# ANNUAL REPORT 2011

www.tmk-group.com

# CONTENTS

# 1. TMK PROFILE AND KEY INDICATORS

*TMK is one of the world's leading producers of steel pipes, Russia's largest producer and exporter of pipes and a noted player on the North American market. The Company's shares are traded on the London Stock Exchange, the OTCQX International Premier trading platform in the United States, and on Russia's major stock exchange — MICEX-RTS.*

*OCTG*

The Company was founded in 2001 and currently integrates production assets in Russia, the United States, Romania and Kazakhstan. TMK includes the Volzhsky Pipe Plant, Seversky Tube Works, Sinarsky Pipe Plant and Taganrog Metallurgical Works, located in Russia, TMK I PSCO, comprised of 11 production facilities in the United States, and TMK-Artrom and TMK-Resita in Romania. The Company also includes oil service assets: Orsky Machine-Building Plant, Truboplast, Central Pipe Yard and the Pipe Maintenance Department, located in Russia, and TMK-Kaztrubprom, located in Kazakhstan.

The consolidation of production assets and the use of leading scientific and engineering developments has allowed the Company to create a modern technological complex that manufactures high-tech and competitive products. TMK's unique production and service capabilities allow it to satisfy the demands of a wide range of customers and offer effective solutions for their operational challenges.

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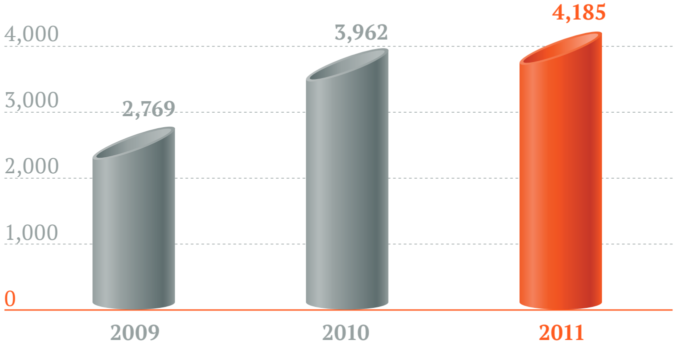
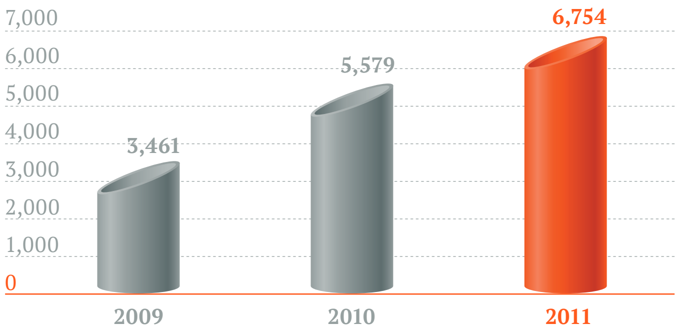
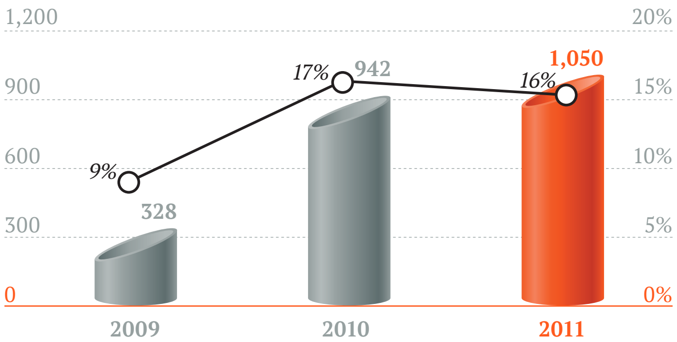
## PIPE SALES VOLUME
*thousand tonnes*



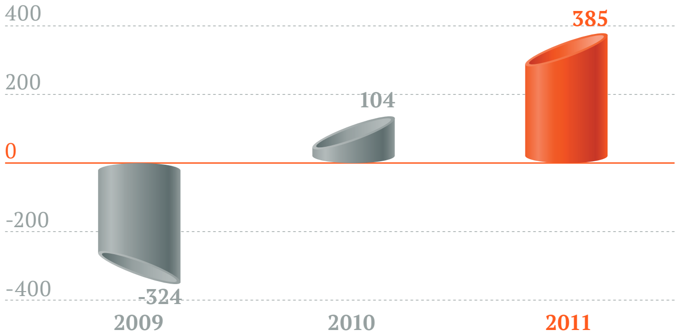

## REVENUE
*U.S.$ million*




## EBITDA
*and EBITDA margin*




## NET INCOME
*U.S.$ million*



# LETTER TO SHAREHOLDERS

# 2. LETTER FROM THE CHAIRMAN OF THE BOARD OF DIRECTORS AND THE CEO OF TMK

**Dmitry A. Pumpyanskiy**
Chairman of the Board of Directors

**Alexander G. Shiryaev**
President and CEO

*Dear Shareholders,*

In 2011, TMK continued both to grow and to deliver a better financial performance: revenues increased by 21%, EBITDA by 11% and net profit by 270%. TMK is once again ranked first globally by volume of pipe products shipped. We have greatly expanded our product mix and geography of sales—delivering pipe to more than 80 countries—and increased the share of high-tech oil and gas pipes in the total volume of pipe shipped. The share of OCTG and line pipe thus increased from 56% to 59% and shipments of TMK's family of Premium Connections and ULTRATM Premium Connections increased by 18.9% over 2010. Exceptionally strong results were demonstrated by our European division which increased the share of high-margin orders for industrial heat-treated alloy pipe in its portfolio. Together with other factors, this contributed to a record growth of annual revenue and EBITDA among the Company's divisions by 46% and 121%, respectively. We

***TMK is striving to strengthen the Company's position as one of the world's largest producers of steel pipe for the oil and gas industry***

also took positive steps to optimize the company's debt portfolio with a decrease in both the level and the cost of servicing the debt. The debt structure also improved, with the share of short-term loans falling to 14.7%, which allows us to comfortably carry out further refinancing in 2012. The current level of debt does not hamper the company's

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growth. Having completed most of TMK's strategic investment program, we do not expect capital expenditures to increase significantly in the near future.

By making increased business profitability a strategic priority, we are focusing strongly on the expansion of the Premium segment of our business. This will also enable us to meet the increasingly stringent demands of customers around the world as they explore and develop under more complex hydrocarbon extraction conditions. We are continually working closely with our customers to better understand their needs; in particular, we have developed four new gas-tight Premium Connections. TMK PF connections for casing and tubing, as well as ULTRA-QXTM connections have been certified according to the leading international ISO 13679:2002 CAL IV standard. We made our first deliveries of 13Cr steel casing and tubing with Premium Connections to Gazprom and Rosneft, and we shipped gas-tight, cold-resistant tubing with Premium Connections to Gazprom. In the U.S., our ULTRA Premium Connections are designed for a large part of the market for tubular products used in the extraction of shale gas. We have plans to increase our market presence in the Canadian oil sands and we have also begun supplying pipe to offshore projects in the Gulf of Mexico, Latin America, Southeast Asia and Russia.

*TMK is once again ranked first globally by volume of pipe products shipped. We have greatly expanded our product mix and geography of sales—delivering pipe to more than 80 countries—and increased the share of high-tech oil and gas pipes in the total volume of pipe shipped.*

In parallel with the development of an international network of licensees to thread our Premium Connections, we are also building our oil and gas services business to better meet the needs of customers. TMK technicians assist with the running of pipe in customers' oil and gas wells, train customers to handle Premium products and provide instruction to the service departments of oil and gas companies.

Despite these achievements, we do not intend to rest on our laurels, for there are still many challenges that lie ahead. These include further expanding the company's position on the global Premium products market, developing innovative products, improving operational efficiency, accelerating the return on investments, strengthening quality control and safety, and further developing research activities.

The launch of the new R&D Center in Houston, Texas (USA) in the summer of 2012 will have a positive effect on TMK's position in the global high-tech steel pipe market. At this center, we will be able to develop, test and certify new products, which will accelerate the journey from product creation to market delivery. In 2011, RosNITI, our Russian research institute, was active in the development of high-tech Premium products and the institute has plans for some 180 projects in 2012. In order to improve manufacturing processes and to reduce costs we have successfully implemented a system of continuous improvement that is based on the internationally recognized Lean Six Sigma methodology.

In 2011, the company continued its capital expenditure program. The main targets were an FQM continuous

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pipe-rolling mill at Seversky Tube Works (Russia) and a steelmaking unit with electric arc furnace at TAGMET (Russia). In 2011, other implemented capital projects included a shop to produce vacuum insulated tubing (VIT) at the Sinarsky Pipe Plant (Russia), a coating line and a pipe packaging and labeling unit at TAGMET, a line for the manufacture of casing with Premium Connections at the Orsk Machine Building Plant (Russia), and a second line to produce ULTRA Premium Connections at TMK IPSCO's facility in Brookfield, Ohio (USA). In 2012, we will continue work on two major projects at TAGMET and Seversky Tube Works. Investments will also be focused on expanding heat treatment and threading capacities at TMK IPSCO facilities in the U.S.

*An important priority of our strategic capital program is the gradual decommissioning of outdated equipment and the transition to the best available technology.*

An important priority of our strategic capital program is the gradual decommissioning of outdated equipment and the transition to the best available technology. Thus in 2011, our efforts were focused on improving the environmental safety of manufacturing processes, reducing the consumption of natural resources and minimizing waste products. Moreover, the use of innovative TMK products for hydrocarbon extraction can significantly improve efficiency and environmental safety. The use of ULTRA Premium Connections has contributed to a fundamental change in the U.S. energy mix in favor of natural gas—a cleaner energy source. In Russia, the use of TMK-manufactured vacuum insulated tubing (VIT) in fields in the permafrost zone avoids thawing and ground collapse around wells, as well as reducing materials consumption per well.

As before, in 2011 we attached great importance to our human resources and social policies. We actively carried out re-training and staff development at all levels and we continued to implement corporate programs related to pensions and medical care.

In developing our business, we remain guided by principles of informational and financial transparency and we continue to adhere to advanced standards of corporate governance as reflected in the constructive interaction between TMK's management and the Board of Directors and its committees.

Today, TMK's multinational team is striving to strengthen the Company's position as one of the world's largest producers of steel pipe for the oil and gas industry and we have set for ourselves the challenges of becoming a global leader in terms of financial performance, as well as improving operational efficiency and product quality. All this will serve as a solid foundation for further growth in shareholder value at TMK and the company's sustainable development as an integral part of the global oil and gas industry.

# KEY EVENTS

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# KEY EVENTS 2011

## *January*

TMK completes certification of large diameter pipe produced at the Volzhsky Pipe Plant from domestically rolled steel; products are in compliance with the DNV-OS-F101 standard for offshore pipelines.

TMK sends a shipment of seamless pipe manufactured at the Sinarsky Pipe Plant and Volzhsky Pipe Plant unique in its technical and operating characteristics to the Portovaya Compressor Station at Nord Stream gas pipeline.

TMK places Eurobonds in the amount of U.S.$ 500 million with a maturity of 2018.

## *March*

TMK takes part in run of pipe with TMK FMT Premium Connections in a well with a depth of more than 2.5 kilometers at a Lukoil offshore field.

A second line to cut ULTRATM Premium Connections was commissioned at TMK IPSCO's facility in Brookfield, Ohio, which allows for an expanded product mix and doubled production capacity.

## *April*

TMK ships casing with ULTRA Premium Connections to Gazprom Neft.

## *May*

TMK ships high-strength 13-Chrome steel pipe with premium connections to Tomskneft (OAO Rosneft) for the Chkalovskoye field.

## *July*

TMK completes independent run of tubing with premium connections in a well at the West Salym field for Salym Petroleum Development N.V.

TMK completes first casing string run in Russia in a well that connects land-based and offshore parts at the Yurkharovskoye field for Novatek.

## *August*

Casing with TMK PF premium connections was shipped by TMK to Daewoo Energy Central Asia, a subsidiary of Daewoo International.

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## *September*

As part of the Offshore Program, TMK ships seamless line pipe for the construction of an offshore pipeline by Gazprom.

The Standard & Poor's ratings agency raised long-term corporate credit rating on TMK from 'B' to 'B+', the Russian national scale rating was raised from 'ruA-'to 'ruA' with a forecast of "Stable."

## *October*

TMK runs production string of 276 casing pipes with premium connections for Gazprom Neft at the South Priobskoye field.

A modern thread line for casing with premium connections with an annual capacity of 24,000 tonnes of pipes was commissioned at the Orsky Machine-Building Plant.

## *November*

According to a joint study by PwC, the non-profit Donors Forum partnership, and the newspaper Vedomosti, TMK was acknowledged as one of the ten most effective corporate benefactors in Russia for 2010.

## *December*

TMK conducts successful tests and sends a trial shipment of casing with lubricant-free coating, which ensures the gas-tightness of connections and significantly reduced time for pipe preparation and running into the well.

TMK and Lukoil sign an agreement for 2012 under which TMK guarantees to supply 100% of pipe products required by Lukoil.

In 2011, four types of TMK premium connections are successfully certified under the international ISO 13679 CAL IV standard, which confirms the global level of quality and reliability of TMK connections and enables the company to enter the ranks of the leading global suppliers of pipe products for complex onshore and offshore hydrocarbon drilling and production projects.

3.

# KEY EVENTS
# 2012

## *February*

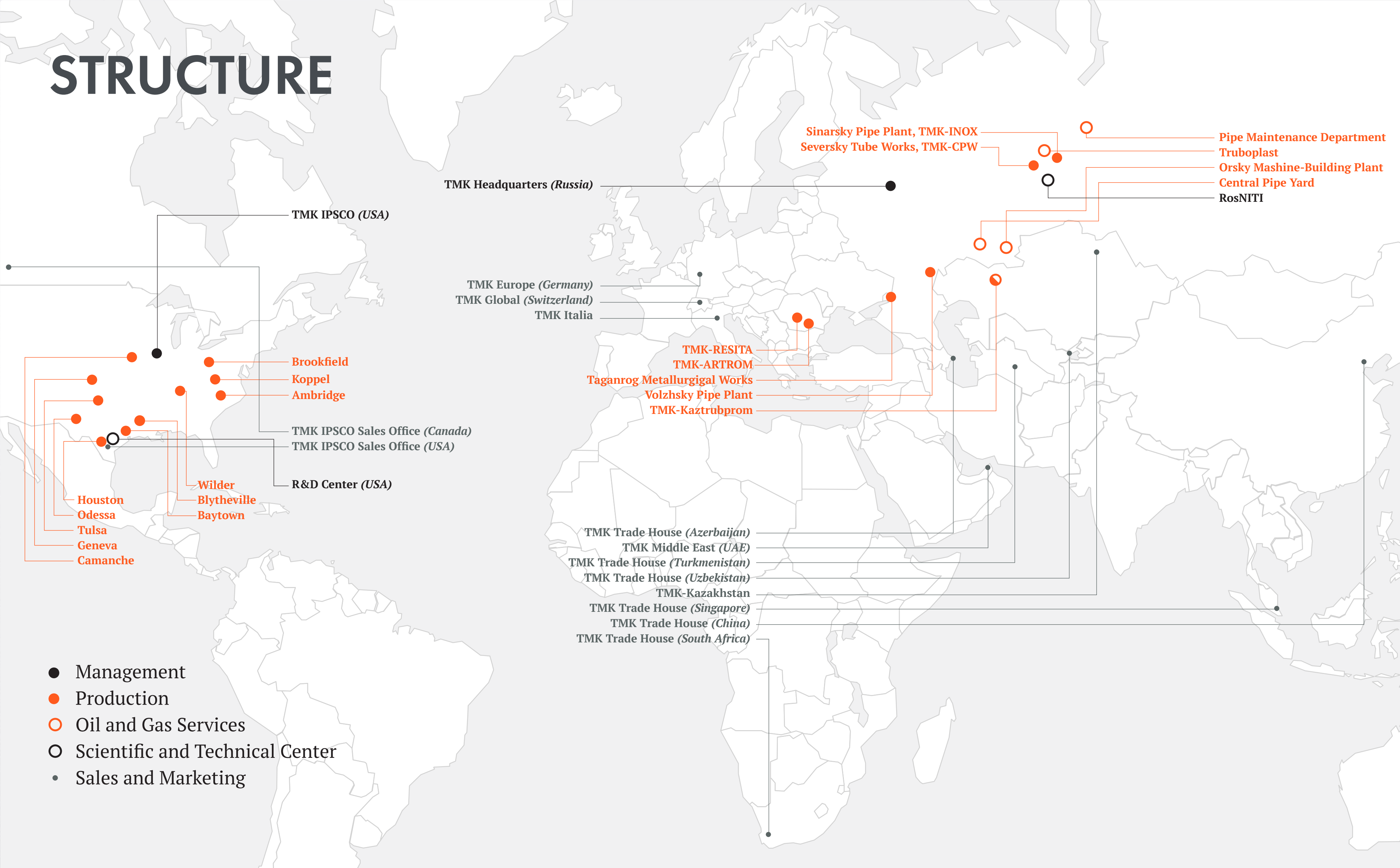
TMK becomes the first company in Russia to produce vacuum insulated tubing (VIT) and sends the first shipment to Gazprom for use in the Bovanenkovskoye gas condensate field on the Yamal Peninsula.

## *March*

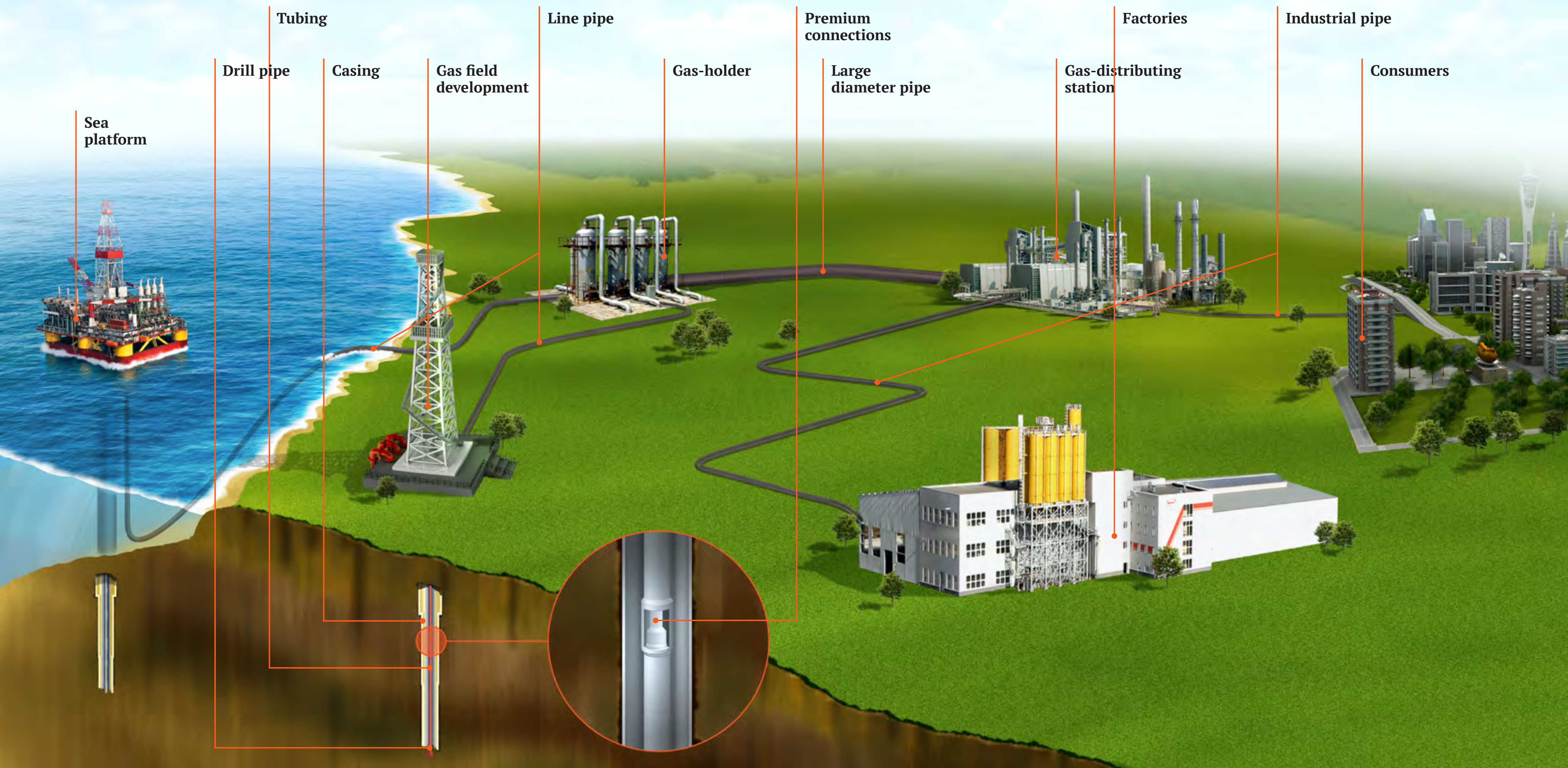
TMK PF ET premium connections successfully undergo testing for 100% gas tightness at the Oil States Industries international testing center.

# ABOUT THE COMPANY

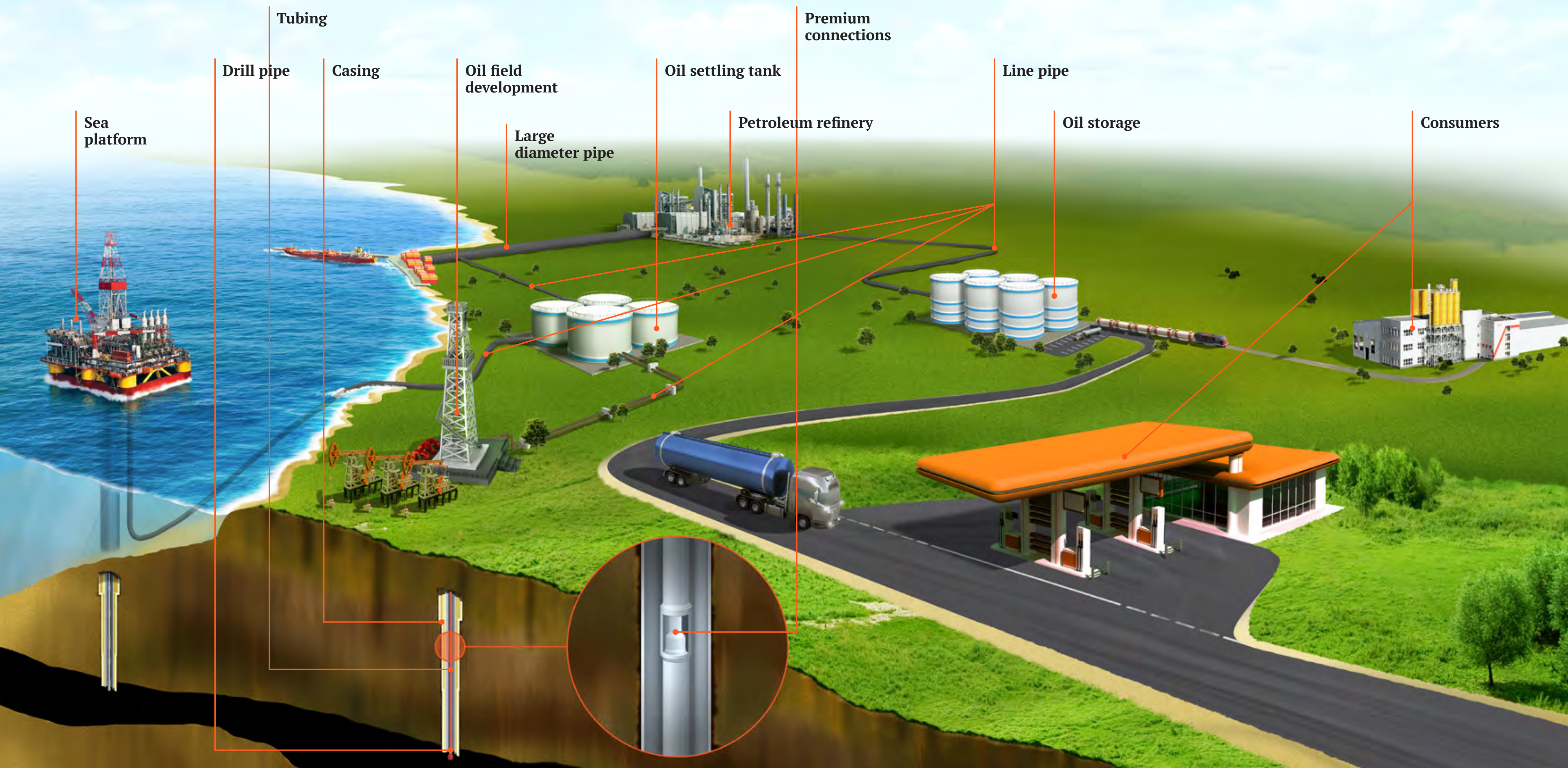
# 4.1 STRUCTURE



# USE OF TMK PIPE PRODUCTS FOR GAS PRODUCTION AND TRANSPORTATION



# USE OF TMK PIPE PRODUCTS FOR OIL PRODUCTION AND TRANSPORTATION



# 4.2 MARKET POSITION IN 2011

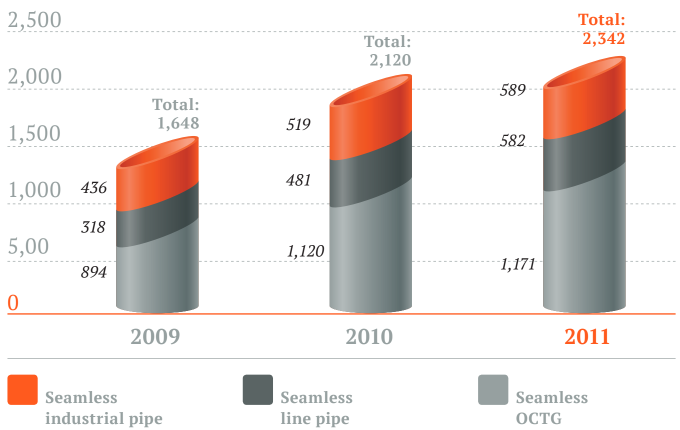
In 2011, the global pipe market showed a positive trend and grew by 8.8% over 12 months. One of the main reasons for the increase in demand was the increase in world oil and gas production.

*Against background of general growth, TMK was able to increase its pipe shipments by 6.6% in comparison to 2010, which is equivalent to an increase from 3,969 thousand tonnes to 4,232 thousand tonnes.*

Based on the results of 2011, TMK held a market share of 25% in Russia, 5.9% in the U.S. and 1.4% in Europe. As before, the production and sale of oil and gas pipe and premium connections remain priority areas for TMK. TMK's most robust market positions are in seamless pipe segments—line pipe and OCTG—as well as welded OCTG, with market shares of 21%, 14% and 9%, respectively.

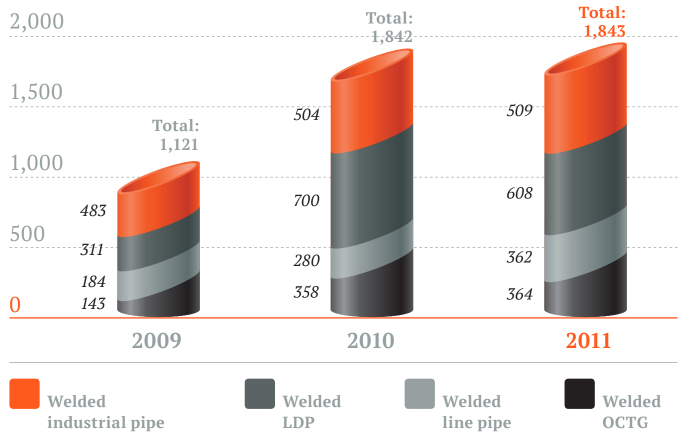
## STRUCTURE OF SEAMLESS PIPE SALES

*tonnes*




## STRUCTURE OF WELDED PIPE SALES

*tonnes*



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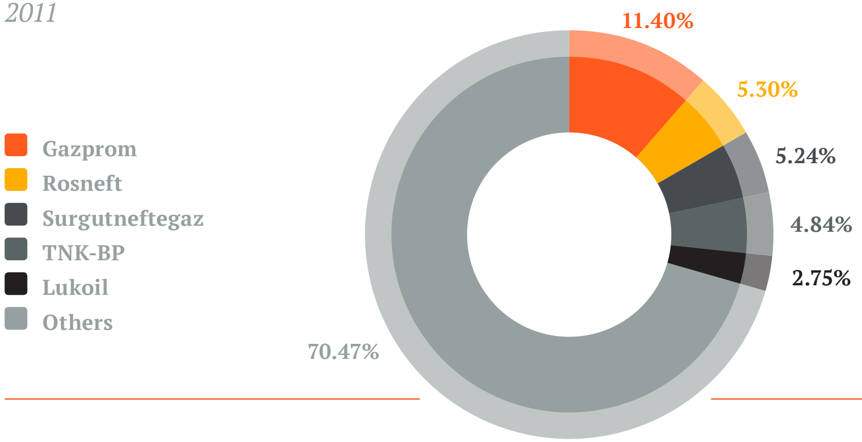
# TMK Sales Volume Trends by Division

| *thousand tonnes* | Russian Division | | | American Division | | | European Division | | |
|---|---|---|---|---|---|---|---|---|---|
| | *2011* | *2010* | *Change,%* | *2011* | *2010* | *Change,%* | *2011* | *2010* | *Change,%* |
| **Seamless pipe** | **1,883** | **1,699** | **+11%** | **281** | **253** | **+11%** | **178** | **169** | **+5%** |
| OCTG | 930 | 876 | +6% | 240 | 238 | +1% | 1 | 7 | -86% |
| Line pipe | 536 | 444 | +21% | 19 | 8 | +138% | 27 | 29 | -7% |
| Industrial pipe | 417 | 379 | +10% | 22 | 7 | +214% | 150 | 133 | +13% |
| **Welded pipe** | **1,232** | **1,290** | **-5%** | **611** | **551** | **+11%** | | - | |
| OCTG | - | - | n/a | 364 | 357 | +2% | | - | |
| Line pipe | 257 | 221 | +16% | 105 | 59 | +78% | | - | |
| Large diameter pipe | 608 | 700 | -13% | - | - | | | - | |
| Industrial pipe | 367 | 369 | -1% | 142 | 135 | +5% | | - | |
| **Total** | **3,115** | **2,989** | **+4%** | **892** | **804** | **+11%** | **178** | **169** | **+5%** |

## TMK SHIPMENTS BROKEN DOWN BY CUSTOMERS

*2011*




Of the pipe manufactured in Russia, 14% is exported. One of the most important export areas is the North American market. U.S. sales are primarily handled through distributor companies, through which products are sold to large energy companies: ExxonMobil, BP, Chesapeake, Chevron and Marathon Oil.

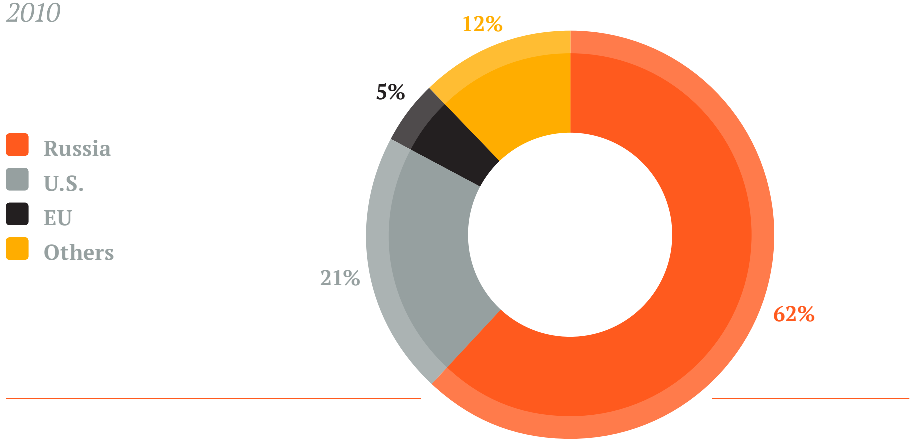
As one of the largest pipe manufacturers in the world, the geography of TMK shipments covers more than 80 countries.

Active demand on the part of U.S. and Canadian customers in 2011 enabled the reallocation of a portion of sales from the Russian and European markets.

4.2

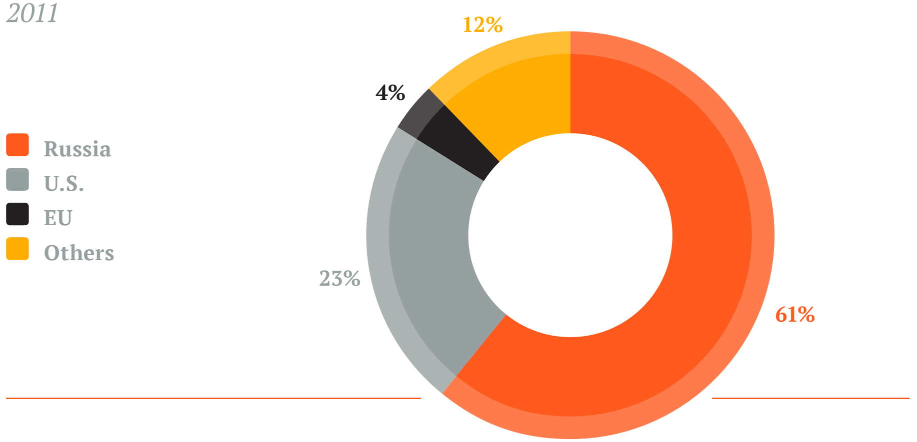
## GEOGRAPHIC BREAKDOWN OF TMK SALES

*2010*




## GEOGRAPHIC BREAKDOWN OF TMK SALES

*2011*




## Russian Market

As before, the Russian pipe market remains the largest for TMK with more than 60% of products sold being shipped to customers in Russia.

Throughout 2011 demand for pipe products in Russia increased by 12%, which was mainly due to growth in the industrial pipe segment—welded and seamless.

### *OCTG*

TMK's main operational priority is the production and sale of high-tech products with high added value, which to a large extent are represented by seamless OCTG.

In 2011, the market for threaded OCTG surpassed the pre-crisis level 2008 for the first time. Throughout 2011, TMK's sales of seamless OCTG in Russia increased by 8.5% compared with 2010, which allowed the company to maintain its market share in this segment at 61%. The main customers are the largest oil companies, including: Rosneft, Surgutneftegaz, TNK-BP Holding, Lukoil and Gazprom Neft.

In order to ensure the stability of pipe supplies to customers and a balanced load in utilizing production capacities, the Company is working to concluded long-term contracts (one year or longer) with its primary customers: TNK-BP, Surgutneftegaz and Lukoil. Thus, in December 2011, TMK and Lukoil signed an agreement for 2012 under which TMK guarantees to supply 100% of pipe products required by Lukoil.

*Large Diameter Pipe*

## *Line Pipe*

Due to the favorable conditions in the oil and gas market in 2011, sales of TMK line pipe increased by 6% compared to 2010. The volume of orders for pipe with internal anti-corrosion coating also increased. TMK is the only supplier among large pipe manufacturers in Russia with its own capacities in this regard.

## *Large Diameter Pipe (LDP)*

In terms of LDP production, 2011 turned out to be less successful for Russian producers than 2010: increased demand in the first half of 2011 stimulated growth in imports from Ukrainian pipe manufacturers, resulting in a decrease in TMK's market share for the year from 19.2% to 16.8%. Nevertheless, 443,000 tonnes of longitudinally welded large diameter pipe were sold to Gazprom, some of which have been used in the construction of an underwater pipeline for the Kirinskoye gas condensate field on the Sakhalin shelf, which, in 2014, will be a source of gas for the Sakhalin-Khabarovsk-Vladivostok pipeline.

Insofar as Gazprom completed several large investment projects in 2011, including the first branch of Nord Stream gas pipeline, the Gryazovets-Vyborg pipeline, the Pochinki-Gryazovets pipeline and the SRTO–Torzhok pipeline, orders declined in the second half of the year, a fact that also served as one of the causes of decline in production of large diameter pipe.

In 2011, following an agreement between Gazprom and producers of large diameter pipe, a price formula was developed and approved, went into force in January 2012 and is reflected in contracts for the supply of large diameter pipe for the needs of Gazprom. This agreement on the use of a single approach in the formation of prices dependent on price quotations for the metallurgical raw materials (iron ore, coking coal and scrap steel), sheet steel, and the price change index of industrial producers will make pricing of the company's products more transparent.

The company also sells large diameter pipe to markets in the CIS. The total volume of TMK shipments to this region was 17 thousand tonnes. Among the most significant pipeline projects that began to be implemented in 2011 were the South Iolotan, construction of a potash plant in Turkmenistan and the Beineu-Shymkent pipeline in Kazakhstan.

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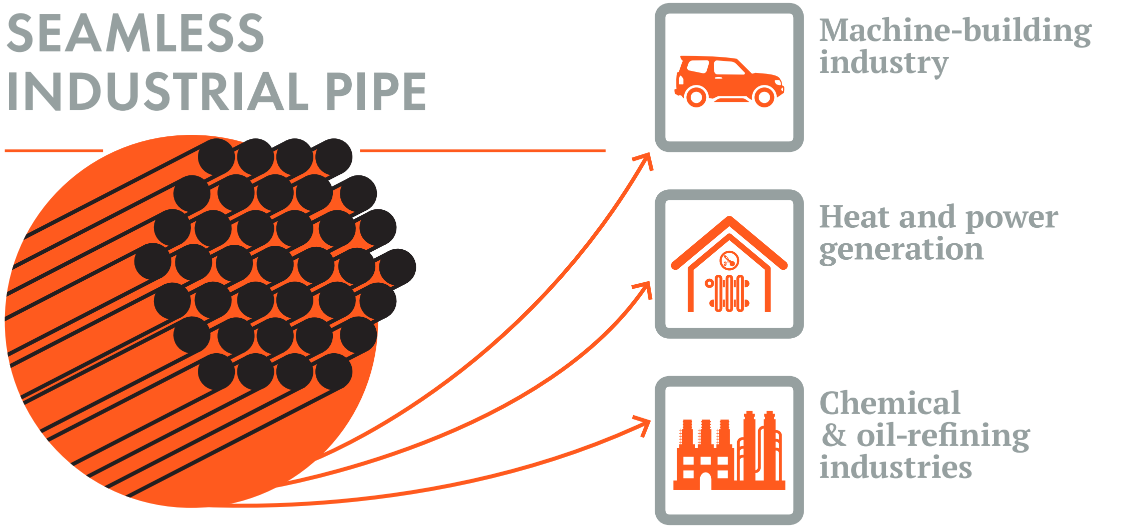
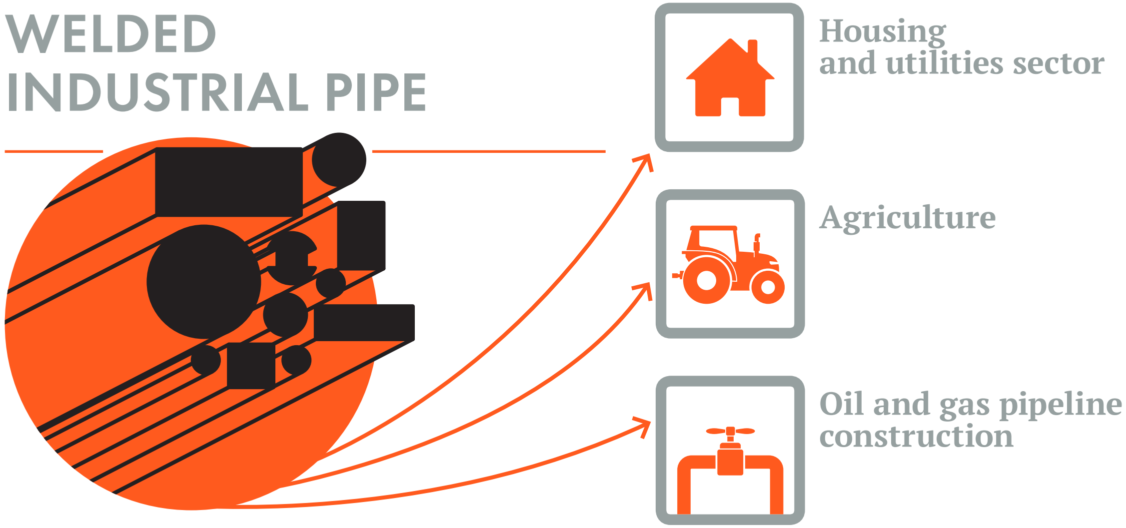
## SEAMLESS INDUSTRIAL PIPE




## WELDED INDUSTRIAL PIPE




### *Industrial Pipe*

Growth in sales of seamless industrial pipe is associated with the revival of demand on the part of:

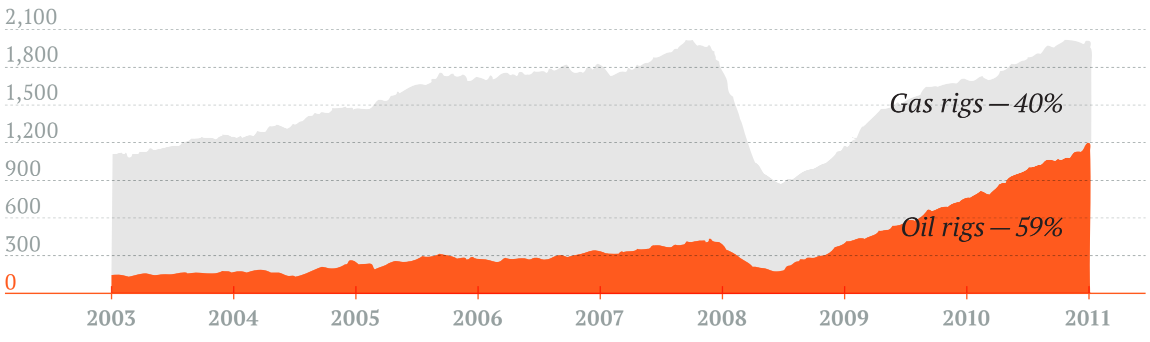
- the machine-building sector, including automotive companies
- oil refineries continuing construction and reconstruction of oil refining capacities in connection with the government program to adopt the EURO III environmental standard.

Significant growth in imports of welded industrial pipe was noted. Moreover, Russian manufacturers are strengthening their positions in other segments. The volume general purpose welded pipe and shaped pipe sales fell by 1% in comparison with 2010.

4.2

## DISTRIBUTION OF DRILLING RIGS IN THE U.S. BY PRODUCT TYPE

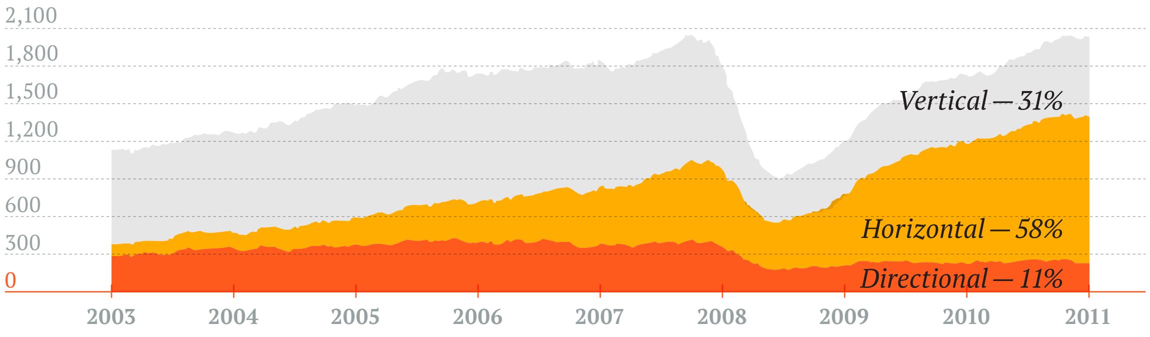
*Number of drilling rigs*




*Source: Baker Hughes*

## DISTRIBUTION OF DRILLING RIGS IN THE U.S. BY RIG TYPE

*Number of drilling rigs*




*Source: Baker Hughes*

## American Market

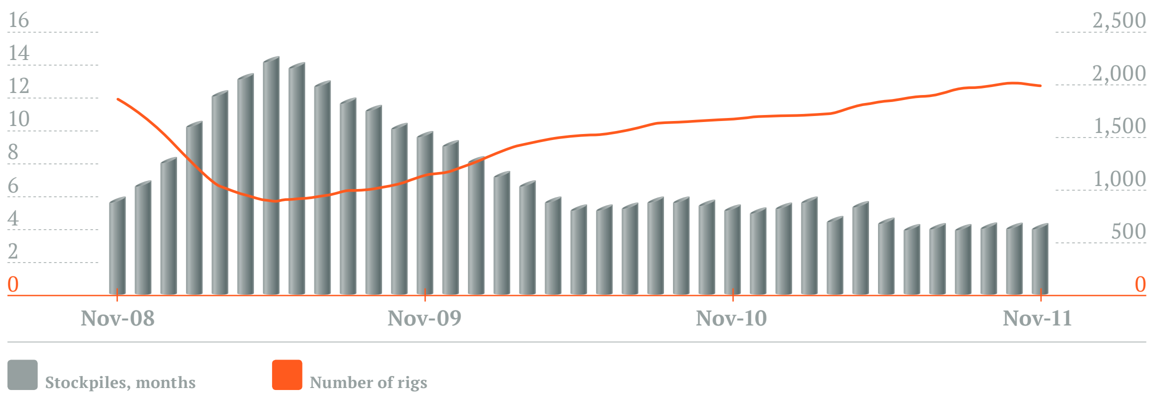
The total number of drilling rigs in the U.S. increased from 1,700 to 2,007 in 2011. Due to the oversupply of natural gas in North America, with a minimum price of U.S.$2.84 per 1 MMBtu achieved in November 2011 and an average price for the year of U.S.$ 4.00 per 1MMBtu. As a result, the number of gas rigs fell by 12%, from 919 units in January to 809 units in December 2011. However, high oil prices (U.S. $95 per barrel on average in the year) triggered an increase in the number of oil rigs by 56% to 1,193 units, and their number exceeded the number of gas rigs for the first time in several years. At the end of the year, the U.S. rig count was 40% for gas and 59% for oil with 1% consisting of mixed units. The largest share of drilling rigs is made up of rigs for horizontal and directional drilling, which are widespread in the U.S. At the end of 2011 their share was 69%.

Demand for pipe in the U.S. from oil and gas companies continued to grow in 2011, especially in the segment of line pipe required to transport extracted hydrocarbons to refining and storage sites. As a result, the market for line pipe in the U.S. grew by 21%, reaching 3.8 million tonnes, and the OCTG market increasing to 6 million tonnes, a 20% increase over 2010. The volume of OCTG stockpiles fell from 5 months to 4 months. The result of the growth in demand for hydrocarbon transport infrastructure has increased TMK's line pipe sales in the U.S. nearly twofold.

4.2

TMK IPSCO continues to strengthen its presence in the Canadian market, whose volume of OCTG in 2011 totaled about 1.2 million tonnes, showing 11% growth in comparison to 2010. Despite the fact that the number of drilling rigs in Canada decreased by 25% in 2011 from 564 to 429 units, production growth in the Bakken oilfield in Saskatchewan, as well as development of the oil sands in Alberta, have stimulated sales of welded OCTG production at TMK IPSCO, which has doubled to reach 87 thousand tonnes. As a large oil-producing region, Latin America is also of considerable interest when it comes to sales of the Company's products. The number of drilling rigs in the region increased in 2011 from 403 in January to 438 in December. TMK continues to strengthen its position in this region, with the first shipments of pipe with ULTRA Premium Connections being made to Peru, and Brazil signing partnership agreements to develop solutions for non-standard types of drilling.

