Russian Pipes: Vyksa for Value

Company	Ticker	Mcap, $m	EV, $m	EV/ EBITDA 10E)	P/E(10E)	Fair price, $	Market price, $	Upside, %	Recommen-dation
TMK	TMRK Li	3 896	7 500	7.8	16.9	18.1	17.7	2%	HOLD
Vyksa Steel Plant	VSMZ RU	1 855	2 650	4.8	9.9	1 485	1080	38%	BUY
Seversky Pipe Plant	SVTZ RU	361	720	8.0	31.8	5.8	7.5	-23%	SELL
Sinarsky Pipe Plant	SNTZ RU	315	563	7.9	31.1	39.3	50	-21%	SELL
Chelybinsk Pipe Plant	CHEP RU	921	2 167	6.5	17.4	1.9	2.0	-3%	HOLD

Investment Summary

We revise our investment case for Russian pipe producers taking account for poor results in 2009, improving prospects, and recent rapid growth of share prices. Russian pipe output will fall by 12% in 2009. The worst performers, Chelyabinsk Pipe Plant Group and TMK, saw 9M09 production declines of 29% and 14% y-o-y respectively. By contrast, Vyksa Steel showed outstanding 3% y-o-y growth of pipe output thanks to LDP business. We make Vyksa Steel our top pick due to its YTD performance, low debt load and attractive relative valuation.

- ✓ The economic crisis has severely affected investment programs of major pipe consumers (oil&gas, construction, machinery and utility companies). Gazprom slashed its capital investment program for 2009 by 24%, and Lukoil made reductions of 20% to $8.7b. Utility companies have rolled over their capacity extension programs. As a result pipe production in Russia is expected to shrink by 12% y-o-y to 6.9m tonnes.
- ✓ However, optimism about economic recovery in 2010 has caused very strong YTD stock performances. Some pipe companies now trade at substantial premiums to their foreign peers. We also expect some improvement in the pipe market in 2010 on the back of general economic recovery. But at this stage we believe that investors are being too optimistic about earnings next year and may be disappointed.
- ✓ We single out Vyksa Steel for its outstanding operational and financial results relative to the industry average. Despite 50% y-o-y decline of its rail wheels business the company's 9M09 revenue increased by 18% y-o-y in ruble terms thanks to 30% growth of LDP sales. The mill remained profitable in all quarters. Vyksa currently trades at 18% and 37% discounts to its EM and DM peers on EV/EBITDA'10, and at 0% and 45% discount on P/E'10. We value Vyksa using DCF and peer multiples (75-25), suggesting fair price of $1485, which justifies a BUY recommendation. Our previous fair price was $700 with a HOLD recommendation.
- ✓ We remain neutral on TMK as it is fairly priced. However, we expect significant improvement of the company's P&L in 2010 on the back of recovery in North America and Russia, which should ensure greater capacity utilization. The company trades at par with DM peers and at 33% and 78% premiums to EM peers on EV/EBITDA'10 and P/E'10. We applaud ST debt restructuring achievements of TMK, but are still concerned by Net debt/EBITDA'09 ratio of 7.5. The company's total debt as of September 30, 2009 (after various restructuring) was still $3.8b, of which $1.8b was short-term. Applying combined DCF and peer multiples we arrive at fair price of $18.1, which offers limited upside, and we recommend to HOLD the shares.
- ✓ We also carried out multiples valuation of Seversky and Sinarsky pipe plants, as well as Chelybinsk Pipe Plant Group. The first two are relatively illiquid and trade at substantial premiums on P/E'10 to both EM and DM peers. We therefore recommend to SELL these stocks in favor of either TMK, their parent company, or Vyksa, which offers more upside. We have a HOLD recommendation for Chelyabinsk Pipe Plant, which has a balanced product mix, and good exposure to OCTG and LDP.

RMG Research, September 29, 2009
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In this Report we look at and value main Russian pipe makers:

- **Vyksa Steel**, the pipe and rail wheel mill, which is the main subsidiary of OMK Group (OMK also owns smaller steel and pipe assets)
- **TMK Group**, which owns Volzhsky, Seversky, Sinarsky, and Taganrog Pipe Plants, TMK Ipsco (US) and some other East European assets
- **Chelyabinsk Pipe Plant Grou**p (ChTPZ Group, consolidates results of Chelyabinsk and Pervouralsk Plants)

We also give summary valuations for two TMK subsidiaries, Seversky and Sinarsky.

