CONTENT

29) Equity (continued)

vii) Recognition of the Change in Non-controlling Interests in the Subsidiary as an Equity Transaction

Non-controlling interest shareholder of OOO "TMK-INOX" has a right to sell its ownership interest to the Group under certain circumstances beyond the Group's control starting 2018. The terms of the put option do not provide the Group with a present ownership interest in the shares subject to the put, thus the Group accounted for this put option as the following:

- the Group derecognised the non-controlling interest's share of loss in OOO "TMK-INOX" in the amount of 439 in the year ended December 31, 2014 as if it was acquired at this date (2013: 217);
- the Group recorded change in the fair value of financial liability in respect of put option held by non-controlling interest shareholder of OOO "TMK-INOX" and accounted for the difference between the non-controlling interest in OOO "TMK-INOX" derecognised and the change in fair value of financial liability in the amount of 2,676 in additional paid-in capital (2013: 8,113 in retained earnings).

viii) Hedges of Net Investment in Foreign Operations

As at December 31, 2014, a proportion of the Group's US dollar-denominated borrowing in the amount of 1,197,710 (December 31, 2013: 1,197,710) was designated as hedges of net investments in the Group's foreign subsidiaries.

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, 2014, the effective portion of net losses from spot rate changes in the amount of 602,032 at historical exchange rates, net of income tax of 120,406, at historical exchange rates was recognised in other comprehensive loss.

ix) Movement on Cash Flow Hedges

The Group hedges its exposure to foreign currency risk using currency forwards and its exposure to variability in cash flows attributable to interest rate risk using interest rate swaps.

The details of movement on cash flow hedges during the years ended December 31, 2014 and 2013 are presented in the following table:

	Currency forward contracts		Interest rate swap contracts		TOTAL	
	2014	2013	2014	2013	2014	2013
Gain/(loss) arising during the period	(26)	103	(744)	(47)	(770)	56
Recognition of realised results in the income statement	26	(49)	2,502	539	2,528	490
Movement on cash flow hedges	**–**	**54**	**1,758**	**492**	**1,758**	**546**
Income tax	–	(8)	(406)	(155)	(406)	(163)
Movement on cash flow hedges, net of tax	**–**	**46**	**1,352**	**337**	**1,352**	**383**

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

In the course of its business, the Group is exposed to a number of financial risks: market risk (including interest rate risk and foreign currency 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.

Market Risk

The Group is exposed to risk from movements in interest rates and foreign currency exchange rates 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. The Group enters into interest rate swaps, in which the Group agrees to exchange, at specified intervals, the difference between fixed and variable rate interest amounts calculated by reference to an agreed-upon notional principal amount. These swaps are designated to hedge underlying debt obligations. Variable rate loans accounted for 8% of the total loan portfolio at the end of 2014, after taking into account the effect of interest rate swaps (9% at the end of 2013).

The Group does not have any financial assets with variable interest rate.

CONTENT

30) Financial Risk Management Objectives and Policies (continued)

Interest Rate Risk (continued)

The following table demonstrates the sensitivity to a reasonably possible change in interest rates on that portion of loans and borrowings affected, after the impact of hedge accounting. With all other variables held constant, the Group's profit/(loss) before tax is affected through the impact on floating rate borrowings, as follows:

	Basis points	Effect on profit/(loss) before tax
As at December 31, 2014		
Increase in LIBOR	2	(40)
Decrease in LIBOR	(2)	40
Increase in EURIBOR	7	(55)
Decrease in EURIBOR	(7)	55
As at December 31, 2013		
Increase in LIBOR	3	(76)
Decrease in LIBOR	(3)	76
Increase in EURIBOR	13	(119)
Decrease in EURIBOR	(13)	119

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.

The Group's exposure to currency risk determined as the net monetary position in respective currencies was as follows as at December 31:

	2014	2013
USD/RUR	(1,571,946)	(1,731,183)
EUR/RUR	(79,014)	(94,785)
USD/EUR	(5,584)	23,877
USD/RON	(4,893)	(14,185)
EUR/RON	(50,723)	(84,008)
KZT/RUR	10,350	8,700
USD/CAD	(25,049)	(9,441)

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 and its exposure to currency risk related to USD denominated sales of Romanian subsidiaries using USD/RON forward contracts. 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.