## OCTG STOCKPILES IN THE U.S.



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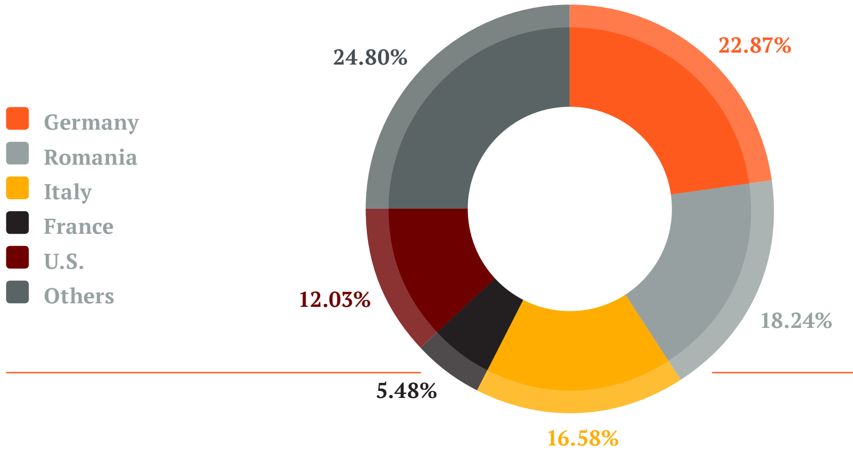
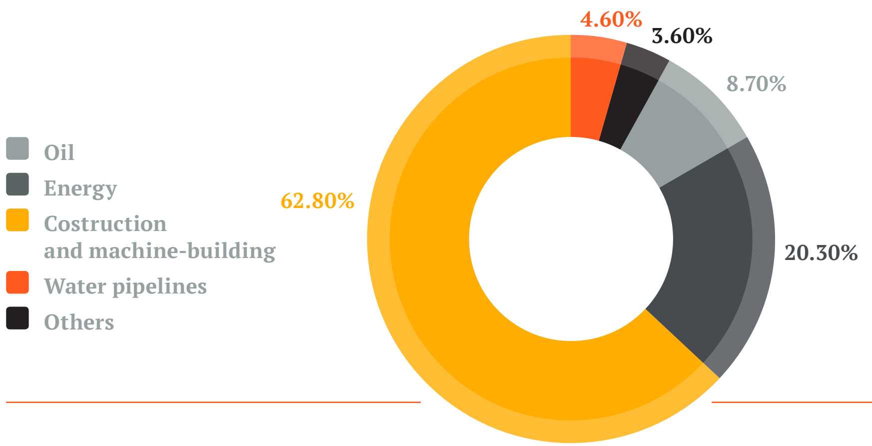
## GEOGRAPHIC BREAKDOWN OF EUROPEAN DIVISION SALES




## EUROPEAN DIVISION SALES BY SECTOR




## European Market

Despite the debt crisis in the European Union, the sales performance of TMK's Romanian facilities in 2011 demonstrate positive trends, with TMK-ARTOM's sales volumes achieving the best performance in the history of the company's existence. The peak of economic activity came in the first half of 2011 when the European market enjoyed a boom. Demand in large part came from countries in northern Europe such as Germany, the Netherlands and France.

*In 2011, the greatest demand was seen by seamless industrial pipe, which is widely used in the automotive industry, as well as mechanical tube and cold-rolled pipe.*

In 2011, TMK-ARTOM began manufacturing a new type of product—heavy-walled drill pipe—with a trial shipment being sold in the U.S. market. The high quality and successful operation experience helped to support an increase in orders for 2012 and expansion of the customer base.

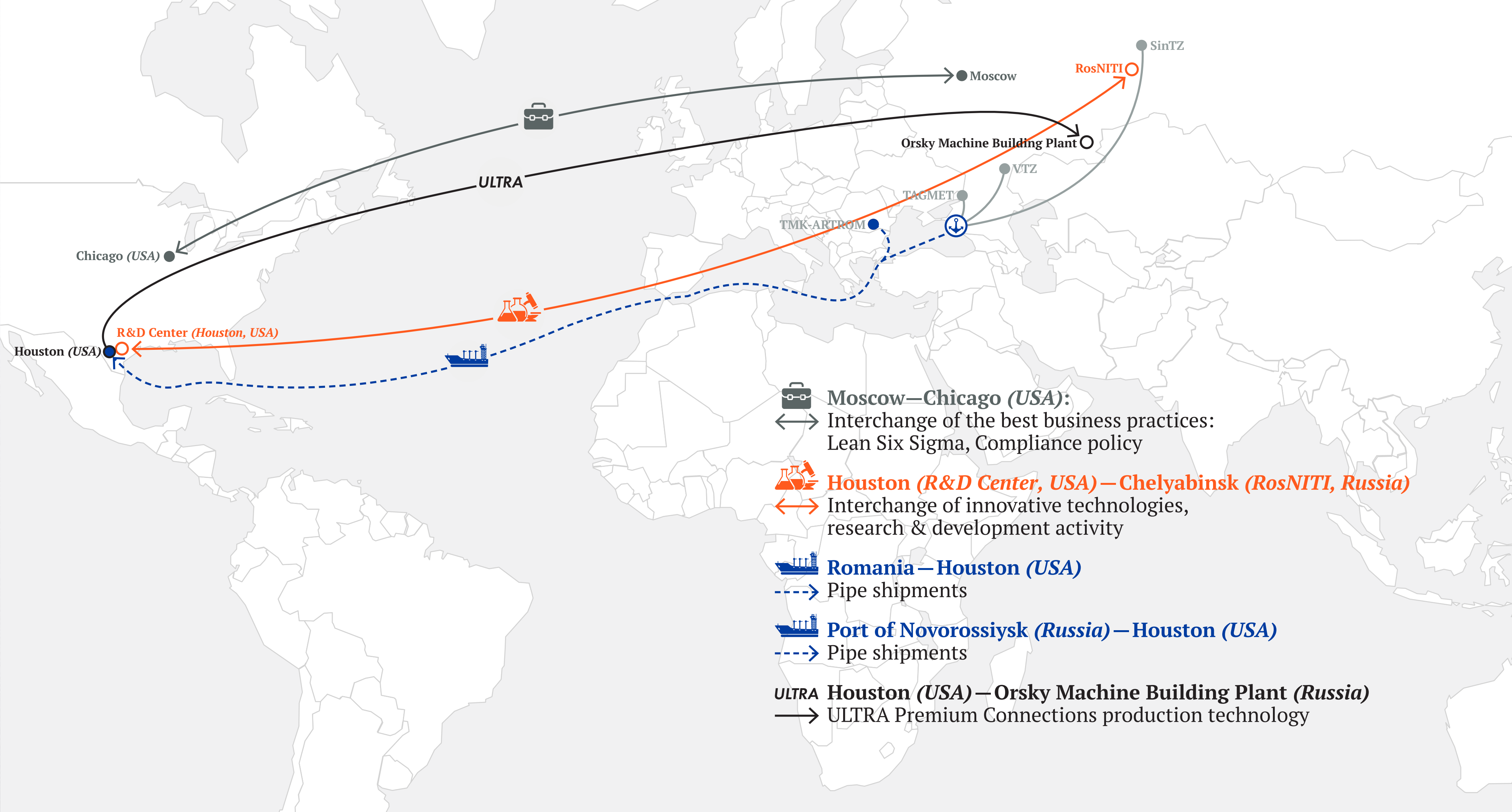
# 4.3 SYNERGY

The U.S. market is the world's largest consumer of OCTG and is showing a trend toward growth due to development of shale oil and gas drilling. At the same time, the capacity of North American pipe manufacturers satisfy no more than 50% of the volume demanded. Thus, TMK's entry into the North American market and the steady positioning of its products was a priority for the company. The acquisition of the IPSCO Tubulars Inc. and NS Group Inc., businesses in 2008, which were later renamed TMK IPSCO, was the first step toward accomplishing this task. In more recent years, the main priority has been to maximize the synergy effect of interaction between the American, European and Russian divisions in the following areas:

1. ***Increased shipments of Russian and Romanian pipe products to TMK IPSCO,*** which not only allow for sales of TMK pipe in North America, but also significantly expands TMK IPSCO's product range. TMK products exported to the U.S. are manufactured using the most modern technology and undergo additional quality control upon arrival at TMK IPSCO. Thus, TMK's lack of corresponding seamless pipe production capacities in the U.S. is offset by shipments from TMK's plants in Russia and Europe.
2. ***Exchange of advanced Russian technologies with TMK IPSCO.*** The company's U.S. facilities have access to the Russian division's modern technologies through the establishment of close relations with the Russian scientific community: research institutes and universities, including cooperation with RosNITI, which performs the role of a corporate research center responsible for the formation and implementation of the TMK Group's R&D plans.

   In addition, an example of successful technological cooperation can be found in the cooperation between TMK IPSCO and TMK-Premium Service, which has resulted in TMK IPSCO being granted a license to cut TMK PF, TMK GF, and TMK FMC premium connections on downhole equipment used by companies like Weatherford, Schlumberger, Halliburton, Davis-Lynch, and Topco.
3. ***The use of advanced American technology at Russian facilities.*** Exports of U.S. technology are reflected in the demand for ULTRA Premium Connections in Russia, which was exemplified by the delivery of casing with ULTRA SF Premium Connections in April 2011 to Gazprom Neft for use in the Urmanskoye field. In addition, in October 2011, TMK commissioned a shop to manufacture casing with premium connections, including ULTRA, at the Orsky Machine-Building Plant.
4. ***Through close cooperation with the American division, the European and Russian divisions have successfully implemented and continue to improve a program to adopt Six Sigma business practices,*** which are widely used in the U.S. and have helped the company to increase its operational efficiency.

# 4.3 SYNERGY MAP




**Moscow—Chicago *(USA)*:**
Interchange of the best business practices:
Lean Six Sigma, Compliance policy

**Houston *(R&D Center, USA)* — Chelyabinsk *(RosNITI, Russia)***
Interchange of innovative technologies,
research & development activity

**Romania — Houston *(USA)***
Pipe shipments

**Port of Novorossiysk *(Russia)* — Houston *(USA)***
Pipe shipments

ULTRA **Houston *(USA)* — Orsky Machine Building Plant *(Russia)***
ULTRA Premium Connections production technology

# 4.4 INVESTMENTS

***TMK began implementing its Strategic Investment Program in 2004. Its main purpose is to increase production efficiency and complete modernization of production processes throughout the entire technological chain. By 2011 most of the program had been successfully implemented. TMK plants are now fitted with the most modern equipment and meet international quality standards.***

Since 2004, the volume of strategic capital investment has exceeded U.S.$ 2 billion with the following being priority directions for investment:

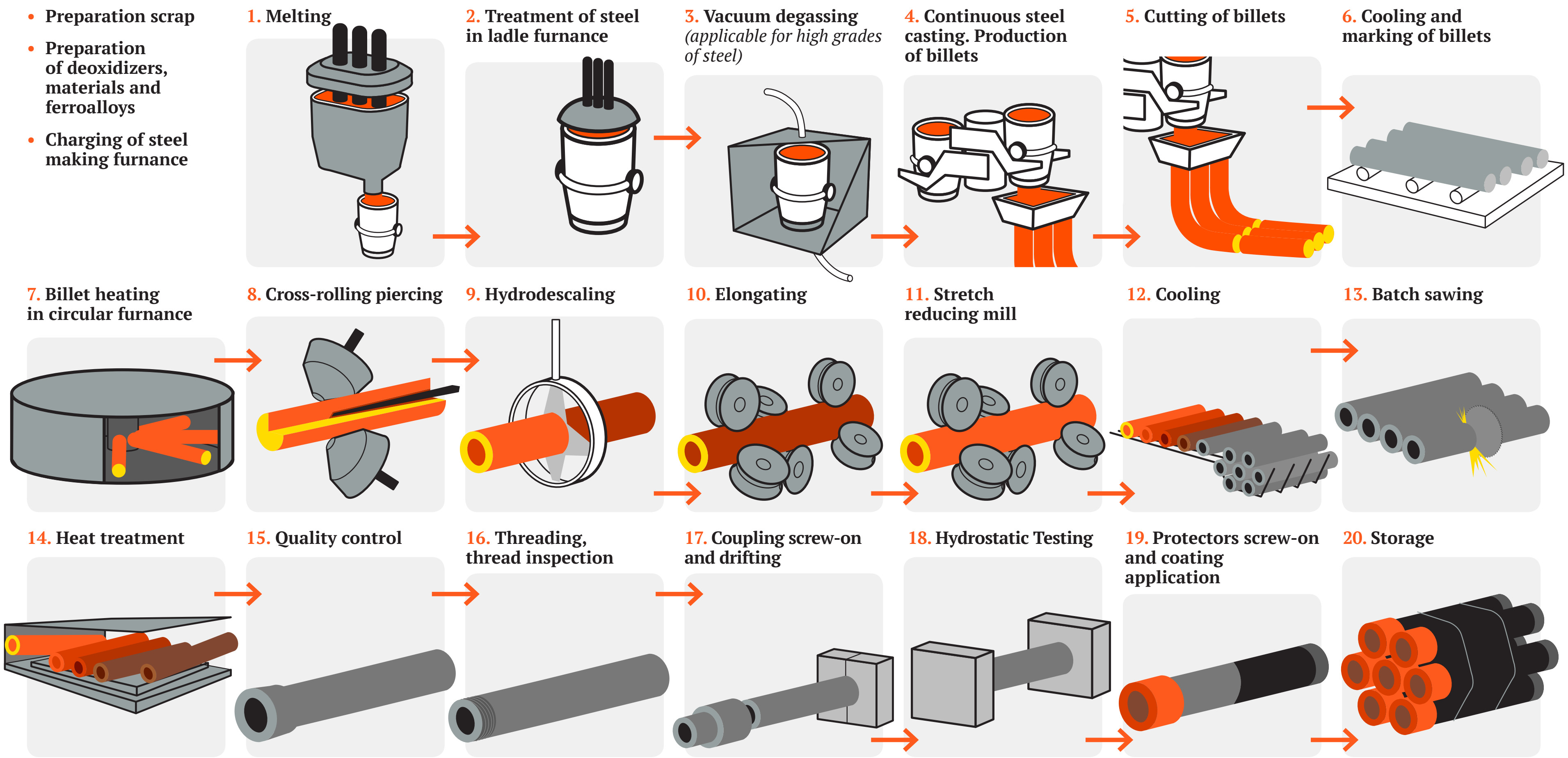
1. Modernization of steelmaking;
2. Increased threading and heat treatment capacities;
3. Improved control and test equipment;
4. Increased production capacities and improved quality of seamless pipe;
5. Modernization of LDP production;
6. Installation of equipment and introduction of technologies for environmental protection.

*Construction of an electric arc furnace at TAGMET*

# 4.4

The main challenge for TMK has been the creation of a continuous, vertically integrated process of manufacturing seamless pipe, beginning with steelmaking and ending with final processing.

## PRODUCTION OF SEAMLESS PIPE (MAIN TECHNOLOGICAL STEPS)



4.4

## *1. Production of seamless pipe*

**1.1. Steel and billets**

Capacities for the production of steel and billets exist at the Volzhsky Pipe Plant, Seversky Tube Works, TAGMET, TMK-RESITA, and TMK IPSCO (Koppel Plant in Pennsylvania). The most important areas of modernization in this area were: abandonment of obsolete technology using the open-hearth furnace, installation of electric arc furnaces (EAF), and the transition to continuous casting technologies.

In 2011, the main focus of investment in this segment was the ongoing construction of an electric arc furnace at TAGMET. Its commissioning is planned for 2013, after which the Company will be able to completely abandon open-hearth production.

With the implementation of this project TMK will complete the investment program with regard to its steel-making capacities.

**1.2. Production capacities to manufacture seamless pipe from round billets**

The main purpose of investing in seamless production is a complete modernization of production equipment, abandonment of obsolete technology (pilger mills), installation of modern continuous pipe-rolling mills, such as the PQF by Germany's SMS Meer and FQM by Italy's Danieli.

Equipment to produce seamless pipe has been installed at the Volzhsky Pipe Plant, Seversky Tube Works, TAGMET, Sinarsky Pipe Plant, TMK-ARTROM and TMK IPSCO.

The main investment target concerning equipment to manufacture seamless pipe is the replacement of the pilger mill at the Seversky Tube Works with a modern continuous FQM pipe-rolling complex, which will significantly improve the quality of pipe manufactured as well as expand the product range. This project is planned for completion in 2014-2015.

*Construction of a continuous FQM pipe-rolling complex at Seversky Tube Works*

**1.3. Finishing operations**

Finishing equipment is present at all plants TMK that have seamless pipe manufacturing capacities. This equipment includes lines for heat treatment, threading, upsetting, and the application of protective coating.

In 2011, the Sinarsky Pipe Plant launched a program to upgrade equipment with the goal of improving the quality of OCTG produced. This program includes the introduction of new lines and the modernization of existing lines for nondestructive testing (NDT), threading machines, a modern hydraulic press for hydraulic testing of pipe and new equipment to handle couplings. Project completion is scheduled for 2013.

At the Orsky Machine-Building Plant a shop to produce casing with premium connections was commissioned. Its design capacity is up to 24 thousand tonnes of pipe per year. In 2012, it is planned that production of ULTRA Premium Connections will be mastered at this site and that it will be equipped with a hydraulic press for testing. In 2012-2013, a new stamping line and billet annealing line are also due to begin operating, which will increase the volume and improve the quality of drill tool joints manufactured at the Orsky Machine-Building Plant, reducing the cost of production.

In March 2011, TMK IPSCO's plant in Brookfield, Ohio commissioned a second line to thread ULTRA Premium Connections. This equipment not only doubled the plant's production capacity, but it also allowed for the product range to be expanded, which includes the possibility of threading the new ULTRA-QX ™ Premium Connections that are of particular value in drilling deep wells under high pressures.

In 2011, at one of the company's Romanian facilities, TMK-ARTROM, launched a program to increase the share of high value added product sales was launched, which involves increasing the production of industrial pipe made of alloy steel that is subject to quench and temper operations, as well as cold-deformed pipe. Under this project construction work began on a new shop for pipe finishing and nondestructive testing.

## *2. Production of welded pipe*

### 2.1. Large diameter pipe

Capacities to manufacture large diameter pipe have been established at the Volzhsky Pipe Plant. The most modern product from a technological point of view and the most in demand on the market today is longitudinally welded large diameter pipe, so most of the investment in the development of large diameter pipe is in this direction. In 2011, additional mechanized transport was commissioned, with production logistics also being optimized.

### 2.2. Production capacities for welded industrial pipe

Capacities to manufacture welded industrial pipe has been established in Russia at the Seversky Tube Works and TAGMET, as well as at TMK IPSCO's plants in the U.S.

This area is not considered a priority for the company, so capital investments are made only when necessary to maintain existing production capacities.

### 2.3. Welded OCTG and welded line pipe

This type of pipe, which enjoys widespread demand by oil and gas companies, is primarily manufactured at TMK IPSCO's facilities.

In 2011, the plant in Wilder built a line to thread OCTG, which was completed and commissioned in late 2011. Total investments amounted to U.S.$ 10 million.

To date, most investment at TMK is focused on expanding the production of high-tech products and premium connections that meet the needs of the company's customers as much as possible.

4.4

In 2011, construction of a modern R&D Center was completed in Houston. The center will serve as a research platform for the development, testing and certification of premium connections. The implementation of these activities will improve the quality of tubular products and premium connections, which is especially important in connection with the increasingly complex conditions of oil and gas production. Construction of the R&D Center has allowed the company to cease using most of the services provided by outside firms related to analysis, modeling and testing of TMK IPSCO products. In 2012, there are plans to install testing stands, which will thus complete the project. In addition, in 2012, a facility to manufacture ULTRA Premium Connections and a service center will be built in Edmonton, Alberta, Canada in close proximity to oil and gas fields.

*In 2011, construction of a modern R&D Center was completed in Houston. The center will serve as a research platform for the development, testing and certification of premium connections.*

# 4.5 PREMIUM CONNECTIONS

*During 2011, TMK shipped 472 thousand premium connections developed in the company's Russian and American divisions, which is 18.9% more than during the same period in 2010. Growth in shipments of TMK's Russian premium connections was nearly 30% over the previous year.*

**Premium connections,** developed by TMK's Russian division are threaded on both casing and tubing intended for the construction of gas-tight strings for various purposes. Premium connections differ from the standard types of threads by their high level of reliability, high level of gas tightness ensured by special seal assemblies, and a wide range of applications in different operating conditions.

These connections have tight manufacturing tolerances, are developed on highly specialized equipment and undergo a thorough control process. To ensure proper assembly and operation of TMK's connections, specially trained specialists regularly take part in running pipe strings of varying complexity.

## The most significant events for TMK in 2011

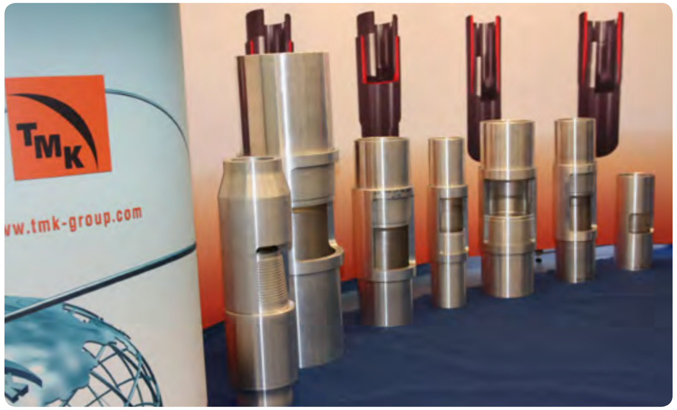
In December 2011, the first shipment of casing (diameter of 168mm) with gas-tight, cold-resistant TMK GF connections was made to Gazprom for use in the Bovanenkovskoye field.

A trial batch of casing with TMK GF premium connections (grade L80) made of 13Cr steel, specially commissioned by Gazprom, was produced at TMK's Volzhsky Pipe Plant. This was the first time production of this type of high-tech pipe had been developed for the Russian pipe market. TMK GF premium connections are used in directional wells and provide a high level of gas tightness in difficult conditions of high bending, compression, and tension stress; high torque and aggressive environments.

In 2011, the first shipment of vacuum insulated tubing (VIT) with premium connections and cold-resistant tubing threaded with gastight TMK FMT connections was made to Gazprom.

In May 2011, TMK shipped 13Cr steel pipe with TMK FMT premium connections to Tomskneft (owned by Rosneft) for use in the Chkalovskoye field. The pipe was manufactured under a cooperative agreement between the Volzhsky and Sinarsky plants.

Also in May, production of a new type of premium connection was mastered. TMK CWB connections are used




*TMK Premium Connections*

in drilling in the casing string. TMK CWB is an improvement on the Buttress connection widely used by Russian oil and gas companies. The new technology allows for increased gas tightness of the connection and improved operational efficiency. A distinctive feature of the TMK CWB is the possibility of joining it with other types of connections and its use as a sub. The new TMK CWB connection, designed for drilling in the casing string, was successfully tested for gas tightness with a combined load at VNIITneft.

> *In July, TMK carried out an independent run of tubing with TMK FMT premium connections into a well at the West Salym field for Salym Petroleum Development N.V.*

In June, certification of tubing with TMK FMT premium connections was carried out by Gazprom VNIIGAZ at TMK-Kaztrubprom. Certification included the analysis of quality management systems, technical documentation, production levels and equipment. Stand and acceptance testing of products was also conducted. As a result of certification, Gazprom VNIIGAZ recommended that tubing with TMK FMT premium connections manufactured by TMK-Kaztrubprom be used in the fields of the Far North, as well as in fields containing hydrogen sulfide.

In July, TMK carried out an independent run of tubing with TMK FMT premium connections into a well at the West Salym field for Salym Petroleum Development N.V. The run was carried out by specialists from TMK's Pipe Maintenance Department and TMK-Premium Service. The well was accepted on the basis of the first pressure test results.

In August, TMK shipped casing with TMK PF premium connections manufactured at TAGMET to Daewoo Energy Central Asia. The product was intended for use in an exploratory drilling program in 2011 in Uzbekistan.

In October, TMK ran a string of casing with TMK FMC premium connections in a well at the South Priobskoye field for Gazprom Neft. A production string comprised of 276 casing pipes with TMK FMC premium connections manufactured at TAGMET was run into the well. It was the first string run conducted by TMK-Premium Service for Gazprom Neft.

In the same month at the Orsky Machine-Building Plant, which is part of TMK's oilfield services division, a shop to produce casing with premium connections was commissioned. The first products manufactured were casing with a diameter of 168.22 mm and threaded with TMK FMC and TMK GF connections, as well as casing with a diameter and 244.83 mm and threaded with TMK GF connections. The design capacity of the new shop is 24 thousand tonnes of pipe of various sizes per year.

In 2011 and early 2012, casing with diameters of 244.48 mm and 178 mm and threaded with TMK PF connections were successfully tested for compliance with the requirements of ISO 13679—the most sophisticated level of CAL IV testing.

In March 2012, TMK PF ET premium connections with a diameter of 177.8 mm and wall thickness of 10.36 mm (grade L80) were tested for 100% gas tightness. During the tests the connections were subjected to internal and external pressure, tension and compression.

Particular attention is being paid to the ***offshore projects of TMK customers***. In 2011, the following projects were successfully implemented:

- Supply of TMK PF connections to the White Cat offshore field (Vietnam);
- Supply of ULTRA-FJ connections to the White Tiger offshore field (Vietnam);
- Supply of TMK FMT and TMK PF connections to Lukoil's offshore Korchagin field in the Caspian Sea;
- Running of pipe with TMK PF premium connections in both the onshore and offshore sections of a well at Novatek's Yurkharovskoye field. TMK is the first pipe company in Russia to run a string in this type of well. All TMK PF premium connections successfully handled the bending load during the transmission from the vertical to the horizontal pert of the well.

*New shop to manufacture casing at Orsky Machine Building Plant*

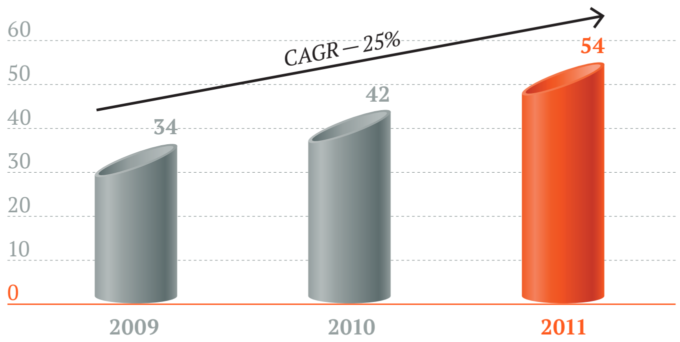
The sale of premium connections is not possible without a ***developed service network of licensees***, companies that manufacture the necessary tooling and casing string equipment and flow columns with premium connections. Such a service is particularly needed in remote areas of Russia and in foreign markets.

Today TMK has 18 existing license agreements to thread TMK premium connections at other enterprises, and 20 contracts are in various stages of signing. A positive example is the cooperation with TMK IPSCO, which has been granted a license to cut TMK PF, TMK GF, and TMK FMC premium connections on downhole equipment for Weatherford, Schlumberger, Halliburton, Davis-Lynch and Topco.

4.5

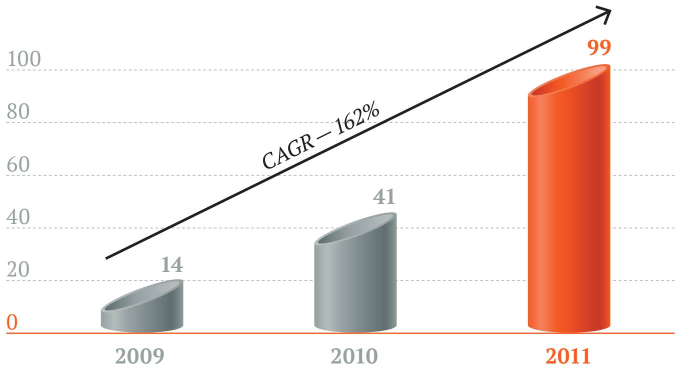
## GROWTH IN SHIPMENTS OF TMK'S RUSSIAN-MANUFACTURED PREMIUM CONNECTIONS

*from2009-2011, thousand tonnes*




## GROWTH IN SHIPMENTS OF TMK'S U.S.-MANUFACTURED ULTRA PREMIUM CONNECTIONS

*from2009-2011, thousand tonnes*



# 4.5

*ULTRA Premium Connections*

**ULTRA Premium Connections** are primarily connections without couplings for casing and tubing manufactured by TMK. They are widely used in developing shale gas in the U.S.

In early March, TMK IPSCO's in Brookfield commissioned a second line to thread ULTRA Premium Connections. The second line has allowed the company to thread pipe with a diameter of up to $13^5/_8$ inches, which exceeds the size range of the first line of up to $7^5/_8$ inches. Each line is capable of producing over 40,000 tonnes of pipe with ULTRA-DQX™, ULTRA-SF™ and ULTRA-FJ™ connections, including the new ULTRA-QX™ Premium Connection, which is of particular value in drilling deep wells and under high pressures.

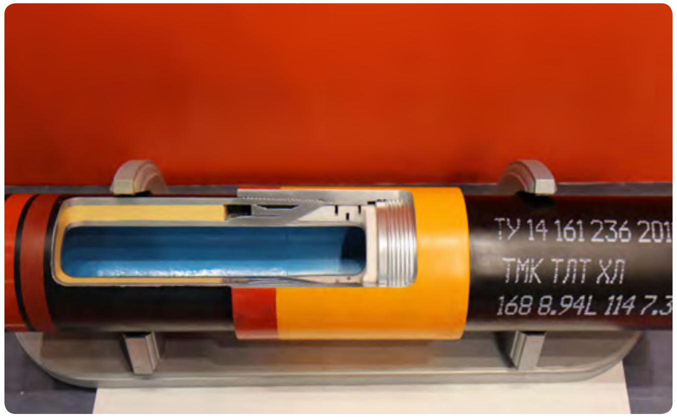
***In 2011, TMK IPSCO expanded its presence in Latin America with the first sales of ULTRA Premium Connections being made in Peru.***

In April, TMK shipped casing with ULTRA-SF Premium Connections to Gazprom Neft. The product is intended for use in the Urmanskoye field in the Tomsk Region.

In June 2011, ULTRA-QX Premium Connections with a diameter of 244.48 mm and a wall thickness of 13.84 mm was certified under the ISO 13679 CAL IV standard. ULTRA-QX Premium Connections are characterized by high tension and compression strength, a high capacity for bending, and resistance to other adverse external factors.

ULTRA Premium Connections are supplied to the U.S., Malaysia, Indonesia, Vietnam, Bolivia, Peru, Colombia, Brazil, Canada and Russia. TMK IPSCO has taken another step to capture the Canadian market by delivering a series of pipe with ULTRA-DQX™ connections to the Cordova Bay in British Columbia. In 2011, TMK IPSCO expanded its presence in Latin America with the first sales of ULTRA Premium Connections being made in Peru. In Brazil, the TMK is continuing to develop individual solutions for customers engaged in non-standard drilling. In 2011, the Premium division of TMK IPSCO produced a record number of 340 thousand ULTRA Premium Connections.

# 4.6 RESEARCH & DEVELOPMENT



Vacuum Insulated Tubing

In Russia, TMK's research center is RosNITI — the largest Russian research institute in the area of pipe-manufacturing technology. RosNITI is responsible for the overall coordination of research and development activity at TMK, as well as R&D at the company's Russian manufacturing facilities.

> ***In January 2011, TMK sent a shipment of seamless pipe to Gazprom for construction of the Portovaya compressor station—unique in its technical and operating characteristics—which will be a starting point for the Nord Stream gas pipeline.***

Research & Development Center in Houston

In the U.S., research activities are concentrated at the R&D Center in Houston, which is installing two connection testers and plans to obtain accreditation for the right to certify premium connections.

## Introduction of research developments into production in 2011

In 2011, TMK was the first in Russia to master the production of vacuum insulated tubing (VLT) at the Sinarsky Pipe Plant, and in early 2012, it had already sent the first shipment of VIT to Gazprom for use at the Bovanenkovskoye gas condensate field on the Yamal Peninsula. The thermal characteristics of TMK's VIT, confirmed by experts at Gazprom VNIIGAZ, allowed the assembly and all procedures preceding the run to be conducted in a timely manner. The VIT construction is designed as a "tube inside a tube" whereby a pipe of a smaller diameter is placed in one of a larger diameter. The space between the pipes contains a multi-layered insulation screen and creates a high vacuum to reduce heat loss. This pipe is intended for fields located in the most difficult conditions of oil and gas production—i.e., in the permafrost zone—and helps prevent thawing of the soil around the well.

In January 2011, TMK sent a shipment of seamless pipe to Gazprom for construction of the Portovaya compressor station—unique in its technical and operating characteristics—which will be a starting point for the Nord Stream gas pipeline. The TMK pipe, manufactured at the Sinarsky and Volzhsky plants, is designed to assemble a manifold pipeline that connects separate units of the Portovaya compressor station, including gas compressor units, a gas treatment facility, etc. Pipe production was carried out at TMK facilities and resulted in the strength properties required by Gazprom's special technical specifications. TMK production facilities proved their readiness to produce specialized products for such a complex and high-tech facility.

At the Volzhsky and Sinarsky plants a new high-tech product was manufactured—casing and tubing made of 13Cr steel and threaded with TMK FMT and TMK GF premium connections. Experimental work related to the selection of materials and steel heat treatment regime for cold resistance down to -60° C was carried out. In May 2011, TMK sent a shipment of tubing made of 13Cr steel to Tomskneft for use in the Chkalovskoye field. TMK became the first Russian pipe manufacturer to produce pipe from this type of steel for use in the extraction of hydrocarbons.

In December 2011, TMK produced a trial batch of casing with lubricant-free coating at TAGMET. The new coating was developed in conjunction with scientists from St. Petersburg. It ensures the gas tightness of connections on a casing string. In addition, lubricant-free coating significantly reduces the time to prepare the pipe for its run into the well by removing the process of washing the threads that was previously required before connection-sealing lubricant was applied. These casing pipes successfully passed a series of tests in an actual oil rig, regaining full gas tightness.

In 2011, TMK-ARTROM, part of TMK's European division, produced and shipped a new product — a heavy-walled drill pipe (level 1340). Before orders for this type were placed, the first consumer — a North American company — conducted an audit at both of TMK's Romanian plants — TMK-ARTROM and TMK-RESITA — which ended with a positive conclusion. In 2011, a shipment of 1,720 tonnes heavy-walled drill pipes was sent to this company.

4.6

## TMK-INOX

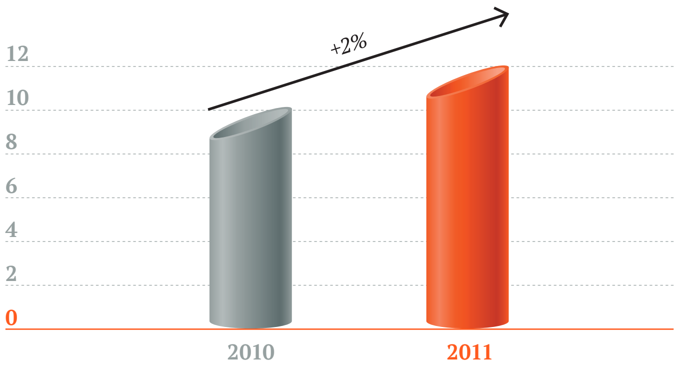
TMK-INOX is a joint venture between TMK and RUSNANO[1] with shares of 51% and 49% respectively. It provides management, organization and logistics services related to the production of precision pipe manufactured from stainless steels and alloys.

During 2011, TMK-INOX mastered the production of stainless steel seamless pipe measuring up to 30 meters in length. It also began to introduce technology to manufacture long welded pipe made of stainless steel.

The main customers of stainless steel seamless pipe manufactured by TMK are power engineering plants, chemical and petroleum engineering plants, nuclear industry enterprises, as well as enterprises, aviation and defense engineering, the chemical and petrochemical industry and metallurgy.

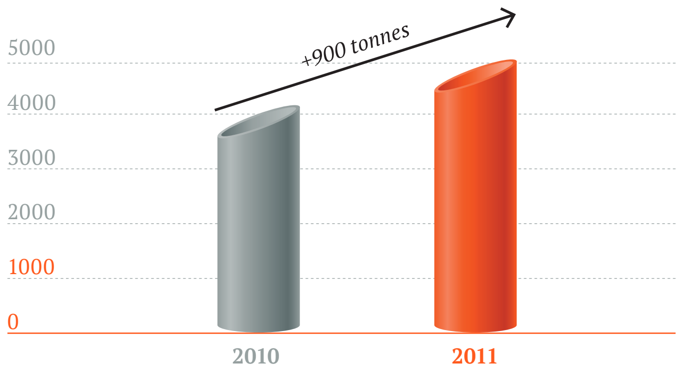
### TMK SHARE OF THE RUSSIAN MARKET FOR STAINLESS STEEL PIPE

*%*




### TMK VOLUMES SUPPLIED TO THE DOMESTIC MARKET

*tonnes*




[1] *RUSNANO was established in March 2011 as an open joint-stock company through reorganization of state corporation Russian Corporation of Nanotechnologies. RUSNANO's mission is to develop the Russian nanotechnology industry through co-investment in nanotechnology projects with substantial economic potential or social benefit. The Government of the Russian Federation owns 100 percent of the shares in RUSNANO.*

# TMK SECURITIES

# 5. SHARE CAPITAL AND DIVIDENDS

## *Share capital structure*

As of December 31, 2011, the share capital of OAO TMK consisted of 937,586,094 fully paid ordinary shares. The nominal value of one share is 10 rubles. OAO TMK does not have any outstanding or declared preferred shares.

## *Main shareholders of OAO TMK as of December 31, 2011*

| | *Number of shares* | *%* |
|---|---|---|
| TMK Steel Ltd. *(incl. affiliated companies)** | 653,264,243 | 69.68% |
| Subsidiaries of OAO TMK | 2,914,540 | 0.31% |
| TMK Bonds S.A.** | 71,505,956 | 7.63% |
| Free float | 209,901,355 | 22.38% |
| **Total:** | **937 586 094** | **100.00%** |

* *Dmitry A. Pumpyanskiy is the main beneficiary of TMK Steel Ltd.*

** *TMK Bonds S.A. owns 71,505,956 shares of OAO TMK, which is 7.63% of the share capital, with a view to ensuring liabilities to convert into TMK GDRs obligations amounting to U.S.$ 412.5 million that were issued in February 2010 and mature in 2015. Conversion of obligations into GDRs is possible at a price of U.S.$ 22.927 per GDR.*

As of December 31, 2011, 22.38% of shares of OAO TMK were in free circulation, of which approximately 90% are in the form of Global Depositary Receipts (GDR) circulating on the London Stock Exchange. Members of the Board of Directors of OAO TMK and the Company's management owned 798,821 shares, which is approximately 0.09% of share capital.

OAO TMK shares are traded on Russian and international exchanges.

Shares are traded on:

- The MICEX-RTS stock exchange under the trade ticker TRMK (Bloomberg:TRMK:RM / Reuters: TRMK.MM); and
- Global Depository Receipts (GDR) on the London Stock Exchange under the trade ticker TMKS (Bloomberg: TMKS:LI / Reuters:TRMKq.L).

| | *REG.S* | *144A* |
|---|---|---|
| CUSIP: | 87260R201 | 87260R102 |
| SEDOL: | B1FY0V4 | B1G3K21 |
| ISIN: | US87260R2013 | US87260R1023 |

5.

American Depository Receipts (ADR) are traded on the OTCQX trading platform under the trade ticker TMKXY (Bloomberg: TMKXY:US / Reuters: TMKXY.PK).

| | |
|---|---|
| CUSIP: | 87260R300 |
| ISIN: | US87260R3003 |

TMK shareholders are entitled to receive dividends for the first quarter, six months, nine months and / or for the financial year subject to the conditions set by the OAO TMK's Regulation on Dividend Policy (http://www.tmk-group.ru/files / divpolicy_150307_l.pdf). TMK's goal is to pay dividends in an amount no less than 25% of the annual consolidated net income, calculated in accordance with International Financial Reporting Standards (IFRS).

Dividend payment history:

| *Period* | *Announced dividends per 1 share, rubles* | *Total announced dividends, rubles* | *Dividends paid, rubles* |
|---|---|---|---|
| 2010 | 0.85 | 796,948,179.9 | 796,761,047.55 |
| 1H 2011 | 0.93 | 871,955,067.42 | 871,783,336.14 |

As of December 31, 2011, TMK's market capitalization was USD 2.1 billion.

The weight of TMK securities in indices as of December 31, 2011:

| *Index* | *Weight* |
|---|---|
| MSCI Russia | 0.29% (GDR) |
| MICEX M&M | 1.88% (shares) |
| MICEX MC | 0.51% (shares) |

# REPORT ON CORPORATE GOVERNANCE

# 6.1 CORPORATE GOVERNANCE SYSTEM

*The Chairman of the OAO TMK Board of Directors, Dmitry Pumpyanskiy, was pronounced the winner of 6th National Prize "Director of the Year" 2011 in the category of "Chairman of the Board of Directors: input in development of corporate management."*

**The corporate governance system** of OAO TMK regulates the interaction process between management bodies and internal Company control, shareholders and other interested parties and is aimed at ensuring balance of their interests.

The corporate governance system is regulated by Company's internal documents that are accessible on the TMK website *(http://www.tmk-group.com/company_documents.php)* and include the Code of Corporate Governance of OAO TMK (the Code), which was approved in the reporting year by OAO TMK's Board of Directors and can be accessed at http://www.tmk-group.ru/files/corp_gov_code_ru.pdf. The Code is fully in line with the Russian legislative requirements concerning joint stock companies and capital market regulator's standards for companies whose securities are included in the highest level of exchange listing. The Code also follows the corporate governance principles of the Organization for Economic Cooperation and Development (OECD), as well as best Russian and international corporate governance practices. The corporate governance practice of the Company in 2011 was in full compliance with the Code of Corporate Governance.

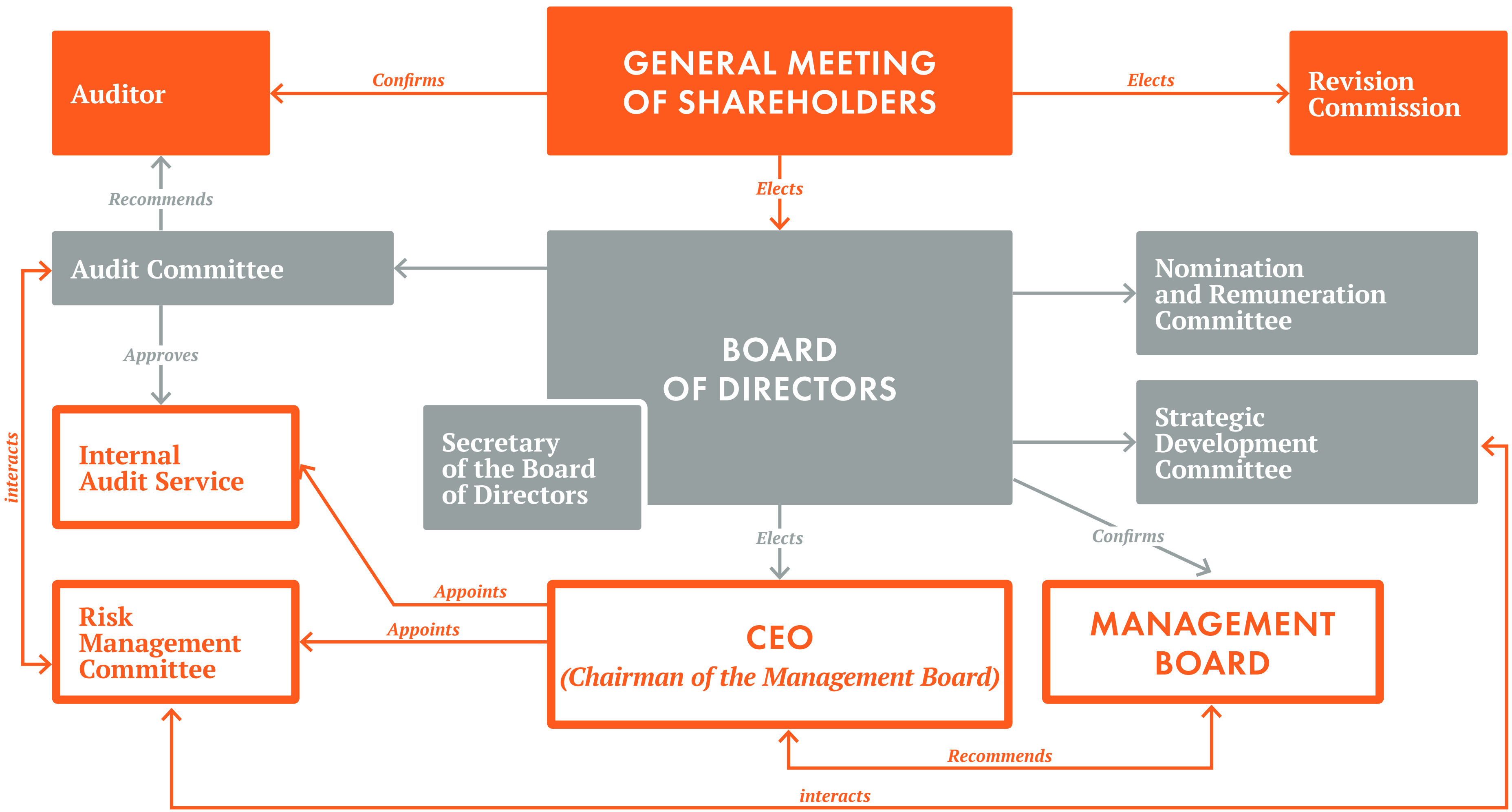
## *OAO TMK's Principles of Corporate Governance*

- equal treatment of the Company's shareholders, observance and protection of their rights;
- accountability of the Board of Directors to the Company's shareholders, as well as performance monitoring of the Company's executive bodies from the Board of Directors;
- maintenance of an effective internal control and audit system at the Company;
- guarantee of informational and financial transparency concerning the Company's operations;
- adherence to ethical standards in business behavior;
- effective interaction with Company employees in resolving social issues and provision of comfortable working conditions.

## *OAO TMK's Corporate Governance Structure*

The Company's highest management body is the General Meeting of Shareholders. The Company's primary management powers are delegated by the shareholders to the Board of Directors. In order to ensure the Company's

# 6.1 OAO TMK CORPORATE GOVERNANCE STRUCTURE



6.1

day-to-day management, the Board of Directors elects the CEO and confirms the members of the Management Board as advised by the CEO. The Board of Directors also establishes committees whose resolutions are of an advisory nature.

*In order to exercise the principle "equal treatment of the Company's shareholders, observance and protection of their rights," TMK purposefully works on increasing shareholders' awareness about the Company's activities and on protecting insider information.*

In order to ensure effective control over the Company's financial and business operations, as well as the Company's adherence to Russian legislative requirements, the General Meeting of Shareholders elects the Revision Commission and confirms the Company's auditor.

In order to exercise the principle "equal treatment of the Company's shareholders, observance and protection of their rights," TMK purposefully works on increasing shareholders' awareness about the Company's activities and on protecting insider information. In 2011, the Company modified its internal documents to meet Russian legislative requirements, and implemented additional procedures on insider information protection as well as on timely release of information. The new revised Provision on insider information *(http://www.tmk-group.ru/files/tmk_pol_inside_ .pdf)* and List of insider information *(http://www.tmk-group.ru/files/tmk_per_inside1.pdf )* can be found on TMK's website.

TMK keeps its accounting practices and prepares financial and accounting reports in compliance with Russian and international standards. Starting from 2011 TMK began quarterly preparation of the consolidated IFRS reports (http://ir.tmk-group.ru/phoenix.zhtml?c=238837&p=irol-resultcenter). In order to provide interested parties with additional information, the Company distributes press releases including analysis of changes in financial indicators and conducts conference calls involving members of Company's executive bodies.

TMK has a functioning structural subdivision, which monitors development and realization of single information policy. There is also a department that controls compliance with legislative requirements on insider information.

# 6.2 GENERAL MEETING OF SHAREHOLDERS

The primary means of protecting shareholders' rights, as reflected in the Company's Charter, is their participation in the General Meeting. The General Meeting of Shareholders is held annually and is mandatory. Also, extraordinary meetings can be held per decision of the Board of Directors or per initiative of the Revision Commission, auditor, or shareholders (shareholder), who own at least 10 percent of TMK's shares.

*Shareholders who own at least 2% of shares can make suggestions to the agenda of the annual General Meeting, propose candidates for the Board of Directors, Revision Commission and Counting Commission, as well as call Board of Directors meetings.*

Shareholders who own at least 2% of shares can make suggestions to the agenda of the annual General Meeting, propose candidates for the Board of Directors, Revision Commission and Counting Commission, as well as call Board of Directors meetings.

In 2011, the annual General Meeting of Shareholders was held, along with one extraordinary meeting. The following questions were included in the meetings' agendas: approval of OAO TMK's annual report and annual financial statements, distribution of profits based on the results of 2010 and 6 months in 2011, election of the Board of Directors and selection of a Revision Commission, confirmation of the auditor, and approval of interested-party transactions.