Pipe market in 2009

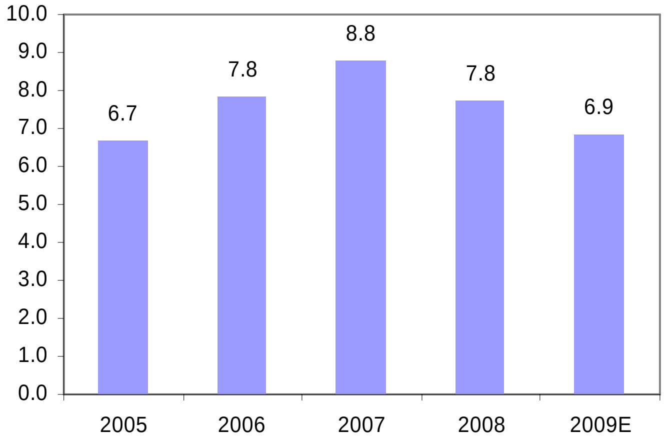
Output

Another year of pipe production decline in Russia

Pipe production in Russia in 2009 is set to decline (for the second year in a row) by 12% y-o-y to 6.9m tonnes. Pipe consumption has shrunk in all segments, reflecting the economic slowdown. Biggest declines have been in seamless industrial pipes (used in construction and engineering), and welded and seamless OCTG (pipes used at oil & gas fields).

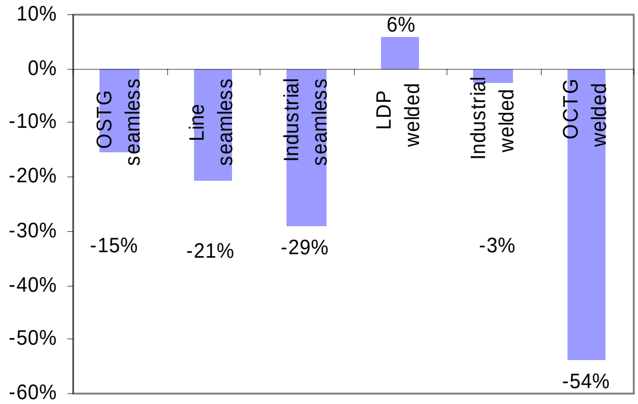
The diagrams show decline of overall Russian pipe output and changes in output of TMK by segments (figures for TMK give a broad view of the market, due to the company's production profile and US presence).

Pipe production in Russia, m tonnes



Source: ChTPZ Group

TMK pipe sales, tones (2009/2008)

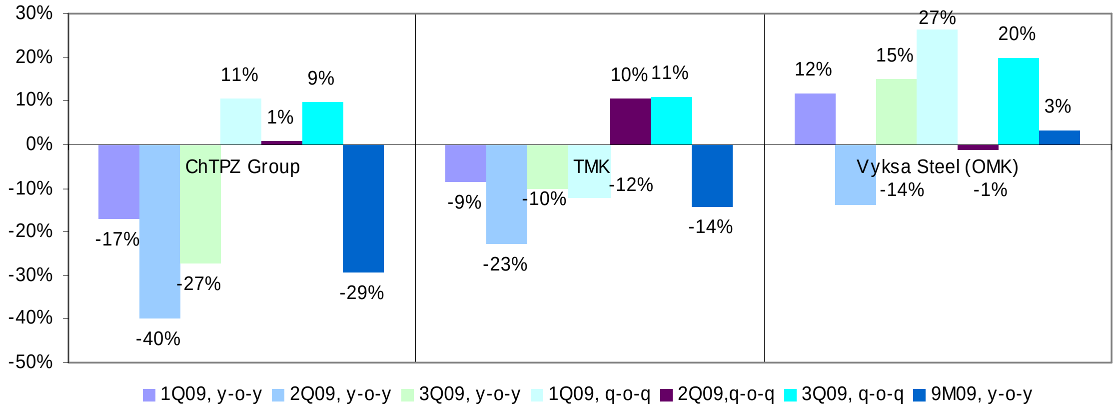


Source: Company data, RMG estimates

ChTPZ and TMK are worst performers

The worst performers, ChTPZ Group and TMK, saw 9M09 y-o-y declines of 29% and 14% in tonnes of pipes sold. TMK struggled in the first half of the year due to its large exposure to the oil & gas sector, as falling rig count and high pipe inventories in the US coincided with cuts in exploration budgets by Russian majors.