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)

Foreign Currency Risk (continued)

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/(loss) before tax and other comprehensive income/(loss). The movement in other comprehensive income/(loss) arises from gains or losses on the US dollar-denominated borrowings related to the effective portion of the hedge of net investments in foreign operations (Note 29 viii). In estimating reasonably possible changes for 2014 the Group assessed the volatility of foreign exchange rates during the year ended December 31, 2014 (2013: historical data for the three preceding years). The approach to the calculation of the volatility was changed in 2014 due to the increased volatility of Russian rouble against other currencies in the past few months.

	As at December 31, 2014					
	Volatility range		Effect on profit/(loss) before tax		Effect on other comprehensive income/(loss)	
	Low	High	Low	High	Low	High
USD/RUR	27.97%	-27.97%	(122,908)	122,908	(316,765)	316,765
EUR/RUR	28.70%	-28.70%	(22,677)	22,677	–	–
USD/EUR	6.15%	-6.15%	(343)	343	–	–
USD/RON	6.64%	-6.64%	(325)	325	–	–
EUR/RON	2.99%	-2.99%	(1,517)	1,517	–	–
KZT/RUR	32.52%	-32.52%	3,366	(3,366)	–	–
USD/CAD	6.37%	-6.37%	(1,596)	1,596	–	–

	As at December 31, 2013					
	Volatility range		Effect on profit/(loss) before tax		Effect on other comprehensive income/(loss)	
	Low	High	Low	High	Low	High
USD/RUR	10.18%	-10.18%	(64,392)	64,392	(111,842)	111,842
EUR/RUR	7.84%	-7.84%	(7,431)	7,431	–	–
USD/EUR	9.24%	-9.24%	2,206	(2,206)	–	–
USD/RON	11.02%	-11.02%	(1,563)	1,563	–	–
EUR/RON	4.60%	-4.60%	(3,864)	3,864	–	–
KZT/RUR	9.96%	-9.96%	867	(867)	–	–
USD/CAD	7.42%	-7.42%	(701)	701	–	–

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.

9. CONSOLIDATED FINANCIAL STATEMENTS

CONTENT

30) Financial Risk Management Objectives and Policies (continued)

Liquidity Risk (continued)

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.

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, 2014	Less than 1 year	1 to 2 years	2 to 3 years	3 to 4 years	>4 years	TOTAL
Trade and other payables	629,789	–	–	–	–	**629,789**
Accounts payable to related parties	43,484	–	–	–	–	**43,484**
Interest-bearing loans and borrowings:						
Principal	728,574	626,217	534,385	514,716	743,783	**3,147,675**
Interest	201,592	168,784	116,442	79,121	59,044	**624,983**
Finance lease liability	7,664	10,434	5,188	4,809	37,844	**65,939**
Dividends payable	1,889	–	–	–	–	**1,889**
Liabilities under put options of non-controlling interest shareholders in subsidiaries	6,639	–	–	15,326	–	**21,965**
Other non-current liabilities	–	3	33	–	8,263	**8,299**
	1,619,631	**805,438**	**656,048**	**613,972**	**848,934**	**4,544,023**

As at December 31, 2013	Less than 1 year	1 to 2 years	2 to 3 years	3 to 4 years	>4 years	TOTAL
Trade and other payables	835,416	–	–	–	–	**835,416**
Accounts payable to related parties	101,151	–	–	–	–	**101,151**
Interest-bearing loans and borrowings:						
Principal	362,168	902,118	561,187	493,876	1,302,195	**3,621,544**
Interest	220,498	182,787	146,618	112,464	137,340	**799,707**
Finance lease liability	5,968	5,739	5,503	5,365	44,051	**66,626**
Dividends payable	5,863	–	–	–	–	**5,863**
Liabilities under put options of non-controlling interest shareholders in subsidiaries	9,323	–	–	–	31,697	**41,020**
Other non-current liabilities	–	41	–	–	8,701	**8,742**
	1,540,387	**1,090,685**	**713,308**	**611,705**	**1,523,984**	**5,480,069**

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 trade and other receivables, cash and cash equivalents.