# 6.3 BOARD OF DIRECTORS AND BOARD COMMITTEES

According to the Charter, the Board of Directors has authority to make fundamental managerial decisions, except for questions related to the shareholder's competencies.

The Board of Directors approves the Company's development strategy, monitors execution and evaluation of its effectiveness.

Members of the Board of Directors are elected by the General Meeting of Shareholders with cumulative voting and can be reelected for an unlimited number of terms. All members of the Board of Directors can be terminated before the end of their term per decision of the General Meeting of Shareholders.

*Members of the Board of Directors are elected by the General Meeting of Shareholders with cumulative voting and can be reelected for an unlimited number of terms.*

The Board of Directors is headed by the Chairman, who calls Board of Directors Meetings and develops an agenda using the suggestions from the Members of the Board of Directors, Revision Commission and the auditor, shareholders who own at least 2% of voting shares, Management and CEO. Per the request of the persons mentioned above a Board of Directors meeting can be called.

In order to ensure the implementation of the Board of Directors' mandated functions, its membership is formed on the basis of criteria such as independence, wide powers and professionalism. Five out of ten members of the Board of Directors are independent directors.

In 2011, the composition of the Board of Directors had the following changes: instead of J. Marous, who became the Head of TMK's European Division in 2010, M. Alekseev was elected to the Board of Directors as an independent director. The Board of Directors consists of the following persons:

**Dmitry A. Pumpyanskiy**

Chairman of the Board of Directors.

*Graduated from the Kirov Urals Polytechnic Institute in 1986. PhD, Doctor of Science. Has been with TMK since 2002.*

*Experience: President of Sverdlovsk Regional Manufacturers and Entrepreneurs Association, President, Chairman of the Board of Directors of ZAO Sinara Group, member of the Board of Directors in industrial and financial companies, member of the Management Board of the Russian Union of Industrialists and Entrepreneurs (RSPP), CEO of OAO TMK, CEO of ZAO Sinara Group, executive of metallurgical and pipe companies.*

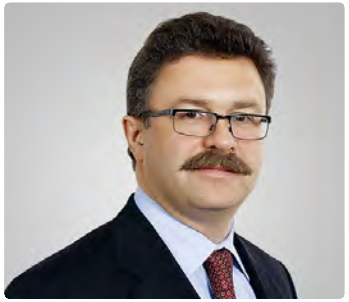
**Mikhail Yu. Alekseev**

Member of the Board of Directors since 2011.

*Graduated from Moscow Financial Institute in 1986. PhD, Doctor of Science.*

*Experience: Chairman of the Board of ZAO UniCredit Bank, President-Chairman of the Board of Russian Industrial Bank, Senior Vice President, Vice Chairman of the Board of ROSBANK.*

*Deputy Head of the Board of ONEKSIM Bank, member of the Board of Intersectoral Commercial Bank, Deputy Head of General Directorate of Ministry of Finance of USSR.*



**Andrey Yu. Kaplunov**

Has been with TMK since 2001.

*Graduated from the Moscow Finance Institute in 1982, PhD.*

*Experience: Senior Vice President of OAO TMK, Chairman of the Board of Directors of TMK's Russian plants and of TMK Trade House, member of the Board of Directors of a number of financial institutions, Vice President of Organizational Development at OAO TMK, Director of the HR and Organizational Development Department at OAO JSB Inkombank and JSB Rosbank, Vice President of ZAO CB Guta Bank, Deputy Head of the Currency and Finance Department of the foreign trade association Zarubezhneft, associate professor in the Economic Theory Faculty at the Moscow Finance Institute.*

**Sergey T. Papin**

Has been with TMK since 2002.

*Graduated from the Donetsk Polytechnic Institute in 1977.*

*Experience: Vice President, Member of the Board of Directors of ZAO Sinara Group, member of the Board of Directors of several companies, Vice President of External and Social Projects of OAO TMK, Vice President of OAO JSB Inkombank and ZAO CB Guta Bank.*

**Thomas Reeve Pickering**

Member of the Board of Directors since 2009.

*Graduated from the University of Melbourne in Australia in 1956. Holds the distinction of Career Ambassador, the highest in the U.S. Foreign Service.*

*Experience: Vice Chairman of International Consultants Hills and Co., Senior Vice President for International Relations and member of the Executive Board at Boeing, Special Assistant to U.S. Secretary of State, U.S. Ambassador to Russia, India, Israel, El Salvador, Nigeria, Jordan; Ambassador to the United Nations.*

6.3

**Geoffrey Townsend**

Member of the Board of Directors since 2005.

*Graduated from St. Catherine's College (Oxford) in 1970, member of the Institute of Chartered Accountants in England and Wales.*

*Experience: CEO of OOO Arnika, member of the Board of Directors of OAO Raspadskaya, Head of the Consulting Department and Corporate Finances Department at KPMG, independent consultant at KPMG.*

**Igor B. Khmelevskiy**

Has been with TMK since 2003.

*Graduated from the Ural State Law Academy in 1995.*

*Experience: Vice President and member of the Board of Directors of ZAO Sinara Group, member of the board of directors at several financial institutions and TMK companies, Vice President of Legal Work at OAO TMK, Head of the Legal Department at ZAO Sinara Group.*

**Alexander G. Shiryaev**

Has been with TMK since 2003.

*Graduated from the Sverdlovsk Institute of National Economy in 1991 (now the Ural State University of Economics).*

*Experience: Chairman of the Board, CEO of OAO TMK, member of the Board of Directors of TMK Russian plants and of TMK Trade House; Vice President of Development, President and then member of the Board of Directors at ZAO Sinara Group, Vice President of Finance and Economics at OAO TMK, CEO of OAO Uralshina.*

**Alexander N. Shokhin**

Member of the Board of Directors since 2008.

*Graduated from the Lomonosov Moscow State University in 1974, PhD, Doctor of Science, professor.*

*Experience: President of RSPP, President of the State University Higher School of Economics, member of the Board of Directors of OAO Lukoil, OAO Russian Railways, OAO Brewery Baltica, OAO Fortum, OAO TNK-BP Limited, member of the Civic Chamber of the Russian Federation, Chairman of the Supervisory Board of Renaissance Capital Investment Group, member of the State Duma (three convocations), Minister of Labor and Employment and Minister of Economic Affairs, Head of the Russian Agency for International Cooperation and Development; twice appointed as Deputy Prime Minister of Russia, represented Russia at the IMF and World Bank.*

**Mukhadin A. Eskindarov**

Member of the Board of Directors since 2005.

*Graduated from the Moscow Finance Institute in 1976, PhD, Doctor of Science, professor.*

*Experience: President of the Finance University under the Government of the Russian Federation, member of the Board of Directors of a number of credit organizations, Senior Vice President of the Finance University under the Government of the Russian Federation.*

6.3

As of December 31, 2011, the Board of Directors of OAO TMK comprised 10 people.

| *Name* | *Year of birth* | *Membership of the Board of Directors committees as of December 31, 2011* | *Position (independence criterion)* | *Year of election to the Board of Directors* | *Participation in Board of Directors meetings in 2011 (32 meetings)* | *Share in the capital of OAO TMK as of December 31, 2011,%** |
|---|---|---|---|---|---|---|
| **Pumpyanskiy, D.A.** *(Chairman)* | 1964 | — | Non-executive director | 2004 | 32 | 0.007** |
| **Kaplunov, A.Yu.** | 1960 | — | Executive director | 2005 | 32 | 0.0116 |
| **Alekseev, M.Yu.** | 1964 | *Member of SDC* [1] | Independent director | 2011 | 18 | 0 |
| **Papin, S.T.** | 1955 | *Member of NRC* [1] | Non-executive director | 2005 | 32 | 0.012 |
| **Pickering, T.** | 1931 | — | Independent director | 2009 | 31 | 0 |
| **Townsend, G.** | 1949 | *Chairman of the AC* [1] *Member of the NRC* | Independent director | 2005 | 32 | 0.0018 |
| **Khmelevskiy, I.B.** | 1972 | *Member of the AC* | Non-executive director | 2004 | 32 | 0.01 |
| **Shiryaev, A.G.** | 1952 | *Member of the SDC* | Executive director | 2003 | 32 | 0.017 |
| **Shokhin, A.N.** | 1951 | *Chairman of the SDC* | Independent director | 2008 | 32 | 0 |
| **Eskindarov, M.A.** | 1951 | *Chairman of the NRC, Member of the AC* | Independent director | 2005 | 32 | 0.0018 |

[1] *AC — Audit Committee;*
*NRC –Nomination and Remuneration Committee;*
*SDC — Strategic Development Committee*

* *Share Capital of OAO TMK only consists of ordinary shares.*

** *Information on beneficiary owners of OAO TMK is given in the Share Capital section of this report on p. 41.*

6.3

## Activity of the Board of Directors in 2011

In 2011, the Board of Directors held 32 meetings, including seven meetings that were held through joint attendance. Key items included:

- Development of TMK's investment projects;
- TMK's HR Policy 2020;
- Logistics management system in the Company;
- TMK Business Plan 2011–2015;
- TMK's consolidated budget for 2012;
- TMK's target structure for 2012;
- Results of Internal Audit Department's activity in 2011.

The activity of OAO TMK's Chairman of the Board of Directors related to the introduction of high corporate management standards was noted by the Association of Independent Directors and by the Russian Union of Industrialists and Entrepreneurs that established the National Prize "Director of the Year" with support from PricewaterhouseCoopers. Dmitry Pumpyanskiy was pronounced the winner in the category of "Chairman of the Board of Directors: input in development of corporate management" for his active role in developing and achieving the Company's main strategic goals to strengthen its positions among global pipe producers and developing such innovative directions like energy efficiency, nanotechnology, environmental security and scientific research.

## Remuneration

In accordance with the Regulation on OAO TMK's Board of Directors, only directors who are not executives of OAO TMK are entitled to remuneration and the compensation of expenses related to the execution of their duties. Prior to the annual General Meeting of Shareholders the Board of Directors had 4 independent directors, 4 non-executive directors and 2 executive directors. As of July 26, the Board of Directors is comprised of 5 independent directors, 3 non-executive directors and 2 executive directors. The remuneration to be paid includes:

- a fixed base remuneration of Chairman or member of the Board paid on a monthly basis in the amount of $^{1}/_{12}$ of the fixed annual amount;
- additional remuneration for the performance of the duties of Chairman or member of a Board Committee, which is paid every six months in the amount of $^{1}/_{2}$ of the annual additional remuneration.

In 2011, the aggregate remuneration of the members of the Board of Directors was U.S$ 2.55 million.*

## Committees of the Board of Directors

The Board of Directors always has three committees: Audit Committee (AC), Nomination and Remuneration Committee (NRC) and Strategic Development Committee (SDC). The composition of the committees is formed in full accordance with the requirements of the Code, which establishes that the Audit Committee and Nomination and Remuneration Committee can include only

* *Based on the average exchange rate for 2011 — 29.39 RUB/U.S.$*

independent directors, and if that not possible due to objective causes, then only independent directors and non-executive directors.

## *Participation of Board Committee Members in Committee Meetings in 2011*

| | *Audit Committee (11 + 4 joint meetings)* | *Nomination and Remuneration Committee (5 joint meeting)* | *Strategic Development Committee (3 + 4 joint meetings)* |
|---|---|---|---|
| **Alekseev, M.Yu.** | | | 3 |
| **Marous, J.** | | | 3 |
| **Papin, S.T.** | | 5 | |
| **Townsend, G.** | 15 | 5 | |
| **Khmelevskiy, I.B.** | 15 | | |
| **Shiryaev, A.G.** | | | 5 |
| **Shokhin, A.N.** | | | 7 |
| **Eskindarov, M.A.** | 4 | 5 | |

# 6.4 AUDIT COMMITTEE REPORT

## Reporting period

This report covers the 2011 calendar year. Activities from January 1, 2012 to March 31, 2012 are also included in as much as activities undertaken relate to the 2011 consolidated financial statements or to the tender for audit services.

## Power and authorities

The tasks of the Committee are determined by the Regulations on the Audit Committee of the Board of Directors of OAO TMK. The Regulations can be found on the corporate website at *http://tmk-group.com/files/audit_e.pdf*.

### *The main tasks of the Committee include:*

- Review of the Company's and of the group's financial statements;
- Review of the Company's standards and procedures for internal control and risk management;
- Review of the annual plan and periodic and annual reports of the Internal Audit Service;
- Cooperation with the Company's Revision Commission;
- Making recommendations to the Board of Directors on the appointment and/or re-appointment of the external auditor;
- Review of plan and scope of the audit;
- Active discussion with the external auditor of matters arising from the audit;
- Overseeing the independence of the external auditor;
- Overseeing the appointment of independent appraisers and review of any independent appraisers' reports.

## Audit Committee in 2011

| | |
|---|---|
| **Townsend, G.** | *Chairman of the Audit Committee and Member of the Nomination and Remuneration Committee, Independent director* |
| **Eskindarov, M.A.** | *Member of the Committee and Chairman of the Nomination and Remuneration Committee, Independent director* |
| **Khmelevskiy, I.B.** | *Member of the Committee, Non-executive director* |

The Board considers that I. Khmelevskiy is independent in substance while not in form. Article 3.2 of the Regulations on the Audit Committee permits his membership.

The Board of Directors considers that Chairmen of the Committee G. Townsend has recent and relevant financial experience as required by the Guidance on Audit Committees published by the Financial Reporting Council (UK) in December 2010.

## Participation in committee meetings

In general, members of the Board of Directors are invited to attend meetings of the Audit Committee. However, the Committee holds at least two meetings per year which are closed to other Board members. The closed meetings include sessions with the external auditor.

## Independent legal advice

Pursuant to the regulation given in clause 2.14 of the Guidance on Audit Committees published by the Financial Reporting Council, the Audit Committee may solicit impartial legal advice as deemed necessary. During 2011 the Committee did not solicit such services.

## Committee oversight of the external audit of the 2011 financial statements

The Audit Committee oversaw on the external audit of the Company's consolidated financial statements for 2011 (IFRS) and the parent company's financial statements prepared according to Russian accounting standards for 2011. Most of this work was carried out in 2012.

The external auditor's opinion on the consolidated financial statements is key to external investors.

The external auditor discussed his audit plans with the Committee before the commencement of the audit. During the course of the audit the external auditor discussed potential problems and their resolution with the Audit Committee. Once the audit was completed, the external auditor presented the following to the Audit Committee:

- a summary on the audit adjustments proposed by the auditor and accepted by TMK;
- a summary on the audit adjustments proposed by the auditor and not accepted by TMK. Management considers that the non-acceptance of these proposed adjustments to be immaterial to the consolidated financial statements of the Company, taken as whole, and the auditors concur with such assessment in the context of forming an opinion on the financial performance and financial position of the Company as shown by the financial statements.

The auditor issued an unqualified audit opinion on TMK's IFRS consolidated financial statements. Furthermore, the Audit Committee reviewed OAO TMK's statutory financial statements prepared in accordance with Russian accounting standards and concluded that these statements are consistent with the IFRS consolidated financial statements given the differences in accounting standards and the fact that statutory financial statements are unconsolidated and include only OAO TMK accounts.

As a result of its work on the oversight of the external audit, the Audit Committee believes that the audit was performed professionally and that there are no material conflicts of interest, and recommends to the Board of Directors that the financial statements be submitted for the approval of shareholders at the annual General meeting.

## Internal control

The Audit Committee is active in this area through its oversight of the Risk Management Committee and the Internal Audit Service.

6.4

## Non-audit services provided by the external auditor

The provision of all non-audit services by the external auditor is subject to prior approval by the audit committee. In 2011 the audit committee also approved consulting services in relation to transfer pricing and also two minor projects concerning VAT in Romania.

## External audit tender

In accordance with the policy on the appointment of the group's external auditor, the audit committee conducted a tender in the period October 2011 until March 2012. Because certain loan covenants restrict the choice of auditor to the Big Four, the invitation to tender was restricted to the Big Four. All Four participated and submitted bids.

The invitation to tender included a list of matters which should be considered carefully by bidders and which would probably be key factors in the evaluation of bids. Bidders were given a two month period in which to familiarise themselves with the business of the group whereupon they submitted bids consisting of technical and financial sections. There was then a period of two months for the evaluation of the technical proposals; the audit committee took soundings from management on its views of the technical proposals. The committee then carried out its own evaluation of the technical proposals and only after this were the financial proposals opened. Final evaluation was performed by creating a weighted total of the technical and financial scores. The winner of the tender was Ernst & Young.

Audit Committee therefore recommended that the board recommends to the shareholders at the AGM the appointment of Ernst & Young as external auditor for the 2012 financial year.

## Nomination and Remuneration Committee

In 2011, the Committee worked with the following composition:

| | |
|---|---|
| **Eskindarov, M.A.** | *Chairman of the Committee, member of the Audit Committee, independent director* |
| **Papin, S.T.** | *Member of the Committee, non-executive director* |
| **Townsend, G.** | *Member of the Committee, Chairman of the Audit Committee, independent director* |

During the reporting period the Committee operated in compliance with the Regulation on the Committee approved by the Board of Directors, annual corporate plan and orders of the Board of Directors.

The main goals of the Committee are to create favorable conditions for the employment of qualified managers in the Company and incentives for their effective work, as well as to improve the corporate governance system and keep it within best international practice.

In 2011, the Committee reviewed and presented to the Board of Directors recommendations on the following key matters:

- Candidacy of senior managers and members of OAO TMK management bodies;
- Key performance indicators for executives and directors of TMK's main business units in accordance with established areas of responsibility and the conditions set forth in personal contracts;
- Incentive program for executives and directors of TMK's main business units;
- TMK's Code of Corporate Management;
- TMK's HR Strategy 2020;
- Implementation of TMK's HR policy;
- Corporate structure, management system, and social policy of the Company's divisions and special-purpose facilities;
- Key indicators of the number of employees and salary for TMK's 2012 budget calculation;
- Personnel changes at TMK Oilfield Services and Trade House TMK.

## Strategic Development Committee

On June 28, 2011, there was a change in the composition of the Strategic Development Committee: M. Alekseev joined the Committee since J. Marous due to his appointment to an executive position at the Company.

| | |
|---|---|
| **Shokhin, A.N.** | *Chairman of the Committee, independent director* |
| **Alekseev, M. Yu.** | *Member of the Committee, independent director* |
| **Shiryaev, A.G.** | *Member of the Committee, CEO and President, Chairman of the Management Board* |

The Committee's tasks are to develop recommendations on issues concerning the formulation of the Company's business priorities and its development strategy, as well as to present these recommendations to the Board of Directors.

In 2011, the Committee reviewed and presented to the Board of Directors recommendations on the following key matters:

- Fulfillment of metal usage and quality indicators by TMK facilities;
- TMK's Business Plan 2011-2015;
- TMK's Investment Program projects for 2012;
- TMK's anti-corruption activities;
- Recommendations on M&A transactions, sales of assets and establishment of joint enterprises.

# 6.5 EXECUTIVE MANAGEMENT

OAO TMK's day-to-day activities are managed by two executive bodies, the CEO and President and the Management Board. The CEO also functions as the Chairman of the Management Board. The Board reviews the most complicated issues that require collective decision-making.

The CEO and the Management Board are elected by the Board of Directors for a one-year term. The CEO suggests candidates for the Management Board. The Board of Directors has the right to terminate at any time the CEO, the Management Board and any member of the Management Board before the end of their term.

In 2011, the Company's Management Board did not change and on December 31, 2011 included eight members:

| *Management Board members* | *Year of birth* | *Participation in OAO TMK share capital, %** |
|---|---|---|
| **Shiryaev, A.G.** *Chairman of the Board, President and CEO of OAO TMK* | 1952 | 0.017 |
| **Kaplunov, A.Yu.** | 1960 | 0.0116 |
| **Klachkov, A.A.** | 1957 | 0.003 |
| **Lyalkov, A.G.** | 1961 | 0.0037 |
| **Oborsky, V.B.** | 1961 | 0.0008 |
| **Petrosyan, T.I.** | 1968 | 0 |
| **Semerikov, K.A.** | 1959 | 0.01 |
| **Shmatovich, V.V.** | 1964 | 0 |

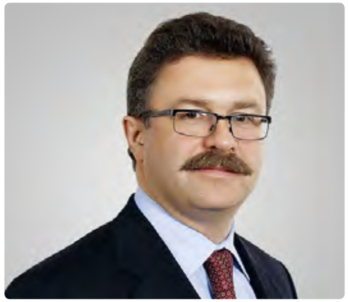
* *As of December 31, 2011, Members of the Board did not participate in the share capital of affiliated companies.*

6.5

**Alexander G. Shiryaev**

President and CEO of OAO TMK, Chairman of the Management Board.

*Biographical information appears in the Board of Directors section.*



**Andrey Yu. Kaplunov**

Senior Vice President of OAO TMK.

*Biographical information appears in the Board of Directors section.*

**Alexander A. Klachkov**

Vice President — Chief Engineer of OAO TMK.

*Has been with TMK since 2002. Graduated from the Moscow Institute of Steel and Alloys in 1979, Candidate of Technical Sciences.*

*Experience: Head of the Technological Development Directorate of OAO TMK, worked at Oskol Elektrometallurgical Plant in different executive positions*

.

**Alexander G. Lyalkov**

Senior Vice President of OAO TMK.

*Has been with TMK since 2003. Graduated from the Volgograd Polytechnic Institute in 1989.*

*Experience: Vice President of Production, Technology and Quality at OAO TMK, CEO of OAO Volzhsky Pipe Plant. Has worked at Volzhsky in different positions since 1990.*

**Vladimir B. Oborsky**

Vice President of Sales at OAO TMK.

*Has been with TMK since 2005.*

*Graduated from the Frunze Military Academy in 1982 and the Frunze Kiev Higher Combined-Arms Command Academy in 1994. PhD.*

*Experience: Senior Vice President — Executive Director of ZAO TMK Trade House, CEO of TMK Trade House, Head of the Transneft and Gas Producers Customer Service Directorate at ZAO TMK Trade House, Head of the Strategic Customer Service Department and Gas Producers Customer Service Department of ZAO Volzhsky Trade House.*

6.5

**Tigran I. Petrosyan**

Chief Financial Officer.

*Has been with TMK since 2001. Graduated from the Erevan State University in 1993.*

*Experience: Member of the Board of Directors of TMK Trade House, Vice President of Economy, Head of Economic and Planning Directorate of OAO TMK, Head of Economic and Planning Department of OAO Volzhsky Pipe Plant, Vice President of LLC Volzhsky Audit, officer at the Armenian Ministry of Economy.*

**Konstantin A. Semerikov**

Senior Vice President — Executive director of OAO TMK.

*Has been with TMK since 2003. Graduated from the Moscow Institute of Steel and Alloys in 1981.*

*Experience: Member of the Board of Directors of Russian plants, CEO of ZAO TMK Trade House, Vice President of Production, then President and CEO of OAO TMK, mayor of Taganrog, CEO of OAO TAGMET.*

**Vladimir V. Shmatovich**

Senior Vice President for Strategy and Business Development.

*Has been with TMK since 2005. Graduated from the Moscow Finance Institute in 1989 and from the University of Notre Dame (MBA) in 1993.*

*Experience: CFO of OAO TMK, Vice President, CFO at several companies (Udmurtneft, Sidanko, Rus- PromAvto), CEO of OAO Interros.*

In 2011, there were three Management Board meetings, during which the following issues were discussed:

- First measures for overcoming the crisis situation;
- Consolidated results of Company's activities for 1H 2011;
- TMK Business Plan 2011-2015;
- TMK's target structure for 2012;
- Implementation of decisions of the Board of Directors.

## Remuneration

The remuneration paid to the President and CEO and to the members of the Management Board consists of:

- fixed salaries, determined according to the employment contract and paid on a monthly basis;
- variable salaries (bonuses), KPI-based and established individually, according to the duties performed (such as EBITDA, shipment volumes, etc.) and approved by the Board of Directors every year. A bonus is paid to the President and CEO and to members of the Management Board if they achieve their key performance indicators, subject to the approval of performance reports by the Board of Directors.

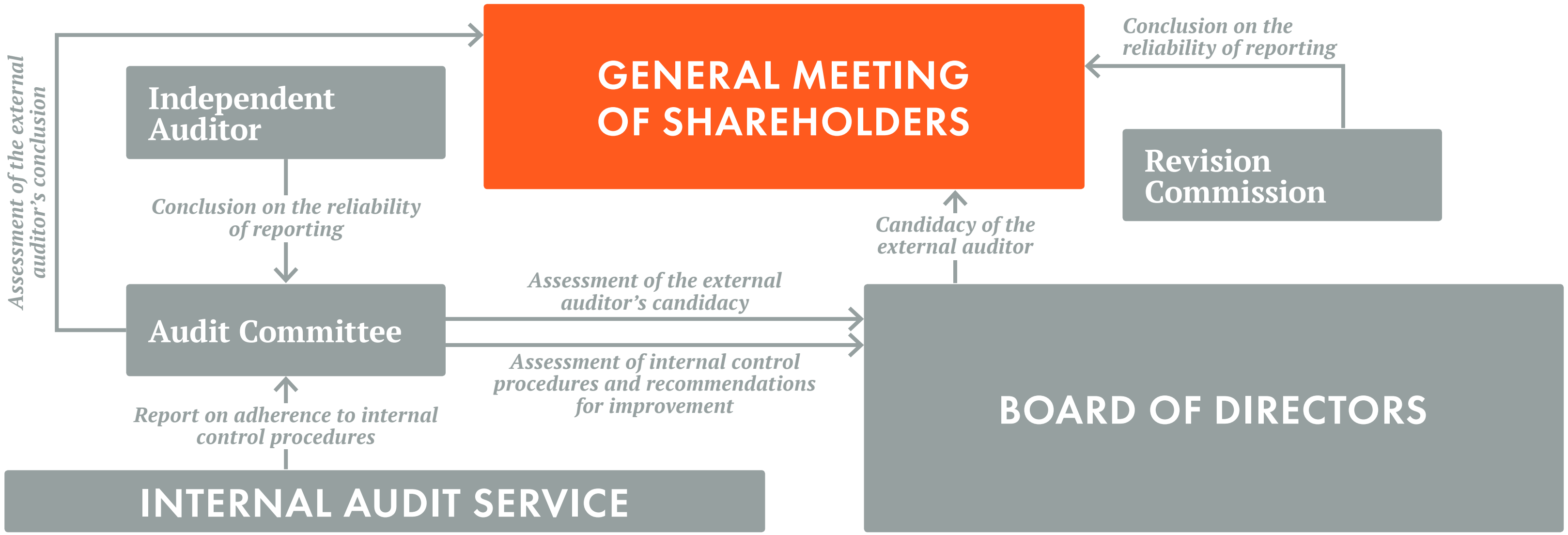
In 2011, the aggregate remuneration of the President and CEO and the members of the Management Board grew and amounted to U.S.$5.58* million as a result of bonus payouts for 2010 performances. In 2010 the bonuses were not paid out.

* *Based on the average exchange rate for 2011 — 29,39 RUB/U.S.$*

# 6.6 INTERNAL CONTROL

Internal control at TMK is a system of procedures that is implemented by the Board of Directors, executive and supervisory bodies, officials and other employees of TMK. They aim to ensure the effectiveness of TMK's operational and investment activities, the reliability of all types of reporting, compliance with laws and internal TMK regulations.

## CONTROL SYSTEM FOR FINANCIAL AND BUSINESS ACTIVITIES



**TMK's Internal Control System is built on the following principles:**

- continuity: allows for timely discovery of deficiencies and implementation of preventative measures to avoid their occurrences in the future;
- reporting: the quality of everyone's performance of duties is monitored by other participants of the internal control system;
- separation of duties: the same individual is not allowed to fulfill duties related to approval of asset activities, asset accounting, assurance of asset soundness and physical inventory;
- appropriate approval of activities;
- organizational insulation of Internal Audit Service and its reporting to the Board of Directors through the Audit Committee;
- cooperation with all subdivisions and departments of TMK;
- continuous development of internal control system;
- timely notification of discovered non-conformances with the purpose of their elimination.

Control over financial and business activities is exercised by the Board of Directors, the Audit Committee, Revision Commission, as well as the Company's independent auditor.

The **Board of Directors** approves internal control procedures and ensures effective control over the Company's finance and business activities.

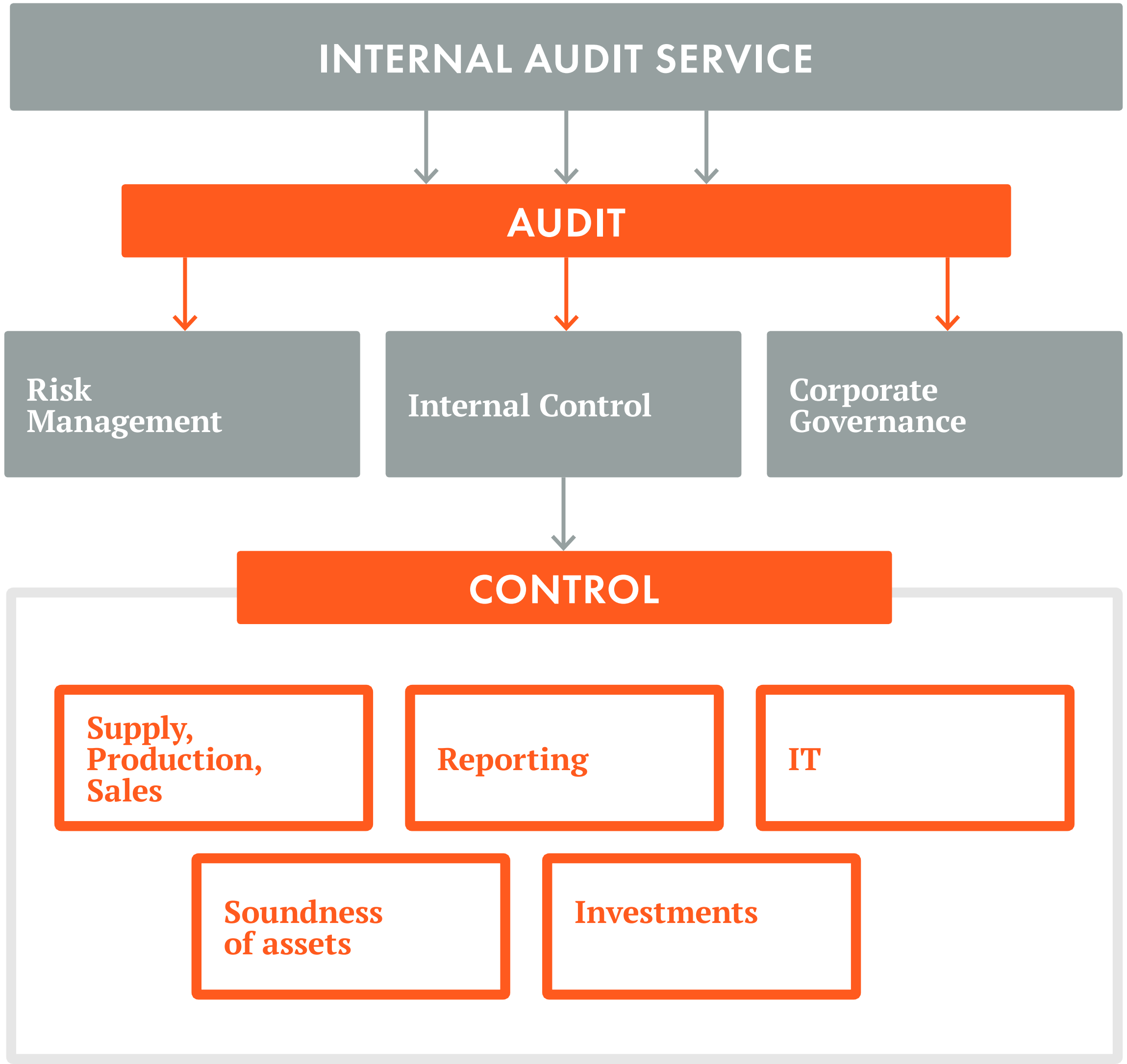
The **Audit Committee** enhances the effectiveness of the internal control and risk management systems based on its assessment and its formulation of corresponding recommendations.

The **Revision Commission** oversees the Company's financial and business activities on behalf of shareholders and, on the basis of its review, provides the General Meeting of Shareholders a conclusion on the adequacy of accounting data, as well as information on deficiencies or violations detected in the Company's activities. In 2011, four meetings of the Revision Commission were held.

| *Members of the Revision Commission* | *Year of Birth* | *Year of Election to the Revision Commission* |
|---|---|---|
| **Maksimenko, A.V.** *(Chairman)* | 1955 | 2005 |
| **Vorobyev, A.P.** | 1957 | 2005 |
| **Pozdnyakova, N.V.** | 1979 | 2009 |

The **Internal Audit Service** operates on the basis of the Regulations of the Internal Audit Service, which has been approved by the Board of Directors (*http://www.tmk-group.ru/files/pol_sva.pdf*), and implements internal audit reviews of the systems of corporate governance, internal control and risk management. Independence and

6.6




objectivity of Internal Audit Service is ensured by the fact that it functionally reports to the Audit Committee and administratively reports to the CEO of OAO TMK. The annual Audit Plan is approved by the Audit Committee and is confirmed by the CEO. In 2011, members of the Internal Audit Service, whose structure also includes the regional internal audit departments at TMK production facilities, conducted 142 reviews of the Company's business units.

The regional location of Internal Audit Service subdivisions allows prompt reaction to any changes in the audited systems and evaluating the impact level of TMK facilities' risks on the possibility to achieve Company's strategic goals. Based on the audit results, Management makes necessary corrections to the Internal Audit Control System in order to manage detected risks, which allows improving processes and the quality of corporate management.

According to the new revision of OAO TMK's Provision on Insider Information, approved by the Board of Directors in December 2011, the Internal Audit Service also monitors the Company's managing bodies', executive officers' and employees' adherence to insider information laws, as well as reports to the Audit Committee.

The **external auditor** expresses an opinion on the fairness of the Company's financial statements prepared in accordance with accounting rules, national and international financial reporting standards (RAS and IFRS).

By decision of TMK's Annual General Meeting of Shareholders on June 28, 2011, OOO Ernst & Young, a member of the non-profit partnership Russian Chamber of Auditors, was approved as the Company's auditor for 2011.

The candidature of the external auditor is suggested to the executive management of OAO TMK and is discussed by the Audit Committee and Board of Directors.

The process for the appointment, reappointment and analysis of the external auditor who is carrying out the audit of the Company's reporting under IFRS, is regulated by the policy to select the Group's external auditor of the consolidated financial statements (*http://www.tmk-group.ru/files/external_auditor_policy_ru.pdf*), and approved by the Board of Directors.

In order to reduce the effects of long-term relationships on the external auditor's independence, members of the audit and the lead partner responsible for the audit are rotated.

The auditor's remuneration for auditing the annual accounts and interim accounts review (including audit reports of some local TMK facilities) for 2011 amounted to U.S.$ 4.8 million, for other audit-related services - U.S.$ 0.4 million, for non-audit services - U.S.$ 0.3 million.

In 2011, the **Committee on Regulating Compliance Risks** was created. The Committee reports to the CEO of OAO TMK and coordinates Company departments' activities on fulfilling legislative requirements related to corruption resistance, recommendations of international organizations for legalizing illegally obtained income and financing terrorism. The Committee develops and ensures introduction of preventative measures, localization and elimination of compliance risks.

As a tool of public control at TMK a "Hot Line" was created. This information system includes a full range of communication channels — telephone lines, fax, email, postal mail, which the Company's employees and counterparties can use to communicate information on corrupt practices and violations.

## *Internal control over financial reporting*

TMK's management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS.

The company's internal control over financial reporting includes policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS and that expenditures are being made only in accordance with authorizations of the Company's management; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have an effect on our financial statements.

Throughout 2011, and to date, the Company has had an operational system of internal control which provides reasonable assurance of effective and efficient operations covering all controls, including financial and operational controls, as well as compliance with laws and regulations.

# CORPORATE CITIZENSHIP AND QUALITY MANAGEMENT

7.1

# HUMAN RESOURCES AND SOCIAL POLICY

*In 2011, TMK began to implement the company's new Human Resources Strategy 2020.*

TMK's Board of Directors welcomed the implementation results of the TMK HR 2006-2010 Policy, which became the basis for the formation of a new human resources strategy for the period up to 2020.

**Goal of our HR Strategy** — to ensure that the Company's human capital is in congruity with strategic business objectives and to create a professional and motivational readiness on the part of employees to achieve these goals, which involves coordination of the HR Strategy with the best international practices, including:

- ensuring TMK facilities are staffed by qualified employees;
- qualitative and quantitative optimization of the employee base with the goal of increasing labor productivity and cost efficiency;
- retention of the company's key employees;
- organization of training and advanced training for specialists according to progressive standards;
- implementation of an effective system of remuneration and incentives conducive to attracting and retaining key employees;
- development and implementation of corporate HR standards that take into account the specifics of TMK, organization of a system to control their fulfillment.

**Our strategic initiative of the new period:** among the best employers in the industry, to offer competitive working conditions, social guarantees and opportunities to discover and make use of the potential of employees oriented toward achieving best performance results.

**Implementation of the TMK HR Strategy in 2011:** On the basis of the TMK Human Resources Strategy 2020, the company's facilities have developed and approved staffing policies aimed at addressing key issues of the HR Strategy 2011-2015 and the formation of a single TMK HR space with a common corporate culture.

## *In the area of HR management*

**TMK employees**

| *Period* | *2009* | *2010* | **2011** | *Change 2011/2010, %* | *Change, 2011/2010, individuals* |
|---|---|---|---|---|---|
| Total individuals, as of December 31 | 46,016 | 46,273 | **45,728** | -1.2 | -545 |
| including: | | | | | |
| **Russian division*** | 42,100 | 41,850 | **41,219** | -1.5 | -631 |
| **European division** | 2,037 | 1,946 | **1,993** | 2.4 | 47 |
| **American division** | 1,876 | 2,477 | **2,516** | 1.6 | 39 |

* *The Russian division is understood as such for the structuring of data and also includes facilities in Kazakhstan, TMK Africa, TMK Middle East and TMK Global.*

Headcount management is focused on achieving business goals through more effective use of human resources.

In 2011, TMK's Russian and European divisions continued a program to optimize manufacturing and commercial activity, resulting in the number and qualifications of employees to fall in line with modernized production capabilities and market trends.

During the same period the American division successfully implemented a new employee recruitment system and the ADP HRIS, which allows data on all HR aspects in the context of each TMK IPSCO employee to be recorded.

## *In the area of employee compensation and incentives*

The company guarantees its employees:

- a competitive level of compensation in labor markets of the countries and regions where it is present;
- regularity in wage payments;
- preservation of basic social protections;
- growth in average wages in accordance with growth in labor productivity.

In 2011, work continued to improve employee incentives aimed at increasing the production of high-tech products, increasing the share of sales, and improving product quality. The American division has successfully implemented a new incentive program aimed at mid-level employees.

During the anniversary year of 2011, plant employees were granted state, industry and corporate awards. The company made special recognition of employees who had worked effectively at TMK over the years. A significant number of employees received bonuses, cars and other valuable gifts.

## *In the area of employee development and training*

In 2011, a program to improve management qualification at TMK facilities was begun. This project aims to form a new qualitative level of company managers, increase the efficiency of the rotating directors, including those between facilities. In 2011, about 100 senior managers of facilities in the Russian division received training under this program.

In 2011, the company's internship program experienced qualitative development, with the number of interns increasing five times over the level of 2010. An internship program to train students at leading technical universities students in TMK IPSCO facilities began, which should lead to an influx of young skilled professionals to the company.

The TMK Youth Scientific and Technical Conference 2011 took place at a new level and gained international status, including young professionals from TMK IPSCO and Kazakhstan.

***In 2011, TMK spent U.S.$ 4.53 million on professional development for employees, which is 25% more than in 2010.***

In 2011, TMK spent U.S.$ 4.53 million on professional development for employees, which is 25% more than in 2010. In the Russian and American divisions funds were primarily spent on training and skills development in sales, as well as development of managerial skills for middle managers.

The logical conclusion of training programs for sales managers at facilities in the Russian division was their certification, which for the first time was conducted using modern methods of employee assessment. As a result of certification, recommendations were developed to improve the efficiency experts' work, as well as identify areas for their development, career planning and incentives.

## *In the area of management and organizational development*

Analysis of business processes continued with the goal of aligning the organizational structure of facilities in a way that maximizes adherence to the company's divisional structure.

Changes to the employee structure and composition were implemented with the aim of meeting new strategic objectives and the requirements of a developing market. Work continues to expand the network and the geography of sales by optimizing the work of TMK's foreign branches and representative offices, as well as by establishing new locations outside Russia.

Improving organizational structures was carried out by optimizing the number of administrative units, balancing their work loads, minimizing the time spent on decision-making and their transmission from top management to executor. Thus, the "flat structure" scheme was introduced at the Sinarsky Pipe Plant for the first time, which minimized the hierarchical management structure with the aim of maximum transparency.

*Houses for STZ employees*

## *In the area of social partnerships*

Interested parties of social partnership with TMK are:

- inside TMK — employees and the employer-company and its authorized representatives;
- in the external environment — the company and external stakeholders: public authorities, public organizations, educational institutions, municipalities, partners and customers.

TMK's social policy is based on the following principles:

- maintaining a stable balance between the interests of the company and its employees,
- compliance with national legislation,
- human rights, eliminating all forms of discrimination,
- cooperation with trade unions and social organizations at TMK based on annual collective agreements and social programs.

All production facilities of the Russian and European divisions, as well as four facilities in the American division build partnerships on the basis of collective bargaining agreements and meet all obligations as responsible employers. In signing (and renegotiating) collective agreements in connection with their expiration, all benefits and social guarantees continue to remain valid.

One of the key social support programs for employees at the facilities has become the plant housing programs and the construction of a cottage village (120 houses) for employees at the Seversky Tube Works. In this project, TMK acts as an active external social partner for federal, municipal and local governments.

We are confident that the work carried out in 2011 in the field of human resources management will serve as a foundation for TMK in 2012 for implementing the most ambitious business goals, as well as improving its rating as an attractive employer.

## Occupational Safety

Modern and safe working conditions for employees have been established at TMK in accordance with national and international law, as well as with collective agreements. All plants are certified and audited annually for compliance with the international standard Occupational Safety and Health Management System OHSAS 18001:2007. Supervisory audits conducted in 2011 confirmed compliance with the standard.

The system of occupational health and safety is under constant control of plants' administrations and trade union committees, and upcoming events in this area are included in the collective bargaining agreement.

In order to maintain a high level of professional skill, employees systematically trained and certified on their knowledge of and compliance with occupational health and safety requirements.

In 2011, TMK spent U.S.$ 30.6 million to implement health and safety measures, purchase of personal protection equipment and compensation, which is 20% more than in 2010. As a result of improved working conditions, the lost time accident frequency rate fell by more than 16%.

The following awards were given to plants for strong performance in the area of health and safety in 2011:

- Seversky Tube Works was declared the winner:
  - an industry-wide competition of the Mining and Metallurgical Workers Union of Russia: "Most Socially Effective Plant in the Mining and Metallurgical Industry";
  - in the Russian national competition: "Most Socially Effective Russian Organization" in the category "Reduction of Workplace Injuries and Illness".

*The majority of TMK facilities have received awards for the best safety and production standards in the cities where they operate.*

- Sinarsky Pipe Plant finished third in a regional competition for manufacturing culture and occupation health and safety (Government Resolution #857 of Sverdlovsk Region from July 5, 2011).
- TAGMET received a letter of gratitude from the administration of the City of Taganrog for active work with young people in the area of occupational safety.
- The Orsky Machine-Building Facility was awarded a "First Level" certificate as a manufacturer "For a High Level and Best Organization of Occupational Safety in Orsk in 2010".
- TMK-Kaztrubprom was awarded a certificate from the Ministry of Labor and Social Protection of the Republic of Kazakhstan in the competition "Best Collective Agreement in Social Responsibility".
- A number of TMK IPSCO facilities were awarded for industrial safety performance in the cities of their presence.

# 7.2 ENVIRONMENTAL MANAGEMENT

***TMK's priority is to transition to the best available technologies with the highest economic and environmental performance.***

Reducing the negative impact on the environment in the regions its operation is an essential condition and one of the main priorities of TMK's strategic development.

The company is implementing a balanced, transparent environmental policy, which is based on the following principles:

- environmental and social responsibility;
- effectiveness of environmental activities and their ability to deliver results;
- openness and willingness to hold a dialogue with stakeholders.

In its operations, TMK follows international initiatives and agreements in the field of environmental protection, as well as fulfills national environmental standards and regulations. In accordance with the principle of sustainable development, our efforts during the year were mainly focused on improving the environmental efficiency of production processes, reducing consumption of natural resources, and minimizing waste disposal.

The uptake of an environmental dimension in the management of business operations enables us to make consistent planning and management decisions in the field of environmental activity during large-scale modernization, technical re-equipment and expansion. Ten of the company's manufacturing facilities are certified and audited annually for compliance with the international standard Environmental Management System ISO 14001:2004. Continuous improvement of environmental management was once again confirmed by international auditors in 2011.

7.2

## Environmental Investments — Transition to Best Available Technologies

A priority of TMK's Strategic Investment Program is the phasing-out of obsolete equipment and the transition to the best available technologies with high economic and environmental performance.

*The total costs of TMK's environmental activities in 2011 were U.S.$ 36.53 million, which is 15.7% more than in the previous year.*

In 2011, 18 environmental investment activities were implemented in the amount of U.S.$ 7.02 million related to the following projects:

- construction of water-recycling systems;
- reducing emissions of pollutants;
- improving the quality of wastewater;
- reclamation of land.

The total costs of TMK's environmental activities in 2011 were U.S.$ 36.53 million, which is 15.7% more than in the previous year.

The following improvements were made in 2011:

- a sound-absorbing device was installed in the electric arc furnace chimney at Seversky Tube Works, which reduced the noise level in the residential area by 5 decibels,
- A decision was made by the Chief State Sanitary Doctor of the Russian Federation to approve a reduction in the size of the sanitary protection zone around TAGMET for current production, which is objective evidence of sustained reduction of negative impacts by the plant on the environment and the health of the population of Taganrog.

## Emissions Control

In order to reduce negative impacts on the air TMK is introducing advanced technology with a high degree of industrial emissions purification. Every year activities in this area are carried out, including overhaul of pollution control equipment to improve the efficiency of gas cleaning, etc.

In general, TMK spent U.S.$ 3.95 million on emissions control, which is 61% more than in 2010.

The main improvements to reduce emissions are:

- the modernization of gas purification in the electric arc furnace at TMK-RESITA, where dust emissions were reduced by 5%,
- transition to advanced steelmaking technology—replacement of open-hearth furnaces with an electric arc furnace—will allow the Seversky Tube Works to reduce harmful emissions from steelmaking by a factor of 2.7.

## Water Management

TMK's plants are implementing an integrated approach to solving the problem of water resources, gradually achieving optimization of water consumption, water distribution, use, and sewage.

The main tasks in this area— reducing water consumption and gradually reducing the impact on water bodies—

were solved in 2011 due to the development of recycling schemes and increasing the efficiency of existing treatment facilities. The transition to recycling water supply is a prerequisite for the introduction of new production capacities, modernization and reconstruction of production facilities.

Current TMK expenditures on the protection of water bodies in 2011 exceeded the level in 2010 by 14.5% and amounted to U.S.$ 14.6 million.

*Current TMK expenditures on the protection of water bodies in 2011 exceeded the level in 2010 by 14.5% and amounted to U.S.$ 14.6 million.*

The following environmental results were achieved at the plants:

- TAGMET completed construction of the OLIVOTTO water recycling and heat separation systems at the pipe-rolling mill, as well as installation of a steel vacuum degasser. As a result, the amount of water diverted from the Gulf of Taganrog was significantly reduced. Construction of a water-recycling system at the electric arc furnace was begun;
- as a result of measures to improve the efficiency of wastewater treatment, discharge of iron fell by 32.4% at Seversky Tube Works; suspended material discharge fell by 1.2%;
- by eliminating leaks and pipeline breaks in the water recycling system at the Volzhsky Pipe Plant, conventionally clean drainage were reduced;
- a set of measures to improve industrial wastewater treatment at Sinarsky Pipe Plant led to a reduction of pollutants in wastewater. Further work is being done to reduce the allowable discharge;
- reconstruction of water supply systems at TMK-RESITA was completed in 2011;
- TMK IPSCO's plant in Blytheville, Arkansas installed an evaporator for sewage treatment, which reduced the amount of waste by 90%.

## Waste Management

The Company's system to manage waste from production aims to implement practical actions to reduce waste generation, recycling, disposal and minimization of placement in the environment.