Pipe sales by main producers (y-o-y and q-o-q), tonnes



Source: Company data

Vyksa results are driven by LDP sales

Vyksa Steel (main subsidiary of OMK) bucked the industry trend with 3% y-o-y sales growth in tones during 9M09. But the result was due to 30% y-o-y growth in sales of large-diameter pipes (without LDP, sales of other pipes would 23% lower y-o-y). Vyksa's LDP business was exceptionally strong in 2009 due to realization of large-scale pipeline projects including Gazprom's Nord Stream and Transneft's BTS-2, as well as projects in CIS countries.

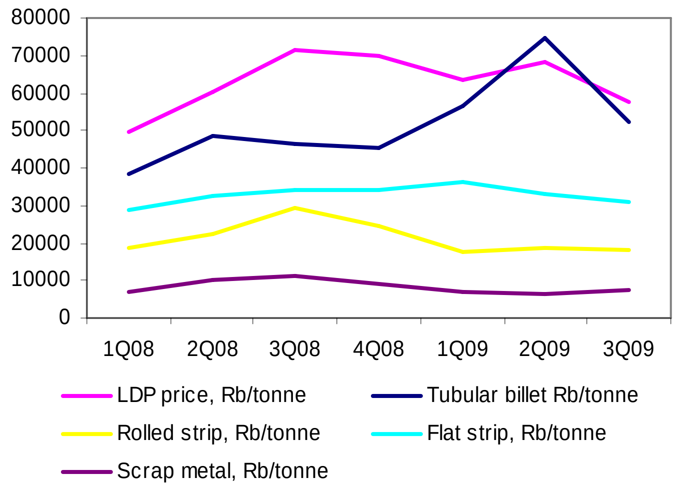
Main pipe shipments by Russian producers in 2009

Vyksa Steel	TMK	ChTPZ
OMK (Vyksa's parent) won a contract in 2007 to deliver LDP for the first stage of the Nord Stream pipeline. Vyksa should deliver 263 000 tonnes of pipes during 2008-2009, representing 25% of total pipes for the project. In 2008 Vyksa won a contract to produce LDP for the Central Asia-China gas pipeline. Vyksa should deliver 355 000 tonnes of LDP in 2008-2009, representing 23% of total pipes for the project. In February 2009 Vyksa won a Transneft tender to deliver LDP for Baltic Pipe System-2. Vyksa should deliver 107 000 tonnes in 2009 and 121 000 tonnes in 2010. In April 2009 OMK signed a contract to deliver 25 000 tonnes of LDP for construction of a gas pipeline in Nigeria.	70 000 tonnes of LDP for Gazprom's Sakhalin-Khabarovsk-Vladivostok gas pipeline. 8700 tonnes of casing tubes for Surgutneftegaz. 10 300 tonnes of LDP for Transneft's ESPO oil pipe line. 28 000 tonnes of LDP for Turkmengaz. 5000 tonnes of LDP for Gazprom's Bovanenkovo-Ukhta gas pipeline.	47 500 tonnes of LDP for Transneft's Baltic Pipe System-2. 6700 tonnes of LDP for KazTransOil (Kazakhstan). LDP for a pipeline spur to China (part of ESPO).

Pipe prices and production costs

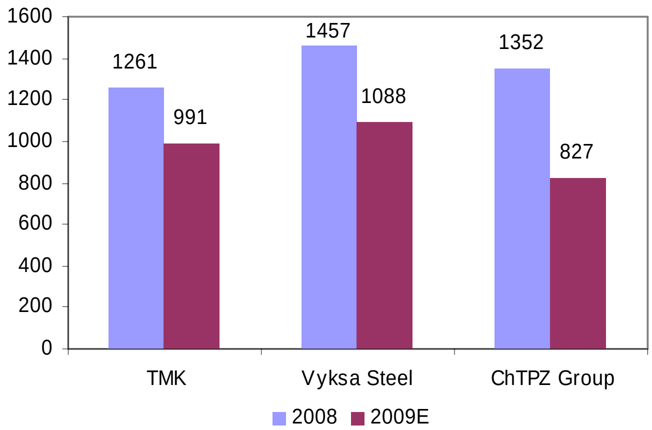
Pricing of pipe sales on the domestic market is rarely revealed. However, Severstal's quarterly reports of LDP pricing and guidance from Volzhsky Pipe Plant on input costs suggest that falling prices for main raw materials (strip, billet and scrap) have been decisive for determining pipe prices. (metal accounts for the biggest share of production costs).