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.

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 applying for the credit terms are subject to credit verification procedures.

As at December 31, 2014, accounts receivable from the three biggest debtors of the Group amounted to 207,044 (December 31, 2013: 317,162). Management determines concentration by reference to receivables from particular customers as percentage of total accounts receivable.

The ageing analysis of trade and other receivables and other financial assets is presented in the table below:

	2014		2013	
	Gross amount	Impairment	Gross amount	Impairment
Current trade and other receivables – not past due	646,515	(18,345)	781,817	(4,459)
Current trade and other receivables – past due				
less than 30 days	61,489	(1,188)	85,771	(546)
between 30 and 90 days	17,608	(282)	85,486	(702)
over 90 days	38,197	(20,385)	73,861	(30,433)
Accounts receivable from related parties – not past due	4,749	(18)	4,608	(32)
Non-current trade and other receivables – not past due	5,215	(38)	27,072	(18,819)
Other – not past due	4,253	–	5,712	–
	778,026	**(40,256)**	**1,064,327**	**(54,991)**

Movement in allowance for doubtful debts was as follows:

	2014	2013
Balance at the beginning of the year	54,991	42,759
Utilised during the year	(6,284)	(800)
Additional increase in allowance	13,997	16,032
Currency translation adjustment	(22,448)	(3,000)
Balance at the end of the year	**40,256**	**54,991**

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 2014, 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.

9. CONSOLIDATED FINANCIAL STATEMENTS

CONTENT

30) Financial Risk Management Objectives and Policies (continued)

Fair Value of Financial Instruments Carried at Fair Value

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

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 which have a significant effect on the recorded fair value that are not based on observable market data.

The Group held the following financial instruments recorded at fair value:

	2014	2013
Embedded Conversion Option	–	(2,080)
Total current derivative financial instruments	**–**	**(2,080)**
Interest rate swaps	(2,076)	(3,501)
Total non-current derivative financial instruments	**(2,076)**	**(3,501)**

Financial instruments at fair value were measured by the Group using valuation techniques based on observable market data (Level 2 fair value measurement hierarchy).

The Group's derivative financial instruments comprised of interest rate swaps and currency forwards. The use of derivatives was governed by the Group's policies consistent with the overall risk management strategy of the Group. The derivatives were designated as hedging instruments in cash flow hedges. The valuation techniques applied to derivatives included forward pricing and swap models, using present value calculations. The models incorporated various inputs including the credit quality of counterparties, foreign exchange forward rates and interest rate curves.

During the reporting period, there were no transfers between Level 1 and Level 2 fair value measurement hierarchy, and no transfers into and out of Level 3 fair value measurement hierarchy.

Fair Value of Financial Instruments not Carried at Fair Value

For financial assets and financial liabilities that are liquid or having a short-term maturity (cash and cash equivalents, short-term accounts receivable, short-term loans) the carrying amounts approximate their fair value.

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 not Carried at Fair Value (continued)

The following table shows financial instruments which carrying values differ from fair values:

	2014		2013	
	Par value	Fair value	Par value	Fair value
Financial liabilities				
Fixed rate long-term bank loans	1,161,283	1,089,008	1,489,452	1,489,888
Variable rate long-term bank loans	408,379	405,099	497,756	480,429
5.25 per cent convertible bonds	311,000	289,043	412,500	415,993
6.75 per cent loan participation notes due 2020	500,000	291,665	500,000	506,755
7.75 per cent loan participation notes due 2018	500,000	320,000	500,000	523,315

For quoted debt instruments (bonds and loan participation notes) the fair values were determined based on quoted market prices. The fair values of unquoted debt instruments were estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

31) Subsequent events

Acquisition of ChermetServis-Snabzhenie

On February 9, 2015, the Group acquired 100% ownership interest in ChermetServis-Snabzhenie specialising on scrap supply to steel plants, which includes not only collection, processing and distribution of ferrous scrap, but also comprehensive procurement services.

Convertible Bonds

The Group fully redeemed its convertible bonds due 2015.