To protect the environment from the effects of waste, the following amounts were spent: U.S.$ 6.242 million by the Russian division, U.S.$ 650,000 by the European division, and U.S.$ 649,000 by the American division.

Despite the growth in production in 2011, TMK facilities produced 5% less waste than in 2010.

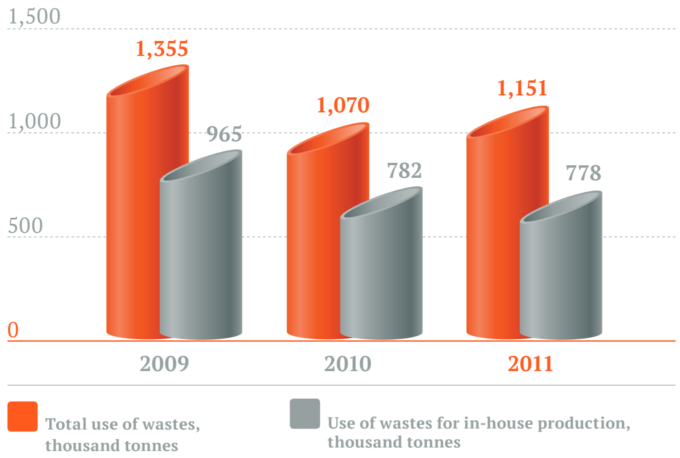
The amount of waste released in 2011 on the sites of TMK facilities fell by 35.8%.

During the year, work continued to solve the tasks laid out by the company's Environmental Policy concerning the use of waste products as raw materials for both in-house production and other industries. 93.6% of waste was directed for further use. The use of accumulated waste and waste from current production in the Russian division exceeded the amount of waste formed.

In 2011, facilities in the Russian division carried out reclamation of disturbed land. The cost of these activities amounted to U.S.$ 1.56 million, which is 2.5 times more than in 2010.

*The Volzhsky Pipe Plant won the Russian national contest "Best Russian Plants: Dynamics, Efficiency, Responsibility 2011" in the category of "Most Environmentally Responsible Business."*

## USE OF WASTE FROM PRODUCTION
*(Russian division)*



# 7.3 QUALITY CONTROL

The Company operates and is continuously upgrading its corporate quality management system, and TMK's plants make use of local systems of environmental management and occupational health and safety that are certified and audited annually by recognized international certification bodies. All TMK tubular products comply with the standards and technical requirements established by international, regional and national standardization organizations.

***All TMK tubular products conform with national and international standards.***

In 2011, TMK implemented the following projects in the area of quality management:

## *Upgrading of the corporate quality management system:*

- Executive managers at TMK plants received corporate training in Lean Six Sigma by SSA & Company
- 21 pilot improvement projects aimed at improving project quality, process efficiency and reducing cycle times were implemented through the use of Lean Six Sigma methodologies, as well as economizing expenditures, including:

— *improved manufacturing process of hot-rolled pipes (Sinarsky Pipe Plant);*
— *improved continuous casting production technology for billets of size 400mm and pipes of steel grade 20KT (Seversky Tube Works);*
— *improved the process of oil and gas pipe heat treatment under TU 14-3R-91-2004 in order to reduce production costs (TAGMET);*
— *increased service life of PQF continuous mandrel mill (TAGMET);*
— *provided required geometrical parameters of pipes with premium connections (Volzhsky Pipe Plant).*

The expected economic effect from implementation of projects is RUB 400 million.

## *Certification*

- A recertification audit for compliance of TMK's corporate quality management system with the requirements of ISO 9001 extended for 3 years the certificate issued by the international certification body Lloyd's Register.
- Products manufactured by the Volzhsky Pipe Plant, TAGMET and Sinarsky Pipe Plant were certified for compliance with European standards and directives, including PED 97/23/EG AD-2000-W0; they also obtained

7.3

the right to bear the CE mark for products manufactured for pressure vessels.
- Seversky Tube Works, TMK-CPV and Volzhsky Pipe Plant were issued certificates of conformity of quality management systems to the STO Gazprom 9001-2006 standard.
- The nondestructive testing laboratory at the Sinarsky Pipe Plant was certified for compliance with the non-destructive testing requirements of Russia's State Committee for Industrial and Mining Safety Supervision.
- TMK Oilfield Services undertook activities to confirm product conformity to national standards, technical regulations; the corresponding certificates were received
- TMK-RESITA certified products (continuously cast billets and blooms from carbon, carbon manganese and alloy steel) at DET NORSKE VERITAS.

## *Qualification*

TMK-Kaztrubprom was qualified at Gazprom, TNK-BP, Karachaganak Petroleum Operating BV, and Tengizchevroil. It was also included in the Register of Domestic Producers of the Republic of Kazakhstan after obtaining a certificate of origin (CT-KZ). As a result, the company has established itself as a reliable supplier of tubular products and has been able to increase the participation in tenders for the supply of products in Kazakhstan.

## *Intercompany cooperation*

- Volzhsky Pipe Plant, Sinarsky Pipe Plant and Kaztrubprom carried out work to grant Kaztrubprom the right to apply API alternative markings;
- TMK-ARTROM mastered production of casing from a new grade of steel (St 1340) developed by TMK-RESITA, as well as heavy-walled drill pipe.

# 7.4 SPONSORSHIP AND CHARITY

*TMK is among the ten best Russian companies in Pricewater-houseCoopers' ranking of corporate sponsorship and charity.*

Adhering to the principles of a socially responsible business, TMK carries out sponsorship and charity activities in all regions where it operates.

In Russia TMK implements sponsorship programs at both the regional and national levels.

TMK's charitable activities are traditionally carried out in collaboration with nonprofit organizations. For example, the Sinara Charitable Foundation, which is under the trusteeship of TMK, carries out charitable programs in the Ural Federal District. In 2011, the Foundation joined the Donors Forum, a coalition of grant-making organizations in Russia.

In 2011, the Foundation allocated grants to 23 nonprofit organizations in the Sverdlovsk Region to implement social projects, including such projects as «Strong Generation," "Caring for Children," "Cultural Heritage," "Native Land," "Youth Initiative," and "Social Entrepreneur."

With the support of TMK and the Foundation, competitions of socially significant programs and projects were organized under "12 Civic Initiatives of the Ural Federal District," an exhibition of social projects in the Ural Federal District, and the "Active 2011».

As part of the project "Corporate Citizenship," TMK employees provide donations each year to help children with serious blood diseases and actively participate in charity events for children in foster homes, as well as specialized educational institutions and social shelters.

TMK is involved in developing the Russian Olympic movement. The Company sponsors the Olympic Support Foundation and the Federation of Ski-Jumping & Nordic Combined of Russia.

TMK is also a sponsor of several sports clubs. In the 10 years it has actively supported the Ural Football Club in Ekaterinburg, all conditions have been established for the team's professional development. Currently, the Ural Football Club takes part in the Championship of Russia along with the teams the National Football League and competes in Russian Premier League. TMK also supports the Sinara mini-football club in Ekaterinburg (in 2010 twice champion of Russia) and the Dinamo Women's Handball Club in Volgograd, a six-time champion in Russia.

In the American division various forms of charitable activity were carried out. TMK IPSCO is a participant in The United Way, a national coalition of charitable organizations. At each facility, there are charity committees that provide financial support to local communities. To celebrate the 10th anniversary of TMK, TMK IPSCO made a donation to After School Matters, an educational organization in Chicago that offers high school students a variety of innovative training programs that develop their talents and skills.

# MANAGEMENT DISCUSSION AND ANALYSIS

## OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

# 8. MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL POSITION AND RESULTS OF OPERATIONS

The following review of our financial position and results of operations is based on, and should be read in conjunction with, our consolidated financial statements and related notes for the year ended December 31, 2011.

Certain information contained in this section, including information with respect to our plans and strategy, includes forward-looking statements and inherently involves risks and uncertainties. In assessing this report, various risk factors must be considered, which means that our actual results may differ significantly from those presented in these forward-looking statements.

### *Rounding*

*Certain monetary amounts, percentages and other figures included in this report are subject to rounding adjustments. On occasion therefore, amounts shown in tables may not be the arithmetic accumulation of the figures that precede them, and figures expressed as percentages in the text and in tables may not total 100%.*

## Executive overview

We are one of the leading global manufacturers and suppliers of tubular products for the energy industry, as well as other industrial applications. We are also the leading manufacturer and supplier of steel pipes for the energy industry in Russia. We focus our efforts on high-margin oil country tubular goods (OCTG) which account for the majority of our sales.

Our industrial operations are geographically diversified with manufacturing facilities in Russia, the United States, Romania and Kazakhstan. We sell our products worldwide to major oil and gas as well as automotive, engineering and power generation companies. In 2011, we delivered 61% of our tubular products to customers located in Russia and 24% to our customers in North America. We also provide related services to oil and gas companies.

Sales volumes of our tubular products increased as the Russian pipe market continued to grow; however, our share in the Russian market decreased from 27% to 25% as competition intensified due to the commissioning of new production facilities for large-diameter pipe and higher imports, in particular from the Ukraine. Nevertheless, we retained a strong market position for our key products, maintaining a 59% market share in seamless OCTG and 64% in seamless line pipe markets.

8.

We are the largest exporter of pipes in Russia. Export sales of pipes produced in Russia accounted for 14% of our total sales volumes for the year as compared to 12% in 2010.

In 2011, we sold 4,185 thousand tonnes of tubular products, an increase of 6% as compared to last year, including 2,342 thousand tonnes of seamless pipe. Our sales of seamless and welded OCTG achieved 1,535 thousand tonnes, a 4% increase as compared to 2010.

In 2011, we reported total consolidated revenue of $6,754 million, up 21% as compared to 2010. Adjusted EBITDA[1] increased 11% to $1,050 million as compared to $942 million in 2010. Adjusted EBITDA margin was 16% as compared to 17% in 2010.

The second half of 2011 saw lower operating results as compared to the first half of 2011, mainly affected by the slowdown in the third quarter. In the third quarter of 2011, our sales volumes declined as compared to those in the each of the preceding two quarters as market activities are usually lower in that quarter of each year and our planned equipment maintenance works occurred during that time. Though not achieved the levels of the first and second quarters, our sales volumes in the fourth quarter increased as compared to those in the third quarter, mainly in the segment of seamless OCTG and line pipe. Therefore we continued to show a positive trend in 2011 as compared to last year.

## Key events

In January 2011, we supplied seamless pipe to Gazprom for construction of the Portovaya compressor station. Unique in its technical and operating characteristics, this compressor station is a starting point for gas supplies via the Nord Stream gas pipeline.

In January 2011, we completed the offering of $500 million of 7.75% loan participation notes which fall due in January 2018. The notes have been admitted for trading on the London Stock Exchange. The proceeds were used to refinance existing indebtedness.

In March 2011, we won an open auction for the acquisition of a 25.5% stake in OAO Volgograd River Port for RUB113 million (approximately $4 million). The auction was held by the Russian Federal Property Management Agency. The acquisition was finalised on August 4, 2011. This acquisition will allow us to optimise logistics for our Volzhsky plant, located close to the Volgograd River Port, and will create additional opportunities to ship OCTG and line pipe to the oil and gas fields in the Caspian region.

In March 2011, the second thread line for ULTRA connections with a capacity of 240 thousand joints was commissioned at TMK IPSCO's facility in Brookfield, U.S.A. The new line will also enhance our product range and help us to meet growing demand from oil and gas companies.

In April 2011, we completed shipments of casing pipe with ULTRA SF Premium Connections to Gazprom Neft for the Urmanskoye field in the Tomsk region in Western Siberia. The pipes were produced by TMK IPSCO. This was the first of our deliveries to Russia of premium tubular products made in the United States.

In May 2011, we finalised the sale of TMK Hydroenergy Power S.R.L., non-core assets previously owned by

[1] *Adjusted EBITDA — See "Selected financial data".*

8.

TMK-RESITA, comprising four hydropower generating units located in Romania.

In June and July 2011, as a part of the Programme on Development and Testing of TMK Premium Connections, we successfully completed qualification tests of TMK PF and ULTRA-QX connections in accordance with ISO 13679 CAL IV standard. Certification of the connections will allow us to provide more tailored solutions to customers and further strengthen our position in the segment of premium pipe products.

In June 2011, we started production of pipe with a new TMK CWB premium connection for drilling with casing. The implementation of new technology will allow us to increase the connection's gas-tightness and operational efficiency. One of the TMK CWB connection's outstanding features is its ability to be coupled with other types of threads without adapters.

In June 2011, the annual shareholders' meeting approved a final dividend in respect of the full-year 2010 in the amount of 796,948 thousand Russian roubles ($28 million at the exchange rate on the date of approval) or 0.85 Russian roubles per share ($0.03 per share), of which 60,839 thousand Russian roubles ($2 million at the exchange rate on the date of approval) related to treasury shares in possession of the Group.

In September 2011, Standard & Poor's Rating Services raised its long-term corporate credit rating on TMK to "B+/ru A". The upgrade reflects the improvement in TMK's liquidity and its operating and financial performance in the first half of 2011.

In October 2011, we commissioned a thread line for casing with premium connections at Orsky Machine Building Plant which is part of TMK's oilfield services division. The capacity of the new thread line is 24,000 tonnes of pipe of the designated product mix per year. Production of casing with gas tight connections will allow the company to expand its product line and ability to offer new products for oil and gas wells and related infrastructure development and services.

In November 2011, an extraordinary general meeting of shareholders approved an interim dividend in respect of the first six months of 2011 in the amount of 871,955 thousand Russian roubles ($28 million at the exchange rate on the date of approval) or 0.93 Russian roubles per share ($0.03 per share), from which 69,211 thousand Russian roubles ($2 million at the exchange rate on the date of approval) related to the treasury shares in possession of the Group.

In December 2011, we signed an agreement with LUKOIL, one of the largest global vertically integrated oil and gas companies, on pipe supplies in 2012. LUKOIL is a longstanding partner of TMK. Under the agreement, we guarantee to supply all of the company's requirements for pipe products. The supply volumes are planned to be not less than 260 thousand tonnes for the year.

In December 2011, TMK IPSCO and Ferrous Metal Processing Co. signed a 12-year agreement to install a slitting line at TMK IPSCO's manufacturing facility in Wilder, KY, U.S.A. This will be the largest slitter in North America. The commercial operation is scheduled to start in autumn 2012. Ferrous will own and operate the new facility and slit steel coils for TMK IPSCO on a toll basis, providing 100 percent of the company's slitting needs for pipe production.

In December 2011, TMK IPSCO completed construction of its new R&D centre located in Houston, TX, USA. Employees and test equipment began moving into the facility in January 2012 and the facility will be fully operational in July 2012. We are one of the few global pipe producers with its own R&D centre and whose testing results are recognised by oil and gas majors. This project underlines TMK's commitment to developing new products to service the industry and to meet the evolving needs and challenges that oil and gas companies face in their business.

In December 2011 and February 2012, TMK PF and TMK PF ET premium connections successfully passed qualification tests. All tests were conducted at the Oil States Industries international testing centre in Aberdeen, UK. TMK PF passed qualification tests in accordance with the ISO 13679 CAL IV standard, while TMK PF ET passed tests designed to ensure gas-tightness under the application of internal and external pressure, tension and compression forces.

We developed and introduced a vacuum insulated tubing (VIT), a technologically unique product offered by a limited number of producers globally. In early 2012, we delivered the first shipment of VIT to Gazprom for use in the Bovanenkovo gas condensate field on the Yamal Peninsula.

## Business structure

Our operating segments reflect the Group's management structure and the way financial information is regularly reviewed. For management purposes, the Group is organised into business divisions based on geographical location, and has three reportable segments:

- Russian division: manufacturing facilities located in the Russian Federation and Kazakhstan, oilfield service companies and trading companies in Russia, Kazakhstan, Switzerland, the United Arab Emirates and South Africa. The Russian division is engaged in the production and supply of seamless and welded pipe, premium products and the rendering of related services to oil and gas companies;
- American division: manufacturing facilities and trading companies located in North America. The American division is engaged in the production and supply of seamless and welded pipe and premium products, including ULTRA connections;
- European division: manufacturing facilities located in Romania, and trading companies located in Italy and Germany. The European division is engaged in the production and supply of seamless pipe and steel billets.

8.

## Financial and operating highlights

In 2011, our operating results demonstrated a positive trend as compared to 2010. The following table provides consolidated operating results for the periods presented:

| | Year ended December 31 | | |
|---|---|---|---|
| | *2011* | *2010* | *Change* |
| | | ***in millions of U.S. dollars*** | ***in %*** |
| Sales volume *(in thousand tonnes)* | 4,185 | 3,962 | 6% |
| Revenue | 6,754 | 5,579 | 21% |
| Cost of sales | (5,307) | (4,285) | 24% |
| **GROSS PROFIT** | **1,446** | **1,293** | **12%** |
| **GROSS PROFIT MARGIN** | **21%** | **23%** | |
| Operating expenses[1] | (675) | (694) | (3)% |
| Foreign exchange (loss)/gain, net | (1) | 10 | (110)% |
| Gain/(loss) on changes in fair value of derivative financial instrument | 45 | (12) | (475)% |
| Finance costs, net | (271) | (412) | (34)% |
| **INCOME BEFORE TAX** | **544** | **185** | **194%** |
| Income tax expense | (159) | (81) | 96% |
| **NET INCOME** | **385** | **104** | **270%** |
| **NET INCOME ADJUSTED FOR GAIN/(LOSS) ON CHANGES IN FAIR VALUE OF DERIVATIVE INSTRUMENT[2]** | **340** | **116** | **193%** |
| **ADJUSTED NET INCOME MARGIN[3]** | **5%** | **2%** | |
| **ADJUSTED EBITDA[4]** | **1,050** | **942** | **11%** |
| **ADJUSTED EBITDA MARGIN** | **16%** | **17%** | |

1 *"Operating expenses" include selling and distribution, general and administrative, advertising and promotion, research and development, impairment/reversal of assets, gain on disposal of assets held for sale and net other operating income/expense.*

2 *Net income adjusted for gain/loss on changes in fair value of derivative financial instrument is presented in the table because we consider it an important supplemental measure of our performance. Net income adjusted for gain/loss on changes in fair value of derivative financial instrument is not a measurement of performance under IFRS and should not be considered as an alternative to net income or any other performance measures derived in accordance with IFRS.*

3 *Adjusted net income margin is calculated as the quotient of Net Income adjusted for gain/loss on changes in fair value of derivative instrument divided by Revenue.*

4 *Adjusted EBITDA — See "Selected financial data".*

8.

For the purposes of this report, net income has been adjusted for the gain on changes in fair value of the derivative financial instrument in the amount of $45 million in 2011 as compared to the adjustment for the comparable loss of $12 million in 2010 to reflect management's opinion in respect of the treatment of the conversion option *(see "Gain/loss on changes in fair value of derivative financial instrument")*.

Following market growth and increased sales volumes, our financial performance and financial indicators improved in 2011. Our operating and financial results by quarter nevertheless demonstrated differing development trends. The following table sets forth information regarding certain key financial indicators as of the dates and for the quarters ended:

| | December 31, 2011 | September 30, 2011 | June 30, 2011 | March 31, 2011 | December 31, 2010 |
|---|---|---|---|---|---|
| | *in millions of U.S. dollars* | | | | |
| Sales volume | 1,017 | 989 | 1,119 | 1,060 | 1,110 |
| Revenue | 1,603 | 1,604 | 1,878 | 1,669 | 1,648 |
| Adjusted EBITDA | 223 | 202 | 332 | 293 | 293 |
| Adjusted EBITDA margin | 14% | 13% | 18% | 18% | 18% |
| Net debt-to-EBITDA ratio LTM[1] | 3.4 | 3.2 | 3.3 | 3.7 | 3.9 |

After two successful quarters, our financial and operating results were negatively affected in the third quarter of 2011 by lower sales of welded large-diameter pipe as a result of the completion of certain major projects in Russia. In addition to the decrease in sales volumes of large-diameter pipe shift in our product mix negatively affected the profitability of the Russian division. At the same time, the profitability of the U.S. welded pipe segment reduced as high cost inventory purchased in the second quarter was consumed. Repair expenses incurred at STZ, VTZ and SinTZ also adversely affected the profitability of the Group.

In the fourth quarter of 2011, our results of operations were higher than in the previous quarter, mainly because of the favorable changes in product mix. Share of seamless OCTG and seamless line pipe increased while share of seamless industrial and welded industrial pipe declined. However, sales volumes of the fourth quarter have not reached those of the first and second quarters, particularly, sales volumes of welded large diameter pipe remained flat as compared to those in the third quarter. At the same time, the decrease in the cost of scrap in the Russian division and the decrease in the cost of coil in the American division positively affected the cost per tonne of seamless pipe in the Russian division and the cost per tonne of welded pipe in the American division, respectively.

*1 Net-Debt-to-EBITDA ratio is defined as the quotient of Net Debt at the end of the given reporting date divided by the Adjusted EBITDA for the 12 months immediately preceding the given reporting date.*

*Adjusted EBITDA — See "Selected financial data".*

For the reasons mentioned above, Adjusted EBITDA decreased in the third quarter of 2011 and showed only moderate growth in the fourth quarter of 2011.

The decrease in our net debt as of December 31, 2011 as compared to December 31, 2010 was mainly due to the Russian rouble depreciation against the U.S. dollar, and increased cash balance. As a result the net debt-to-EBITDA ratio improved from 3.9 as of December 31, 2010 to 3.4 as of December 31, 2011.

Following the improvement in our operating performance and stronger financial position, we have resumed the payment of dividends. We distributed a final dividend in respect of 2010 and an interim dividend in respect of the first six months of 2011. No dividends have been paid since 2008.

## Sales volume

The following table presents pipe sales volumes by reporting segment for the periods presented:

| | **Year ended December 31** | | | |
|---|---|---|---|---|
| | *2011* | *2010* | *Change* | *Change* |
| | ***in thousand tonnes*** | | ***in thousand tonnes*** | ***in %*** |
| Russia | 3,115 | 2,989 | 126 | 4% |
| America | 892 | 804 | 88 | 11% |
| Europe | 178 | 169 | 9 | 5% |
| **TOTAL PIPE** | **4,185** | **3,962** | **223** | **6%** |

***Russia.*** In 2011, sales volumes of **seamless** pipe demonstrated an 11% increase year-on-year, on the back of increased demand for seamless pipe, whereas **welded** pipe sales decreased 5%. Sales of all types of **seamless** pipe increased with **seamless line** and **seamless OCTG** demonstrating the most significant growth, reflecting the increase in demand from oil and gas companies. **Seamless OCTG** sales growth was achieved despite slowing export sales caused by the political instability in North Africa and the Middle East. Lower sales of **welded** pipe were mostly attributed to a reduction in deliveries of **large-diameter welded** pipe for the construction of major pipelines as a result of the completion of some major projects in the first half of the year as well as the postponement of new pipeline projects. The growing production capacities by other pipe producers and higher imports also negatively impacted sales of large-diameter welded pipe which were consequently 13% lower than last year.

***America.*** Sales in the American division increased 11% in 2011 as compared to 2010 reflecting growth in pipe consumption in the U.S. market. Greater volumes were mainly driven by increases in both **seamless** and **welded line** pipe sales jumping 85% year-on-year. Sales growth was driven by strong drilling activity reflecting growth in the shales and high oil prices.

***Europe.*** The division produces **seamless pipe** and steel **billets**. Sales of **seamless industrial** pipe, a core product for the division, increased 13% reflecting high market demand, mainly from the engineering industry.

In 2011, our **seamless** pipe sales volumes increased, bringing total sales up 6%. Sales of **welded** pipe remained flat. The table below presents sales volumes by group of products for the periods presented:

| | Year ended December 31 | | | |
|---|---|---|---|---|
| | *2011* | *2010* | *Change* | *Change* |
| | ***in thousand tonnes*** | | ***in thousand tonnes*** | ***in %*** |
| Seamless pipe | 2,342 | 2,120 | 222 | 10% |
| Welded pipe | 1,843 | 1,842 | 1 | 0% |
| **TOTAL PIPE** | **4,185** | **3,962** | **223** | **6%** |

## Revenue

The table below presents revenue by reporting segment for the periods presented:

| | Year ended December 31 | | | |
|---|---|---|---|---|
| | *2011* | *2010* | *Change* | *Change* |
| | ***in millions of U.S. dollars*** | | ***in millions of U.S. dollars*** | ***in %*** |
| Russia | 4,788 | 3,998 | 790 | 20% |
| America | 1,590 | 1,324 | 266 | 20% |
| Europe | 375 | 256 | 119 | 46% |
| **TOTAL REVENUE** | **6,754** | **5,579** | **1,175** | **21%** |

***Russia.*** Year-on-year, revenue generated by the Russian division increased 20%, or $790 million, primarily reflecting higher selling prices and sales volumes of tubular products.

The revenue growth mainly benefited from higher average selling prices and changes in product mix of **seamless** and **welded** pipe which accounted for a $396 million and $63 million increase, respectively. A volume effect accounted for a $242 million increase in **seamless** pipe revenue, whereas revenue from sales of **welded** pipe decreased $75 million.

Revenue from other operations grew $10 million mainly due to an increase in revenue from pipe-related services, e.g. protective coating, repair and field services.

The favorable effect of translation from the functional to the presentation currency[1] accounted for $155 million.

***America.*** In the American division, revenue grew 20% or $266 million in 2011 as compared to 2010.

Revenue growth due to higher selling prices and changes in product mix of tubular products contributed $94 million and $64 million to the growth of **seamless** and **welded** pipe revenue, respectively. In 2011, the share of high-priced **seamless OCTG pipe with premium connections** more than doubled in total sales volumes of **seamless OCTG**.

The revenue growth of **seamless** and **welded** pipe attributable to changes in sales volumes accounted for $58 million and $78 million, respectively. The growth was mostly derived from increased sales volumes of **welded** and **seamless line pipe** as well as **seamless industrial** pipe.

Revenue from other operations, mainly premium threading services, declined $28 million as threading capacities were intensively used for pipes manufactured by TMK production subsidiaries, including plants located in Russia and Romania. As a result, sales of own-produced pipe with ULTRA premium connection increased and

*1 For the purposes of this management discussion and analysis, the translation effect on revenue/costs and income/expense illustrates an influence of different rates used for translation of such revenue/costs or incomes/expenses from functional to presentation currency in different reporting periods.*

revenue from pipe threading services for external customers declined.

***Europe.*** A 46% year-on-year revenue growth was driven primarily by an increase in selling prices for tubular products in response to the market recovery and increased costs of raw materials.

Changes in selling prices and product mix contributed $51 million to the total revenue growth. Revenue growth attributable to higher sales volumes amounted to $11 million, mainly driven by increased sales of **seamless industrial** pipe.

An increase in revenue from other operations in the amount of $42 million reflected the substantial growth in sales volumes of steel **billets**.

The favorable effect of translation from the functional to the presentation currency accounted for a $15 million increase.

In 2011, total revenue growth was mainly attributable to increased sales of **seamless** pipe. The table below presents pipe sales volumes by group of product for the periods presented:

| | Year ended December 31 | | | |
|---|---|---|---|---|
| | *2011* | *2010* | *Change* | *Change* |
| | *in millions of U.S. dollars* | | *in millions of U.S. dollars* | *in %* |
| Seamless pipe | 3,911 | 2,952 | 959 | 32% |
| Welded pipe | 2,536 | 2,352 | 184 | 8% |
| **REVENUE — PIPE** | **6,447** | **5,304** | **1,143** | **22%** |
| Other operations | 307 | 275 | 32 | 12% |
| **TOTAL REVENUE** | **6,754** | **5,579** | **1,175** | **21%** |

## Cost of sales

In 2011, our cost of sales increased 24% to $5,307 million as compared to $4,285 million in 2010. The table below presents the cost of sales by reporting segment for the periods presented:

| | Year ended December 31 | | | |
|---|---|---|---|---|
| | *2011* | *2010* | *Change* | *Change* |
| | *in millions of U.S. dollars* | | *in millions of U.S. dollars* | *in %* |
| Russia | 3,752 | 3,066 | 686 | 22% |
| America | 1,280 | 1,023 | 257 | 25% |
| Europe | 275 | 197 | 78 | 40% |
| **TOTAL COST OF SALES** | **5,307** | **4,285** | **1,022** | **24%** |

***Russia.*** In 2011, an increase in the average cost per tonne, reflecting higher prices for raw materials and changes in product mix, resulted in a $235 million and $186 million growth of the cost of sales of **seamless** and **welded** pipe, respectively.

An increase in the cost of sales of **seamless** pipe attributable to the growth of sales volumes amounted to $184 million. The cost of sales of **welded** pipe, however, decreased $57 million as a result of lower sales volumes of large-diameter welded pipe.

The cost of other operations increased $18 million, while the effect of translation from the functional to the presentation currency accounted for a $121 million increase in the cost of sales of the division.

8.

***America.*** An average cost per tonne and changes in product mix, which mainly increased as a result of growth in coil and scrap prices, considerably affected the division's cost of sales. The cost of sales of **seamless** and **welded** pipe increased $71 million and $74 million, respectively.

Higher sales volumes of **seamless** and **welded** pipe contributed $39 million and $69 million, respectively.

In 2011, the cost of sales from other operations increased $4 million.

***Europe.*** In 2011, an increase in the average cost per tonne caused by a significant growth of scrap prices at the end of 2010, as well as changes in product mix resulted in a $21 million increase in the cost of sales. Growth in the cost of sales attributable to an increase in sales volumes of **seamless** pipe amounted to $8 million.

An increase in the cost of sales from other operations in the amount of $38 million primarily reflected a substantial growth in the sales volume of steel billets.

The effect of translation from the functional to the presentation currency resulted in an $11 million growth in the cost of sales.

The table below shows our total cost of sales by group of products for the periods presented:

| | **Year ended December 31** | | | |
|---|---|---|---|---|
| | ***2011*** | ***2010*** | ***Change*** | ***Change*** |
| | *in millions of U.S. dollars* | | *in millions of U.S. dollars* | *in %* |
| Seamless pipe | 2,837 | 2,200 | 637 | 29% |
| Welded pipe | 2,192 | 1,875 | 317 | 17% |
| **COST OF SALES — PIPE** | **5,029** | **4,075** | **954** | **23%** |
| Other operations | 278 | 210 | 68 | 32% |
| **TOTAL COST OF SALES** | **5,307** | **4,285** | **1,022** | **24%** |

The following table provides a breakdown of the cost of sales for the periods presented:

| | Year ended December 31 | | | |
|---|---|---|---|---|
| | *2011* | *2010* | *Change* | *Change* |
| | *in millions of U.S. dollars* | | *in millions of U.S. dollars* | *in %* |
| Raw materials and consumables | 3,721 | 2,972 | 749 | 25% |
| Labour costs | 662 | 540 | 122 | 23% |
| Energy and utilities | 400 | 336 | 64 | 19% |
| Depreciation | 258 | 218 | 40 | 18% |
| Other costs | 378 | 313 | 65 | 21% |
| **PRODUCTION COST** | **5,419** | **4,379** | **1,040** | **24%** |
| Change in finished goods and work in progress | (147) | (171) | 24 | (14)% |
| Cost of externally purchased goods and obsolete stock and write offs | 36 | 77 | (41) | (53)% |
| **TOTAL COST OF SALES** | **5,307** | **4,285** | **1,022** | **24%** |

The principal components of the cost of sales are discussed below.

## *Raw materials and consumables*

Raw materials and consumables are the principal components of our costs; they include scrap, coils, steel sheets, ferroalloys, steel billets and other consumables.

Growth in purchase prices and changes in the consumed raw materials structure, driven by the current product mix, contributed $472 million to the growth in the total cost of sales.

All our divisions were exposed to volatility in prices for certain raw materials in 2011 as compared to 2010. In the Russian division, average purchase prices for scrap and coils increased 25% and 17%, respectively. Average prices for scrap and coils in the American division increased 22% and 19%, respectively. The average purchase price for scrap in the European division was up 20%.

Our sales growth resulted in higher production volumes which contributed $184 million to the increase in the cost of raw materials and consumables.

The effect of translation from the functional to the presentation currency accounted for a $93 million increase in the cost of sales.

## *Labour costs*

Labour costs growth in 2011 resulted mainly from the increase in payroll rates in all divisions of the Group, as well as from changes in the Russian tax legislation in respect of social security contributions effective from January 1, 2011 which entail an increase in insurance contribution rates from 26% to 34% and changes in the calculation methodology. The foregoing accounted for $93 million of the change in labour costs.

The growth of the American division's headcount due to rehiring production workers accounted for a $23 million increase in labour costs; this was partially offset by a $10 million decline due to a minor decrease in the headcount of the Russian division.

The effect of translation from the functional to the presentation currency accounted for a $16 million increase in labour costs.

## *Energy and utilities*

An increase in prices for energy and utilities consumed in production processes resulted in energy costs growth of $34 million in 2011 as compared to 2010.

As a result of growth in production volumes in 2011 as compared to 2010, energy costs increased $18 million.

In 2011 as compared to 2010, on average, the electricity and natural gas tariffs in the Russian division increased 13%. In the American division, the average electricity tariff barely changed while the average natural gas tariff decreased 6% because of the regressive tariffs system. The average electricity and natural gas tariffs in the European division were up 28% and 15%, respectively.

The effect of translation from the functional to the presentation currency accounted for a $12 million increase in energy costs.

## *Depreciation*

Depreciation increased $40 million in 2011 as compared to 2010. The effect of translation from the functional to the presentation currency accounted for a $7 million increase. The principal share of the remaining increase relates to the reduction of estimated useful lives of some open-hearth furnaces, a pilger mill and the 2520 welded pipe mill in the Russian division due to the planned replacement of this equipment before the end of the previously assessed useful lives.

## *Other costs*

Other costs include repair and maintenance, contracted manufacture, transportation among production sites, taxes and other expenses. Growth of other expenses was consistent with the movement in operating activity.

The effect of translation from the functional to the presentation currency accounted for a $4 million increase.

## *Change in finished goods and work in progress*

The gradual growth of finished goods and work-in-progress balances in 2011 and 2010 reflects growing prices for raw materials and tubular products as well as increased stock driven by the growth of sales volumes.

## Gross profit

The following table shows gross profit and gross margin by reporting segment for the periods presented:

| | Year ended December 31 | | | | |
|---|---|---|---|---|---|
| | *2011* | | *2010* | | *Change* |
| | *in millions of U.S. dollars* | *in %* | *in millions of U.S. dollars* | *in %* | *in millions of U.S. dollars* |
| Russia | 1,036 | 22% | 932 | 23% | 104 |
| America | 311 | 20% | 302 | 23% | 9 |
| Europe | 100 | 27% | 59 | 23% | 40 |
| **GROSS PROFIT** | **1,446** | **21%** | **1,293** | **23%** | **153** |

In 2011, gross profit increased 12% or $153 million as compared to 2010 and amounted to $1,446 million. The gross margin decreased to 21% in 2011.

***Russia.*** The gross margin in the Russian division declined from 23% in 2010 to 22% in 2011, reflecting a lower gross margin contribution from **large-diameter welded** pipe as a result of completion of certain higher-margin projects. The projects included long-distance delivery terms which resulted in higher selling prices and additional selling and distribution expenses. However, the decrease in the gross margin of **large-diameter welded** pipe was partially offset by the growth in the gross margin of **seamless OCTG** and **seamless line** pipe.

The increase in gross profit was mainly attributable to the growth in selling prices for **seamless** pipe that outpaced the growth in the average cost per tonne; together with changes in product mix this contributed $161 million. However the lower gross profit per tonne of **welded** pipe resulted in a $123 million decrease in gross profit.

An increase in sales volumes accounted for a $58 million growth in the gross profit of **seamless** pipe. The gross profit of **welded** pipe, however, declined $18 million as a result of an unfavorable volume effect.

Gross profit from other operations declined $8 million. The effect of translation from the functional to the presentation currency resulted in a $34 million growth in the gross profit of the Russian division.

***America.*** Gross profit in the American division grew 3% or $9 million in 2011 as compared to 2010. A decrease in the gross margin of both **welded** and **seamless** pipe sales caused the division's gross margin to fall from 23% in 2010 to 20% in 2011.

8.

An increase in sales volumes contributed $19 million and $9 million to the gross profit of **seamless** and **welded** pipe, respectively.

In 2011, the higher gross profit per tonne of **seamless** pipe resulted in a $23 million growth of the division's gross profit. However, the difficulties in recovering the significant increase in coil costs adversely influenced gross profit on sales of welded pipe and resulted in a $10 million decrease. This was driven by the serious impact of Korean imports, which deflated market pricing on **welded** carbon casing pipe, and a lower share of **welded** OCTG in total sales volumes of welded pipe.

The division's gross profit from other operations declined $32 million mainly due to less threading services rendered and changes in the product mix. Product mix of premium connections applied to customer-owned pipe worsened as a result of lower volumes of the more profitable premium connections for pipe used in shale plays offset by increased volumes of less profitable premium connections for pipe used in oil basins.

***Europe.*** In 2011, gross margin in the European division was 27% as compared to 23% in 2010, reflecting the favorable market situation and, in particular, an increased share of high-margin orders related to **industrial** heat-treated alloy pipe. An increase in gross profit per tonne of **seamless** pipe and higher sales volumes accounted for a $31 million and $3 million increase, respectively, in the division's total gross profit. Gross profit of steel billets was up $2 million. The effect of translation from the functional to the presentation currency resulted in a $4 million growth in gross profit.

The following table represents our gross profit by group of products for the periods presented:

| | **Year ended December 31** | | | | |
|---|---|---|---|---|---|
| | *2011* | | *2010* | | *Change* |
| | ***in millions of U.S. dollars*** | ***in %*** | ***in millions of U.S. dollars*** | ***in %*** | ***in millions of U.S. dollars*** |
| Seamless pipe | 1,074 | 28% | 752 | 26% | 322 |
| Welded pipe | 344 | 14% | 477 | 20% | (133) |
| **GROSS PROFIT — PIPE** | **1,418** | **22%** | **1,229** | **23%** | **189** |
| Other operations | 29 | 9% | 65 | 24% | (36) |
| **TOTAL GROSS PROFIT** | **1,446** | **21%** | **1,293** | **23%** | **153** |

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## Selling, general and administrative expenses

Selling, general and administrative expenses were slightly down as a percentage of revenue to 11% in 2011 as compared to 12% in 2010. The following table sets out our operating SG&A expenses for the periods presented:

| | Year ended December 31 | | | |
|---|---|---|---|---|
| | *2011* | *2010* | *Change* | *Change* |
| | *in millions of U.S. dollars* | | *in millions of U.S. dollars* | *in %* |
| Russia | 530 | 470 | 60 | 13% |
| America | 149 | 153 | (4) | (3)% |
| Europe | 43 | 36 | 7 | 19% |
| **TOTAL SG&A EXPENSES** | **722** | **660** | **62** | **9%** |

***Russia.*** The increase was mainly attributable to the growth in sales staff costs in 2011 as compared to 2010. Growing salaries and related social security contributions resulted in a $29 million growth in selling, general and administrative expenses. The decrease in freight expenses under certain sales contracts, though partially offset by grown freight tariffs, resulted in a $2 million decline in selling expenses. The effect of translation from the functional to the presentation currency and changes in other expenses accounted for $17 million and $15 million of the total increase, respectively.

***America.*** Selling, general and administrative expenses declined reflecting primarily a $16 million decrease in depreciation mainly due to the amortisation of the intangible asset "Customer relationships"; the asset is amortised using the diminishing balance method to reflect the pattern of consumption of the related economic benefits. Staff costs and other expenses increased $2 million and $10 million, respectively.

***Europe.*** An increase in selling, general and administrative expenses in the European division reflects higher sales activities in the European division which caused a $2 million growth in freight expenses in 2011 as compared to 2010. The effect of translation from the functional to the presentation currency and changes in staff and other costs accounted for $2 million and $3 million, respectively

The table below provides a breakdown of our total selling, general and administrative expenses for the periods presented:

| | Year ended December 31 | | | |
|---|---|---|---|---|
| | *2011* | *2010* | *Change* | *Change* |
| | *in millions of U.S. dollars* | | *in millions of U.S. dollars* | *in %* |
| Staff costs | 229 | 190 | 39 | 21% |
| Freight | 219 | 212 | 7 | 3% |
| Depreciation | 80 | 95 | (15) | (16)% |
| Professional services | 73 | 68 | 5 | 7% |
| Other expenses | 121 | 95 | 26 | 27% |
| **TOTAL SG&A EXPENSES** | **722** | **660** | **62** | **9%** |

## Impairment of assets

We determined that the value in use of the European division significantly exceeded its carrying value. We applied a 13.36% pre-tax discount rate for the calculation of the value in use of this cash generating unit. The increase of its recoverable amount was mostly due to the projected increase in the share of most profitable products in total production and the projected increase of sales volumes of the European division. As a result, we reversed the impairment loss recognised in 2008 and 2009 in respect of property, plant and equipment of the European division in the amount of $73 million.

In 2011, we recorded a loss from impairment of investment in associate, the Volgograd River Port, in the amount of $2 million.

In 2011, we determined that the carrying value of TMK-Kaztrubprom exceeded its recoverable amount. As a result, we recognised a loss from the impairment of goodwill in the amount of $3 million.

## Foreign exchange gain/loss, net

In 2011, a foreign exchange loss was recognised in the amount of $1 million as compared to a $10 million gain in 2010. In addition, we recognised a foreign exchange loss from exchange rate fluctuations in the amount of $54 million (net of income tax) in 2011 as compared to a $7 million loss (net of income tax) in 2010 in the statement of other comprehensive income. The amount in the statement of comprehensive income represents the effective portion of foreign exchange gains or losses on our hedging instruments. At the date of acquisition of controlling interests in NS Group, Inc. and IPSCO Tubulars, Inc. we hedged our net investment in these operations against foreign currency risk using U.S. dollar denominated borrowings made by Russian entities of TMK. Hedging is used to eliminate the foreign currency exchange rate risk associated with the repayment of these liabilities resulting from changes in the U.S. dollar/Russian rouble spot rates.

## Gain/loss on changes in fair value of derivative financial instrument

In February 2010, we issued $413 million 5.25% convertible bonds due 2015, convertible into TMK's GDRs. The convertible bonds represent a combined financial instrument containing two components: (i) a bond liability and (ii) an embedded derivative representing a conversion option in foreign currency combined with an issuer call. In accordance with IFRS, a bond liability of $368 million (net of transaction costs of $9 million) was recognised and the liability under the embedded conversion option of $35 million at the initial recognition date.

As of December 31, 2011, the bond liability and the liability under the embedded conversion option were $386 million and $3 million, respectively. As of December 31, 2010, the bond liability and the liability under the embedded conversion option were $378 million and $48 million respectively. As a result, we recognised a gain of $45 million on changes in fair value of the derivative financial instrument in 2011 as compared to a $12 million loss in 2010.

8.

Management nevertheless believes that the IFRS accounting treatment of the conversion option of the bond does not reflect the expected outflow of resources under the conversion rights. The conversion option, whether exercised or expired, will not result in cash outflows. In the event of the bond not being converted, the liability under the conversion option will be recognised as a gain in our income statement. In the event of the exercise of the option, the liability will be transferred to equity (together with the carrying value of the converted bonds); no gain or loss will be recognised on the transaction. Additionally, the accounting treatment of the conversion option requires that changes in fair value of the embedded instrument be recognised in the income statement. The price and volatility of TMK's GDRs have significant impact on fair value of the embedded derivative. In the event the GDRs perform well, the liability under the conversion option will increase and result in losses in the income statement. Changes in fair value may be material in comparison to our net income and may cause distortions in the income statement.

As such, for the purposes of this report, in addition to net income as reflected in the consolidated income statement, it has been decided to present, in this report, an adjusted net income so that it does not reflect gain/loss on changes in fair value of the derivative financial instrument with respect to the embedded derivative component of the convertible bond. The adjusted net income is an alternative performance measure that is not reflected in our consolidated financial statements and has not been audited or reviewed in accordance with ISA.

## Finance costs, net

Finance costs decreased 30%, or $128 million, in 2011 as compared to 2010. In late 2010 and the beginning of 2011, we negotiated lower interest rates for existing loans with major creditors and obtained lower interest rate loans to refinance existing debt. Consequently, the weighted average nominal interest rate stood at 6.92% as of December 31, 2011 as compared to 7.86% as of December 31, 2010. A significant reduction in the amount of unamortised debt issue costs recognised in the income statement in 2011 also decreased our finance costs.

Finance income increased 70% or $13 million in 2011, primarily due to growing dividend income.

As a result, net finance costs decreased $141 million or 34% in 2011 as compared to 2010.

## Income tax

TMK, as a global company with production facilities and trading companies located in Russia, the CIS, the United States, and Europe, is exposed to local taxes charged to businesses. In 2010 and 2011, the following corporate income tax rates were in force in the countries where our production facilities are located: 20% in Russia, 35% (federal rate) in the United States and 16% in Romania.

In 2011, a pre-tax income of $544 million was reported as compared to $185 million in 2010 and in 2011 an income tax expense of $159 million was recognised as compared to $81 million in 2010. Our effective income tax rate declined from 44% to 29%, closer to the normal level of the income tax rate of the Group considering the fiscal residence

8.

structure of the Group's assets. The effective income tax rate declined due to, first, a significant growth in pre-tax income accompanied by a lower level of non-deductible expenses, second, a higher share of profit before tax of the entities with lower than the Group average income tax rate, and, third, non-taxable income related to gain on changes in fair value of derivative financial instrument.

## Net income

As a result of the above-mentioned factors, net income in the amount of $385 million was recognised in 2011 as compared to $104 million in 2010. Net income adjusted for the gain on changes in fair value of the derivative financial instrument grew to $340 million in 2011 from $116 million in 2010 (See *"Gain/loss on changes in fair value of derivative financial instrument"* for the reasons for using this non-IFRS measure). Adjusted net income margin[1] increased to 5% in 2011 from 2% in 2010.

## Adjusted EBITDA[2]

Adjusted EBITDA margin slightly decreased from 17% in 2010 to 16% in 2011. The following table shows the Adjusted EBITDA by reporting segments:

| | **Year ended December 31** | | | |
|---|---|---|---|---|
| | *2011* | *2010* | *Change* | *Change* |
| | ***in millions of U.S. dollars*** | | ***in millions of U.S. dollars*** | ***in %*** |
| Russia | 721 | 633 | 88 | 14% |
| America | 265 | 281 | (16) | (6)% |
| Europe | 64 | 29 | 35 | 121% |
| **TOTAL ADJUSTED EBITDA** | **1,050** | **942** | **108** | **11%** |

***Russia.*** In 2011, Adjusted EBITDA increased 14% or $88 million. The faster pace in cost growth as compared to growth in revenue was partially compensated by the decrease in the share of selling, general and administrative expenses in revenue. As a result, the Adjusted EBITDA margin decreased from 16% to 15%.

***America.*** Adjusted EBITDA decreased 6% or $16 million in 2011. Adjusted EBITDA margin decreased from 21% to 17% following a decline in gross profit margin from 23% to 20%.

***Europe.*** The growth of Adjusted EBITDA margin from 11% to 17% mostly resulted from an increased share of certain high-margin orders for industrial heat-treated alloy pipe.

1 *Adjusted net income margin is calculated as a quotient of Net Income adjusted for gain on changes in fair value of derivative instrument divided by Revenue.*

2 *Adjusted EBITDA — See "Selected financial data".*

8.

# Liquidity and capital resources

## Cash flows

The following table illustrates cash flow for the periods presented:

| | Year ended December 31 | | | |
|---|---|---|---|---|
| | *2011* | *2010* | *Change* | *Change* |
| | *in millions of U.S. dollars* | | *in millions of U.S. dollars* | *in %* |
| Net cash provided by operating activities | 787 | 386 | 401 | 104% |
| Net cash used in investing activities | (377) | (271) | (106) | 39% |
| Net cash used in financing activities | (335) | (186) | (149) | 80% |
| **Increase/(decrease) in cash and cash equivalents** | **75** | **(71)** | **146** | **206%** |
| Effect of exchange rate changes | (2) | (15) | 13 | (87)% |
| Cash and cash equivalents at the beginning of year | 158 | 244 | (86) | (35)% |
| **Cash and cash equivalents at year end** | **231** | **158** | **73** | **46%** |

### *Operating activities*

Compared to 2010, a cash inflow provided by operating activities doubled in 2011.

Net cash provided by operating activities before changes in working capital increased from $942 million in 2010 to $1,050 million in 2011. The increase was mainly attributable to improved operating performance. Cash flows in the amount of $156 million were used to finance working capital as compared to $527 million in 2010. Working capital increased in 2010 at a faster pace in response to growing production and sales activities following the period of the economic downturn.