Pipe prices and raw material costs



Source: Severstal, Volzhsky Plant

Cash costs of pipe production, $



Source: Company data, RMG estimates

Costs have been reduced where possible

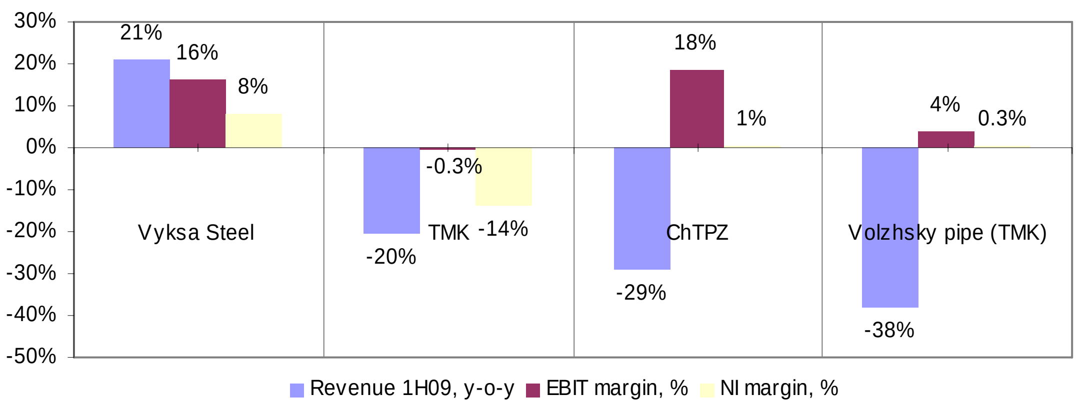
Companies have substantially reduced production costs by cutting employee headcount and optimizing production processes, in particular TMK's Seversky Plant has replaced an outdated open-hearth furnace with a more efficient electrical furnace, and Chelyabinsk Plant has cut its employee headcount by 23%.

Profitability in 2009

Vyksa was profitable in all quarters

Vyksa Steel is the only pipe producer that has remained profitable throughout 2009. Despite 50% decline in sales of rail car wheels (the other component of Vyksa's business) booming LDP business kept Vyksa profitable in all quarters.

Revenue and margins of major pipe producers in 1H09



Source: Company data, RMG estimates

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Debt

Financial leverage varies greatly between companies. Several Russian pipe producers took substantial debt before the crisis to finance large-scale investment programs. From 2008 ChTPZ has been implementing a 500m euro program to install an LDP mill with 600 000 tonnes capacity, due for launch in 2010. TMK has a $1.5b investment program for 2009-2013 to modernize, upgrade and expand OCTG, line pipe and industrial seamless pipe capacity (a 650 000 tonne LDP line was commissioned this year at TMK's Volzhsky Plant).

TMK and ChTPZ are most leveraged

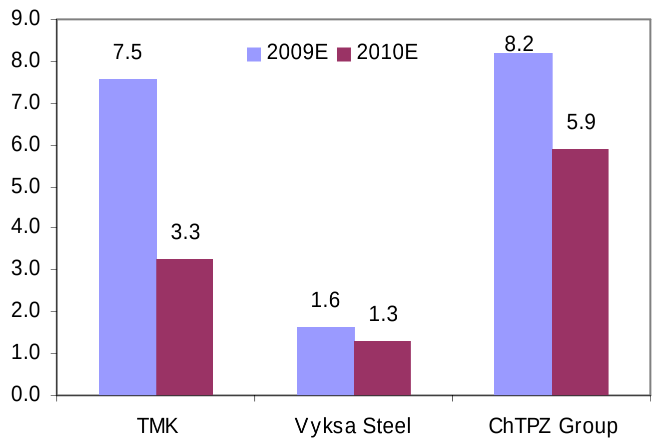
TMK and ChTPZ Group are the most leveraged Russian pipe producers, although TMK has recently taken various actions to regulate its debt situation. By October 1, 2009, TMK had successfully restructured most debt, which was due by the end of this year. In particular the company fully redeemed $300m Eurobonds in September using a one-year loan from VTB, which can be extended to five years. TMK has also amended its January agreement with Gazprombank, extending the loan term from 2.5 to 5 years and reducing the interest rate (the facility will be repaid in tranches starting from 2011).

