to imports of goods from Ukraine, including one-piece rolled railway wheels.

⁵ Infographic on this page – source: Pipe Industry Development Fund