### *Investing activities*

In 2011, net cash used in investing activities equalled to $377 million or 39% above 2010. In 2011, significant payments for certain capital projects were made, particularly the construction of the electric arc furnace at Tagmet and the modernisation of our seamless pipe production line with a new FQM mill at STZ.

### *Financing activities*

In 2011, net cash used in financing activities amounted to $335 million as compared to $186 million in 2010.

The net cash obtained to finance our capital requirements amounted to $4 million as compared to $103 million in the previous year. We spent $288 million on interest payments, or 16% less as compared to 2010 as a result of lower interest rates negotiated with our creditors. Significant amounts of cash related to proceeds and repayments of borrowings reflect refinancing of existing loans with lower interest rates.

In 2011, we paid a full year dividend for 2010 and an interim dividend in respect of the first six months of 2011 in the total amount of $47 million to OAO TMK shareholders as approved by the annual shareholders' meeting in June 2011 and the extraordinary shareholders' meeting in November 2011, respectively. We also paid $2 million to non-controlling shareholders of our subsidiaries as compared to $1 million in 2010.

## Indebtedness

The following table illustrates the maturity profile of our total financial debt:

| | 1 year or less | 1 to 3 years | Over 3 years | Unamortised debt issue costs | Total debt |
|---|---|---|---|---|---|
| | *in millions of U.S. dollars* | | | | |
| As of December 31, 2011 | 602 | 1,468 | 1,740 | (23) | 3,787 |
| As of December 31, 2010 | 706 | 1,222 | 1,968 | (24) | 3,872 |

The current debt portfolio comprises diversified debt instruments, including bank loans, bonds, convertible bonds and other credit facilities. Total financial debt decreased 2% from $3,872 million as of December 31, 2010 to $3,787 million as of December 31, 2011. The depreciation of the Russian rouble against the U.S. dollar resulted in a decrease of the U.S. dollar equivalent of the Russian rouble-denominated loans in the financial statements as of December 31, 2011. The net amount of proceeds from borrowings in 2011 equaled to $4 million. As of December 31, 2011, U.S. dollar-, Russian rouble- and euro-denominated debt accounted for 48%, 46% and 6%, respectively, of the total financial debt.

As a result of actions undertaken to improve the debt maturity profile, the share of short-term debt decreased to 16% as of December 31, 2011 as compared to 18% as of December 31, 2010.

Our debt portfolio includes fixed as well as floating interest rate debt facilities. As of December 31, 2011, borrowings with a floating interest rate represented $617 million, or 16%, as compared to $3,134 million, or 84%, of borrowings with a fixed interest rate.

The weighted average nominal interest rate decreased 94 basis points as compared to December 31, 2010 and stood at 6.92% as of December 31, 2011. We are constantly seeking an optimum loan portfolio structure.

8.

The most significant credit facilities as of December 31, 2011 were as follows:

| Type of borrowing | Bank | Original currency | Outstanding principal amount | Maturity period |
|---|---|---|---|---|
| | | | *in millions of U.S. dollars* | |
| 7.75% LPN | | USD | 500 | January 2018 |
| 5.25% convertible bonds | | USD | 413 | February 2015 |
| Loan | Gazprombank | USD | 400 | January 2017 |
| Loan | Alfa-Bank | RUR | 317 | November 2016 |
| Loan | Sberbank of Russia | RUR | 311 | September 2015 |
| Loan | Nordea Bank | USD | 200 | January 2017 |
| Bonds, series БО-01 | | RUR | 155 | October 2013 |
| Loan | Gazprombank | RUR | 142 | March 2014 |
| Loan | Sberbank of Russia | RUR | 137 | April 2016 |
| Loan | Sberbank of Russia | RUR | 122 | December 2015 |
| Loan | Gazprombank | RUR | 106 | February 2014 |
| Loan | Gazprombank | RUR | 106 | January 2014 |
| Loan | Wells Fargo | USD | 86 | August 2016 |
| Loan | Gazprombank | USD, RUR | 84 | November 2012 |
| | | | **3,079** | |
| Other facilities | | | 667 | |
| **TOTAL BORROWINGS** | | | **3,746** | |

In January 2011, we completed the offering of 7.75% loan participation notes in the amount of $500 million due in January 2018. The notes have been admitted for trading on the London Stock Exchange. The proceeds from the issue were used to refinance existing indebtedness.

In July 2011, we fully repaid 10% loan participation loans in the amount of $187 million.

## Capital expenditure

A comprehensive renovation of production facilities has resulted in a considerable increase in the efficiency of seamless and large-diameter welded production processes and advanced product quality.

Our key projects planned for the next several years include:

- replacement of the open hearth furnaces with EAF steelmaking facilities at TAGMET in order to reduce steel-making costs and increase an annual billet-production capacity to 950 thousand tonnes; the project is planned to be completed in 2014;
- construction of a new Fine Quality Mill ("FQM") at STZ with an annual seamless pipe production capacity of 550 thousand tonnes and completion in 2014-2015;
- installation of additional non-destructive testing instrumentation, construction of the new hydro-press, new pipe-threading and coupling-threading facilities at SinTZ to further improve the quality of OCTG; the project is planned to be completed in 2013.

In 2011, we completed the modernization of a hot-rolled section and a continuous casting machine at VTZ. It will significantly enhance production capacity for hot-rolled pipe at VTZ and increase the quality of pipe produced.

A new line to produce premium threaded casing was constructed at our Orsk Machine-Building Plant, with a 30 thousand tonne annual capacity. The line was commissioned in 2011. In 2012, we plan to install a hydro-press to run quality tests.

The following projects will enable TMK IPSCO to strengthen its position in the segment of premium connections for horizontal and directional drilling in North America:

- the threadshop line at the plant located in Wilder, KY became operational in October 2011;
- consolidation of threading operations at the production facility located in Odessa, TX is also underway.

As a part of an environmental protection programme, TMK-ARTROM and TMK-RESITA commenced renovation of gas cleaner facilities. The projects will be completed in 2012.

## Development trends

We confirm our positive outlook on the pipe market in 2012 and expect a slight increase in sales volumes and further improvement in the product mix compared to 2011. E&P budgets of Russian oil companies are continuing to grow in 2012 driven by continued high oil prices, which should support demand for seamless OCTG and seamless and welded line pipe. Although a number of pipelines in both Russia and the CIS countries are scheduled to be started in 2012, overall demand for large-diameter pipe is looking weaker this year compared to a year ago.

The U.S. market outlook remains positive for 2012. Strong oil rig count growth should offset the gas rig count decline as the price of natural gas is expected to remain depressed throughout 2012. Oil and liquid plays, such as the Eagle Ford and Permian Basin, will continue to drive growth in the U.S. Line pipe for new shale gas pipelines will continue its growth trend. TMK is well-positioned to support these diverse and often demanding environments with a flexible and customised portfolio of steel tubulars and premium connections.

Given the current trends in raw materials prices and continuing improvement in the product mix, we expect a growth in EBITDA and EBITDA margin in the first quarter of 2012 as compared to the fourth quarter of 2011. The sustainability of improvement in EBITDA and profitability for 2012 will depend on the level of steel prices and welded pipe sales, particularly large-diameter welded pipe.

We intend to further reduce our indebtedness and to continue to optimise the debt profile. Despite some negative developments on global financial markets, we continue to refinance our debt at favorable terms and expect to extend maturities of our debt facilities as planned.

# 8. Selected financial data

## *Adjusted EBITDA*

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

| | December 31, 2011 | September 30, 2011 | June 30, 2011 | March 31, 2011 | December 31, 2010 |
|---|---|---|---|---|---|
| | *in millions of U.S. dollars* | | | | |
| Income before tax | 544 | 425 | 443 | 318 | 185 |
| Depreciation and amortisation | 336 | 333 | 321 | 312 | 301 |
| Finance costs, net | 271 | 346 | 366 | 376 | 412 |
| (Reversal of impairment)/Impairment of assets | (68) | 3 | 3 | - | - |
| (Gain)/loss on changes in fair value of derivative financial instrument | (45) | (22) | 29 | (18) | 12 |
| Foreign exchange loss/(gain), net | 1 | 11 | (29) | 10 | (10) |
| (Gain)/Loss on disposal of property, plant and equipment | (17) | (16) | (15) | 9 | 10 |
| Movement in allowances and provisions | 28 | 39 | 35 | 24 | 32 |
| Other non-cash items | 0 | 0 | - | - | - |
| **Adjusted EBITDA** | **1,050** | **1,119** | **1,153** | **1,031** | **942** |

Adjusted EBITDA is not a measurement of our operating performance under IFRS and should not be considered as an alternative to gross profit, net profit or any other performance measures derived in accordance with IFRS or as an alternative to cash flow from operating activities or as a measure of our liquidity. In particular, Adjusted EBITDA should not be considered to be a measure of discretionary cash available to invest in our growth. Adjusted EBITDA has limitations as analytical tool, and potential investors should not consider it in isolation, or as a substitute for analysis of our operating results as reported under IFRS. Some of these limitations include:

- Adjusted EBITDA does not reflect the impact of financing or finance costs on our operating performance, which can be significant and could further increase if we were to incur more debt;
- Adjusted EBITDA does not reflect the impact of income taxes on our operating performance;
- Adjusted EBITDA does not reflect the impact of depreciation and amortisation on our operating perfor-

mance. The assets which are being depreciated and/or amortised will have to be replaced in the future and such depreciation and amortisation expense may approximate the cost to replace these assets in the future. By excluding this expense from Adjusted EBITDA, it does not reflect our future cash requirements for these replacements; and

- Adjusted EBITDA does not reflect the impact of other non-cash items on our operating performance, such as foreign exchange (gain)/loss, impairment/(reversal of impairment) of non-current assets, movements in allowances and provisions, (gain)/loss on disposal of property, plant and equipment, (gain)/loss on changes in fair value of financial instruments, share of (profit)/loss of associate and other non-cash items. Other companies in the pipe industry may calculate Adjusted EBITDA differently or may use it for other purposes, limiting its usefulness as comparative measure.

We compensate for these limitations by relying primarily on its IFRS operating results and using Adjusted EBITDA only supplementally.

## *Net Debt*

Net debt has been calculated as of the dates indicated:

| | December 31, 2011 | September 30, 2011 | June 30, 2011 | March 31, 2011 | December 31, 2010 |
|---|---|---|---|---|---|
| | *in millions of U.S. dollars* | | | | |
| Short-term loans and borrowings | 599 | 446 | 539 | 520 | 702 |
| Long-term loans and borrowings | 3,188 | 3,323 | 3,478 | 3,509 | 3,170 |
| **TOTAL DEBT** | **3,787** | **3,769** | **4,017** | **4,029** | **3,872** |
| *Net of:* | | | | | |
| Cash and short-term financial investments | (235) | (157) | (174) | (176) | (161) |
| **NET DEBT** | **3,552** | **3,612** | **3,843** | **3,853** | **3,711** |

Net Debt is not a measure under IFRS, and it should not be considered to be an alternative to other measures of financial position. Other companies in the pipe industry may calculate Net Debt differently and therefore comparability may be limited. Net Debt is a measure of our operating performance that is not required by, or presented in accordance with, IFRS. Although Net Debt is a non IFRS measure, it is widely used to assess liquidity and the adequacy of a company's financial structure. We believe Net Debt provides an accurate indicator of our ability to meet our financial obligations, represented by gross debt, from available cash. Net Debt demonstrates investors the trend in our net financial position over the periods presented. However, the use of Net Debt assumes that gross debt can be reduced by cash. In fact, it is unlikely that all available cash will be used to reduce gross debt all at once, as cash must also be available to pay employees, suppliers and taxes, and to meet other operating needs and capital expenditure requirements. Net Debt and its ratio to equity, or leverage, are used to evaluate our financial structure in terms of sufficiency and cost of capital, level of debt, debt rating and funding cost.

These measures also make it possible to evaluate if our financial structure is adequate to achieve our business and financial targets. Our management monitors the net debt and leverage or similar measures as reported by other companies in Russia or abroad in order to assess our liquidity and financial structure relative to such companies. Our management also monitors the trends in our Net Debt and leverage in order to optimise the use of internally generated funds versus borrowed funds.

## Principal risks and uncertainties

### Industry risks

#### *Dependence on the oil and gas industry*

The oil and gas industry is the principal consumer of steel pipe products worldwide and accounts for most of our sales, in particular sales of OCTG, line pipe and large-diameter welded pipe. In 2011, sales volumes of pipes used in oil and gas industry (mainly OCTG, line pipe and large-diameter pipe) accounted for approximately 74% of our tubular products. The oil and gas industry has historically been volatile and downturns in the oil and gas markets can adversely affect demand for our products, which largely depends on the number of oil and gas wells being drilled, completed and reworked, the depth and drilling conditions of wells and the construction of oil and gas pipelines. The level of such industry specific activities in turn depends on the level of capital spending by major oil and gas companies. The level of investment activities of oil and gas companies, which is largely driven by prevailing prices for oil and natural gas and their stability, significantly affects the level of consumption of our products. In case of significant and/or sustained decline in oil and natural gas prices energy companies could reduce their levels of expenditures. As a result, the demand for oil and gas pipes can substantially decrease, leading to the tightening of competition and a possible decrease of market prices for tubular products. Thus, the decline in oil and gas exploration, drilling and production activities and prices for energy commodities could have a negative impact on our results of operations and financial position.

#### *Increases in the cost of raw materials*

We require substantial quantities of raw materials to produce steel pipes. The principal raw materials used in production processes include scrap, pig iron, ferroalloys and refractories for use in steelmaking operations, steel billets used for the production of seamless pipes and steel coils and plates for the production of welded pipes. The demand for the principal raw materials we utilise is generally correlated with macroeconomic fluctuations, which are in turn affected by global economic conditions.

In 2011, the costs of raw materials and consumables accounted for 69% of total cost of production. Prices for raw materials and supplies are one of the main factors affecting our results of operations. They are influenced by many factors, including oil and gas prices, worldwide production capacity, capacity utilisation rates, inflation, exchange rates, trade barriers and improvements in steel-making processes. Raw material prices increased in 2011 as compared to 2010. However in the fourth quarter of 2011, prices began to fall. Prices for certain types of raw materials and supplies varied depending on the region. In 2011, in the Russian division, the average purchase cost of metal scrap increased 25%, the average price for coils increased 17% and the average purchase price for pig iron increased 11% as compared to 2010. The average purchase cost of metal scrap and coils in the American division increased 22% and 19%, respectively, as compared to 2010. Average purchase costs for metal scrap in the European division were higher by 20% in 2011 than those in 2010. As a result of the increase both in prices for raw materials and sales volumes, our costs of raw materials and consumables increased from $2,972 million in 2010 to $3,721 million in 2011.

Raw materials prices continue to have a key influence on our production costs. The increase in prices for scrap, coils and other raw materials, if not passed on to customers in a timely fashion, can adversely affect our profit margins and results of operations.

Our plants also consume significant quantities of energy, particularly electricity and gas. In 2011, energy costs amounted to 7% of the total cost of production. In January 2011, the liberalisation of the Russian electricity market was finalised, which resulted in an increase in electricity tariffs. Average natural gas tariffs in Russia, although remaining significantly below Western European levels, also increased in 2011. At the same time, natural gas consumption has been decreasing recently as we have replaced most of open hearth furnaces with EAFs. Further price increases for energy resources will increase our costs of production and could have an adverse effect on results of operations and financial results.

## *Dependence on a small group of customers*

As we focus on supplying primarily the oil and gas industry, our largest customers are oil and gas companies. In 2011, our five largest customers were Gazprom (excluding Gazprom Neft), Rosneft, Surgutneftegas, TNK BP and Lukoil, which together accounted for 34% of total revenue. We maintain strong business relationships with key customers and expect this concentration of customers in Russia to continue for the foreseeable future. The increased dependence of pipe sales on a single large customer bears the risk of an adverse effect on results of operations in the event that our relationship with any of these major customers deteriorated. In the United States, TMK IPSCO cooperates with a wide range of distributors in North America, whose shares in our total sales are not significant.

Our large-diameter welded pipe business is largely dependent on one of our largest customers, Gazprom, and is subject to increasing competitive pressure. Gazprom is one of our largest customers for 1,420 mm diameter welded pipes used for construction of gas trunk pipelines. Increased competition in the supply of large-diameter pipes or a change in relationships with Gazprom could negatively affect our competitive position in the 1,420 mm diameter pipe market, resulting in decreased revenues from sales of these products and adversely affecting our business, financial position and results of operations. Additionally, large-diameter welded pipe business depends significantly upon the level of construction of new oil and gas pipelines in Russia and the CIS. The delay, cancellation or other changes in the scale or scope of significant pipeline projects, or the selection by the sponsors of such projects of other suppliers could have an adverse effect on our sales of large-diameter welded pipes, and thus on the results of operations and financial position. Thereby in the second half of 2011, Gazprom finished construction of several pipelines, including Gryazovets-Vyborg, Pochinki-Gryazovets, SRTO-Torzhok and the first string of Nord Stream. We mitigate this risk by developing cooperation with new customers from CIS countries.

### *Competition*

The global market for steel pipe products, particularly in the oil and gas sector, is highly competitive and primarily based on compliance with technical requirements, price, quality and related services. In the Russian and CIS markets, we face competition primarily from ChTPZ, which produces both welded and seamless pipes, OMK, which produces welded pipes, and the Ukrainian pipe producers. Outside Russia and the CIS, we compete against a limited number of producers of premium-quality principally seamless steel pipe products, including Tenaris, Vallourec, Sumitomo and a limited number of Chinese producers, including Baosteel and TPCO. In the United States, TMK IPSCO faces competition primarily from Boomerang, Tenaris, U.S. Steel and V&M Star, a subsidiary of Vallourec, as well as from imported OCTG and line pipe products, principally from Asia, Canada and Mexico. In 2011, our several key competitors added new capacities and started their ramp-up, which is expected to increase competition we face on international pipe markets.

## Financial risks

### *Liquidity risk*

As a result of borrowings undertaken for the acquisition of TMK IPSCO in 2008, as well as a result of continued large-scale capital expenditure program, our leverage remains significant. As of December 31, 2011, our total debt amounted to $3,787 million as compared to $3,872 million at the end of 2010. The decrease of our total debt in 2011 was primarily attributable to the rouble depreciation. Together with the improvement of our operating performance in 2011, our leverage decreased and Net-Debt-to-EBITDA ratio reduced to 3.4 as of December 31, 2011.

In 2011, we continued to concentrate on improving our liquidity profile and optimising financial performance. We negotiated extensions of credit terms and lower interest rates in order to improve our financial position and overall debt maturity profile. The actions relating to the loan portfolio allowed us to further decrease the share of short-term debt in the total credit portfolio, which stood at 16% as of December 31, 2011 as compared to 18% at the end of 2010.

Improving liquidity profile remains one of our priorities, and we continue to carry out measures to maintain sufficient liquidity and improve loan portfolio structure. Thus, in January 2011 we partially repaid Gazprombank loan facilities in the total amount of $1,108 million using the proceeds from the issuance of TMK 7.75% $500 million Eurobonds due in 2018. In October 2011, we refinanced a loan from Gazprombank in the aggregated amount of $208 million using the proceeds from operating cash flow and from a $200 million Nordea Bank loan due 2017 with a lower interest rate. Due to improved liquidity in 2011 our S&P rating was upgraded to B+/ruA, outlook stable and Moody's rating of B1/A2.ru, outlook stable was confirmed. Nevertheless, there can be no assurance that our efforts to improve liquidity profile and reduce leverage will prove successful. The negative market reaction on deteriorating global financial situation may have an adverse impact on our ability to borrow in banks or capital markets, and may put pressure on our liquidity, increase borrowing costs, temporary reduce the availability of credit lines and lead to unavailability of financing on acceptable terms.

## *Compliance with covenants*

Certain of our loan agreements and public debt securities currently include financial covenants. For example, some covenants are set in relation to leverage, total indebtedness and tangible net worth, and impose financial ratios that must be maintained. Other covenants impose restrictions in respect of certain transactions, including restrictions in respect of indebtedness. A breach of a financial or other covenant in existing debt facilities, if not resolved by means such as obtaining a waiver from the relevant lender, could trigger a default under our obligations.

In January 2011, we undertook a consent solicitation to modify certain covenants contained in the loan agreement relating to the loan participation notes fully repaid in July 2011 issued by TMK Capital S.A. in order to continue our growth strategy and further enhance our flexibility to implement refinancing plan. In relation to other debt facilities covenants were not revised due to our stable financial and economic position and absence of covenants violation.

Nevertheless, in case financial markets or economic environment deteriorate in the future, we may not comply with relevant covenants. Though, historically, we have successfully secured from the relevant lenders all necessary waivers or standstill letters to address possible breaches of financial covenants we may not be able to secure such necessary waivers or standstill letters during future reporting periods if not in compliance with financial covenants. We do not expect the occurrence of such events in the near future.

## *Interest rate risk*

Interest expenses are the prevailing part of our finance costs. In 2011, our finance costs decreased 30% or $128 million and amounted to $303 million as compared to $431 million in 2010. The decrease in a nominal interest expense, net of transaction and issue costs, was achieved primarily as a result of our negotiations to reduce interest rates on most of significant borrowings that took place as a part of the measures to improve the structure of our loan portfolio. Consequently, our weighted average nominal interest rate as of December 31, 2011 decreased by 94 basis points as compared to December 31, 2010. Although we currently benefit from relatively low interest rates, there can be no assurance that rates will stay low in the future. The cost of funding for Russian and international banks may increase in the future, which can increase our interest expense and adversely affect our financial position.

Additionally, certain part of our loan portfolio is represented by loans taken out at floating interest rates. As of December 31, 2011, loans with floating interest rates represented $617 million or 16% of our total credit portfolio. The underlying rates in current loans with floating interest rates are LIBOR and EURIBOR. In 2011, floating interest rates remained close to their historical lows, which kept our interest expense on the relevant loans low. Taking into account current low levels of interest rates, we considered to hedge a part of interest rate risks at the beginning of 2012. Nevertheless, several loans with floating interest rates still exist in our credit portfolio and, should floating interest rates increase in the future, interest expenses on relevant loans will increase.

## *Currency risk*

Our products are typically priced in roubles for Russian sales and in U.S. dollars and euros for CIS, U.S. and other international sales. Our direct costs, including raw materials, labour and transportation costs are largely incurred in roubles and U.S. dollars. Other costs, such as interest expense, are currently incurred largely in U.S. dollars and roubles, and capital expenditures are incurred principally in roubles, euros and U.S. dollars.

We hedge our net investment in operations located in the Unites States against foreign currency risks using U.S. dollar denominated liabilities. Gains or losses on the hedging instruments relating to the effective portion of the hedge are recognised as other comprehensive income while any gains or losses relating to the ineffective portion are recognised in the income statement. In 2011, we incurred foreign exchange losses from spot rate changes in the total amount of $69 million, including $1 million recognised in the income statement and $68 million recognised in the statement of comprehensive income. Losses in the statement of comprehensive income from foreign exchange difference relating to hedged financial instruments arose from the revaluation of U.S. dollar denominated loans attracted by Russian companies of the Group.

The rouble remains volatile. Our debt is currently largely denominated in U.S. dollars, and the possible devaluation of the rouble against the dollar in the future could result in foreign exchange losses. To mitigate this risk, during 2011 we refinanced certain U.S. dollar denominated loans with a series of loans taken in roubles. As a result, the share of U.S. dollar denominated loans in the loan portfolio as of December 31, 2011 decreased to 48% as compared to 50% at the end of 2010. Since revenue of the Group is nominated in EUR, USD and Russian rouble due to the geographic diversification of sales, this provides a natural hedge for our foreign exchange position. Nevertheless, if the U.S. dollar appreciates against the rouble in the future, this could adversely affect our net profit as coherent losses will be reflected in our consolidated income statements.

### *Inflation risk*

A significant amount of our production activities are located in Russia, and a majority of direct costs are incurred in Russian roubles. We tend to experience inflation-driven increases in certain costs, such as raw material costs, transportation costs, energy costs and salaries that are linked to the general price level in Russia. In 2011, inflation in Russia reached 6.1% as compared to 8.8% in 2010. In spite of the intention of the Russian government to reduce rates of inflation in the coming years, inflation may increase in the future. We may not be able to increase the prices sufficiently in order to preserve existing operating margins.

Inflation rates in the United States, with respect to TMK IPSCO operations, are historically much lower than in Russia. Nevertheless, in 2011, inflation in the United States increased to 3.0% in comparison to 1.5% in 2010. Accordingly, high rates of inflation, especially in Russia, could increase our costs, decrease our operating margins and materially adversely affect our business and financial position.

## Legal risks

### *Changes in tax legislation and tax system*

Our subsidiaries make significant tax payments, in particular, profit tax, VAT, social and pension payments and property tax. Changes in tax legislation could lead to an increase in tax payments and, as a result, to a lowering of financial results. As significant part of the operations is located in Russia, the main risks relate to changes in the legislation of the Russian tax system. The Russian Government continually reviews the Russian tax system and passes a number of laws to carry out tax reforms. The new laws generally reduce the number of taxes and the overall tax burden on business while simplifying tax legislation. Despite measures to improve the tax system, tax legislation continues to give wide latitude to local tax authorities and leaves a multitude of unresolved problems which may have a negative effect on our operating results.

In 2010, the Russian government returned to the system of separate contributions by employers to the state pension, medical insurance and social insurance funds, which are payable in connection with employee salaries. Starting on January 1, 2011, the applicable rate for social contributions increased from 26% to 34%. As a result in 2011, our total costs of social contributions in Russia increased. However in 2012, the regressive taxation system has come into effect and the upper bound of social security tax has been limited to 30%.

In addition, the Russian oil industry is subject to substantial taxes, including significant resources production taxes and significant export customs duties. Changes to the tax regime and customs duties rates may adversely affect the level of oil and gas exploration and development in Russia, which can adversely affect the demand for our products in Russia.

### *Changes in environmental law*

We meet the requirements of national environmental regulations at our Russian plants, the directives and regulations of the European Union and Romanian legislation at our Romanian plants, and the U.S. environmental laws.

The main ecological-and-economical risks are related to expected changes and tightening of Russian environmental protection laws. Environmental legislation in Russia is currently undergoing significant change. The imposition of a new environmental law and regulation system may require further expenditures to modernize production operations, install pollution control equipment, perform site clean-ups and reclamation, pay fees and fines or make other payments if not in compliance with new environmental laws and regulations. Stricter regulations will also lead to increases in the rate of payments for negative impact on the environment and the use of increasing payment coefficients. Compliance with the regulations will be accompanied by stricter control by state monitoring authorities. Such changes in existing legislation may lead to additional costs or unforeseen environmental liabilities, which could have a material adverse effect on our financial position and results of operations.

We are also responsible for compliance with stringent U.S. environmental laws. The environmental protection regime in the United States is more onerous than what we face with respect to operations in Russia and other countries and compliance with these U.S. laws may expose us to additional costs. We estimate that the environmental legislation of the European Union and the United States will not undergo any material changes in the near future. Romania's admission into the European Union, which occurred in 2007, resulted in increased environmental liabilities for our Romanian operations. Our Romanian subsidiaries may be required to adopt and implement more stringent environmental and labor laws in the future. There can be no assurance that the European Union will not impose new environmental regulations or that Romanian state authorities will not change national environmental laws in the future.

Although we don't anticipate any significant environmental matters in the United States and Romania, if such matters arise, the cost of compliance could have a material adverse effect on our business.

## Other risks

### *Equipment failures or production curtailments or shutdowns*

Our production capacities are subject to the risk of equipment failures due to unanticipated events, such as fires, explosions and adverse weather conditions. Manufacturing processes depend on critical pieces of steelmaking and pipe-making equipment. Such equipment may, on occasion, be out of service as a result of unanticipated failures could require us to close part of the relevant production facility or cause to reduce production on one or more of production lines. Any interruption in production capability may require us to make significant and unanticipated capital expenditures to affect relevant repairs, which could have a negative effect on our profitability and cash flows. We currently maintain insurance against losses that may arise in case of property damage, accidents and transportation of goods. We also maintain corporate product liability and directors' and officers' liability insurance policies. Nevertheless, any recoveries under insurance coverage that may be obtained in the future may not offset lost revenues or increased costs resulting from a disruption of operations.

### *Insurance against all potential risks and losses*

We do not carry insurance against all potential risks and losses that may arise in connection with the quality of our products, property damage, work-related accidents and occupational illnesses, natural disasters and environmental contamination. We currently maintain no business interruption insurance. Losses or liabilities arising from these or other events could increase our costs and could adversely affect our business, financial position and operating results.

### *Ability to effect staff alterations and shortages of skilled labor*

Our Russian subsidiaries are in many regions the largest employers in the cities in which they operate, such as Volzhsky, Taganrog, Kamensk-Uralsky and Polevskoy. While we do not have any specific legal social obligations or responsibilities with respect to these regions, the ability to effect alterations in the number our employees may nevertheless be subject to political and social considerations. Any inability to make planned reductions in the number of employees or other changes to operations in such regions could have an adverse effect on the results of operations and prospects.

Competition for skilled labor in the steel pipe industry remains relatively intense, and labor costs continue to increase moderately, particularly in the CIS, Eastern Europe and the United States. We expect the demand and, hence, costs for skilled engineers and operators will continue to increase, reflecting the significant demand from other industries and public infrastructure projects. Continual high demand for skilled labor and continued increases in labor costs could have a material adverse effect on our business, financial position and results of operations.

Furthermore, any work stoppages, strikes or other labor-related developments could have an adverse effect on our business, financial position and results of operations.

## Responsibility statement

We confirm to the best of our knowledge that:

1. the consolidated financial statements prepared in conformity with International Financial Reporting Standards and presented together with this management discussion and analysis of financial condition and results of operation give a true and fair view of the assets, liabilities, financial position and profit or loss of OAO TMK and its consolidated subsidiaries, taken as a whole; and
2. the management report includes a fair review of the development and performance of the business and the position of OAO TMK and its consolidated subsidiaries, taken as a whole.

# CONSOLIDATED FINANCIAL STATEMENTS

# 9. INDEPENDENT AUDITORS' REPORT

To the shareholders and Board of Directors
OAO TMK

We have audited the accompanying consolidated financial statements of OAO TMK and its subsidiaries ('the Group'), which comprise the consolidated statement of financial position as at December 31, 2011, the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

## *Management's responsibility for the consolidated financial statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

## *Auditors' responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## *Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at December 31, 2011, and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Ernst & Young LLC*

Ernst & Young LLC
March 15, 2012
Moscow, Russia

# 9.



## OAO TMK

## Consolidated Financial Statements

*for the year ended December 31, 2011*

### Contents



## OAO TMK

## Consolidated Income Statement

## for the year ended December 31, 2011

*(All amounts in thousands of US dollars)*

| | NOTES | Year ended December 31, 2011 | 2010 |
|---|---|---|---|
| Revenue: | 1 | 6,753,517 | 5,578,599 |
| *Sales of goods* | | *6,645,963* | *5,421,084* |
| *Rendering of services* | | *107,554* | *157,515* |
| Cost of sales | 2 | (5,307,243) | (4,285,349) |
| **Gross profit** | | **1,446,274** | **1,293,250** |
| Selling and distribution expenses | 3 | (411,252) | (403,143) |
| Advertising and promotion expenses | 4 | (9,204) | (11,099) |
| General and administrative expenses | 5 | (282,785) | (231,975) |
| Research and development expenses | 6 | (18,690) | (13,309) |
| Other operating expenses | 7 | (53,325) | (44,978) |
| Other operating income | 8 | 13,090 | 11,042 |
| Impairment of goodwill | 19 | (3,368) | – |
| Impairment of investment in associate | 10 | (1,833) | – |
| Reversal of impairment of property, plant and equipment | 18 | 73,417 | – |
| Foreign exchange (loss)/gain, net | | (1,254) | 9,512 |
| Finance costs | | (302,786) | (430,586) |
| Finance income | 9 | 32,063 | 18,895 |
| Gain/(loss) on changes in fair value of derivative financial instrument | 24 | 44,792 | (12,361) |
| Share of loss of associate | 10 | (185) | – |
| Gain on disposal of assets classified as held for sale | 11 | 19,184 | – |
| **Profit before tax** | | **544,138** | **185,248** |
| Income tax expense | 12 | (159,441) | (81,174) |
| **Profit/(loss) for the year** | | **384,697** | **104,074** |
| **Attributable to:** | | | |
| Equity holders of the parent entity | | 380,130 | 104,334 |
| Non-controlling interests | | 4,567 | (260) |
| | | **384,697** | **104,074** |
| **Earnings per share attributable to equity holders of the parent entity (in US dollars)** | | | |
| Basic | 13 | **0.44** | **0.12** |
| Diluted | 13 | **0.40** | **0.12** |

*The accompanying notes are an integral part of these consolidated financial statements.*

# 9.



## OAO TMK

## Consolidated Statement of Comprehensive Income

## for the year ended December 31, 2011

*(All amounts in thousands of US dollars)*

| | NOTES | 2011 | 2010 |
|---|---|---|---|
| **Profit for the year** | | **384,697** | **104,074** |
| Exchange differences on translation to presentation currency [a] | | (57,619) | (12,547) |
| Foreign currency loss on hedged net investment in foreign operation [b] | 29 (x) | (67,772) | (8,847) |
| Income tax [b] | 29 (x) | 13,554 | 1,769 |
| | | **(54,218)** | **(7,078)** |
| **Other comprehensive income/(loss) for the year, net of tax** | | **(111,837)** | **(19,625)** |
| **Total comprehensive income/(loss) for the year, net of tax** | | **272,860** | **84,449** |
| **Attributable to:** | | | |
| Equity holders of the parent entity | | 273,303 | 85,929 |
| Non-controlling interests | | (443) | (1,480) |
| | | **272,860** | **84,449** |

(a) The amount of exchange differences on translation to presentation currency represents other comprehensive loss of 52,609 (2010: 11,327) attributable to equity holders of the parent entity and other comprehensive loss of 5,010 (2010: 1,220) attributable to non-controlling interests.

(b) The amount of foreign currency loss on hedged net investment in foreign operation, net of income tax, was attributable to equity holders of the parent entity.

*The accompanying notes are an integral part of these consolidated financial statements.*

## OAO TMK

## Consolidated Statement of Financial Position

## as at December 31, 2011

*(All amounts in thousands of US dollars)*

| | NOTES | 2011 | | 2010 | |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| **Current assets** | | | | | |
| Cash and cash equivalents | 14, 27 | 230,593 | | 157,524 | |
| Trade and other receivables | 15 | 766,155 | | 716,897 | |
| Accounts receivable from related parties | 27 | 5,526 | | 3,395 | |
| Inventories | 16 | 1,418,455 | | 1,207,540 | |
| Prepayments and input VAT | 17 | 170,708 | | 154,302 | |
| Prepaid income taxes | | 29,580 | | 18,099 | |
| Other financial assets | | 4,047 | 2,625,064 | 3,966 | 2,261,723 |
| Assets classified as held for sale | | – | **2,625,064** | 8,003 | **2,269,726** |
| **Non-current assets** | | | | | |
| Investments in associates | 10 | 1,717 | | – | |
| Intangible assets | 19 | 413,263 | | 474,791 | |
| Property, plant and equipment | 18 | 3,347,648 | | 3,386,660 | |
| Goodwill | 19 | 547,211 | | 554,353 | |
| Deferred tax asset | 12 | 97,880 | | 135,307 | |
| Other non-current assets | 20 | 99,458 | **4,507,177** | 40,697 | **4,591,808** |
| **TOTAL ASSETS** | | | **7,132,241** | | **6,861,534** |
| **LIABILITIES AND EQUITY** | | | | | |
| **Current liabilities** | | | | | |
| Trade and other payables | 21 | 862,940 | | 732,733 | |
| Advances from customers | | 188,861 | | 136,885 | |
| Accounts payable to related parties | 27 | 733 | | 8,434 | |
| Provisions and accruals | 22 | 46,075 | | 42,153 | |
| Interest-bearing loans and borrowings | 23, 24 | 599,377 | | 701,864 | |
| Derivative financial instrument | 24 | 3,024 | | 47,816 | |
| Dividends payable | | 323 | | 430 | |
| Income tax payable | | 4,078 | 1,705,411 | 3,846 | 1,674,161 |
| Liabilities directly associated with the assets classified as held for sale | | – | **1,705,411** | 143 | **1,674,304** |
| **Non-current liabilities** | | | | | |
| Interest-bearing loans and borrowings | 23, 24 | 3,187,564 | | 3,169,714 | |
| Deferred tax liability | 12 | 304,785 | | 300,484 | |
| Provisions and accruals | 22 | 25,336 | | 24,096 | |
| Post-employment benefits | 25 | 51,836 | | 53,612 | |
| Other liabilities | | 32,525 | **3,602,046** | 32,020 | **3,579,926** |
| **Total liabilities** | | | **5,307,457** | | **5,254,230** |
| **Equity** | 29 | | | | |
| Parent shareholders' equity | | | | | |
| Issued capital | | 326,417 | | 326,417 | |
| Treasury shares | | (327,339) | | (318,351) | |
| Additional paid-in capital | | 384,581 | | 376,485 | |
| Reserve capital | | 16,390 | | 15,387 | |
| Retained earnings | | 1,421,437 | | 1,094,561 | |
| Foreign currency translation reserve | | (88,551) | 1,732,935 | 18,276 | 1,512,775 |
| Non-controlling interests | | | 91,849 | | 94,529 |
| **Total equity** | | | **1,824,784** | | **1,607,304** |
| **TOTAL EQUITY AND LIABILITIES** | | | **7,132,241** | | **6,861,534** |

*The accompanying notes are an integral part of these consolidated financial statements.*

1

## OAO TMK

## Consolidated Statement of Changes in Equity

## for the year ended December 31, 2011

*(All amounts in thousands of US dollars)*

| | Attributable to equity holders of the parent | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Issued capital | Treasury shares | Additional paid-in capital | Reserve capital | Retained earnings | Foreign currency translation reserve | Total | Non-controlling interests | TOTAL |
| **At January 1, 2011 (as reported)** | **326,417** | **(318,351)** | **362,898** | **15,387** | **1,122,771** | **18,276** | **1,527,398** | **109,509** | **1,636,907** |
| Voluntary change in accounting policy | – | – | – | – | (28,210) | – | **(28,210)** | (1,393) | **(29,603)** |
| Recognition of the change in non-controlling interests in the subsidiary as an equity transaction (Note 29 vi) | – | – | 13,587 | – | – | – | **13,587** | (13,587) | **–** |
| **At January 1, 2011 (as restated)** | **326,417** | **(318,351)** | **376,485** | **15,387** | **1,094,561** | **18,276** | **1,512,775** | **94,529** | **1,607,304** |
| Profit for the year | – | – | – | – | 380,130 | – | **380,130** | 4,567 | **384,697** |
| Other comprehensive income/(loss) for the year, net of tax | – | – | – | – | – | (106,827) | **(106,827)** | (5,010) | **(111,837)** |
| **Total comprehensive income/(loss) for the year, net of tax** | **–** | **–** | **–** | **–** | **380,130** | **(106,827)** | **273,303** | **(443)** | **272,860** |
| Purchase of treasury shares (Note 29 xi) | – | (8,988) | – | – | – | – | **(8,988)** | – | **(8,988)** |
| Increase in reserve capital (Note 29 ii) | – | – | – | 1,003 | (1,003) | – | **–** | – | **–** |
| Dividends declared by the parent entity to its shareholders (Note 29 iii) | – | – | – | – | (51,993) | – | **(51,993)** | – | **(51,993)** |
| Dividends declared by subsidiaries of the Group to the non-controlling interest owners (Note 29 ix) | – | – | – | – | – | – | **–** | (338) | **(338)** |
| Sale of non-controlling interests (Note 29 v) | – | – | – | – | (42) | – | **(42)** | 9,307 | **9,265** |
| Increase in liability to non-controlling interests (Note 29 v) | – | – | (1,952) | – | – | – | **(1,952)** | – | **(1,952)** |
| Recognition of the change in non-controlling interests in the subsidiary as an equity transaction (Note 29 vi) | – | – | 9,609 | – | – | – | **9,609** | (9,609) | **–** |
| Acquisition of non-controlling interests in subsidiaries (Note 29 iv) | – | – | 439 | – | (14) | – | **425** | (1,799) | **(1,374)** |
| Increase in non-controlling interests from contributions of assets by the Group (Note 29 viii) | – | – | – | – | (202) | – | **(202)** | 202 | **–** |
| **At December 31, 2011** | **326,417** | **(327,339)** | **384,581** | **16,390** | **1,421,437** | **(88,551)** | **1,732,935** | **91,849** | **1,824,784** |

*The accompanying notes are an integral part of these consolidated financial statements.*

9.



## OAO TMK

## Consolidated Statement of Changes in Equity

## for the year ended December 31, 2011 (continued)

*(All amounts in thousands of US dollars)*

| | Attributable to equity holders of the parent | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Issued capital | Treasury shares | Additional paid-in capital | Reserve capital | Retained earnings | Foreign currency translation reserve | Total | Non-controlling interests | TOTAL |
| **At January 1, 2010 (as reported)** | **305,407** | **(37,378)** | **104,003** | **15,387** | **1,019,322** | **36,681** | 1,443,422 | **75,874** | **1,519,296** |
| Voluntary change in accounting policy | – | – | – | – | (28,210) | – | (28,210) | (1,393) | **(29,603)** |
| **At January 1, 2010 (as restated)** | **305,407** | **(37,378)** | **104,003** | **15,387** | **991,112** | **36,681** | 1,415,212 | **74,481** | **1,489,693** |
| Profit/(loss) for the year | – | – | – | – | 104,334 | – | **104,334** | (260) | **104,074** |
| Other comprehensive income/(loss) for the year, net of tax | – | – | – | – | – | (18,405) | **(18,405)** | (1,220) | **(19,625)** |
| **Total comprehensive income/(loss) for the year, net of tax** | **–** | **–** | **–** | **–** | **104,334** | **(18,405)** | **85,929** | **(1,480)** | **84,449** |
| Issue of share capital (Note 29 i) | 21,010 | – | 258,417 | – | – | – | **279,427** | – | **279,427** |
| Purchase of treasury shares (Note 29 xi) | – | (280,973) | – | – | – | – | **(280,973)** | – | **(280,973)** |
| Dividends declared by subsidiaries of the Group to the non-controlling interest owners (Note 29 ix) | – | – | – | – | – | – | **–** | (8) | **(8)** |
| Sale of non-controlling interests (Note 29 v) | – | – | – | – | (741) | – | **(741)** | 13,587 | **12,846** |
| Recognition of the change in non-controlling interests in the subsidiary as an equity transaction (Note 29 vi) | – | – | 13,587 | – | – | – | **13,587** | (13,587) | **–** |
| Contributions from non-controlling interest owners (Note 29 vii) | – | – | – | – | – | – | **–** | 23,124 | **23,124** |
| Acquisition of non-controlling interests in subsidiaries (Note 29 iv) | – | – | 478 | – | (144) | – | **334** | (1,588) | **(1,254)** |
| **At December 31, 2010** | 326,417 | (318,351) | 376,485 | 15,387 | 1,094,561 | 18,276 | 1,512,775 | 94,529 | **1,607,304** |

*The accompanying notes are an integral part of these consolidated financial statements.*

## OAO TMK

## Consolidated Statement of Cash Flows

## for the year ended December 31, 2011

*(All amounts in thousands of US dollars)*

| | NOTES | Year ended December 31, 2011 | 2010 |
|---|---|---|---|
| **Operating activities** | | | |
| Profit before tax | | 544,138 | 185,248 |
| **Adjustments to reconcile profit before tax to operating cash flows:** | | | |
| Depreciation of property, plant and equipment | | 266,537 | 215,416 |
| Amortisation of intangible assets | 19 | 69,234 | 85,199 |
| Loss on disposal of property, plant and equipment | 7 | 2,319 | 10,195 |
| Impairment of goodwill | 19 | 3,368 | – |
| Reversal of impairment of property, plant and equipment | 18 | (73,417) | – |
| Impairment of investment in associate | 10 | 1,833 | – |
| Foreign exchange loss/(gain), net | | 1,254 | (9,512) |
| Finance costs | | 302,786 | 430,586 |
| Finance income | 9 | (32,063) | (18,895) |
| (Gain)/loss on changes in fair value of derivative financial instrument | 24 | (44,792) | 12,361 |
| Gain on disposal of assets classified as held for sale | 11 | (19,184) | – |
| Share of loss of associate | 10 | 185 | – |
| Allowance for net realisable value of inventory | 16 | (662) | (4,818) |
| Allowance for doubtful debts | 30 | 19,551 | 5,420 |
| Movement in other provisions | | 9,039 | 31,115 |
| **Operating cash flows before working capital changes** | | **1,050,126** | **942,315** |
| **Working capital changes:** | | | |
| Increase in inventories | | (280,232) | (277,508) |
| Increase in trade and other receivables | | (110,210) | (148,208) |
| (Increase)/decrease in prepayments | | (26,862) | 21,095 |
| Increase in trade and other payables | | 172,369 | 90,862 |
| Increase/(decrease) in advances from customers | | 88,875 | (213,250) |
| **Cash generated from operations** | | **894,066** | **415,306** |
| Income taxes paid | | (106,926) | (28,987) |
| **Net cash flows from operating activities** | | **787,140** | **386,319** |
| **Investing activities** | | | |
| Purchase of property, plant and equipment and intangible assets | | (402,459) | (314,096) |
| Proceeds from sale of property, plant and equipment | | 1,431 | 386 |
| Proceeds from disposal of subsidiaries | 11 | – | 26,027 |
| Purchase of ownership interest in associate | 10 | (4,004) | – |
| Issuance of loans | | (1,333) | (968) |
| Proceeds from repayment of loans issued | | 962 | 1,277 |
| Interest received | | 2,638 | 2,120 |
| Dividends received | | 25,425 | 14,092 |
| **Net cash flows used in investing activities** | | **(377,340)** | **(271,162)** |
| **Financing activities** | | | |
| Purchase of treasury shares | 29 (xi) | (8,988) | (280,973) |
| Proceeds from issue of share capital | 29 (i) | – | 279,427 |
| Proceeds from borrowings | | 2,768,477 | 3,097,306 |
| Repayment of borrowings | | (2,764,149) | (2,994,735) |
| Interest paid | | (287,533) | (342,743) |
| Reimbursement of interest paid | | 1,272 | 3,905 |
| Payment of finance lease liabilities | | (3,014) | (2,822) |
| Acquisition of non-controlling interest | | (1,374) | (1,085) |
| Proceeds from sale of non-controlling interests | 29 (v) | 9,265 | 32,939 |
| Contributions from non-controlling interest owners | 29 (vii) | – | 23,124 |
| Dividends paid to equity holders of the parent | | (47,313) | – |
| Dividends paid to non-controlling interest shareholders | | (1,531) | (599) |
| **Net cash flows used in financing activities** | | **(334,888)** | **(186,256)** |
| Net increase/(decrease) in cash and cash equivalents | | 74,912 | (71,099) |
| Net foreign exchange difference | | (1,843) | (15,133) |
| Cash and cash equivalents at January 1 | | 157,524 | 243,756 |
| **Cash and cash equivalents at December 31** | | **230,593** | **157,524** |

*The accompanying notes are an integral part of these consolidated financial statements.*

## OAO TMK

## Notes to the Consolidated Financial Statements
## for the year ended December 31, 2011

*(All amounts are in thousands of US dollars, unless specified otherwise)*

### Corporate Information

These consolidated financial statements of OAO TMK and its subsidiaries (the "Group") for the year ended December 31, 2011 were authorised for issue in accordance with a resolution of the General Director on March 15, 2012.

OAO TMK (the "Company"), the parent company of the Group, is an open joint stock company ("OAO"). Both registered and principal office of the Company is 40/2a Pokrovka Street, Moscow, the Russian Federation.

As at December 31, 2011, the Company's controlling shareholder was TMK Steel Limited. TMK Steel Limited is ultimately controlled by D.A. Pumpyanskiy.

The Group is one of the world's leading producers of steel pipes for the oil and gas industry, a global company with extensive network of production facilities, sales companies and representative offices.

The principal activities of the Group are the production and distribution of seamless and welded pipes, including pipes with the entire range of premium connections backed by extensive technical support. Research centres established in Russia and in the United States are involved in new product design and development, experimental and validation testing and advanced metallurgical research.

### Basis of Preparation of the Financial Statements

*Statement of Compliance*

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB").