Debt profiles of pipe producers, as of September 30, 2009, $m

	Total debt	ST (due in 12 months)	EBITDA (2009E)	Net debt/ EBITDA
TMK	3 783	1 815	467	7.5
ChTPZ Group	1 840	1 070	225	8.2
Vyksa plant	1 000	649	488	1.6

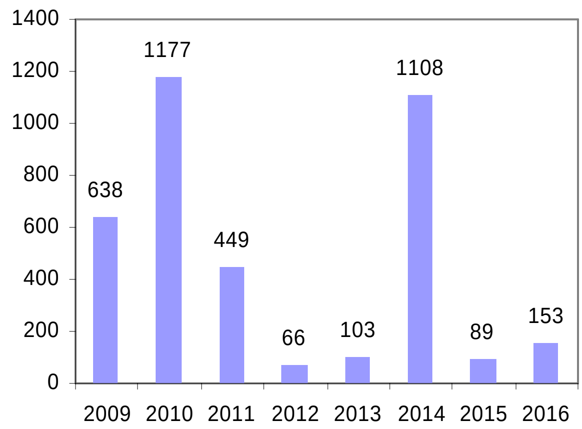
Source: Company data, RMG estimates

Net debt/EBITDA



Source: Company data, RMG estimates

TMK debt maturities as of September 30, 2009, $m



Source: Company data

Outlook for 2010

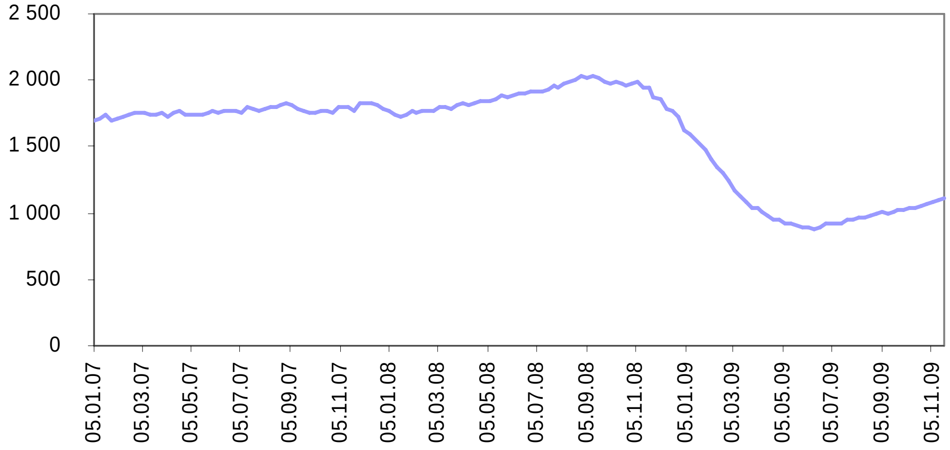
We expect modest growth (12-15%) of pipe volumes in 2010 on the back of general economic recovery. Pipe market recovery will be supported by several specific factors.

Recovery of export demand

The US market is recovering slowly

There are some signs of pipe market recovery in North America where the number of new oil rigs has been growing lately. The pipe business consultancy, Duane Murphy & Asssociates, reports that OCTG pipe inventories declined from a peak of 15 months in May to less than 11 months in September. This is still very high compared with 4 months before the crisis, but the de-stocking tendency is evident.

US rig count



Source: Baker Hughes

Large pipeline projects of Russian oil & gas majors are still on the agenda

Large-scale pipeline projects are still on the agenda

The Russian government's energy development strategy through 2020 calls for increase of gas exploration by 20% and oil exploration by almost 40% compared with 2000. The strategy also envisages that Russia will export 21% of total gas output and 42% of oil output by 2020. These plans will boost and support the country's LDP sector. Export pipeline projects (Nord Stream, South Stream, ESPO, Baltic Pipeline System) have high priority for the Russian government, so major delays in implementation are very unlikely.

Russia's largest pipeline projects

	Length, km	Implementation
Gas		
Nord Stream (land)	917	2005-2011
Nord Stream (sea)	1220	2011-2012
South Stream (sea)	900	2010-2015
Oil		
ESPO-1 (Taishet-Skovorodino)	2694	2006-2009
ESPO-2 (Skovorodino-Kozmino)	2000	2010-2013
Baltic Pipe System -2 (Unecha-Ust-Luga)	998	2009-2012
Purpe-Samotlor	424	2009-2012

Source: Gazprom, Transneft

"Buy Russian!"