*Basis of Accounting*

Group companies maintain their accounting records in their local currency and prepare their statutory financial statements in accordance with the regulations on accounting and reporting of the country in which the particular subsidiary is resident. The consolidated financial statements are based on the statutory accounting records, with adjustments and reclassifications for the purpose of fair presentation in compliance with IFRS. The principal adjustments relate to (1) expense and revenue recognition, (2) valuation of unrecoverable assets, (3) depreciation and valuation of property, plant and equipment, (4) accounting for income taxes, (5) use of fair values, (6) business combinations and (7) translation to the presentation currency.

The consolidated financial statements have been prepared on an accrual basis and under the historical cost convention, except as disclosed in the accounting policies below. For example, property, plant and equipment are accounted for at deemed cost at the date of transition to IFRS.

All Group companies and associates have a December 31 accounting year-end.

## Basis of Preparation of the Financial Statements (continued)

*Functional and Presentation Currency*

The presentation currency for the purpose of these consolidated financial statements of the Group is the US dollar because the presentation in US dollars is convenient for the major current and potential users of the Group's financial statements.

The functional currency of the Company and its subsidiaries located in the Russian Federation, Kazakhstan, Switzerland and Cyprus is the Russian rouble. The functional currencies of other foreign operations of the Group are the Euro, the United States dollar, the Romanian lei and Canadian dollar, which are the currencies of countries in which the Group's entities are incorporated.

On consolidation, assets and liabilities of Group companies reported in their functional currencies are translated into US dollars, the Group's presentation currency, at year-end exchange rates. Income and expense items are translated into US dollars at the annual weighted average rates of exchange or at the rate on the date of the transaction for significant items.

Transactions in foreign currencies are initially recorded in the functional currency at the rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency spot rate of exchange ruling at the end of reporting period. All resulting differences are taken to the income statement with the exception of differences on foreign currency borrowings accounted for as hedges of net investment in foreign operations. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as 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 was determined.

The Group hedges its net investment in operations located in the Unites States against foreign currency risks using US dollar denominated liabilities. Gains or losses on the hedging instruments relating to the effective portion of the hedge are recognised as other comprehensive income while any gains or losses relating to the ineffective portion are recognised in the income statement. On the disposal of the foreign operation, the cumulative value of any such gains or losses recognised as a component of other comprehensive income is transferred to the income statement.



## Significant Estimates and Assumptions

The key assumptions concerning the future and other key sources of estimation of uncertainty at the end of reporting period that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

*Impairment of Property, Plant and Equipment*

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 estimates the asset's recoverable amount. This requires an estimation of the value in use of the cash-generating units to which the item is allocated. The determination of impairments of property, plant and equipment involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. 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, discontinuance of service, current replacement costs and other changes in circumstances that indicate 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 recoverable value and ultimately the amount of any property, plant and equipment impairment.

Assets that suffered an impairment are tested for possible reversal of the impairment at each reporting date if indications exist that impairment losses recognised in prior periods no longer exist or have decreased.

In 2011 and 2010, no impairment losses were recognised in respect of property, plant and equipment. In 2011, the Group reversed impairment losses of 73,417 recognised in 2008-2009 in respect of property, plant and equipment of European division cash-generating unit (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. If expectations differ from previous estimates, the changes accounted for as a change in an accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. There were no any changes in accounting estimates of remaining useful lives of items of property, plant and equipment in 2011.

*Fair Value of Assets and Liabilities Acquired in Business Combinations*

The Group is required to recognise separately, at the acquisition date, the identifiable assets, liabilities and contingent liabilities acquired or assumed in the business combination at their fair values, which involves estimates. Such estimates are based on valuation techniques, which require considerable judgment in forecasting future cash flows and developing other assumptions.

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Estimates and Assumptions (continued)

*Impairment of Goodwill and Intangible Assets with Indefinite Useful Lives*

The Group determines whether goodwill and intangible assets with indefinite useful lives are impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill and intangible assets with indefinite useful lives are 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. The carrying amount of goodwill as at December 31, 2011 was 547,211 (2010: 554,353). In 2011, the Group recognised impairment losses in the amount of 3,368 in respect of goodwill (Note 19) (2010: nil).

*Post-Employment Benefits*

The Group uses the actuarial valuation method for measurement of the present value of post-employment benefit obligations and related current service cost. This involves the use of demographic assumptions about the future characteristics of current and former employees who are eligible for benefits (mortality, both during and after employment, rates of employee turnover, disability and early retirement, etc.) as well as financial assumptions (discount rate, future salary). In the event that further changes in the key assumptions are required, the future amounts of the post-employment benefit costs may be affected materially (Note 25).

*Allowances*

The Group makes allowances for doubtful debts. Significant judgment is used to estimate doubtful accounts. In estimating doubtful accounts, such factors are considered as current overall economic conditions, industry-specific economic conditions, historical and anticipated customer performance. Changes in the economy, industry, or specific customer conditions may require adjustments to the allowance for doubtful debts recorded in the consolidated financial statements. As at December 31, 2011 and 2010, allowances for doubtful debts have been made in the amount of 31,782 and 17,947, respectively (Notes 15, 20, 30).

The Group makes allowances for obsolete and slow-moving raw materials and spare parts. In addition, certain finished goods, work in process and raw materials of the Group are carried at net realisable value. Estimates of net realisable 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 reporting period to the extent that such events confirm conditions existing at the end of the period. As at December 31, 2011 and 2010, allowances for net realisable value of inventory were 15,826 and 17,112, respectively (Note 16).

OAO TMK
Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Estimates and Assumptions (continued)

*Litigations*

The Group exercises considerable judgment in measuring and recognising provisions and the exposure to contingent liabilities related to pending litigations or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation, as well as other contingent liabilities. Judgement is necessary in assessing the likelihood that a pending claim will succeed, or a liability will arise, and to quantify the possible range of the final settlement. Because of the inherent uncertainties in this evaluation process, actual losses may differ from the originally estimated provision. These estimates are subject to change as new information becomes available, primarily with the support of internal specialists, if available, or with the support of external consultants, such as actuaries or legal counsel. Revisions to the estimates may significantly affect future operating results of the Group.

*Current Taxes*

The Group is subject to taxes in different countries all over the world. Taxes and fiscal risks recognised in these consolidated financial statements reflect management's best estimate of the outcome based on the facts known at each reporting date in each individual country. These facts may include but are not limited to change in tax laws and interpretation thereof in the various jurisdictions where the Group operates.

Tax, currency and customs legislation is subject to varying interpretations and changes occur frequently. Furthermore, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group's entities may not coincide with that of management.

As a result, tax authorities may challenge transactions and Group's entities may be assessed additional taxes, penalties and interest, which can be significant. The final taxes paid are dependent upon many factors, including negotiations with taxing authorities in various jurisdictions, outcomes of tax litigation and resolution of disputes arising from tax audits. As at December 31, 2011, management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained (Note 28).

*Deferred Tax Assets*

Management judgment is required for the calculation of deferred income taxes. Deferred tax assets are recognised to the extent that their utilisation is probable. The utilisation of deferred tax assets will depend on whether it is possible to generate sufficient taxable income in the respective tax type and jurisdiction. Various factors are used to assess the probability of the future utilisation of deferred tax assets, including past operating results, the operational plan, expiration of tax losses carried forward, and tax planning strategies. If actual results differ from these estimates or if these estimates are 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 utilisation indicates that the carrying amount of deferred tax assets must be reduced, this reduction is recognised in profit or loss.

9.





## Significant Judgments

In the process of applying the Group's accounting policies, management has made the following judgments, apart from those judgments involving estimates, which have a significant effect on the amounts recognised in the consolidated financial statements:

*Consolidation of Special Purpose Entities*

The Group determined that the substance of the relationship between the Group and TMK Capital S.A., a special purpose entity, indicates that the Group controls TMK Capital S.A. In July 2008 and in January 2011, TMK Capital S.A. issued notes due July 2011 and January 2018, respectively, to provide financing to the Group's companies (Note 23).

The Group determined that the substance of the relationship between the Group and TMK Bonds S.A., a special purpose entity, indicates that the Group controls TMK Bonds S.A. In February 2010, TMK Bonds S.A. completed the offering of convertible bonds due 2015 convertible into Global Depository Receipts each representing four ordinary shares of OAO TMK to provide financing to the Group's companies (Note 24).

## Changes in Accounting Policies

*Application of New and Amended IFRS and IFRIC*

The Group has adopted the following new and amended IFRS and IFRIC in the consolidated financial statements for the annual period beginning on January 1, 2011:

- IAS 24 *Related Party Disclosures* (revised);
- IAS 32 *Financial Instruments: Presentation* (amended);
- IFRIC 14 *Prepayments of a Minimum Funding Requirement* (amended);
- IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*;
- Improvements to IFRSs (May 2010)

The principle effect of these changes in policies is discussed below.

IAS 24 *Related Party Disclosures* (revised)

The revision clarifies the definition of a related party. The new definitions emphasise a symmetrical view of related party relationships and clarify in which circumstances persons and key management personnel affect related party relationships of an entity. The revision introduces an exemption from the general related party disclosure requirements for transactions with a government and entities that are controlled, jointly controlled or significantly influenced by the same government as the reporting entity. The revision did not have any impact on the financial position or performance of the Group.



## Changes in Accounting Policies (continued)

*Application of New and Amended IFRS and IFRIC (continued)*

IAS 32 *Financial Instruments: Presentation* (amended) – Classification of Rights Issues

The amendment alters the definition of a financial liability in order to classify rights issues and certain options or warrants as equity instruments. The amendment is applicable if the rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. The amendment did not have effect on the financial position or performance of the Group.

IFRIC 14 *Prepayments of a Minimum Funding Requirement* (amended)

The amendment removes an unintended consequence when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover such requirements. The amendment permits an entity to recognise a prepayment of future service cost as pension assets. The amendment had no impact on the financial position or performance of the Group.

IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*

The new interpretation addresses the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability. The interpretation had no effect on the financial position or performance of the Group.

Improvements to IFRSs

In May 2010, the International Accounting Standards Board issued "Improvements to IFRSs", primarily with a view to removing inconsistencies and clarifying wording. These are separate transitional provisions for each standard. The document sets out amendments to International Financial Reporting Standards, which are mainly related to changes for presentation, recognition or management purposes terminology or editorial changes. These amendments did not have any impact on the financial position or performance of the Group.

*Voluntary Change in Accounting Policies*

In the year ended December 31, 2011, the Group changed its accounting treatment in respect of certain payments made to retired employees. Previously such benefits were treated as those that do not represent a constructive obligation. Starting 2011, the Group considers such payments as a constructive obligation as the Group intends to continue paying such benefits. Consequently, the Group recognised liability on such benefits retrospectively as a part of defined benefit obligation. The impact of this voluntary change in accounting policy on the consolidated financial statements resulted in reduced retained earnings attributable to equity holders of the parent, reduced balance of non-controlling interests and increased post-employment benefits liability.

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Changes in Accounting Policies (continued)

*Reclassifications*

Certain corresponding information presented in the consolidated financial statements for the year ended December 31, 2010 has been reclassified in order to achieve comparability with the presentation used in these consolidated financial statements.

*New Accounting Pronouncements*

The following new or amended (revised) IFRS and IFRIC have been issued but are not yet effective and not applied by the Group. This listing of standards and interpretations issued are those that the Group reasonably expects to have an impact on disclosures, financial position and performance when applied at a future date. The Group intends to adopt these standards when they become effective.

IFRS 7 *Financial Instruments: Disclosures* (amended)

In October 2010, the International Accounting Standards Board issued amendments to IFRS 7 – *Disclosures – Transfers of Financial Assets.* These amendments require additional disclosure about financial assets that have been transferred but not derecognised to enable users of the Group's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendments require disclosures about continuing involvement in derecognised assets to enable users to evaluate the nature of, and risks associated with, the Group's continuing involvement in those derecognised assets. These amendments become effective for financial years beginning on or after July 1, 2011. In December 2011, the International Accounting Standards Board further amended IFRS 7 by clarifying requirements for offsetting financial assets and financial liabilities. These amendments become effective for financial years beginning on or after January 1, 2013. The amendments affect disclosure only and will have no impact on the Group's financial position or performance.

IFRS 9 *Financial Instruments* (effective for financial years beginning on or after January 1, 2015)

The standard as issued reflects the first phase of the International Accounting Standards Boards work on the replacement of IAS 39 *Financial Instruments: Recognition and Measurement* and applies to classification and measurement of financial assets and financial liabilities. In subsequent phases, the International Accounting Standards Board will address impairment methodology and hedge accounting. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets and financial liabilities. The Group will quantify the effect in conjunction with the other phases, when issued, to present a comprehensive picture.

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Changes in Accounting Policies (continued)

*New Accounting Pronouncements (continued)*

IFRS 10 *Consolidated Financial Statements* (effective for financial years beginning on or after January 1, 2013)

IFRS 10 replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also includes the issues raised in SIC-12 *Consolidation — Special Purpose Entities.* IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgement to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in IAS 27. The Group expects that the adoption of the new standard will not have a significant impact on its financial position or performance in the period of initial application.

IFRS 11 *Joint Arrangements* (effective for financial years beginning on or after January 1, 2013)

IFRS 11 replaces IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly-controlled Entities — Non-monetary Contributions by Venturers.* IFRS 11 removes the option to account for jointly controlled entities using proportionate consolidation. Jointly controlled entities must be accounted for using the equity method. The Group expects that the adoption of the new standard will not have a significant impact on its financial position or performance in the period of initial application.

IFRS 12 *Disclosure of Involvement with Other Entities* (effective for financial years beginning on or after January 1, 2013)

IFRS 12 includes all of the disclosures that were previously in IAS 27 *Consolidated and Separate Financial Statements* related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 *Interests in Joint Ventures* and IAS 28 *Investments in Associates.* These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. The amendment affects disclosures only and will have no impact on the Group's financial position or performance.

IFRS 13 *Fair Value Measurement* (effective for financial years beginning on or after January 1, 2013)

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Group is currently assessing the impact that this standard will have on the financial position and performance.

IAS 1 *Financial Statement Presentation* (amended) – Presentation of Items of Other Comprehensive Income (effective for financial years beginning on or after July 1, 2012)

The amendments change the grouping of items presented in other comprehensive income. Items that could be reclassified to profit or loss at a future point in time would be presented separately from items that will never be reclassified. The amendments affect presentation only and will have no impact on the Group's financial position or performance.

## Changes in Accounting Policies (continued)

*New Accounting Pronouncements (continued)*

IAS 12 *Income Taxes* (amended) – Deferred Tax: Recovery of Underlying Assets (effective for financial years beginning on or after January 1, 2012)

The amendment clarifies the determination of deferred tax on investment property measured at fair value. The amendment introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. Furthermore, it introduces the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 always be measured on a sale basis of the asset. The Group expects that the adoption of the amended standard will not have a significant impact on its financial position or performance in the period of initial application.

IAS 19 *Employee Benefits* (revised) (effective for financial years beginning on or after January 1, 2013)

The revision includes a number of changes that range from fundamental changes such as removing the "corridor" mechanism (the revised standard requires actuarial gains and losses to be recognised in other comprehensive income when they occur) and the concept of expected returns on plan assets to new and revised disclosure requirements and simple clarifications and re-wording. The Group expects that the adoption of the amended standard will affect disclosures and presentation of financial statements only and will have no impact on the Group's financial position or performance as the Group's current accounting policy is to recognise actuarial gains and losses in the income statement in the period in which they occurred without using the "corridor" mechanism.

IAS 27 *Separate Financial Statements* (revised) (effective for financial years beginning on or after January 1, 2013)

As a consequence of the new IFRS 10 *Consolidated Financial Statements* and IFRS 12 *Disclosure of Involvement with Other Entities*, what remains of IAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The revision will have no impact on the consolidated financial statements of the Group.

IAS 28 *Investments in Associates and Joint Ventures* (revised) (effective for financial years beginning on or after January 1, 2013)

As a consequence of the new IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Involvement with Other Entities*, IAS 28 has been renamed to IAS 28 *Investments in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The Group expects that the adoption of the amended standard will not have a significant impact on its financial position or performance in the period of initial application.

OAO TMK
Notes to the Consolidated Financial Statements (continued)
*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Accounting Policies

### Index to Accounting Policies

9.



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Accounting Policies (continued)

### A) Basis of Consolidation

A subsidiary is an entity in which the Group has an interest of more than one-half of the voting rights or otherwise has power to exercise control over its operations. Subsidiaries are consolidated from the date when control over their activities is transferred to the Company and are no longer consolidated from the date when control ceases.

All intragroup balances, transactions and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transactions provide evidence of an impairment of the asset transferred. Where necessary, accounting policies in subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

Non-controlling interest is the equity in a subsidiary not attributable, directly or indirectly, to a parent. Non-controlling interests at the end of the reporting period represent the non-controlling interest shareholders' portion of the fair values of the identifiable assets and liabilities of the subsidiary at the acquisition date and the non-controlling interests' portion of movements in equity since the date of the combination. Non-controlling interest is presented within equity, separately from the parent's shareholders' equity.

Losses within subsidiary are attributed to the non-controlling interest even if that results in deficit balance.

When the Group increases its ownership interests in subsidiaries, the differences between the carrying values of net assets attributable to interests in subsidiaries acquired and the consideration given for such increases is either added to additional paid-in capital, if positive, or charged to accumulated profits, if negative.

When the Group grants put options to non-controlling interest shareholders at the date of acquiring control of a subsidiary the Group considers the terms of transaction to conclude on accounting treatment.

Where the terms of the put option provide the Group with a present ownership interest in the shares subject to the put, the shares are accounted for as acquired. Financial liabilities in respect of put options are recorded at fair value at the time of entering into the options, and are subsequently re-measured to fair value with the change in fair value recognised in the income statement.

When the terms of the put option do not provide a present ownership interest in the shares subject to the put, the Group determined that its accounting policy is to partially recognise non-controlling interests and to account such put options as the following:

- the Group determines the amount recognised for the non-controlling interest, including its share of profits and losses (and other changes in equity) of the subsidiary for the period;
- the Group derecognises the non-controlling interest as if it was acquired at that date;
- the Group records the fair value of financial liability in respect of put options; and
- the Groups accounts for the difference between the non-controlling interest derecognised and the fair value of financial liability as a change in the non-controlling interest as an equity transaction (in accordance with the Group's policy for the increase of its ownership interests in subsidiaries).

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Accounting Policies (continued)

### A) Basis of Consolidation (continued)

When the Group loses control over a subsidiary, it:

- Derecognises the assets (including goodwill) and liabilities of the subsidiary
- Derecognises the carrying amount of any non-controlling interest
- Derecognises the cumulative translation differences, recorded in equity
- Recognises the fair value of the consideration received
- Recognises the fair value of any investment retained
- Recognises any surplus or deficit in profit or loss
- Reclassifies the parent's share of components previously recognised in other comprehensive income to profit or loss or retained earnings, as appropriate.

### B) Business Combination and Goodwill

*Acquisition of Subsidiaries*

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition costs are included in administrative expenses in the periods in which the costs are incurred.

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 at the acquisition date. This includes the separation of embedded derivatives in host contracts by the acquiree.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the acquirer is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration which is deemed to be an asset or liability, are recognised either in profit or loss or as a change to other comprehensive income. If the contingent consideration is classified as equity, it is not remeasured until it is finally settled within equity.

*Goodwill*

Goodwill is initially measured at cost being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interest over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in profit or loss. Goodwill is recorded in the functional currencies of the acquired subsidiaries.

9.





*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Accounting Policies (continued)

### B) Business Combination and Goodwill (continued)

*Goodwill (continued)*

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that its carrying amount may be impaired. As at the acquisition date, goodwill is allocated to each of the cash-generating units (groups of cash-generating units), expected to benefit from the synergies of the combination. Impairment is determined by assessing the recoverable amount of the cash-generating unit (groups of cash-generating units), to which the goodwill relates. Where recoverable amount of cash-generating unit (groups of cash-generating units) is less than the carrying amount, an impairment loss is recognised.

Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

*Acquisition of Subsidiaries from Entities under Common Control*

Purchases of subsidiaries from entities under common control are accounted for using the pooling of interests method.

The assets and liabilities of the subsidiary transferred under common control are recorded in the financial statements at the historical cost of the controlling entity (the "Predecessor"). Any difference between the total book value of net assets, including the Predecessor's goodwill, and the consideration paid is accounted for in the consolidated financial statements as an adjustment to equity. The financial statements, including corresponding figures, are presented as if the Company had acquired the subsidiary on the date it was initially acquired by the Predecessor.

### C) Cash and Cash Equivalents

Cash is comprised of cash in hand and cash at banks.

Cash equivalents are comprised of short-term, liquid investments (with original maturity date less than 90 days) that are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value. Cash equivalents are carried at fair value.



*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Accounting Policies (continued)

### D) Financial Assets

*Initial Recognition and Measurement*

The Group classifies its financial assets into the following categories: loans and receivables, financial assets at fair value through profit or loss, held-to-maturity investments and available-for-sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial assets on initial recognition and, where allowed and appropriate, revaluates this designation at each reporting date.

Financial assets are initially recognised at fair value plus directly attributable transaction costs. However when a financial asset at fair value through profit or loss is recognised, the transaction costs are expensed immediately.

*Subsequent Measurement*

The subsequent measurement of financial assets depends on their classification as described below:

*Loans and Receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments not quoted in an active market. Subsequent to initial measurement, such assets are carried at amortised cost using the effective interest method less any allowance for impairment. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Trade receivables, which generally are short term, are carried at original invoice amount less an allowance for doubtful debts. An allowance for doubtful debts is established in case of objective evidence that the Group will not be able to collect amounts due according to the original terms of contract. The Group periodically analyses trade receivables and makes adjustments to the amount of the allowance. The amount of the allowance is the difference between the carrying amount and recoverable amount. The amount of the doubtful debts expense is recognised in the income statement.

*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. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments as defined by IAS 39. Gains or losses on held-for-trading assets are recognised in the income statement.

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Accounting Policies (continued)

### D) Financial Assets (continued)

*Held-to-Maturity Investments*

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity, when the Group has the positive intention and ability to hold to maturity. Subsequent to initial recognition, held-to-maturity investments are recognised at amortised cost using the effective interest method less any allowance for impairment. During the period, the Group did not hold any investments in this category.

*Available-for-Sale Financial Assets*

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial recognition, available-for-sale financial assets are measured at fair value with unrealised gains or losses being recognised as other comprehensive income until the financial assets are derecognised or determined to be impaired, at which time the cumulative gain or loss is included in the income statement.

*Derivatives Designated as Hedging Instruments*

Derivatives are financial instruments that change their values in response to changes in the underlying variable, require no or little net initial investment and are settled at a future date. Derivatives are primarily used to manage exposures to foreign exchange risk, interest rate risk and other market risks.

For the purpose of hedge accounting, derivatives are designated as instruments hedging the Group's exposure to changes in the fair value of a recognised asset or liability (fair value hedges), as instruments hedging the Group's exposure to variability in cash flows attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction (cash flow hedges) and as hedges of a net investment in a foreign operation.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group applies hedge accounting and the risk management objective and strategy for undertaking the hedge.

The Group's derivatives mainly consist of currency forwards and their use is governed by the Group's policies which are consistent with Group's overall risk management strategy. These derivatives are designated as hedging instruments in cash flow hedge. The objective of the hedge is to protect the value of highly probable future export sales in foreign currency against unfavourable variations of exchange rates.

The Group assesses effectiveness of such hedges at inception and verifies at regular intervals and at least on a quarterly basis, using prospective and retrospective testing. The effective part of the changes in fair value of hedging instruments is recognised in other comprehensive income while any ineffective part is recognised immediately in the income statement. When forecasted transaction occurs, the gains or losses previously recognised in other comprehensive income are transferred to the income statement. If the forecast transaction is no longer expected to occur, the cumulative gain or loss previously recognised in other comprehensive income is transferred to the income statement.

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Accounting Policies (continued)

### D) Financial Assets (continued)

*Impairment of Financial Assets*

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that 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 indicators that a debtor or a group of debtors is experiencing significant financial difficulties, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

The amount of the impairment loss is measured as a difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of financial assets other than loans and receivables is reduced directly without the use of an allowance account and the amount of loss is recognised in the income statement.

### E) Borrowings

Borrowings are initially recognised at fair value less directly attributable transaction costs. In subsequent periods, borrowings are measured at amortised cost using the effective interest method. Any difference between the initial fair value less transaction costs and the redemption amount is recognised within finance costs over the period of the borrowings.

Finance cost of the loans, including the issue costs and any discount on issue, is dealt with as a profit and loss charge over the term of the debt using the effective interest method. Carrying amount of the loan is decreased by unamortised balance of debt issue 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 are capitalised as part of cost of respective assets. All other borrowing costs are expensed in the period they occur. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds.

### F) Inventories

Inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and costs necessary to make the sale. The cost of inventories is determined on the weighted average basis.

9.



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Accounting Policies (continued)

### F) Inventories (continued)

The costs of inventories are comprised of all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present condition and location. The value of work in progress and finished goods includes costs of raw materials, direct labor, direct production costs and indirect production overheads including depreciation. Financing costs are not included in stock valuation.

The Group periodically analyses inventories to determine whether they are damaged, obsolete or slow-moving or if their net realisable value has declined, and makes allowance for such inventories.

In preparing the consolidated financial statements, unrealised profits resulting from intragroup transactions are eliminated in full.

### G) Property, Plant and Equipment

Property, plant and equipment, except for the items acquired prior to January 1, 2003, are stated at historical cost, excluding the costs of day-to-day servicing, less accumulated depreciation and any impairment in value. Such cost includes the cost of replacing part of plant and equipment when the cost is incurred if the recognition criteria are met.

The items of property, plant and equipment acquired prior to January 1, 2003, the date of transition to IFRS, were accounted for at deemed cost being their fair value as at January 1, 2003.

Depreciation is calculated on a straight-line basis. Average depreciation periods, which represent estimated useful economic lives of respective assets, are as follows:

| | |
|---|---|
| Land | Not depreciated |
| Buildings | 8-100 years |
| Machinery and equipment | 5-30 years |
| Transport and motor vehicles | 4-15 years |
| Furniture and fixtures | 2-10 years |

Repair and maintenance expenditure is expensed as incurred. Major renewals and improvements are capitalised, and assets replaced are retired. Gains and losses arising from retirement of property, plant and equipment are included in the income statement as incurred.

When material repairs are performed, the Group recognises cost of repair as a separate component within the relevant item of property, plant and equipment if the recognition criteria are met.

The Group has the title to certain non-production and social assets, primarily buildings and social infrastructure facilities. The items of social infrastructure do not meet the definition of an asset according to IFRS. Construction and maintenance costs of social infrastructure facilities are expensed as incurred.

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Accounting Policies (continued)

### H) Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset.

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the 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 charged to finance costs in the income statement.

The depreciation policy for depreciable leased assets is consistent with that for depreciable assets which are owned. If there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is fully depreciated over the shorter of the lease term or its useful life.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

### I) Intangible Assets (Other than Goodwill)

Intangible assets (other than goodwill) are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed as either finite or indefinite.

Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that intangible asset may be impaired. Amortisation period and amortisation method for an intangible asset with a finite life are reviewed at least at each year end. Changes in expected useful life or expected pattern of consumption of future economic benefits embodied in the asset are treated as changes in accounting estimates. Amortisation expense of intangible assets is recognised in the income statement in the expense category consistent with the function of an intangible asset.

Intangible assets with indefinite useful lives are not amortised, they are tested for impairment annually either individually or at the cash-generating unit level.

## Significant Accounting Policies (continued)

### I) Intangible Assets (Other than Goodwill) (continued)

*Research and Development*

Costs incurred on development (relating to design and testing of new or improved products) are recognised as intangible assets only when the Group can demonstrate technical feasibility of completing intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, availability of resources to complete and ability to measure reliably the expenditure during the development. Other development expenditures are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs that have been capitalised are amortised from commencement of commercial production of the product on a straight-line basis over the period of its expected benefit. The carrying value of development costs is reviewed for impairment annually when the asset is not yet in use or more frequently when an indication of impairment arises during the reporting year.

### J) Impairment of Non-Financial Assets (Other than Goodwill)

An assessment is made at each reporting date to determine whether there is an objective evidence that an asset or a group of assets may be impaired. When there is an indication that an asset may be impaired, the recoverable amount is assessed and, when impaired, the asset is written down immediately to its recoverable amount, which is the higher of the fair value less costs to sell and the value in use.

Fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, after deducting any direct incremental disposal costs. Value in use is the present value of estimated future cash flows expected to arise from continuing use of an asset and from its disposal at the end of its useful life.

In assessing value in use, estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and risks specific to the asset. For an asset that does not generate cash inflows largely independent of those from other assets, recoverable amount is determined for the cash-generating unit to which the asset belongs.

Impairment loss is recognised for the difference between estimated recoverable amount and carrying value. Carrying amount of an asset is reduced to its estimated recoverable amount and the amount of loss is included in the income statement for the period.

Impairment loss is reversed if there is an indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may be decreased and if subsequent increase in recoverable amount can be related objectively to event occurring after the impairment loss was recognised. Impairment loss is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, if no impairment loss had been recognised.

Intangible assets not yet available for use are tested for impairment annually.

OAO TMK
Notes to the Consolidated Financial Statements (continued)
*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Accounting Policies (continued)

### K) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that outflow of resources will be required to settle obligation, and a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

If the effect of time value of money is material, provisions are determined by discounting expected future cash flows at a pre-tax rate that reflects current market assessments of time value of money and where appropriate, risks specific to the liability. Where discounting is used, increase in provision due to the passage of time is recognised as a finance cost.

### L) Post-Employment Benefits

The Group companies provide additional pensions and other post-employment benefits to their employees in accordance with collective bargaining agreements. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age, the completion of a minimum service period and the amount of the benefits stipulated in the collective bargaining agreements.

Liability recognised in the statement of financial position in respect of post-employment benefits is the present value of defined benefit obligation at the end of the reporting period less fair value of the plan assets. Defined benefit obligation is calculated by external consultants quarterly using the projected unit credit method. Present value of the benefits is determined by discounting estimated future cash outflows using interest rates of high-quality government bonds that are denominated in currency in which benefits would be paid, and that have terms to maturity approximating to the terms of the related obligations.

Actuarial gains and losses are recognised in the income statement in the period in which they occurred. Past service cost is recognised as an expense on a straight-line basis over the average period until the benefits become vested.

### M) Value Added Tax

The Russian tax legislation partially permits settlement of value added tax ("VAT") on a net basis.

VAT is payable upon invoicing and delivery of goods, performing work or rendering services, as well as upon collection of prepayments from customers. VAT on purchases, even if they have not been settled at the end of the reporting period, is deducted from the amount of VAT payable.

Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

## Significant Accounting Policies (continued)

### N) Deferred Income Tax

Deferred tax assets and liabilities are calculated in respect of temporary differences using the liability method. Deferred income tax is recognised in the income statement, except to the extent that it relates to items directly taken to equity or other comprehensive income, in which case it is recognised against equity or other comprehensive income.

Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where deferred income tax arises from initial recognition of goodwill or of an asset or liability in transaction that is not a business combination and, at the time of the transaction, affects neither accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the end of the reporting period.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where timing of reversal of temporary differences can be controlled and it is probable that temporary differences will not be reversed in the near future.

### O) Equity

*Share Capital*

Ordinary shares are classified as equity. External costs directly attributable to the issue of new shares, other than on a business combination, are shown as a deduction from proceeds in equity.

*Treasury Shares*

Own equity instruments which are acquired by the Group (treasury shares) are deducted from equity. No gain or loss is recognised in the income statement on the purchase, sale, issue or cancellation of treasury shares.

*Dividends*

Dividends are recognised as a liability and deducted from equity at the end of the reporting period only if they are declared before or on the end of the reporting period. Dividends are disclosed in the financial statements when they are proposed before the end of the reporting period or proposed or declared after the end of the reporting period but before the financial statements are authorised for issue.

OAO TMK
Notes to the Consolidated Financial Statements (continued)
*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Significant Accounting Policies (continued)

### P) Revenue Recognition

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Group and the amount of revenue can be measured reliably. Revenues from sales of inventory are recognised when significant risks and rewards of ownership of goods have passed to the buyer. Revenues arising from rendering of services are recognised in the same period when the services are provided.

Revenues are measured at the fair value of the consideration received or receivable. When the fair value of consideration received cannot be measured reliably, revenue is measured at the fair value of goods or services provided.

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## Index to the Notes to the Consolidated Financial Statements



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 1) Segment Information

Operating segments reflect the Group's management structure and the way financial information is regularly reviewed. For management purposes, the Group is organised into business divisions based on geographical location, and has three reportable segments:

- Russia segment represents the results of operations and financial position of plants located in Russian Federation, a finishing facility in Kazakhstan, Oilfield service companies and traders located in Russia, Kazakhstan, the United Arab Emirates, Switzerland, South Africa that are selling their production (seamless and welded pipes).
- Americas segment represents the results of operations and financial position of plants located in the United States of America and traders located in the United States of America and Canada (seamless and welded pipes).
- Europe segment represents the results of operations and financial position of plants and traders located in Europe (excluding Switzerland) selling their production (seamless pipes and steel billets).

Management monitors the operating results of its operating segments separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on adjusted EBITDA. Adjusted EBITDA is determined as profit/(loss) for the period excluding finance costs and finance income, income tax (benefit)/expense, depreciation and amortisation, foreign exchange (gain)/loss, impairment/(reversal of impairment) of non-current assets, movements in allowances and provisions, (gain)/loss on disposal of property, plant and equipment, (gain)/loss on changes in fair value of financial instruments, share of (profit)/loss of associate and other non-cash items. Group financing (including finance costs and finance income) is managed on a group basis and is not allocated to operating segments.

The following tables present revenue and profit information regarding the Group's reportable segments for the years ended December 31, 2011 and 2010, respectively.

| **Year ended December 31, 2011** | **Russia** | **Americas** | **Europe** | **TOTAL** |
|---|---|---|---|---|
| Revenue | 4,788,039 | 1,590,399 | 375,079 | **6,753,517** |
| Cost of sales | (3,752,176) | (1,279,603) | (275,464) | **(5,307,243)** |
| **GROSS PROFIT** | **1,035,863** | **310,796** | **99,615** | **1,446,274** |
| Selling, general and administrative expenses | (529,741) | (149,305) | (42,885) | **(721,931)** |
| Other operating income/(expenses), net | (38,780) | 2,255 | (3,710) | **(40,235)** |
| **OPERATING PROFIT** | **467,342** | **163,746** | **53,020** | **684,108** |
| **ADD BACK:** | | | | |
| Depreciation and amortisation | 228,405 | 98,476 | 8,890 | **335,771** |
| Loss/(gain) on disposal of property, plant and equipment | 2,083 | (49) | 285 | **2,319** |
| Allowance for net realisable value of inventory | (426) | (107) | (129) | **(662)** |
| Allowance for doubtful debts | 17,819 | 897 | 835 | **19,551** |
| Movement in other provisions | 5,408 | 2,427 | 1,204 | **9,039** |
| | **253,289** | **101,644** | **11,085** | **366,018** |
| **ADJUSTED EBITDA** | **720,631** | **265,390** | **64,105** | **1,050,126** |

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 1) Segment Information (continued)

| **Year ended December 31, 2011** | **Russia** | **Americas** | **Europe** | **TOTAL** |
|---|---|---|---|---|
| **RECONCILIATION TO PROFIT BEFORE TAX:** | | | | |
| **ADJUSTED EBITDA** | **720,631** | **265,390** | **64,105** | **1,050,126** |
| Reversal of adjustments from operating profit to EBITDA | (253,289) | (101,644) | (11,085) | **(366,018)** |
| **OPERATING PROFIT** | **467,342** | **163,746** | **53,020** | **684,108** |
| Impairment of goodwill | (3,368) | – | – | **(3,368)** |
| Impairment of investment in associate | (1,833) | – | – | **(1,833)** |
| Reversal of impairment of property, plant and equipment | – | – | 73,417 | **73,417** |
| Foreign exchange gain/(loss), net | (2,021) | (2,738) | 3,505 | **(1,254)** |
| **OPERATING PROFIT AFTER IMPAIRMENT AND FOREIGN EXCHANGE GAIN/(LOSS)** | **460,120** | **161,008** | **129,942** | **751,070** |
| Finance costs | | | | **(302,786)** |
| Finance income | | | | **32,063** |
| Gain on changes in fair value of derivative financial instrument | | | | **44,792** |
| Share of loss of associate | | | | **(185)** |
| Gain on disposal of assets classified as held for sale | | | | **19,184** |
| **PROFIT BEFORE TAX** | | | | **544,138** |

| **Year ended December 31, 2010** | **Russia** | **Americas** | **Europe** | **TOTAL** |
|---|---|---|---|---|
| Revenue | 3,997,737 | 1,324,380 | 256,482 | **5,578,599** |
| Cost of sales | (3,065,574) | (1,022,663) | (197,112) | **(4,285,349)** |
| **GROSS PROFIT** | **932,163** | **301,717** | **59,370** | **1,293,250** |
| Selling, general and administrative expenses | (470,495) | (152,734) | (36,297) | **(659,526)** |
| Other operating income/(expenses), net | (32,867) | 700 | (1,769) | **(33,936)** |
| **OPERATING PROFIT** | **428,801** | **149,683** | **21,304** | **599,788** |
| **ADD BACK:** | | | | |
| Depreciation and amortisation | 172,647 | 119,928 | 8,040 | **300,615** |
| Loss/(gain) on disposal of property, plant and equipment | 9,650 | (26) | 571 | **10,195** |
| Allowance for net realisable value of inventory | (3,247) | (529) | (1,042) | **(4,818)** |
| Allowance for doubtful debts | 6,520 | (1,103) | 3 | **5,420** |
| Movement in other provisions | 18,346 | 12,603 | 166 | **31,115** |
| | **203,916** | **130,873** | **7,738** | **342,527** |
| **ADJUSTED EBITDA** | **632,717** | **280,556** | **29,042** | **942,315** |

| **Year ended December 31, 2010** | **Russia** | **Americas** | **Europe** | **TOTAL** |
|---|---|---|---|---|
| **RECONCILIATION TO PROFIT BEFORE TAX:** | | | | |
| **ADJUSTED EBITDA** | **632,717** | **280,556** | **29,042** | **942,315** |
| Reversal of adjustments from operating profit to EBITDA | (203,916) | (130,873) | (7,738) | **(342,527)** |
| **OPERATING PROFIT** | **428,801** | **149,683** | **21,304** | **599,788** |
| Foreign exchange gain/(loss), net | 19,391 | – | (9,879) | **9,512** |
| **OPERATING PROFIT AFTER FOREIGN EXCHANGE GAIN/(LOSS)** | **448,192** | **149,683** | **11,425** | **609,300** |
| Finance costs | | | | **(430,586)** |
| Finance income | | | | **18,895** |
| Loss on changes in fair value of derivative financial instrument | | | | **(12,361)** |
| **PROFIT BEFORE TAX** | | | | **185,248** |

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 1) Segment Information (continued)

The following tables present additional information of the Group's reportable segments as at December 31, 2011 and 2010:

| **Year ended December 31, 2011** | **Russia** | **Americas** | **Europe** | **TOTAL** |
|---|---|---|---|---|
| Segment assets | 4,771,557 | 1,957,104 | 403,580 | **7,132,241** |
| Property, plant and equipment expenditure | 247,629 | 64,322 | 14,047 | **325,998** |

| **Year ended December 31, 2010** | **Russia** | **Americas** | **Europe** | **TOTAL** |
|---|---|---|---|---|
| Segment assets | 4,585,342 | 1,941,572 | 334,620 | **6,861,534** |
| Property, plant and equipment expenditure | 228,657 | 36,188 | 5,456 | **270,301** |

The following table presents the revenues from external customers for each group of similar products and services for the years ended December 31, 2011 and 2010, respectively:

| **Sales to external customers** | **Welded pipes** | **Seamless pipes** | **Other operations** | **TOTAL** |
|---|---|---|---|---|
| Year ended December 31, 2011 | 2,535,658 | 3,910,622 | 307,237 | **6,753,517** |
| Year ended December 31, 2010 | 2,351,729 | 2,951,592 | 275,278 | **5,578,599** |

The following tables present the geographic information. The revenue information is disclosed based on the location of the customer. Non-current assets are disclosed based on the location of the Group's assets and include property, plant and equipment, intangible assets and goodwill.

| **Year ended December 31, 2011** | **Russia** | **Americas** | **Cent.Asia & Caspian Region** | **Middle East & Gulf Region** | **Africa** | **Europe** | **Asia & Far East** | **TOTAL** |
|---|---|---|---|---|---|---|---|---|
| Revenue | 4,070,519 | 1,801,174 | 197,276 | 67,671 | 4,237 | 589,397 | 23,243 | **6,753,517** |
| Non-current assets | 2,746,620 | 1,296,053 | 21,633 | 42 | 17 | 243,757 | – | **4,308,122** |

| **Year ended December 31, 2010** | **Russia** | **Americas** | **Cent.Asia & Caspian Region** | **Middle East & Gulf Region** | **Africa** | **Europe** | **Asia & Far East** | **TOTAL** |
|---|---|---|---|---|---|---|---|---|
| Revenue | 3,485,287 | 1,434,653 | 161,115 | 56,132 | 13,030 | 398,586 | 29,796 | **5,578,599** |
| Non-current assets | 2,882,293 | 1,330,740 | 25,270 | 46 | 23 | 177,432 | – | **4,415,804** |

9.



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 2) Cost of Sales

Cost of sales for the year ended December 31 was as follows:

| | 2011 | 2010 |
|---|---|---|
| Raw materials and consumables | 3,720,904 | 2,971,841 |
| Staff costs including social security | 661,764 | 540,214 |
| Energy and utilities | 400,169 | 336,072 |
| Depreciation and amortisation | 257,589 | 218,251 |
| Repairs and maintenance | 162,434 | 110,087 |
| Freight | 63,741 | 52,259 |
| Contracted manufacture | 55,625 | 70,597 |
| Taxes | 51,777 | 43,543 |
| Professional fees and services | 25,841 | 19,986 |
| Rent | 10,450 | 8,900 |
| Travel | 2,596 | 1,568 |
| Communications | 1,173 | 858 |
| Insurance | 803 | 774 |
| Other | 3,798 | 4,045 |
| **Total production cost** | **5,418,664** | **4,378,995** |
| Change in own finished goods and work in progress | (147,035) | (170,645) |
| Cost of sales of externally purchased goods | 33,235 | 80,949 |
| Obsolete stock, write-offs/(reversal of write-offs) | 2,379 | (3,950) |
| **Cost of sales** | **5,307,243** | **4,285,349** |

## 3) Selling and Distribution Expenses

Selling and distribution expenses for the year ended December 31 were as follows:

| | 2011 | 2010 |
|---|---|---|
| Freight | 212,425 | 207,384 |
| Depreciation and amortisation | 65,536 | 81,304 |
| Staff costs including social security | 58,807 | 53,980 |
| Consumables | 20,020 | 18,465 |
| Bad debt expense | 19,618 | 5,740 |
| Professional fees and services | 14,701 | 18,196 |
| Rent | 7,953 | 6,690 |
| Travel | 4,501 | 4,185 |
| Utilities and maintenance | 2,169 | 1,587 |
| Insurance | 1,731 | 1,303 |
| Communications | 1,294 | 1,282 |
| Taxes | 849 | 1,281 |
| Other | 1,648 | 1,746 |
| | **411,252** | **403,143** |

## 4) Advertising and Promotion Expenses

Advertising and promotion expenses for the year ended December 31 were as follows:

| | 2011 | 2010 |
|---|---|---|
| Exhibits and catalogues | 5,451 | 4,014 |
| Outdoor advertising | 2,256 | 5,800 |
| Media | 877 | 636 |
| Other | 620 | 649 |
| | **9,204** | **11,099** |

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 5) General and Administrative Expenses

General and administrative expenses for the year ended December 31 were as follows:

| | 2011 | 2010 |
|---|---|---|
| Staff costs including social security | 158,573 | 126,525 |
| Professional fees and services | 55,056 | 47,737 |
| Depreciation and amortisation | 13,224 | 12,658 |
| Travel | 12,928 | 9,132 |
| Utilities and maintenance | 9,126 | 7,626 |
| Transportation | 6,130 | 4,571 |
| Insurance | 5,366 | 3,957 |
| Communications | 5,307 | 4,102 |
| Rent | 5,294 | 5,427 |
| Taxes | 5,174 | 5,241 |
| Consumables | 4,123 | 2,795 |
| Other | 2,484 | 2,204 |
| | **282,785** | **231,975** |

## 6) Research and Development Expenses

Research and development expenses for the year ended December 31 were as follows:

| | 2011 | 2010 |
|---|---|---|
| Staff costs including social security | 11,669 | 9,510 |
| Professional fees and services | 2,999 | 1,578 |
| Depreciation and amortisation | 1,003 | 643 |
| Consumables | 860 | 379 |
| Travel | 731 | 378 |
| Utilities and maintenance | 727 | 426 |
| Transportation | 285 | 153 |
| Other | 416 | 242 |
| | **18,690** | **13,309** |

## 7) Other Operating Expenses

Other operating expenses for the year ended December 31 were as follows:

| | 2011 | 2010 |
|---|---|---|
| Sponsorship and charitable donations | 17,579 | 10,207 |
| Social and social infrastructure maintenance expenses | 16,859 | 12,104 |
| Penalties, fines and expenses related to tax issues | 12,567 | 8,675 |
| Loss on disposal of property, plant and equipment | 2,319 | 10,195 |
| Other | 4,001 | 3,797 |
| | **53,325** | **44,978** |

9.



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 8) Other Operating Income

Other operating income for the year ended December 31 was as follows:

| | 2011 | 2010 |
|---|---|---|
| Gain from penalties and fines | 4,235 | 2,340 |
| Reimbursement from insurance company | 1,272 | – |
| Assets received for free | 494 | 553 |
| Gain on sales of current assets | 43 | 296 |
| Income from emission rights sale | – | 2,149 |
| Other | 7,046 | 5,704 |
| | **13,090** | **11,042** |

## 9) Finance Income

Finance income for the year ended December 31 was as follows:

| | 2011 | 2010 |
|---|---|---|
| Dividends | 27,481 | 14,992 |
| Interest income - bank accounts and deposits | 3,333 | 3,024 |
| Gain on disposal of other investments | 1,249 | 879 |
| | **32,063** | **18,895** |

## 10) Investments in Associates

*Volgograd River Port*

On August 4, 2011, the Group acquired 25.5% ownership interest in Volgograd River Port for 112,825 thousand Russian roubles (4,004 at the exchange rates as at the payment dates).

As at December 31, 2011, there was objective evidence of impairment of investment in Volgograd River Port, therefore, the Group performed an impairment test at that date in respect of this investment. As a result of that test, the Group determined that the carrying value of investment in Volgograd River Port exceeds its recoverable amount. Consequently, the Group recognised impairment of investment in Volgograd River Port in the amount of 1,833.

Movement in investment in Volgograd River Port was as follows:

| | |
|---|---|
| Acquisition of share in associate | 4,004 |
| Share of loss of associate | (185) |
| Impairment of investment in associate | (1,833) |
| Currency translation adjustment | (324) |
| **Investment in associate as at December 31, 2011** | **1,662** |

*Lhoist-TMK B.V.*

On November 4, 2011, the Group established a new entity Lhoist-TMK B.V. with the ownership interest of 30%.

As at December 31, 2011, the carrying value of investment in Lhoist-TMK B.V. was 55.

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 11) Gain on Disposal of Assets Classified as Held for Sale

On May 27, 2011, the Group sold 100% ownership interest in TMK HYDROENERGY POWER S.R.L.

As at the date of disposal the carrying amounts of assets and liabilities were as follows:

| | May 27, 2011 |
|---|---|
| Cash and cash equivalents | 12 |
| Trade receivables | 685 |
| Inventories | 59 |
| Prepayments | 12 |
| **Current assets** | **768** |
| Property, plant and equipment | 8,702 |
| Intangible assets | 105 |
| Deferred tax asset | 138 |
| **Non-current assets** | **8,945** |
| **Total assets** | **9,713** |
| Trade and other payables | (170) |
| **Total liabilities** | **(170)** |
| **Net assets** | **9,543** |

Gain from disposal of TMK HYDROENERGY POWER S.R.L. in the amount of 19,184 was included in the income statement for the year ended December 31, 2011.

In December 2010, the Group received 26,027 as a consideration from the purchaser. The cash consideration received was included in advances from customers.

## 12) Income Tax

Income tax expense for the year ended December 31 was as follows:

| | 2011 | 2010 |
|---|---|---|
| Current income tax expense | 98,034 | 53,985 |
| Current income tax benefit | – | (2,430) |
| Adjustments in respect of income tax of previous periods | (634) | (1,697) |
| Deferred tax expenses arising from write-down of deferred tax asset | 2,193 | 46 |
| Deferred income tax expense related to origination and reversal of temporary differences | 59,848 | 31,270 |
| **Total income tax expense** | **159,441** | **81,174** |

Profit before tax for financial reporting purposes is reconciled to tax expense as follows:

| | 2011 | 2010 |
|---|---|---|
| Profit before tax | 544,138 | 185,248 |
| Theoretical tax charge at statutory rate in Russia of 20% | 108,828 | 37,050 |
| Adjustment in respect of income tax of previous years | (634) | (1,697) |
| Effect of items which are not deductible or assessable for taxation purposes | 17,333 | 30,455 |
| Effect of different tax rates in countries other than Russia | 25,228 | 14,689 |
| Tax on dividends distributed by the Group's subsidiaries to parent company | 11,537 | 2,085 |
| Effect of differences in tax rates on dividend income | (3,023) | (1,649) |
| Effect of change of US (state) effective tax rate | (1,909) | 1,317 |
| Deferred tax expenses arising from write-down of deferred tax asset | 2,193 | 46 |
| Effect of unrecognised tax credits, tax losses and temporary difference of a prior period | 152 | (971) |
| Other | (264) | (151) |
| **Total income tax expense** | 159,441 | 81,174 |

9.



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 12) Income Tax (continued)

Deferred income tax assets and liabilities, their movements for the years ended December 31, 2011 and 2010 were as follows:

| | 2011 | Change recognised in income statement | Change recognised in other compre-hensive income | Foreign currency translation reserve | 2010 | Change recognised in income statement | Change recognised in other compre-hensive income | Foreign currency translation reserve | 2009 |
|---|---|---|---|---|---|---|---|---|---|
| **Deferred income tax liability:** | | | | | | | | | |
| Valuation and depreciation of property, plant and equipment | (282,741) | (22,522) | – | 11,557 | (271,776) | (18,945) | – | 1,481 | (254,312) |
| Valuation and amortisation of intangible assets | (46,686) | 12,615 | – | (16) | (59,285) | 13,330 | – | (1) | (72,614) |
| Valuation of accounts receivable | (5,985) | (34) | – | 339 | (6,290) | 429 | – | 50 | (6,769) |
| Valuation of inventory | (2,960) | (12,401) | – | 131 | 9,310 | (8,854) | – | (30) | 18,194 |
| Prepayments and other current assets | (529) | 1,976 | – | (11) | (2,494) | (2,996) | – | (3) | 505 |
| | **(338,901)** | **(20,366)** | **–** | **12,000** | **(330,535)** | **(17,036)** | **–** | **1,497** | **(314,996)** |
| **Deferred income tax asset:** | | | | | | | | | |
| Tax losses available for offset | 98,049 | (42,957) | 13,554 | (4,244) | 131,696 | (21,395) | 1,769 | (975) | 152,297 |
| Provisions and accruals | 14,441 | 1,350 | – | (457) | 13,548 | 8,951 | – | (45) | 4,642 |
| Trade and other payable | 5,393 | 565 | – | 39 | 4,789 | (2,025) | – | (9) | 6,823 |
| Finance lease obligations | 6,709 | 71 | – | (381) | 7,019 | (1) | – | (55) | 7,075 |
| Impairment of accounts receivable | 5,477 | 3,354 | – | (423) | 2,546 | (397) | – | (14) | 2,957 |
| Other | 1,927 | (4,058) | – | 225 | 5,760 | 587 | – | (17) | 5,190 |
| | **131,996** | **(41,675)** | **13,554** | **(5,241)** | **165,358** | **(14,280)** | **1,769** | **(1,115)** | **178,984** |
| **Net deferred income tax liability** | **(304,785)** | **(14,313)** | **–** | **10,012** | **(300,484)** | **(30,076)** | **–** | **1,256** | **(271,664)** |
| **Net deferred income tax asset** | **97,880** | **(47,728)** | **13,554** | **(3,253)** | **135,307** | **(1,240)** | **1,769** | **(874)** | **135,652** |

In the context of the Group's current structure, tax losses and current tax assets of the different companies are not offset against taxable profits and current tax liability of other companies and, accordingly, taxes may accrue even where there is a net consolidated tax loss. Therefore, a deferred tax asset of one subsidiary of the Group is not offset against the deferred tax liability of another subsidiary.

As at December 31, 2011, the deferred tax asset for 3,439 (2010: 3,633) relating to tax deductible losses incurred in transactions with securities has not been recognised, as it is not probable that sufficient taxable profit on transactions with securities will be available to offset the deductible temporary differences to which the asset relates. Such tax losses are offset only against future taxable profits generated in transactions with securities over a period of 3 years.

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 12) Income Tax (continued)

The Group recognised the deferred tax assets for the companies with net loss. The Group believes that this tax loss will be recovered as future taxable profits will exceed recognised tax asset on tax loss.

As at December 31, 2011, the Group has not recognised deferred tax liability in respect of 1,301,486 (2010: 1,321,361) temporary differences associated with investments in subsidiaries as the Group is able to control the timing of the reversal of those temporary differences and does not intend to reverse them in the foreseeable future.

## 13) Earnings per Share

Basic earnings per share are calculated by dividing the profit for the period attributable to ordinary shareholders of the parent entity by the weighted average number of ordinary shares in issue during the period.

Diluted earnings per share are calculated by dividing the profit for the period attributable to ordinary shareholders of the parent entity adjusted for interest expense and other gains and losses for the period, net of tax, relating to convertible bonds by the weighted average number of ordinary shares outstanding during the period plus the weighted average number of shares that would be issued on the conversion of all the potential dilutive ordinary shares into ordinary shares.

In calculation of diluted earnings per share, the denominator represents the weighted average number of ordinary shares which could be outstanding assuming that all of the convertible bonds were converted into ordinary shares (Note 24).

| | Year ended December 31, 2011 | 2010 |
|---|---|---|
| Profit for the year attributable to the equity holders of the parent entity | 380,130 | 104,334 |
| Effect of convertible bonds, net of tax (if dilutive) | (1,710) | – |
| Profit for the year attributable to the equity holders of the parent entity adjusted for the effect of dilution | 378,420 | 104,334 |
| Weighted average number of ordinary shares outstanding | 864,976,286 | 860,480,570 |
| Weighted average number of ordinary shares outstanding adjusted for the effect of dilution | 936,751,609 | 860,480,570 |
| **Earnings per share attributable to equity holders of the parent entity, basic and diluted in US dollars** | | |
| Basic | 0.44 | 0.12 |
| Diluted | 0.40 | 0.12 |
| **Earnings per share attributable to equity holders of the parent entity, basic and diluted in Russian roubles** | | |
| Basic | 12.91 | 3.68 |
| Diluted | 11.87 | 3.68 |

In the year ended December 31, 2010, the convertible bonds were antidilutive as the interest expense and other gains and losses for the period, net of tax, relating to convertible bonds divided by the number of ordinary shares obtainable on the conversion of the convertible bonds exceeded basic earnings per share.

9.





## 14) Cash and Cash Equivalents

Cash and cash equivalents were denominated in the following currencies:

| | 2011 | 2010 |
|---|---|---|
| Russian rouble | 164,695 | 108,516 |
| US dollar | 60,980 | 39,819 |
| Euro | 3,235 | 4,823 |
| Romanian lei | 1,205 | 4,035 |
| Other currencies | 478 | 331 |
| | **230,593** | **157,524** |

The above cash and cash equivalents consisted primarily of cash at banks.

As at December 31, 2011, the amount of cash and cash equivalents included 42,291 which is available to finance investing activities only (December 31, 2010: 55,780).

## 15) Trade and Other Receivables

Trade and other receivables consisted of the following:

| | 2011 | 2010 |
|---|---|---|
| Trade receivables | 758,343 | 710,714 |
| Officers and employees | 1,964 | 2,235 |
| Other accounts receivable | 37,630 | 21,884 |
| **Gross accounts receivable** | **797,937** | **734,833** |
| Allowance for doubtful debts | (31,782) | (17,936) |
| **Net accounts receivable** | **766,155** | **716,897** |

Accounts receivables in the amount of 103,851 were pledged as security for borrowings as at December 31, 2011 (December 31, 2010: 91,661) (Note 23).

## 16) Inventories

Inventories consisted of the following:

| | 2011 | 2010 |
|---|---|---|
| Raw materials | 389,140 | 335,362 |
| Work in process | 373,423 | 356,392 |
| Finished goods and finished goods in transit | 429,573 | 333,205 |
| Goods for resale | 17,254 | 4,084 |
| Supplies | 224,891 | 195,609 |
| **Gross inventories** | **1,434,281** | **1,224,652** |
| Allowance for net realisable value of inventory | (15,826) | (17,112) |
| **Net inventories** | **1,418,455** | **1,207,540** |

Inventories carried at net realisable value in the amount of 330,008 (December 31, 2010: 262,328) were included in inventories as at December 31, 2011.

As at December 31, 2011, certain items of inventory with a carrying amount of 121,365 (December 31, 2010: 122,794) were pledged as security for borrowings (Note 23).

OAO TMK
Notes to the Consolidated Financial Statements (continued)
(All amounts are in thousands of US dollars, unless specified otherwise)

## 16) Inventories (continued)

The following summarises the changes in the allowance for net realisable value of inventory:

| | 2011 | 2010 |
|---|---|---|
| Balance at the beginning of the year | 17,112 | 22,133 |
| Decrease in allowance | (662) | (4,818) |
| Currency translation adjustments | (624) | (203) |
| **Balance at the end of the year** | **15,826** | **17,112** |

## 17) Prepayments and Input VAT

Prepayments and input VAT consisted of the following:

| | 2011 | 2010 |
|---|---|---|
| Prepayment for VAT, input VAT | 111,459 | 92,304 |
| Prepayment for services, inventories | 51,435 | 45,778 |
| Prepayment for insurance | 3,708 | 9,887 |
| Deferred charges | 2,221 | 4,372 |
| Prepayment for other taxes | 931 | 1,551 |
| Prepayment for property tax | 698 | 179 |
| Prepayment for rent | 256 | 231 |
| | **170,708** | **154,302** |

Input VAT, representing amounts payable or paid to suppliers, is recoverable from the tax authorities via offset against VAT payable to the tax authorities on the Group's revenue or via direct cash receipts from the tax authorities. Management periodically reviews the recoverability of the balance of input VAT and believes it is recoverable within one year.

## 18) Property, Plant and Equipment

Movement in property, plant and equipment for the year ended December 31, 2011 was as follows:

| | Land and buildings | Machinery and equipment | Transport and motor vehicles | Furniture and fixtures | Leasehold improve-ments | Construction in progress | TOTAL |
|---|---|---|---|---|---|---|---|
| **COST** | | | | | | | |
| Balance at January 1, 2011 | 1,248,487 | 2,536,920 | 60,317 | 47,585 | 9,911 | 554,106 | **4,457,326** |
| Additions | – | – | – | – | – | 325,998 | **325,998** |
| Assets put into operation | 71,153 | 272,618 | 3,784 | 10,820 | 3,051 | (361,426) | **–** |
| Disposals | (3,977) | (15,739) | (1,723) | (662) | – | (376) | **(22,477)** |
| Currency translation adjustments | (64,078) | (129,406) | (2,925) | (2,865) | (102) | (22,899) | **(222,275)** |
| **BALANCE AT DECEMBER 31, 2011** | **1,251,585** | **2,664,393** | **59,453** | **54,878** | **12,860** | **495,403** | **4,538,572** |
| **ACCUMULATED DEPRECIATION AND IMPAIRMENT** | | | | | | | |
| Balance at January 1, 2011 | (181,734) | (834,077) | (25,587) | (26,576) | (2,692) | – | **(1,070,666)** |
| Depreciation charge | (37,687) | (217,261) | (4,267) | (8,252) | (711) | – | **(268,178)** |
| Reversal of impairment | – | 73,417 | – | – | – | – | **73,417** |
| Disposals | 2,048 | 10,755 | 1,645 | 619 | – | – | **15,067** |
| Currency translation adjustments | 11,210 | 45,007 | 1,417 | 1,779 | 23 | – | **59,436** |
| **BALANCE AT DECEMBER 31, 2011** | **(206,163)** | **(922,159)** | **(26,792)** | **(32,430)** | **(3,380)** | **–** | **(1,190,924)** |
| **NET BOOK VALUE AT DECEMBER 31, 2011** | **1,045,422** | **1,742,234** | **32,661** | **22,448** | **9,480** | **495,403** | **3,347,648** |
| **NET BOOK VALUE AT JANUARY 1, 2011** | **1,066,753** | **1,702,843** | **34,730** | **21,009** | **7,219** | **554,106** | **3,386,660** |

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 18) Property, Plant and Equipment (continued)

Movement in property, plant and equipment for the year ended December 31, 2010 was as follows:

| | Land and buildings | Machinery and equipment | Transport and motor vehicles | Furniture and fixtures | Leasehold improve-ments | Construction in progress | TOTAL |
|---|---|---|---|---|---|---|---|
| **COST** | | | | | | | |
| Balance at January 1, 2010 | 1,243,839 | 2,370,728 | 59,571 | 40,466 | 9,439 | 567,204 | **4,291,247** |
| Additions | – | – | – | – | – | 270,301 | **270,301** |
| Assets put into operation | 32,374 | 232,626 | 4,263 | 8,172 | 485 | (277,920) | **–** |
| Transfer to assets held for sale | (8,844) | (730) | (301) | (13) | – | (158) | **(10,046)** |
| Disposals | (1,779) | (33,227) | (1,289) | (576) | – | (707) | **(37,578)** |
| Currency translation adjustments | (17,103) | (32,477) | (1,927) | (464) | (13) | (4,614) | **(56,598)** |
| **BALANCE AT DECEMBER 31, 2010** | **1,248,487** | **2,536,920** | **60,317** | **47,585** | **9,911** | **554,106** | **4,457,326** |
| **ACCUMULATED DEPRECIATION AND IMPAIRMENT** | | | | | | | |
| Balance at January 1, 2010 | (150,761) | (692,309) | (23,150) | (20,758) | (1,589) | – | **(888,567)** |
| Depreciation charge | (35,720) | (177,543) | (4,165) | (6,506) | (1,024) | – | **(224,958)** |
| Transfer to assets held for sale | 1,486 | 527 | 59 | 3 | – | – | **2,075** |
| Disposals | 563 | 21,129 | 1,027 | 424 | – | – | **23,143** |
| Currency translation adjustments | 2,698 | 14,119 | 642 | 261 | (79) | – | **17,641** |
| **BALANCE AT DECEMBER 31, 2010** | **(181,734)** | **(834,077)** | **(25,587)** | **(26,576)** | **(2,692)** | **–** | **(1,070,666)** |
| **NET BOOK VALUE AT DECEMBER 31, 2010** | **1,066,753** | **1,702,843** | **34,730** | **21,009** | **7,219** | **554,106** | **3,386,660** |
| **NET BOOK VALUE AT JANUARY 1, 2010** | **1,093,078** | **1,678,419** | **36,421** | **19,708** | **7,850** | **567,204** | **3,402,680** |

As at December 31, 2011, bank borrowings were secured by properties and equipment with a carrying value of 391,897 (December 31, 2010: 746,307) (Note 23).

In 2011 and 2010, no impairment losses were recognised in respect of property, plant and equipment.

As at December 31, 2011, the Group determined that the value in use of European division cash-generating unit significantly exceeded its carrying value. The Group used pre-tax discount rate of 13.36% for the calculation of the value in use of this cash-generating unit. The increase of its recoverable amount was mostly due to the increase of the share of the most profitable products in total production and sales volume of European division cash-generating unit. As a result, the Group reversed the impairment loss recognised in 2008-2009 in respect of property, plant and equipment of European division cash-generating unit in the amount of 73,417.

*Capitalised Borrowing Costs*

The Group started to capitalise borrowing costs for all eligible assets where construction was commenced on or after January 1, 2009. The amount of borrowing costs capitalised during the year ended December 31, 2011 was 4,682 (2010: 4,488). The rate of the specific borrowing used to determine the amount of borrowing costs eligible for capitalisation was 5.19% in 2011 (2010: 5.19%).

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 19) Goodwill and Other Intangible Assets

Movement in intangible assets for the year ended December 31, 2011 was as follows:

| | Patents and trademarks | Goodwill | Software | Customer relation-ships | Proprietary technology | Backlog | Other | TOTAL |
|---|---|---|---|---|---|---|---|---|
| **COST** | | | | | | | | |
| Balance at January 1, 2011 | 209,578 | 567,681 | 16,972 | 472,300 | 14,100 | 8,500 | 7,265 | **1,296,396** |
| Additions | 11 | – | 6,850 | – | – | – | 1,861 | **8,722** |
| Disposals | (4) | – | (861) | – | – | – | (2,537) | **(3,402)** |
| Currency translation adjustments | (44) | (4,858) | (1,419) | – | – | – | (315) | **(6,636)** |
| **BALANCE AT DECEMBER 31, 2011** | **209,541** | **562,823** | **21,542** | **472,300** | **14,100** | **8,500** | **6,274** | **1,295,080** |
| **ACCUMULATED AMORTISATION AND IMPAIRMENT** | | | | | | | | |
| Balance at January 1, 2011 | (231) | (13,328) | (11,963) | (226,389) | (4,499) | (8,500) | (2,342) | **(267,252)** |
| Amortisation charge | (81) | – | (2,309) | (63,685) | (1,762) | – | (1,397) | **(69,234)** |
| Impairment | – | (3,368) | – | – | – | – | – | **(3,368)** |
| Disposals | 1 | – | 849 | – | – | – | 2,117 | **2,967** |
| Currency translation adjustments | 17 | 1,084 | 1,120 | – | – | – | 60 | **2,281** |
| **BALANCE AT DECEMBER 31, 2011** | **(294)** | **(15,612)** | **(12,303)** | **(290,074)** | **(6,261)** | **(8,500)** | **(1,562)** | **(334,606)** |
| **NET BOOK VALUE AT DECEMBER 31, 2011** | **209,247** | **547,211** | **9,239** | **182,226** | **7,839** | **–** | **4,712** | **960,474** |
| **NET BOOK VALUE AT JANUARY 1, 2011** | **209,347** | **554,353** | **5,009** | **245,911** | **9,601** | **–** | **4,923** | **1,029,144** |

Movement in intangible assets for the year ended December 31, 2010 was as follows:

| | Patents and trademarks | Goodwill | Software | Customer relation-ships | Proprietary technology | Backlog | Other | TOTAL |
|---|---|---|---|---|---|---|---|---|
| **COST** | | | | | | | | |
| Balance at January 1, 2010 | 209,740 | 568,891 | 17,049 | 472,300 | 14,100 | 8,500 | 5,708 | **1,296,288** |
| Additions | 28 | – | 75 | – | – | – | 1,907 | **2,010** |
| Disposals | (181) | – | – | – | – | – | (304) | **(485)** |
| Currency translation adjustments | (9) | (1,210) | (152) | – | – | – | (46) | **(1,417)** |
| **BALANCE AT DECEMBER 31, 2010** | **209,578** | **567,681** | **16,972** | **472,300** | **14,100** | **8,500** | **7,265** | **1,296,396** |
| **ACCUMULATED AMORTISATION AND IMPAIRMENT** | | | | | | | | |
| Balance at January 1, 2010 | (217) | (13,429) | (8,930) | (147,092) | (2,737) | (8,500) | (1,562) | **(182,467)** |
| Amortisation charge | (82) | – | (3,118) | (79,297) | (1,762) | – | (940) | **(85,199)** |
| Disposals | 61 | – | – | – | – | – | 143 | **204** |
| Currency translation adjustments | 7 | 101 | 85 | – | – | – | 17 | **210** |
| **BALANCE AT DECEMBER 31, 2010** | **(231)** | **(13,328)** | **(11,963)** | **(226,389)** | **(4,499)** | **(8,500)** | **(2,342)** | **(267,252)** |
| **NET BOOK VALUE AT DECEMBER 31, 2010** | **209,347** | **554,353** | **5,009** | **245,911** | **9,601** | **–** | **4,923** | **1,029,144** |
| **NET BOOK VALUE AT JANUARY 1, 2010** | **209,523** | **555,462** | **8,119** | **325,208** | **11,363** | **–** | **4,146** | **1,113,821** |

## 19) Goodwill and Other Intangible Assets (continued)

Customer relationships represent non-contracted interactions with clients. Remaining amortisation period for customer relationships is 5-7 years. Customer relationships are amortised using the diminishing balance method which reflects the pattern of consumption of the economic benefits that customer relationships provide.

Goodwill relates to the assembled workforce and synergy from integration of the acquired subsidiaries into the Group.

Patents and trademarks include intangible assets with indefinite useful lives with the carrying value of 208,700 (2010: 208,700).

The carrying amount of goodwill and intangible assets with indefinite useful lives were allocated among cash-generating units as follows as at December 31:

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Goodwill | Intangible assets with indefinite useful lives | Goodwill | Intangible assets with indefinite useful lives |
| American division | 472,968 | 208,700 | 472,968 | 208,700 |
| European division | 6,185 | – | 6,324 | – |
| Kaztrubprom Plant | 4,863 | – | 8,301 | – |
| Oilfield division | 29,957 | – | 31,648 | – |
| Other cash-generating units | 33,238 | – | 35,112 | – |
| | 547,211 | 208,700 | 554,353 | 208,700 |

The Group determines whether goodwill and intangible assets with indefinite useful lives are impaired on an annual basis and when circumstances indicate the carrying value may be impaired.

As at June 30, 2011, there were indicators of impairment of Kaztrubprom Plant cash-generating unit, therefore, the Group performed an impairment test at that date in respect of this unit. As a result of that test, the Group determined that the carrying value of Kaztrubprom Plant cash-generating unit exceeds its recoverable amount. Consequently, the Group recognised impairment of Kaztrubprom Plant cash-generating unit's goodwill in the amount of 3,368.

Goodwill and intangible assets with indefinite useful lives were tested for impairment at December 31, 2011. As a result of the test, the Group determined that the carrying values of all cash-generating units do not exceed their recoverable amounts. Consequently, no additional impairment losses were recognised in the year ended December 31, 2011. In 2010, no impairment losses were recognised in respect of goodwill and intangible assets with indefinite useful lives.

For the purpose of impairment testing of goodwill the Group has determined value in use of each of its cash-generating units. The value in use has been calculated using cash flow projections based on the actual operating results and business plans approved by management and appropriate discount rates reflecting time value of money and risks associated with respective cash-generating unit or group of cash-generating units. The key assumptions used by management in calculation of the value in use are presented in the table below. For the periods not covered by management plans, cash flow projections have been estimated by extrapolating the respective business plans taking into account business cycles using zero growth rate.

OAO TMK
Notes to the Consolidated Financial Statements (continued)
(All amounts are in thousands of US dollars, unless specified otherwise)

19) Goodwill and Other Intangible Assets (continued)

| Cash-generating units | Period of forecast, years | Pre-tax discount rate, % |
|---|---|---|
| American division | 5 | 12.01 |
| European division | 5 | 13.36 |
| Kaztrubprom Plant | 5 | 11.59 |
| Oilfield division | 5 | 12.48 |
| Other cash-generating units | 5 | 11.92 |

With regard to the assessment of value in use of European division no reasonably possible change in the key assumptions would cause the carrying value of this unit to exceed its recoverable amount.

The recoverable amounts of American division, Kaztrubprom Plant, Oilfield division and Taganrog Metallurgical Works (which is included in other cash-generating units) are based on the business plans approved by management. The reasonably possible deviation of assumptions from these plans could lead to an impairment. The calculation of value in use of these cash-generating units was the most sensitive to the following assumptions:

*Discount Rates*

Discount rates reflect the current market assessment of the risks specific to cash generating unit. The discount rates have been determined using the CAPM concept and analysis of industry peers. Reasonably possible change in discount rate could lead to impairment of goodwill.

A 10% increase in the discount rate of Oilfield division would result in an impairment of goodwill in the amount of 987.

*Costs*

If costs of American division were 5% higher than those assumed in the impairment test during the period of forecast, this would lead to the full impairment of goodwill in the amount of 472,968.

If costs of Kaztrubprom Plant were 5% higher than those assumed in the impairment test during the period of forecast, this would lead to an impairment of goodwill in the amount of 4,469.

If costs of Oilfield division were 5% higher than those assumed in the impairment test during the period of forecast, this would lead to the full impairment of goodwill in the amount of 29,957.

If costs of Taganrog Metallurgical Works were 5% higher than those assumed in the impairment test during the period of forecast, this would lead to the full impairment of goodwill in the amount of 31,103.

*Commodity Prices*

If prices of American division forecasted for 2012 were 5% lower than those assumed in the impairment test, this would lead to the full impairment of goodwill in the amount of 472,968.

If prices of Kaztrubprom Plant forecasted for 2012 were 5% lower than those assumed in the impairment test, this would lead to the full impairment of goodwill in the amount of 4,863.

9.



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 19) Goodwill and Other Intangible Assets (continued)

If prices of Oilfield division forecasted for 2012 were 5% lower than those assumed in the impairment test, this would lead to the full impairment of goodwill in the amount of 29,957.

If prices of Taganrog Metallurgical Works forecasted for 2012 were 5% lower than those assumed in the impairment test, this would lead to the full impairment of goodwill in the amount of 31,103.

## 20) Other Non-Current Assets

Other non-current assets consisted of the following:

| | 2011 | 2010 |
|---|---|---|
| Prepayments for acquisition of property, plant and equipment | 80,389 | 29,774 |
| Restricted cash deposits for fulfillment of guaranties | 7,850 | 1,659 |
| Loans to employees | 5,840 | 5,357 |
| Other | 5,379 | 3,918 |
| | **99,458** | **40,708** |
| Allowance for doubtful debts | – | (11) |
| | **99,458** | 40,697 |

## 21) Trade and Other Payables

Trade and other payables consisted of the following:

| | 2011 | 2010 |
|---|---|---|
| Trade payables | 653,100 | 531,888 |
| Liabilities for VAT | 55,103 | 28,120 |
| Accounts payable for property, plant and equipment | 42,282 | 65,410 |
| Payroll liabilities | 30,348 | 29,942 |
| Accrued and withheld taxes on payroll | 16,204 | 14,368 |
| Liabilities under put options of non-controlling interest shareholders in subsidiaries | 14,051 | 14,934 |
| Liabilities for property tax | 13,399 | 10,281 |
| Notes issued to third parties | 8,408 | 7,226 |
| Sales rebate payable | 7,926 | 7,134 |
| Liabilities for other taxes | 3,442 | 4,500 |
| Other payables | 18,677 | 18,930 |
| | **862,940** | 732,733 |

## 22) Provisions and Accruals

Provisions and accruals consisted of the following:

| | 2011 | 2010 |
|---|---|---|
| *Current:* | | |
| Provision for bonuses | 21,488 | 20,710 |
| Accrual for unused annual leaves, current portion | 10,549 | 9,546 |
| Accrual for long-service benefit | 10,209 | 8,468 |
| Current portion of post-employment benefits | 2,693 | 1,850 |
| Provision for tax and other fines | 204 | 241 |
| Environmental provision, current portion | 932 | 1,338 |
| | **46,075** | **42,153** |
| *Non-current:* | | |
| Accrual for unused annual leaves | 20,930 | 19,379 |
| Environmental provision | 4,406 | 4,717 |
| | **25,336** | **24,096** |

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 23) Interest-Bearing Loans and Borrowings

Interest-bearing loans and borrowings consisted of the following:

| | 2011 | 2010 |
|---|---|---|
| *Current:* | | |
| Bank loans | 242,830 | 201,585 |
| Interest payable | 27,981 | 26,473 |
| Current portion of non-current borrowings | 329,009 | 125,104 |
| Current portion of bearer coupon debt securities | – | 350,759 |
| Unamortised debt issue costs | (2,269) | (3,648) |
| | **597,551** | **700,273** |
| Finance lease liability - current | 1,826 | 1,591 |
| **Total short-term loans and borrowings** | **599,377** | 701,864 |
| *Non-current:* | | |
| Bank loans | 2,459,613 | 2,733,457 |
| Bearer coupon debt securities | 1,043,806 | 897,034 |
| Unamortised debt issue costs | (21,136) | (20,048) |
| Less: current portion of non-current borrowings | (329,009) | (125,104) |
| Less: current portion of bearer coupon debt securities | – | (350,759) |
| | **3,153,274** | **3,134,580** |
| Finance lease liability - non-current | 34,290 | 35,134 |
| **Total long-term loans and borrowings** | **3,187,564** | 3,169,714 |

As at December 31, 2010, the Group pledged its rights under sales contracts in Romania totaling to 9,444 as collateral under loan agreements in addition to collaterals disclosed in Notes 15, 16, 18. There were no such pledges as at December 31, 2011.

The carrying amounts of the Group's borrowings are denominated in the following currencies:

| | Interest rates for the year | 2011 | Interest rates for the year | 2010 |
|---|---|---|---|---|
| Russian rouble | Fixed 6.7% - 9.5% | 1,712,829 | Fixed 4.3% - 10% | 1,640,713 |
| US Dollar | | | Fixed 10% | 193,129 |
| | Fixed 5.25% | 385,981 | Fixed 5.25% | 377,910 |
| | Fixed 7.75% | 512,935 | | |
| | Fixed 3.15% - 7% | 447,541 | Fixed 2.6% - 8.5% | 1,244,629 |
| | Cost of funds + 1.75% - 2.5% (*) | 5,424 | | |
| | Variable: | 440,304 | Variable: | 112,546 |
| | Libor (1m) + 2.25% - 4.15% | | Libor (1m) + 1.75% - 5.65% | |
| | Libor (3m - 13m) + 1% - 2.75% | | Libor (1w) + 2.39% | |
| Euro | Fixed 5.19% | 74,510 | Fixed 5.19% | 84,420 |
| | Variable: | 170,953 | Variable: | 179,248 |
| | Euribor (1m) + 1.6% - 4.05% | | Euribor (1m) + 1.6% | |
| | Euribor (3m) + 2.7% - 3.5% | | Euribor (3m) + 2.7% - 4% | |
| | Euribor (6m) + 0.26% - 0.3% | | Euribor (5m) + 1.1% | |
| | Euribor (10m - 15m) + 1.1% | | Euribor (6m) + 0.26% - 1.1% | |
| | | | Euribor (8m) + 1.1% | |
| | | | Euribor (12m) + 1.2% | |
| Romanian Lei | Robor (6m) + 3% | 348 | Fixed 10.5% - 11% | 2,253 |
| Swiss Frank | | – | Variable: | 5 |
| | | | Libor (1w) + 2.39% | |
| | | **3,750,825** | | **3,834,853** |

(*) Cost of funds represents internal rate of a bank.

9.



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 23) Interest-Bearing Loans and Borrowings (continued)

*Loan Participation Notes*

On January 27, 2011, TMK Capital S.A., a Luxemburg special purpose entity, completed the offering of loan participation notes due 2018 in the total amount of 500,000 with a coupon of 7.75% per annum, payable on semi-annual basis. The notes are admitted for trading on the London Stock Exchange. As at December 31, 2011, an aggregate of 500,000 of notes remained outstanding.

On July 29, 2011, the Group fully repaid 10% loan participation notes in the amount of 186,700 issued in 2008 by TMK Capital S.A.

*Bank Loans*

In January 2011, the Group partially repaid 1,107,542 Gazprombank loan facilities using the proceeds from issuance of 7.75% loan participation notes in the amount of 500,000. In October 2011, the Group refinanced a further part of Gazprombank loan facilities in the amount of 207,542 using proceeds from Nordea Bank loan and cash generated from operations. As at December 31, 2011, the principle outstanding balance of the loan facilities in Gazprombank was 400,000.

In February-April 2011, the Group entered into several loan agreements with Gazprombank with a maturity in 2014. The proceeds from these loans were used to repay loans from Sberbank in the aggregated amount of 4,000,000 thousand Russian roubles (135,206 at the exchange rates as at the payment dates), a loan from VTB in the amount of 94,000 and for settlement of liability under 5,000,000 thousand Russian roubles bonds issued on February 21, 2006 (170,892 at the exchange rate as at the payment date). As at December 31, 2011, the aggregated principle outstanding balance of these loans in Gazprombank was 11,400,490 thousand Russian roubles (354,096 at the exchange rate as at December 31, 2011).

In April 2011, the Group refinanced Sberbank loans in the aggregated amount of 7,118,490 thousand Russian roubles (250,273 at the exchange rates as at the payment dates) with new Sberbank loans in the aggregated amount of 6,900,000 thousand Russian roubles (244,477 at the exchange rates as at the cash proceeds dates). As at December 31, 2011, the aggregated principle outstanding balance of these loans in Sberbank was 6,900,000 thousand Russian roubles (214,312 at the exchange rate as at December 31, 2011).

In July 2011, the Group entered into loan agreement with Gazprombank in the amount of 150,000 with a maturity in 2012. The proceeds from this loan were used for partial repayment of 10% loan participation notes in the amount of 186,700 issued by TMK Capital S.A. As at December 31, 2011, the principle outstanding balance of this loan in Gazprombank was 36,660.

In August 2011, the Group entered into syndicated credit facility with Wells Fargo Capital Finance, LLC, Bank of America, N.A., GE Capital Finance Inc., JPMorgan Chase Bank, N.A. and ING Capital LLC with a maturity in 2016. The proceeds from this credit facility were partially used to refinance 96,706 of the Wells Fargo senior secured credit facility. As at December 31, 2011, the aggregated principle outstanding balance under the facility was 146,168.

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 23) Interest-Bearing Loans and Borrowings (continued)

*Bank Loans (continued)*

In October 2011, the Group entered into loan with Nordea Bank in the amount of 200,000 with a maturity in 2017. The proceeds from this loan were used for partial repayment of Gazprombank loan facilities. As at December 31, 2011, the principle outstanding balance of Nordea Bank loan was 200,000.

*Russian Bond Obligations*

On February 15, 2011, the Group fully repaid its liability under 5,000,000 thousand Russian roubles bonds issued on February 21, 2006 (170,892 at the exchange rate as at the payment date) using the proceeds from the loan provided by Gazprombank.

*Unamortised Debt Issue Costs*

Unamortised debt issue costs represent agent commission and arrangement costs paid by the Group in relation to the arrangement of loans and issue of notes.

As at December 31, 2011, the Group had unutilised borrowing facilities in the amount of 736,163 (December 31, 2010: 588,281).

*Finance Lease Liabilities*

Starting from 2001, the Group entered into lease agreements under certain of which it has a bargain option to acquire the leased assets at the end of lease term ranging from 3 to 20 years. The estimated average remaining useful life of leased assets varies from 8 to 17 years.

The leases are accounted for as finance leases in the consolidated financial statements. The carrying value of the leased assets was as follows as at December 31:

| | 2011 | 2010 |
|---|---|---|
| Machinery and equipment | 26,030 | 28,372 |
| Transport and motor vehicles | 609 | 183 |
| | **26,639** | **28,555** |

The leased assets are included in property, plant and equipment in the consolidated statement of financial position.

Future minimum lease payments under finance leases with the present value of the net minimum lease payments were as follows as at December 31, 2011:

| | Minimum payments | Present value of payments |
|---|---|---|
| 2012 | 3,011 | 1,826 |
| 2013-2016 | 11,563 | 7,500 |
| after 2016 | 32,456 | 26,790 |
| Total minimum lease payments | **47,030** | **36,116** |
| Less amounts representing finance charges | (10,914) | |
| Present value of minimum lease payments | **36,116** | **36,116** |

9.



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 23) Interest-Bearing Loans and Borrowings (continued)

*Finance Lease Liabilities (continued)*

Future minimum lease payments under finance leases with the present value of the net minimum lease payments were as follows as at December 31, 2010:

| | Minimum payments | Present value of payments |
|---|---|---|
| 2011 | 2,779 | 1,591 |
| 2012-2015 | 10,779 | 6,571 |
| after 2015 | 35,142 | 28,563 |
| Total minimum lease payments | **48,700** | **36,725** |
| Less amounts representing finance charges | (11,975) | |
| Present value of minimum lease payments | **36,725** | **36,725** |

In the years ended December 31, 2011 and December 31, 2010, the average interest rate under the finance lease liabilities was 3%.

## 24) Convertible Bonds

On February 11, 2010, TMK Bonds S.A., the Group's special purpose entity, completed the offering of 4,125 convertible bonds due 2015 convertible into Global Depository Receipts ("GDR") each representing four ordinary shares of OAO TMK. The bonds are listed on the London Stock Exchange. The bonds have nominal value of 100,000 US dollars each and were issued at 100% of their principal amount. The convertible bonds carry a coupon of 5.25% per annum, payable on a quarterly basis. The conversion can be exercised at the option of bondholders on any date during the period commencing 41 days following the February 11, 2010 and ending on the date falling seven London business days prior to the maturity date or, if earlier, ending on the seventh day prior to any earlier date fixed for redemption of the Convertible bonds. As at December 31, 2011, the bonds are convertible into GDRs at conversion price of 22.927 US dollars per GDR (December 31, 2010: 23.075 US dollars per GDR). The conversion price was adjusted in 2011 as a result of dividends in respect of 2010 distributed by the parent entity.

The Group can early redeem all outstanding bonds, in whole but not in part, at any time on or after March 4, 2013 at their principal amount plus accrued interest, if the volume weighted average price of the GDRs traded on the London Stock Exchange during 30 consecutive dealing days exceeds 130 per cent of the conversion price (the "Issuer Call"). In addition, the Group has the option to redeem the bonds at the principal amount plus accrued interest if 15% or less of the bonds remain outstanding. Bondholders have the right to request redemption of the bonds on the third anniversary following the issue date at the principal amount plus accrued interest.

The Group determined that the convertible bonds represent a combined financial instrument containing two components: the bond liability (host component) and an embedded derivative representing conversion option in foreign currency combined with the Issuer Call (the "Embedded Conversion Option").

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 24) Convertible Bonds (continued)

The Embedded Conversion Option in foreign currency was classified as financial instrument at fair value through profit or loss. The Embedded Conversion Option was initially recognised at the fair value of 35,455. The Group used binomial options pricing model for initial and subsequent measurement of fair value of this embedded derivative. For the purposes of this model, the Group assessed that the credit spread comprised 1,094 bps and 650 bps as at December 31, 2011 and 2010, respectively. As at December 31, 2011, the fair value of the Embedded Conversion Option was 3,024 (December 31, 2010: 47,816). The change in the fair value of the embedded derivative during the year ended December 31, 2011 resulted in a gain of 44,792 (2010: loss of 12,361), which has been recorded as gain/(loss) on changes in fair value of derivative financial instrument in the income statement.

The fair value of the host component of 368,149 at the initial recognition date has been determined as a residual amount after deducting the fair value of the Embedded Conversion Option from the issue price of the convertible bonds of 412,500 adjusted for transaction costs of 8,896. The host component is subsequently carried at the amortised cost using the effective interest method. As at December 31, 2011, the carrying value of the host component was 385,981 (December 31, 2010: 377,910).

There were no conversions of the bonds during the year ended December 31, 2011.

## 25) Post-Employment Benefits

The Group companies provide additional pensions and other post-employment benefits to their employees in accordance with collective bargaining agreements. Defined benefits consist of lump-sum amounts payable at the retirement date and certain regular post-retirement payments. These benefits generally depend on years of service, level of compensation and amount of pension payment under the collective bargaining agreement. The Group pays the benefits when they fall due for payment.

9.



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 25) Post-Employment Benefits (continued)

The following table summarises the components of net benefit expense recognised in the consolidated income statement and amounts recognised in the consolidated statement of financial position by country:

| | Russia | | Romania | | USA | | Total | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| *Movement in the benefit liability:* | | | | | | | | |
| At January 1 | 52,855 | 48,242 | 1,651 | 1,342 | 956 | – | 55,462 | 49,584 |
| Benefit expense | 3,371 | 6,136 | (47) | 595 | 707 | 458 | 4,031 | 7,189 |
| Benefit paid | (1,768) | (1,363) | (83) | (157) | (142) | – | (1,993) | (1,520) |
| Other | – | – | – | – | – | 498 | – | 498 |
| Currency translation adjustment | (2,962) | (160) | (9) | (129) | – | – | (2,971) | (289) |
| **At December 31** | **51,496** | **52,855** | **1,512** | **1,651** | **1,521** | **956** | **54,529** | **55,462** |
| **Short-term** | **2,596** | **1,772** | **97** | **78** | **–** | **–** | **2,693** | **1,850** |
| **Long-term** | **48,900** | **51,083** | **1,415** | **1,573** | **1,521** | **956** | **51,836** | **53,612** |
| *Net benefit expense (recognised in cost of sales, general and administrative expenses and selling and distribution expenses):* | | | | | | | | |
| Current service cost | 1,065 | 796 | 88 | 65 | 380 | 290 | 1,533 | 1,151 |
| Interest cost on benefit obligation | 2,092 | 1,807 | 150 | 121 | 55 | 30 | 2,297 | 1,958 |
| Net actuarial (gain)/loss recognised in the period | (484) | 3,363 | (263) | 202 | 272 | 138 | (475) | 3,703 |
| Past service cost | 698 | 170 | (22) | 207 | – | – | 676 | 377 |
| **Net benefit expense/(income)** | **3,371** | **6,136** | **(47)** | **595** | **707** | **458** | **4,031** | **7,189** |

The Group expects to contribute 2,693 to its defined post-employment benefit programme in 2012.

| | 2011 | 2010 |
|---|---|---|
| Present value of defined benefit obligation | 56,455 | 57,655 |
| Unrecognised past service cost | (1,926) | (2,193) |
| **Benefit liability as at December 31** | **54,529** | **55,462** |

The Group had no plan assets and unrecognised actuarial gains or losses in the year ended December 31, 2011.

The following table is a summary of the present value of the benefit obligation and experience adjustments as at December 31:

| | 2011 | 2010 |
|---|---|---|
| **Defined benefit obligation as at December 31** | **56,455** | **57,655** |
| Experience adjustments on plan liabilities | 325 | 4,120 |

The principal actuarial assumptions used in determining pension obligations for the Group's plan are shown below:

| | Russia | | Romania | | USA | |
|---|---|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| Discount rate | 8.31% | 7.96% | current 9.21%, decreasing to 4.38% in the long- term | current 8.74%, decreasing to 4.29% in the long- term | 4.85% | 5.75% |
| Average long-term rate of compensation increase | 6.7% | 6.3% | current 3.14%, changing to 3.5% in the long-term | current 5.5%, decreasing to 3.5% in the long-term | 3.5% | 3.5% |

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 26) Principal Subsidiaries

| Company | Location | Main activity | Actual ownership interest | Effective ownership interest | Actual ownership interest | Effective ownership interest |
|---|---|---|---|---|---|---|
| | | | December 31, 2011 | | December 31, 2010 | |
| OAO "Seversky Tube Works" | Russia | Manufacturing of seamless and welded steel pipes, steel billets | 94.63% | 94.63% | 94.37% | 94.37% |
| OAO "Sinarsky Pipe Plant" | Russia | Manufacturing of seamless steel pipes | 94.40% | 94.40% | 94.27% | 94.27% |
| OAO "Taganrog Metallurgical Works" | Russia | Manufacturing of seamless and welded steel pipes, steel billets | 96.13% | 96.13% | 96.10% | 96.10% |
| OAO "Volzhsky Pipe Plant" | Russia | Manufacturing of seamless and welded steel pipes, steel billets | 100.00% | 100.00% | 100.00% | 100.00% |
| OAO "Orsky Machine Building Plant" | Russia | Manufacturing of joints for drill pipes and other products | 75.00% | 75.00% | 75.00% | 75.00% |
| OOO "TMK-INOX" * | Russia | Manufacturing and sales of steel pipes | 51.00% | 48.15% | 53.00% | 49.97% |
| ZAO "TMK-CPW" * | Russia | Manufacturing of welded steel pipes | 51.00% | 48.26% | 51.00% | 48.13% |
| TOO "TMK-Kaztrubprom" | Kazakhstan | Manufacturing of seamless steel pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| IPSCO Tubulars Inc. | USA | Manufacturing of welded steel pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| IPSCO Koppel Tubulars, L.L.C. | USA | Manufacturing of seamless steel pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| IPSCO Tubulars (KY) Inc. | USA | Manufacturing of welded steel pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| IPSCO Tubulars (OK) Inc. | USA | Manufacturing of seamless and welded steel pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| Ultra Premium Oilfield Services, Ltd | USA | Manufacturing of premium pipes connections, services for oil and gas industries | 100.00% | 100.00% | 100.00% | 100.00% |
| S.C. TMK-ARTROM S.A. | Romania | Manufacturing of seamless steel pipes | 92.66% | 92.66% | 92.66% | 92.66% |
| S.C. TMK-RESITA S.A. | Romania | Manufacturing of steel billets | 100.00% | 100.00% | 100.00% | 100.00% |
| OOO "TMK-Premium Services" | Russia | Promotion and development of premium connections | 100.00% | 100.00% | 100.00% | 100.00% |
| ZAO "Trade House TMK" | Russia | Sales & distribution of pipes, raw materials procurement | 100.00% | 100.00% | 100.00% | 100.00% |
| OOO "Skladskoy Kompleks TMK" | Russia | Sales & distribution of pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| TOO "TMK-Kazakhstan" | Kazakhstan | Sales & distribution of pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| TMK Global S.A. | Switzerland | Sales & distribution of pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| TMK Europe GmbH | Germany | Sales & distribution of pipes, raw materials and equipment procurement | 100.00% | 100.00% | 100.00% | 100.00% |
| TMK Italia s.r.l. | Italy | Sales & distribution of pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| TMK Middle East FZCO | UAE | Sales & distribution of pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| TMK North America Inc. | USA | Sales & distribution of pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| TMK IPSCO INTERNATIONAL, L.L.C. | USA | Sales & distribution of pipes | 100.00% | 100.00% | 0.00% | 0.00% |
| TMK IPSCO Canada, Ltd. | Canada | Sales & distribution of pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| TMK Africa Tubulars (PTY) Ltd. | South Africa | Sales & distribution of pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| OOO "Predpriyatiye "Truboplast" | Russia | Coating of pipes | 100.00% | 100.00% | 100.00% | 100.00% |
| ZAO "Pipe Repair Department" | Russia | Services for oil and gas industries | 100.00% | 100.00% | 100.00% | 100.00% |
| OOO "Central Pipe Yard" | Russia | Services for oil and gas industries | 100.00% | 100.00% | 100.00% | 100.00% |
| OAO "Russian Research Institute of the Tube and Pipe Industries" | Russia | In-house R&D facility | 97.36% | 97.36% | 97.36% | 97.36% |
| OAO "Sinarskaya heat and power plant" | Russia | Heat and electrical energy production | 68.79% | 64.93% | 68.79% | 64.85% |
| TMK HYDROENERGY POWER S.R.L. | Romania | Electrical energy production | 0.00% | 0.00% | 100.00% | 100.00% |
| OOO "TMK Metallurgical Service" | Russia | Maintenance and repair of equipment | 0.00% | 0.00% | 100.00% | 94.37% |
| TMK NSG, L.L.C. (former NS Group, Inc.) | USA | Holding company of US assets | 100.00% | 100.00% | 100.00% | 100.00% |
| UPOS GP, L.L.C. | USA | Holding company of US assets | 100.00% | 100.00% | 100.00% | 100.00% |
| UPOS, L.L.C. | USA | Holding company of US assets | 100.00% | 100.00% | 100.00% | 100.00% |
| Blytheville Finance Corporation | USA | Financial investments | 100.00% | 100.00% | 100.00% | 100.00% |
| Rockarrow Investments Ltd. | Cyprus | Stock servicing | 100.00% | 100.00% | 100.00% | 100.00% |
| TMK Capital S.A. | Luxembourg | Financing (SPV) | 0.00% | 0.00% | 0.00% | 0.00% |
| TMK Bonds S.A. | Luxembourg | Financing (SPV) | 0.00% | 0.00% | 0.00% | 0.00% |
| OOO "Pokrovka 40" | Russia | Assets holding | 100.00% | 100.00% | 100.00% | 100.00% |
| OOO "TMK Oilfield Services" | Russia | Management services | 100.00% | 100.00% | 100.00% | 100.00% |
| OOO "Accounting services center" | Russia | Accounting shared-services | 100.00% | 100.00% | 100.00% | 100.00% |
| OOO "Blagoustroystvo" | Russia | Services | 100.00% | 100.00% | 100.00% | 100.00% |
| OOO "SinaraTransAvto" | Russia | Services | 100.00% | 94.40% | 100.00% | 94.27% |
| OOO "TMK-Trans" | Russia | Logistics | 100.00% | 100.00% | 100.00% | 100.00% |

* The Group recorded a liability under put option in the consolidated financial statements

Actual ownership interest in subsidiaries differs from the effective ownership interests due to the existence of non-controlling interests in subsidiaries that hold ownership interest in other subsidiaries.

9.



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 27) Related Parties Disclosures

For the purposes of the financial statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions. In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

The nature of the related party relationships for those related parties with whom the Group entered into significant transactions or had significant balances outstanding as at December 31, 2011 and 2010 are detailed below.

*Transactions with the Parent Company and Entities with Significant Influence*

As at December 31, 2010, the Group had a liability of 5,300 in respect of the guarantee provided by Bravecorp Limited (an entity under common control with the parent company, TMK Steel Limited). During the year ended December 31, 2011, the Group settled a liability in full amount.

In June 2011, the Group approved the distribution of final dividends in respect of 2010 year, from which 555,274 thousand Russian roubles (19,588 at the exchange rate at the date of approval) related to TMK Steel Limited, Bravecorp Limited and Tirelli Holdings Limited (entities under common control with TMK Steel Limited).

In November 2011, the Group approved the distribution of interim dividends in respect of six months 2011, from which 607,536 thousand Russian roubles (19,697 at the exchange rate at the date of approval) related to TMK Steel Limited, Bravecorp Limited and Tirelli Holdings Limited.

The Group paid final dividends in respect of 2010 year and interim dividends in respect of six months 2011 to TMK Steel Limited, Bravecorp Limited and Tirelli Holdings Limited in full amount as at December 31, 2011.

*Transactions with Associates*

During the year ended December 31, 2011, the Group rendered services to its associates and received services from its associates in the amounts of 415 and 532, respectively (2010: nil).

*Compensation to Key Management Personnel of the Group*

Key management personnel comprise members of the Board of Directors, the Management Board and certain executives of the Group, totaling 29 persons as at December 31, 2011 (28 persons as at December 31, 2010).

The Group provides compensation to key management personnel only in the form of short-term employee benefits, which include:

- Wages, salaries, social security contributions and other benefits in the amount of 15,211 for the year ended December 31, 2011 (2010: 9,136);
- Provision for performance bonuses which are dependent on operating results for 2011 year in the amount of 4,335 for the year ended December 31, 2011 (2010: 3,086).

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 27) Related Parties Disclosures (continued)

*Compensation to Key Management Personnel of the Group (continued)*

The amounts disclosed above are recognised as general and administrative expenses in the income statement during the reporting period.

In the years ended December 31, 2011 and 2010, the Group did not provide compensation to key management personnel in the form of post-employment benefits, other long-term benefits, share-based payment or termination benefits.

The balance of loans issued to key management personnel amounted to 1,103 as at December 31, 2011 (December 31, 2010: 396).

The Group guaranteed debts of key management personnel outstanding as at December 31, 2011 in the amount of 2,574 with maturity in 2014 – 2017 (December 31, 2010: 3,368).

In 2010, the Group paid 2,494 to the member of key management personnel for the guarantee issued.

*Transactions with Other Related Parties*

The following table provides balances with other related parties as at December 31:

| | 2011 | 2010 |
|---|---|---|
| Cash and cash equivalents | 125,687 | 47,151 |
| Accounts receivable | 5,417 | 3,305 |
| Prepayments | 109 | 90 |
| Accounts payable | (733) | (2,157) |
| Interest payable | – | (977) |

The following table provides the total amount of transactions with other related parties for the year ended December 31:

| | 2011 | 2010 |
|---|---|---|
| Sales revenue | 12,440 | 4,718 |
| Purchases of goods and services | 8,700 | 7,576 |
| Interest income from loans and borrowings | 614 | 521 |
| Interest expenses from loans and borrowings | 235 | 460 |

In the year ended December 31, 2011, sales transactions with related parties constituted approximately 0.18% of the total Group's sales (2010: 0.08%).

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 28) Contingencies and Commitments

*Operating Environment of the Group*

Significant part of the Group's principal assets are located in the Russian Federation and USA, therefore its significant operating risks are related to the activities of the Group in these countries.

In the wake of the global financial crisis, all countries continue to face an uneven economic recovery. Despite the stabilisation measures introduced by the Russian Government in 2011 there continues to be uncertainty regarding further economic growth which could negatively affect the Group's future financial position, results of operations and business prospects.

The US economy is recovering slower than expected, and the economic growth slowed-down starting the second quarter of 2011. An uncertainty over the US economic growth could have a negative impact on the Group's future financial position, results of operations and business prospects.

While management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Group's results and financial position in a manner not currently determinable.

*Taxation*

Tax, currency and customs legislation is subject to varying interpretations and changes, which can occur 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. 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.

Recent events within the Russian Federation suggest that the tax authorities are taking a 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. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavourable outcome. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

Up to the date of authorisation of these consolidated financial statements for issuance, the court proceedings had not been finalised for the claims in the amount of 36,807 thousand Russian roubles (1,143 at the exchange rate as at December 31, 2011). Management believes that the Group's position is justified and it is not probable that the ultimate outcome of these matters will result in additional losses for the Group. Consequently, the amounts of tax claims being contested by the Group were not accrued in the consolidated financial statements for the year ended December 31, 2011.



*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 28) Contingencies and Commitments (continued)

*Contractual Commitments and Guarantees*

As at December 31, 2011, the Group had contractual commitments for the acquisition of property, plant and equipment from third parties for 3,884,084 thousand Russian roubles (120,638 at the exchange rate as at December 31, 2011), 35,551 thousand Euros (46,014 at the exchange rate as at December 31, 2011), 489 thousand Romanian lei (147 at the exchange rate as at December 31, 2011) and 26,155 thousand US dollars for the total amount of 192,954 (all amounts of contractual commitments are expressed net of VAT). The Group had paid advances of 80,389 with respect to such commitments (2010: 29,774).

Under contractual commitments disclosed above, the Group opened unsecured letters of credit in the amount of 8,739 (2010: 8,330).

*Insurance Policies*

The Group currently maintains insurance against losses that may arise in case of property damage, accidents, transportation of goods. The Group also maintains corporate product liability and directors and officers liability insurance policies. Nevertheless, any recoveries under maintained insurance coverage that may be obtained in the future may not offset the lost revenues or increased costs resulting from a disruption of operations.

*Legal Claims*

During the period, the Group was involved in a number of court proceedings (both as a plaintiff and a defendant) arising in the ordinary course of business. Management believes there are no current legal proceedings or other claims outstanding, which could have a material effect on the result of operations or financial position of the Company.

*Guarantees of Debts of Others*

The Group guaranteed debts of others outstanding as at December 31, 2011 in the amount of 3,378 (December 31, 2010: 4,664).

## 29) Equity

*i) Share Capital*

| | 2011 | 2010 |
|---|---|---|
| **Number of shares** | | |
| *Authorised, issued and fully paid* | | |
| *Ordinary shares of 10 Russian roubles each* | | |
| As at January 1 | 937,586,094 | 873,001,000 |
| Share capital increase | – | 64,585,094 |
| As at December 31 | **937,586,094** | **937,586,094** |

## 29) Equity (continued)

*i) Share Capital (continued)*

On February 5, 2010, the Board of Directors authorised an increase of share capital.

In June 2010, the Group received 8,589,818 thousand Russian roubles (279,427 at the historical exchange rate) as consideration from shareholders for the issuance of 64,585,094 shares with par value of 10 Russian roubles each at price of 133 Russian roubles per share.

On November 30, 2010, the Group finalised the increase of share capital by 64,585,094 shares with par value of 10 Russian roubles each by means of an open subscription at price of 133 Russian roubles per share. Number of shares subscribed represented approximately 7.4% of the Company's issued and fully paid share capital before additional issue. After completion of the share capital increase, the total number of the issued and fully paid shares was 937,586,094.

*ii) Reserve Capital*

According to Russian Law, the Company must create a reserve capital in the amount of 5% of the share capital per the Russian statutory accounts by annual appropriations that should be at least 5% of the annual net profit per the Russian statutory financial statements. The reserve capital can be used only for covering losses and for the redemption of the Company's bonds and purchase of its own shares if there are no other sources of financing.

In 2011 the Company reported net profit in Russian statutory accounts (net loss in 2010) and subsequently increased reserve capital by 32,292 Russian roubles (1,003 at the exchange rate as at December 31, 2011) to the amount of 5% of the share capital per the Russian statutory accounts.

*iii) Dividends Declared by the Parent Entity to its Shareholders*

On June 28, 2011, the annual shareholder meeting approved final dividends in respect of 2010 year in the amount of 796,948 thousand Russian roubles (28,113 at the exchange rate at the date of approval) or 0.85 Russian roubles per share (0.03 US dollars per share), from which 60,839 thousand Russian roubles (2,146 at the exchange rate at the date of approval) related to the treasury shares in possession of the Group.

On November 7, 2011, the extraordinary shareholders' meeting approved interim dividends in respect of six months 2011 in the amount of 871,955 thousand Russian roubles (28,270 at the exchange rate at the date of approval) or 0.93 Russian roubles per share (0.03 US dollars per share), from which 69,211 thousand Russian roubles (2,244 at the exchange rate at the date of approval) related to the treasury shares in possession of the Group.

In accordance with Russian legislation, dividends may only be declared to the shareholders from accumulated undistributed and unreserved earnings as shown in the Company's Russian statutory financial statements. The Company had 246,033 of undistributed and unreserved earnings recognised in Russian statutory financial statements as at December 31, 2011. In addition, the Group's share in the undistributed and unreserved earnings of its subsidiaries was 1,322,904 as at December 31, 2011.



## 29) Equity (continued)

*iv) Acquisition of Non-controlling Interests in Subsidiaries*

In the year ended December 31, 2011, the Company purchased additional 0.26% of OAO "Seversky Tube Works" shares, 0.13% of OAO "Sinarsky Pipe Plant" shares, 0.03% of OAO "Taganrog Metallurgical Works" shares. The total cash consideration for the shares amounted to 1,374.

The excess in the amount of 14 of the consideration given for the shares over the carrying values of net assets attributable to interest in OAO "Taganrog Metallurgical Works" was charged to accumulated profit. The excess in the amount of 439 of the carrying values of net assets attributable to interest in OAO "Seversky Tube Works" and OAO "Sinarsky Pipe Plant" over the consideration paid for such non-controlling interest is recorded in additional paid-in capital.

In the year ended December 31, 2010, the Company purchased additional 0.15% of OAO "Seversky Tube Works" shares, 0.11% of OAO "Sinarsky Pipe Plant" shares, 0.04% of OAO "Taganrog Metallurgical Works" shares and 49% ownership interest in OOO "TMK Metallurgical Service". The total cash consideration for the shares amounted to 1,254.

The excess in the amount of 144 of the consideration given for the shares over the carrying values of net assets attributable to interest in OAO "Seversky Tube Works", OAO "Sinarsky Pipe Plant" and OAO "Taganrog Metallurgical Works" was charged to accumulated profit. The excess in the amount of 478 of the carrying values of net assets attributable to interest in OAO "Seversky Tube Works" over the consideration paid for such non-controlling interest is recorded in additional paid-in capital.

*v) Sale of Non-controlling Interests*

In December 2010, the Group increased share capital of OOO "TMK-INOX". The share capital increase was partially financed by the non-controlling interest shareholder. Cash consideration received from the non-controlling interest shareholder amounted to 1,000 million Russian roubles (32,939 at historical exchange rate). As a result of the transaction, the ownership interest of the Group in OOO "TMK-INOX" decreased and amounted to 53.00%. The difference between the consideration received and the carrying values of net assets attributable to non-controlling interest in the amount of 741 was charged to accumulated profit. As non-controlling interest shareholder has a right to sell its ownership interest to the Group under certain circumstances beyond the Group's control starting 2018, the Group recognised the amount of 20,015 at the exchange rate as at December 31, 2010 as a liability to non-controlling interest shareholder under put option and included it in other non-current liabilities. As at December 31, 2011, the fair value of liability under put option was reassessed by the Group and amounted to 20,898.

(All amounts are in thousands of US dollars, unless specified otherwise)

## 29) Equity (continued)

*v) Sale of Non-controlling Interests (continued)*

In the year ended December 31, 2011, the Group increased share capital of OOO “TMK-INOX”. The share capital increase was partially financed by the non-controlling interest shareholder. Cash consideration received from the non-controlling interest shareholder amounted to 298,500 thousand Russian roubles (9,265 at historical exchange rate). As a result of the transaction, the ownership interest of the Group in OOO “TMK-INOX” decreased to 51.00%. The difference between the consideration received and the carrying values of net assets attributable to non-controlling interests in the amount of 42 was charged to accumulated profit.

*vi) Recognition of the Change in Non-controlling Interests in the Subsidiary as an Equity Transaction*

In the year ended December 31, 2011, the increase of non-controlling interests in OOO “TMK-INOX” amounted to 9,609, including 302 of the non-controlling interest’s share of profit, net of dividends attributable to the non-controlling interest shareholder (2010 year: 13,587 and nil, respectively). This amount was recognised in additional paid-in capital.

*vii) Contributions from Non-controlling Interest Owners*

In 2010, the Group established a new subsidiary, OAO “Sinarskaya heat and power plant”. The 31.21% ownership interest in OAO “Sinarskaya heat and power plant” was acquired by a third party for 700 million Russian roubles (23,124 at historical exchange rate). As a result of the transaction, the Group’s ownership interest in OAO “Sinarskaya heat and power plant” amounted to 68.79%. As at the date of the transaction, the Group recognised non-controlling interest in the amount of 23,124.

*viii) Increase in Non-controlling Interests from Contribution of Assets by the Group*

During the year ended December 31, 2011, the Group made additional contribution of assets to the capital of OAO “Sinarskaya heat and power plant”. As a result of the transaction, net assets attributable to non-controlling interests increased by 202. The effect of the increase of non-controlling interests in the amount of 202 was charged to accumulated profit.

*ix) Dividends Declared by Subsidiaries of the Group to the Non-controlling Interest Owners*

During the years ended December 31, 2011 and 2010, the Group’s subsidiaries declared dividends to the non-controlling interest owners in the amounts of 338 and 8, respectively.



## 29) Equity (continued)

*x) Hedges of Net Investment in Foreign Operations*

At the date of the acquisition of controlling interests in NS Group, Inc. and IPSCO Tubulars, Inc. the Group hedged its net investment in these operations against foreign currency risk using borrowings in US dollars made by Russian companies of the Group. As at December 31, 2011, the Group designated US dollar denominated loans in the amount of 1,158,610 (December 31, 2010: 1,158,610) as the hedging instrument. The aim of the hedging was to eliminate foreign currency risk associated with the repayment of these liabilities resulting from changes in US dollar/Russian rouble spot rates.

The effectiveness of the hedging relationship was tested using the dollar offset method by comparing the cumulative gains or losses due to changes in US dollar/Russian rouble spot rates on the hedging instrument and on the hedged item. In the year ended December 31, 2011, the effective portion of net losses from spot rate changes in the amount of 1,991,882 thousand Russian roubles (67,772 at historical exchange rates), net of income tax benefit of 398,376 thousand Russian roubles (13,554 at historical exchange rates), was recognised in other comprehensive income (foreign currency translation reserve).

*xi) Treasury Shares*

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Number of shares | Cost | Number of shares | Cost |
| Outstanding as at January 1 | 71,575,796 | 318,351 | 7,097,364 | 37,378 |
| Purchased during the period | 2,844,700 | 8,988 | 64,478,432 | 280,973 |
| **Outstanding as at December 31** | **74,420,496** | **327,339** | **71,575,796** | **318,351** |

In the year ended December 31, 2011, the Group purchased 2,844,700 shares of the Company for 8,988. As at December 31, 2011, the Group owned 74,420,496 treasury shares.

In the year ended December 31, 2010, the Group purchased 64,478,432 shares of the Company from TMK Steel for 280,973 (including transaction fees of 2,000).

In order to facilitate the issuance of the convertible bonds, investment banks offered to certain institutional investors an opportunity to borrow GDRs of OAO TMK during the term of the bonds.

## 30) Financial Risk Management Objectives and Policies

The Group’s principal financial liabilities comprise bank loans, bonds issued, trade payables, liabilities under put options of non-controlling interest shareholders in subsidiaries and finance leases. The main purpose of these financial liabilities is to raise finance for the Group’s operations. The Group has various financial assets such as trade receivables and cash and deposits, which arise directly from its operations.

In the course of its business, the Group is exposed to a number of financial risks: market risk (including interest rate risk, foreign currency risk and other price risk), liquidity risk and credit risk. The presented information shows susceptibility of the Group concerning each of these risks. The Board of Directors reviews and establishes policies for managing each of these risks which are summarised below.

(All amounts are in thousands of US dollars, unless specified otherwise)

## 30) Financial Risk Management Objectives and Policies (continued)

*Market Risk*

The Group is exposed to risk from movements in interest rates, foreign currency exchange rates and market prices that affect its assets, liabilities and anticipated future transactions. The objective of market risk management is to manage and control market risk exposures, while optimising the return on the risk.

*Interest Rate Risk*

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Group's interest rate risk management policy is to minimise risk with the aim to achieve financial structure objectives defined and approved in the management's plans. Borrowing requirements of the Group's companies are pooled by the Group's central finance department in order to manage net positions and the funding of portfolio developments consistently with management's plans while maintaining a level of risk exposure within prescribed limits.

The Group borrows on both a fixed and variable rate basis. EURIBOR and LIBOR served as the basis for the calculation of interest rates on loans with variable rate. These loans accounted for 16% of the total loan portfolio at the end of 2011 (8% at the end of 2010). The Group considers such risks as not significant and is not using instruments to hedge such interest-rate risks at present. Nevertheless, the Group monitors interest rates and will use instruments to hedge such risk as necessary.

The Group does not have any financial assets with variable interest rate.

The following table demonstrates the sensitivity to reasonably possible changes in interest rates, with all other variables held constant, of the Group's profit before tax (through the impact on floating rate borrowings).

| | Basis points | Effect on profit before tax |
|---|---|---|
| **As at December 31, 2011** | | |
| Increase in LIBOR | 15 | (660) |
| Decrease in LIBOR | (15) | 660 |
| Increase in EURIBOR | 15 | (262) |
| Decrease in EURIBOR | (15) | 262 |
| **As at December 31, 2010** | | |
| Increase in LIBOR | 100 | (1,126) |
| Decrease in LIBOR | (25) | 281 |
| Increase in EURIBOR | 100 | (1,792) |
| Decrease in EURIBOR | (25) | 448 |

*Foreign Currency Risk*

The Group's exposure to currency risk relates to sales, purchases and borrowings that are denominated in a currency other than the respective functional currencies of the Group's subsidiaries, and the Group's net investments in foreign operations. The currencies in which these transactions and balances primarily denominated are US dollars and Euro.



## 30) Financial Risk Management Objectives and Policies (continued)

*Foreign Currency Risk (continued)*

The Group's exposure to currency risk determined as the net monetary position in respective currencies was as follows as at December 31:

| | 2011 | 2010 |
|---|---|---|
| USD/RUR (*) | (1,336,893) | (1,457,948) |
| EUR/RUR | (198,643) | (323,931) |
| EUR/USD | (17,634) | 21,467 |
| USD/RON | (11,445) | (90,967) |
| EUR/RON | (70,128) | (5,541) |
| KZT/RUR | 5,621 | 4,544 |
| USD/CAD | 600 | – |

* As disclosed in Note 29 the Group hedged its net investments in foreign operations against foreign currency risk using borrowings in US dollars made by Russian companies of the Group. The net monetary position in USD/RUR included the hedging instruments in the amount of 1,158,610 (2010: 1,158,610) which exposure to currency risk is reflected directly in other comprehensive income.

The Group hedges its exposure to currency risk related to Euro denominated sales of Romanian subsidiaries using EUR/RON forward contracts. The fair value of these forward contracts in the amount of 3 was included in other financial assets as at December 31, 2011.

The Group doesn't have other formal arrangements to manage currency risks of the Group's operations and balances. However, the Group seeks to bring its financial liabilities in foreign currency in line with export net sales, thus mitigating currency risk.

The following table demonstrates the sensitivity to reasonably possible changes in the respective currencies, with all other variables held constant, of the Group's profit before tax and other comprehensive income. In estimating reasonably possible changes for 2011 and 2010 the Group assessed the volatility of foreign exchange rates during the three years preceding the end of the reporting period.

| | As at December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Volatility range | | Effect on Income Statement | | Effect on Statement of Comprehensive Income | |
| | Low | High | Low | High | Low | High |
| USD/RUR | 12.57% | -12.57% | (22,410) | 22,410 | (145,637) | 145,637 |
| EUR/RUR | 9.96% | -9.96% | (19,785) | 19,785 | – | – |
| EUR/USD | 11.44% | -11.44% | (2,017) | 2,017 | – | – |
| USD/RON | 14.24% | -14.24% | (1,630) | 1,630 | – | – |
| EUR/RON | 5.04% | -5.04% | (3,537) | 3,537 | – | – |
| KZT/RUR | 16.88% | -16.88% | 949 | (949) | – | – |
| USD/CAD | 11.61% | -11.61% | 70 | (70) | – | – |

| | As at December 31, 2010 | | | | | |
|---|---|---|---|---|---|---|
| | Volatility range | | Effect on Income Statement | | Effect on Statement of Comprehensive Income | |
| | Low | High | Low | High | Low | High |
| USD/RUR | 11.91% | -11.91% | (35,651) | 35,651 | (137,990) | 137,990 |
| EUR/RUR | 10.07% | -10.07% | (32,620) | 32,620 | – | – |
| EUR/USD | 11.75% | -11.75% | 2,522 | (2,522) | – | – |
| USD/RON | 16.49% | -16.49% | (15,000) | 15,000 | – | – |
| EUR/RON | 7.85% | -7.85% | (435) | 435 | – | – |
| KZT/RUR | 12.57% | -12.57% | 571 | (571) | – | – |

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## 30) Financial Risk Management Objectives and Policies (continued)

*Other Price Risk*

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

The Group's exposure to other price risk relates to changes of the fair value of its derivative financial instrument as a result of fluctuations of GDR's quotations. The Group manages its exposure to other price risk by holding treasury shares in the quantity corresponding to the number of shares in which convertible bonds are convertible.

The reasonably possible changes in the price of underlying GDRs, with all other variables held constant, would have an effect on the Group's profit before tax. In estimating reasonably possible fluctuations of GDR's quotations, the Group assessed the volatility of GDRs during the year ended December 31, 2011. A 43.69% increase to the value of GDR as at December 31, 2011 would reduce profit before tax by 12,065. A 43.69% decrease from the value of GDR as at December 31, 2011 would result in the increase of profit before tax by 2,898.

*Liquidity Risk*

Liquidity risk arises when the Group encounters difficulties to meet commitments associated with liabilities and other payment obligations. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group manages liquidity risk by targeting an optimal ratio between equity and total debt consistent with management plans and business objectives. This enables the Group to maintain an appropriate level of liquidity and financial capacity as to minimise borrowing expenses and to achieve an optimal profile of composition and duration of indebtedness. The Group has access to a wide range of funding at competitive rates through the capital markets and banks and coordinates relationships with banks centrally. At present, the Group believes it has access to sufficient funding and has also both committed and uncommitted borrowing facilities to meet currently foreseeable borrowing requirements.

Effective management of the liquidity risk has the objective of ensuring both availability of adequate funding to meet short-term requirements and due obligations, and a sufficient level of flexibility in order to fund the development plans of the Group's business, maintaining an adequate finance structure in terms of debt composition and maturity. This implies the adoption of a strategy for pursuing an adequate structure of borrowing facilities (particularly availability of committed borrowings facilities) and the maintenance of cash reserves.

OAO TMK
Notes to the Consolidated Financial Statements (continued)
*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 30) Financial Risk Management Objectives and Policies (continued)

*Liquidity Risk (continued)*

The table below summarises the maturity profile of the Group's financial liabilities based on contractual undiscounted payments, including interest payments:

| **As at December 31, 2011** | **Less than 3 months** | **3 to 12 months** | **1 to 2 years** | **2 to 3 years** | **3 to 4 years** | **> 4 years** | **Total** |
|---|---|---|---|---|---|---|---|
| Trade and other payables | 716,807 | 5,521 | – | – | – | – | **722,328** |
| Accounts payable to related parties | 733 | – | – | – | – | – | **733** |
| Interest-bearing loans and borrowings: | | | | | | | |
| Principal | 143,427 | 430,238 | 794,855 | 697,143 | 326,800 | 1,413,894 | **3,806,357** |
| Interest | 73,454 | 178,888 | 204,430 | 140,586 | 109,790 | 147,356 | **854,504** |
| Dividends payable | 323 | – | – | – | – | – | **323** |
| Liabilities under put options of non-controlling interest shareholders in subsidiaries | 14,051 | – | – | – | – | – | **14,051** |
| Other non-current liabilities | – | – | 403 | 595 | 1,129 | 30,398 | **32,525** |
| | **948,795** | **614,647** | **999,688** | **838,324** | **437,719** | **1,591,648** | **5,430,821** |

| **As at December 31, 2010** | **Less than 3 months** | **3 to 12 months** | **1 to 2 years** | **2 to 3 years** | **3 to 4 years** | **> 4 years** | **Total** |
|---|---|---|---|---|---|---|---|
| Trade and other payables | 617,862 | 5,171 | – | – | – | – | **623,033** |
| Accounts payable to related parties | 7,457 | 977 | – | – | – | – | **8,434** |
| Interest-bearing loans and borrowings: | | | | | | | |
| Principal | 346,061 | 332,978 | 429,252 | 822,783 | 560,812 | 1,407,200 | **3,899,086** |
| Interest | 91,411 | 207,935 | 238,268 | 189,386 | 139,254 | 171,767 | **1,038,021** |
| Dividends payable | 261 | 169 | – | – | – | – | **430** |
| Liabilities under put options of non-controlling interest shareholders in subsidiaries | 14,934 | – | – | – | – | – | **14,934** |
| Other non-current liabilities | – | – | 599 | 1,040 | 466 | 29,915 | **32,020** |
| | **1,077,986** | **547,230** | **668,119** | **1,013,209** | **700,532** | **1,608,882** | **5,615,958** |

*Credit Risk*

Credit risk is the potential exposure of the Group to losses that would be recognised if counterparties failed to perform or failed to pay amounts due. Financial instruments that potentially expose the Group to concentrations of credit risk consist primarily of cash and trade accounts receivable.

The credit risk arising from the Group's normal commercial operations is controlled by each operating unit within Group-approved procedures for evaluating the reliability and solvency of each counterparty, including receivable collection. The monitoring activity of credit risk exposure is performed at the Group level according to set guidelines and measurement techniques to qualify and monitor counterparty risk.

9.



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 30) Financial Risk Management Objectives and Policies (continued)

*Credit Risk (continued)*

The Group sells goods to some of the biggest Russian and international companies on credit terms. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures.

As at December 31, 2011, accounts receivable from the three biggest debtors of the Group amounted to 256,961 (December 31, 2010: 234,055). Management determines concentration by reference to receivables from particular customers as percentage of total accounts receivable.

The maximum exposure to credit risk is equal to the carrying amount of financial assets, which are disclosed below:

| | 2011 | 2010 |
|---|---|---|
| Cash and cash equivalents | 230,593 | 157,524 |
| Trade and other receivables | 766,226 | 716,940 |
| Accounts receivable from related parties | 5,417 | 3,305 |
| Other financial assets | 4,047 | 3,966 |
| Other | 13,690 | 7,016 |
| | **1,019,973** | 888,751 |

The ageing analysis of trade and other receivables, accounts receivable from related parties and other financial assets is presented in the table below:

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | **Gross amount** | **Impairment** | **Gross amount** | **Impairment** |
| Current Trade and other receivables - not past due | 636,820 | (2,345) | 578,481 | (292) |
| Current Trade and other receivables - past due | | | | |
| less than 30 days | 77,758 | (990) | 65,141 | (43) |
| between 30 and 90 days | 24,139 | (3,489) | 33,412 | (229) |
| over 90 days | 59,220 | (24,958) | 57,799 | (17,372) |
| Accounts receivable from related parties - not past due | 5,417 | – | 3,305 | – |
| Non-current Trade and other receivables - not past due | 71 | – | 54 | (11) |
| Other - not past due | 13,690 | – | 7,016 | – |
| | **817,115** | **(31,782)** | **745,208** | **(17,947)** |

Movement in allowance for doubtful debts was as follows:

| | 2011 | 2010 |
|---|---|---|
| Balance at the beginning of the year | 17,947 | 15,172 |
| Utilised during the year | (3,431) | (2,347) |
| Additional increase in allowance | 19,551 | 5,420 |
| Currency translation adjustment | (2,285) | (298) |
| **Balance at the end of the year** | **31,782** | **17,947** |

OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 30) Financial Risk Management Objectives and Policies (continued)

*Capital Management*

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximise the return to shareholders. The Board of directors reviews the Group's performance and establishes key performance indicators. In addition, the Group is subject to externally imposed capital requirements (debt covenants) which are used for capital monitoring. Through 2011, the Group was in compliance with such externally imposed capital requirements. The Group met its objectives for managing capital.

Capital includes equity attributable to the equity holders of the parent entity.

The Group manages its capital structure and adjusts it by issue of new shares, dividend payments to shareholders, purchase of treasury shares. The Group monitors the compliance of the amount of legal reserve with the statutory requirements and makes appropriations of profits to legal reserve. In addition, the Group monitors distributable profits on a regular basis and determines the amounts and timing of dividend payments.

*Fair Value of Financial Instruments*

The carrying amounts of financial instruments, such as cash and cash equivalents, short-term and long-term investments, short-term accounts receivable and short-term loans approximate their fair value.

The following table shows financial instruments which carrying amounts differ from fair values:

| | As at December 31, 2011 | | As at December 31, 2010 | |
|---|---|---|---|---|
| | **Net carrying amount** | **Fair Value** | **Net carrying amount** | **Fair Value** |
| **Financial Liabilities** | | | | |
| Fixed rate long term bank loans | 1,778,324 | 1,776,743 | 2,471,628 | 2,469,174 |
| Variable rate long term bank loans | 467,749 | 439,413 | 244,378 | 242,660 |
| Bonds due 2013 | 155,298 | 155,143 | 164,059 | 165,371 |
| Bonds due 2011 | – | – | 164,059 | 165,010 |
| 5.25 per cent convertible bonds liability | 388,508 | 384,054 | 382,216 | 404,123 |
| 7.75 per cent loan participation notes due 2018 | 500,000 | 429,690 | – | – |
| 10 per cent loan participation notes due 2011 | – | – | 186,700 | 193,261 |

The fair value of the bonds and notes was determined based on market quotations. The fair value of fixed-rate bank loans was calculated based on the present value of future principal and interest cash flows, discounted at prevailing interest rates of 9%, 7% and 5% per annum for loans denominated in Russian rouble, US dollar and Euro, respectively, as at December 31, 2011 (9%, 8% and 5% per annum for loans denominated in Russian rouble, US dollar and Euro, respectively, as at December 31, 2010).

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

9.



OAO TMK

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of US dollars, unless specified otherwise)*

## 30) Financial Risk Management Objectives and Policies (continued)

*Fair Value of Financial Instruments (continued)*

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly;

Level 3: techniques which use inputs that have a significant effect on the recorded fair value that are not based on observable market data.

As at December 31, 2011 and 2010, the Group held the following financial instruments measured at fair value:

| | 2011 | Level 2 | 2010 | Level 2 |
|---|---|---|---|---|
| **Liabilities measured at fair value** | | | | |
| Derivative financial instrument | 3,024 | 3,024 | 47,816 | 47,816 |

During the reporting period, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

## 31) Subsequent Events

*Bank Loans*

In January 2012, the Group fully repaid a short-term loan from Gazprombank in the principal amount of 36,660 in accordance with the terms of the loan agreement.

# MAJOR TRANSACTIONS

## AND RELATED PARTY TRANSACTIONS EXECUTED BY OAO TMK IN 2011

# 10. MAJOR TRANSACTIONS

## AND RELATED PARTY TRANSACTIONS EXECUTED BY OAO TMK IN 2011

### *Major Transactions*

Approved by the Board of Directors of OAO TMK

| *#* | *Parties to the Transaction* | *Subject of the Transaction and Essential Conditions* |
|---|---|---|
| 1 | Lender — TMK Capital S.A;<br>Borrower — OAO TMK | The Lender transfers the ownership of the funds with interest payments and a commission to the Borrower.<br>Subsidiaries of OAO TMK provide their surety.<br>The size of the transaction in monetary terms: RUB 23,123,049,360.<br>Deadline for the fulfillment of obligations under the transaction: Jan. 27, 2018 |

### *Related Party Transactions*

All translations with related parties were carried out on market conditions.

Transactions approved by the General Meeting of Shareholders of OAO TMK.

| *#* | *Parties to the Transaction* | *Subject of the Transaction and Main Terms* | *Related Parties* |
|---|---|---|---|
| 1 | Bank — OAO Bank VTB;<br>Principal — ZAO TMK Trade House,<br>Guarantor — OAO TMK | The Surety agreement provided to the bank to secure the obligations of the Principal under the Agreement of Bank Guarantee.<br>Amount — RUB 143,800.<br>Period — 05.06.2014 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Eskindarov, M.A., Shiryaev, A.G.;*<br>Members of the Management Board:<br>*Semerikov, K.A., Petrosyan, T.I.* |
| 2 | Bank — OAO Bank VTB;<br>Principal — ZAO TMK Trade House,<br>Guarantor — OAO TMK | The Surety agreement provided to the bank to secure the obligations of the Principal under the Agreement of Bank Guarantee.<br>Amount — RUB 73,530,520 .<br>Period — 15.05.2014 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Eskindarov, M.A., Shiryaev, A.G.;*<br>Members of the Management Board:<br>*Semerikov, K.A., Petrosyan, T.I.* |

# 10.

| # | *Parties to the Transaction* | *Subject of the Transaction and Main Terms* | *Related Parties* |
|---|---|---|---|
| 3 | Bank — OAO Bank VTB;<br>Principal — ZAO TMK Trade House,<br>Guarantor — OAO TMK | The Surety agreement provided to the bank to secure the obligations of the Principal under the Agreement of Bank Guarantee.<br>Amount — RUB 51,767,544.<br>Period— 09.06.2014 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Eskindarov, M.A., Shiryaev, A.G.;*<br>Members of the Management Board:<br>*Semerikov, K.A., Petrosyan, T.I.* |
| 4 | Beneficiary — Societe Generale,<br>Guarantor — OAO TMK,<br>Borrower — OAO Seversky Tube Works | Amendment to the Surety agreement between the Beneficiary and the Guarantor, under the Facility agreement in amount of RUB 3,556,838,600. | Members of the Board of Directors:<br>*Pumpyanskiy, D.A., Kaplunov, M.A., Shiryaev, A.G.;*<br>Members of the Management Board:<br>*Semerikov, K.A., Petrosyan, T.I.* |
| 5 | Lender — OAO TMK,<br>Borrower — ZAO TAGMET | Loan agreement<br>Amount — RUB 500,000,000.<br>Period — 14.09.2012 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Petrosyan T.I.* |
| 6 | Lender — OAO TMK,<br>Borrower — OAO Volzhsky Pipe Plant | Loan agreement<br>Amount — RUB 500,000,000.<br>Period — 14.09.2012 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Lyalkov A.G., Petrosyan T.I.* |
| 7 | Lender — OAO TMK,<br>Borrower — OAO Seversky Tube Works | Loan agreement<br>Amount — RUB 500,000,000.<br>Period — 08.09.2012 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Klachkov A.A., Petrosyan T.I.* |
| 8 | Lender — OAO TMK,<br>Borrower — OAO Seversky Tube Works | Loan agreement<br>Amount — RUB 170,000,000<br>Period: 29.08.2012 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Klachkov A.A., Petrosyan T.I.* |
| 9 | Lender — OAO TMK,<br>Borrower — ZAO TAGMET | Loan agreement prolongation<br>Amount — RUB 500,000,000.<br>Period — 27.08.2012 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Petrosyan T.I.* |
| 10 | Lender — OAO TMK,<br>Borrower — OAO Volzhsky Pipe Plant | Loan agreement prolongation<br>Amount — RUB 700,000,000.<br>Period — 24.08.2012 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Lyalkov A.G., Petrosyan T.I.* |

# 10.

| # | *Parties to the Transaction* | *Subject of the Transaction and Main Terms* | *Related Parties* |
|---|---|---|---|
| 11 | Lender — OAO TMK,<br>Borrower — ZAO TAGMET | Loan agreement prolongation<br>Amount — RUB 430,000,000.<br>Period — 27.08.2012 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Petrosyan T.I.* |
| 12 | Lender — OAO TMK,<br>Borrower — OAO Volzhsky Pipe Plant | Loan agreement prolongation<br>Amount — RUB 1,500,000.<br>Period — 26.10.2012 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Lyalkov A.G., Petrosyan T.I.* |
| 13 | Lender — OAO TMK,<br>Borrower — OAO Seversky Tube Works | Loan agreement prolongation<br>Amount — RUB 1,000,000<br>Period — 26.10.2012 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Klachkov A.A., Petrosyan T.I.* |
| 14 | Lender — OAO TMK,<br>Borrower — ZAO TAGMET | Loan agreement prolongation<br>Amount — RUB 100,000,000<br>Period — 27.10.2012 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Petrosyan T.I.* |
| 15 | Lender — OAO TMK,<br>Borrower — OAO Sinarsky Pipe Plant | Loan agreement prolongation<br>Amount — RUB 340,000.<br>Period — 20.11.2012 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Petrosyan T.I.* |
| 16 | Lender — OAO TMK,<br>Borrower — OAO Volzhsky Pipe Plant | Loan agreement prolongation<br>Amount — RUB 350,000.<br>Period — 19.11.2012 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Lyalkov A.G., Petrosyan T.I.* |
| 17 | Bank — OAO «Nordea Bank»;<br>Borrower — OAO Volzhsky Pipe Plant,<br>Guarantor — OAO TMK | The Surety agreement to secure the future obligations of the Borrower under the facility agreement<br>Amount — RUB 6,038,000,000.<br>Period — 13.03.2013 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Lyalkov A.G., Petrosyan T.I.* |
| 18 | Bank — OAO Bank VTB;<br>Applicant — ZAO TMK Trade House,<br>Guarantor — OAO TMK | The Surety agreement under Applicant's letter of credit in amount of RUB 250,000,000.<br>Period — 29.11.2014 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Eskindarov, M.A., Shiryaev, A.G.;*<br>Members of the Management Board:<br>*Semerikov, K.A., Petrosyan T.I.* |

10.

| # | *Parties to the Transaction* | *Subject of the Transaction and Main Terms* | *Related Parties* |
|---|---|---|---|
| 19 | Bank — OAO Bank VTB;<br>Principal — ZAO TMK Trade House,<br>Guarantor — OAO TMK | The Surety agreement under the agreement on providing of the Bank Guaranty.<br>Amount — RUB 786,855.84<br>Period — 31.07.2015 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Eskindarov, M.A., Shiryaev, A.G.*<br>Members of the Management Board:<br>*Semerikov, K.A., Petrosyan T.I.* |
| 20 | Bank — OAO Bank VTB;<br>Principal — ZAO TMK Trade House,<br>Guarantor — OAO TMK | The Surety agreement under the agreement on providing of the Bank Guaranty.<br>Amount — RUB 22,782,260.<br>Period — 24.06.2014 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Eskindarov, M.A., Shiryaev, A.G.*<br>Members of the Management Board:<br>*Semerikov, K.A., Petrosyan T.I.* |
| 21 | Bank — OAO Bank VTB;<br>Principal — ZAO TMK Trade House,<br>Guarantor — OAO TMK | The surety agreement under the agreement on providing of the Bank Guaranty.<br>Amount — RUB 250,000,000.<br>Period — 12.11.2014 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Eskindarov, M.A., Shiryaev, A.G.*<br>Members of the Management Board:<br>*Semerikov, K.A., Petrosyan T.I.* |
| 22 | Bank — OAO Bank VTB;<br>Principal — ZAO TMK Trade House,<br>Guarantor — OAO TMK | The surety agreement under the agreement on providing of the Bank Guaranty.<br>Amount — RUB 207,615.<br>Period — 26.07.2014 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Eskindarov, M.A., Shiryaev, A.G.*<br>Members of the Management Board:<br>*Semerikov, K.A., Petrosyan T.I.* |
| 23 | Bank — OAO Bank VTB;<br>Principal — ZAO TMK Trade House,<br>Guarantor — OAO TMK | The surety agreement under the agreement on providing of the Bank Guaranty Amount — RUB 5,602,000<br>Period — 04.10.2014 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Eskindarov, M.A., Shiryaev, A.G.*<br>Members of the Management Board:<br>*Semerikov, K.A., Petrosyan T.I.* |
| 24 | Bank — OAO Bank VTB;<br>Principal — ZAO TMK Trade House,<br>Guarantor — OAO TMK | The surety agreement under the agreement on providing of the Bank Guaranty Amount — RUB 83,910.<br>Period — 17.09.2014 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Eskindarov, M.A., Shiryaev, A.G.*<br>Members of the Management Board:<br>*Semerikov, K.A., Petrosyan T.I.* |
| 25 | Bank — OAO Bank VTB;<br>Applicant — ZAO TMK Trade House,<br>Guarantor — OAO TMK | The Surety agreement under Applicant's letters of credit agreement in amount of RUB 250,000,000.<br>Period — 30.12.2016 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Lyalkov A.G., Petrosyan T.I.* |

10.

Transactions approved by the Board of Directors of OAO TMK

| # | *Parties to the Transaction* | *Subject of the Transaction and Main Terms* | *Related Parties* |
|---|---|---|---|
| 1 | OAO TMK — Seller;<br>Lhoist — TMK B.V. — Buyer | The Share purchase agreement in respect of acquisition of shares of OJSC «ProLAIM».<br>Amount — RUB 20,000<br>Date 30.12.2011 | Management Board Member:<br>*Shmatovich V.V.*<br>OAO TMK |
| 2 | Creditor -ING Belgium NV,<br>Guarantor — OAO TMK;<br>Beneficiary — TMK Europe GmbH | The Surety agreement under the Creditor in respect of the full amount of Borrower's obligations<br>Amount — RUB 828,200,000<br>Period: 30.12.2012 | OAO TMK |
| 3 | Bank — UniCredit Tiriak Bank S.A.,<br>Guarantor — OAO TMK;<br>Borrower — S.C. TMK — ARTROM S.A. | The Surety agreement under the Bank in respect of the full amount of Borrower's obligations<br>Amount — RUB 621,900,000<br>Period: 31.12.2016 | OAO TMK |
| 4 | OAO TMK;<br>OAO Volzhsky Pipe Plant | The Additional agreement to the Agreement on transfer of powers of the Sole executive body of OAO Volzhsky Pipe Plant to OAO TMK, which stipulates prolongation of powers of the Sole executive body and increasing of e costs of its service<br>Amount — RUB 591,888,000<br>Period — till 01.01.2014 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Lyalkov A.G., Petrosyan T.I.* |
| 5 | OAO TMK;<br>OAO Sinarsky Pipe Plant | The Additional agreement to the Agreement on transfer of powers of the Sole executive body of OAO Sinarsky Pipe Plant to OAO TMK, which stipulates prolongation of powers of the Sole executive body and increasing of costs of its service<br>Amount — RUB 295,944,000<br>Period — till 01.01.2013 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Petrosyan T.I.* |

10.

| # | Parties to the Transaction | Subject of the Transaction and Main Terms | Related Parties |
|---|---|---|---|
| 6 | OAO TMK;<br>OAO Seversky Tube Works | The Additional agreement to the Agreement on transfer of powers of the Sole executive body of OAO Seversky Tube Works to OAO TMK, which stipulates prolongation of powers of the Sole executive body and increasing of costs of its service<br>Amount — RUB 538,080,000<br>Period — till 01.01.2013 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Klachkov A.A., Petrosyan T.I.* |
| 7 | OAO TMK,<br>OAO TAGMET | The Additional Agreement to the agreement on transfer of powers of the Sole executive body of OAO TAGMET to OAO TMK, which stipulates prolongation of the powers of the Sole executive body and increasing of costs of its service<br>Amount — RUB 295,944,000<br>Period — till 01.01.2013 | Members of the Board of Directors:<br>*Kaplunov, A.Yu., Shiryaev, A.G.,*<br>Members of the Management Board:<br>*Petrosyan T.I.* |
| 8 | Bank — Bank ВТБ (Austria) AG,<br>Guarantor — OAO TMK;<br>Borrower — SC TMK — ARTROM SA | The Surety agreement under the Agreement on providing the bank credit<br>Amount –RUB 792,000,000<br>Period — 08.08.2016 | OAO TMK |
| 9 | Bank — Banka Comerciala Romana S.A.,<br>Guarantor — OAO TMK;<br>Borrower — S.C. TMK — ARTROM S.A. | The Surety agreement under the Bank in respect of the full amount of Borrower's obligations<br>Amount — RUB 1,737,600,000<br>Period — 03.04.2017 | OAO TMK |
| 10 | Bank — OAO Bank VTB Germany ,<br>Guarantor — OAO TMK;<br>Borrower — TMK Europe GmbH | The Surety agreement under the Agreement on providing the bank credit<br>Amount — RUB 1,218,900,000<br>Period — 13.06.2014 | OAO TMK |

# 11. GLOSSARY

### *API*
American Petroleum Institute is the main US trade association for the oil and natural gas industry (*www.api.org*).

### *Casing*
Steel pipes used to line the walls of a well.

### *DNV*
Det Norske Veritas, one of the world's three major companies in the classification society business and a provider of services for managing risk. Important industries where the company operates include sea freight, energy, aviation, and automotive (*www.dnv.com*).

### *Drill pipes*
Seamless pipes used to drill oil and gas wells; these pipes make up the drill string with tool joints. Drill pipes are used for lowering and raising the drill bit, transmitting rotational force, creating axial load on the tool and sending drilling mud or compressed air into the well.

### *EAF*
Electric Arc Furnace, a scrap iron charged furnace that is energized by an electrical arc flowing between three electrodes.

### *EBITDA*
Earnings before Interest, Taxes, Depreciation, and Amortization.

### *FQM*
Fine Quality Mill, is a retained mandrel mill that uses the state-of-the-art process for seamless tube rolling, featuring 3-roll stands. The mill produces tubes of the highest quality up to 18" in a wider range of sizes and steel grades, as compared with the traditional two-roll process. The mill is based on a compact and simplified design, with a high degree of component standardization, and allows easy and quick roll changes (www.danieli.com).

### *IFRS*
International Financial Reporting Standarts

### *ISO 9000*
Series of standards for quality management systems (*www.iso.org*).

### *ISO 14000*
Series of standards for corporate environmental management, allowing to secure a harmonious approach to the Company's environment protection activity.

11.

## *ISO 13679*

Series of standards for guaranteed quality of casing and tubing connections used in oil and gas industry.

## *Large-diameter pipe (LD)*

This type of pipe is used in the construction of trunk pipeline systems for the long distance transportation of natural gas, crude oil and petroleum products. TMK produces longitudinal and spiral large-diameter welded pipes with diameters ranging from 457mm to 2520mm, wall thickness of up to 42mm and in strength groups of up to X100.

## *Line pipes*

Line pipe is used in the construction of oil and gas pipelines for the short-distance transportation of crude oil, oil products and natural gas from deposits to storage reservoirs, oil terminals, and loading and distribution centers. TMK produces both welded and seamless line pipe.

## *OCTG*

Oil Country Tubular Goods. These are threaded pipes used in the oil and gas industry including, drill pipe, casing, and tubing. TMK produces both welded and seamless OCTG.

## *OHSAS 18001*

An international occupational health and safety management system specification.

## *PQF*

Premium Quality Finishing, a 3-roll type retained mandrel mill for the production of seamless pipes. The use of PQF technology provides advantages in the piercing and sizing and stretch reducing operations (*www.sms-meer.com*).

## *RAS*

Russian Accounting Standarts

## *RSPP*

Russian Union of Industrialists and Entrepreneurs (*www.rspp.ru*)

## *Seamless pipes*

Pipes manufactured through the insertion of a solid billet in a press or a piercing mill (with subsequent hot or cold working). As its name implies, this type of pipe has no weld seam.

## *Tubing*

A pipe that is inserted inside the casing string to bring oil or gas to the surface.

## *Welded pipe*

Pipe that is made from metal coil, plate, strip or sheet, rolled and welded, manufactured on a tube welding mill.

# 12. CONTACTS

## *Information about the Company*

Full name: OAO TMK
Short name: TMK
Legal address: Russian Federation,
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