The Russian government is protecting domestic pipe producers

Since the recession Russian government officials are trying to ensure that state companies procure more of their needs domestically. Gazprom and Transneft have shifted pipe procurement from German, Japanese and Ukrainian suppliers to domestic pipe makers. The Russian government has also agreed to protect domestic pipe producers from foreign competitors. In September 2009 the government raised import duty on oil & gas pipes from previous levels of 5-20% to 28.1%. This will reduce pipe imports from Ukraine, China, Brazil and Japan.

Cost optimization

Russian companies now make wide sheet for LDP, replacing imports

Russian LDP producers used to depend on imports of wide sheet from Japan and Germany (duties on the imports were annulled in 2008). Launch of new 5000 plate mills at MMK and Severstal have already made wide sheet available domestically and in 2007 Vyksa began construction of a Mill 5000 with 1.5 mt capacity. Vyksa's new mill will fully supply the company's own LDP output and enable deliveries to other pipe makers, machine-builders, shipbuilders, and the nuclear industry. There will be large positive effect on Vyksa's costs.

Pipe quality improvement

Russian pipe producers have modernized production facilities to improve pipe quality and production efficiency. Vyksa and Izhora (owned by Severstal) already have the important Det Norske Veritas (DNV) quality certification, which is a requirement for sub-sea pipelines. Volzhsky Plant and ChTPZ ,also expect to obtain DNV certification. Quality improvement is increasing access to export markets, as seen in Vyksa's contract to ship LDP for a gas pipeline in Nigeria.

Catalysts

Vyksa Steel	TMK	ChTPZ
Participation in the second stage of Nord Stream. Tender results will be announced in 1Q10	North American OCTG market recovery	Participation in LDP supply for the second stage of ESPO
Recovery in rail transportation, which should restore demand for rail car wheels	Participation in LDP supply for the second stage of ESPO	Russian and CIS OCTG market recovery

Source: Company data

Valuation

We use multiples and DCF for TMK and Vyksa, multiples only for others

We valued TMK and Vyksa by DCF and peer multiples, giving 75% and 25% weights to the two approaches. Seversky, Sinarsky and Chelyabinsk Plants were valued using multiples only. We applied no discounts to multiples of DM peers, due to superior growth prospects of Russian companies in 2010.

Comparative multiples of peers, 2010E

	Country	MCap, $m	EV, $m	EV / S	EV / EBITDA	P / E	P / BV	EBITDA margin, %	Net margin,%
EM peers									
Maharashtra seamless Ltd	India	522	436	1.04	5.07	10.03	2.02	21%	12%
Anhui Tianda Oil Pipe	China	446	439	0.90	4.82	7.82	2.42	19%	12%
Xinxing Ductile Iron Pipes	China	2 704	2 797	0.74	8.66	19.18	1.89	9%	4%
Tube Investments of India	India	243	538	0.95	6.73	8.99	1.67	14%	5%
Median, EM peers				**0.93**	**5.90**	**9.51**	**1.96**	**16%**	**8%**
DM peers									
Tenaris SA	Luxembourg	24 537	23 980	2.70	9.38	17.81	2.56	29%	16%
Vallourec	France	9 479	9 055	1.39	7.47	16.96	1.68	19%	9%
Sumitomo Metal Industries	Japan	12 327	22 146	1.37	7.64	20.21	1.35	18%	4%
Tubacex SA	Spain	563	781	1.07	11.32	25.57	1.56	9%	3%
Tubos Reunidos SA	Spain	547	822	1.06	7.69	10.32	1.64	14%	7%
Maruichi Steel Tube	Japan	1 640	1 267	0.98	6.36	18.23	0.81	15%	7%
Median, DM peers				**1.22**	**7.66**	**18.02**	**1.60**	**17%**	**7%**
TMK	Russia	3 872	7 476	**1.69**	**7.83**	**16.92**	**2.42**	**19%**	**3%**
Premium/Discount to:									
EM Peers				**83%**	**33%**	**78%**	**24%**		
DM Peers				**39%**	**2%**	**-6%**	**52%**		
Vyksa Steel	Russia	1 855	2 650	**0.96**	**4.83**	**9.90**	**1.25**	**20%**	**7%**
Premium/Discount to:									
Peers EM				**4%**	**-18%**	**4%**	**-36%**		
Peers DM				**-21%**	**-37%**	**-45%**	**-22%**		

Source: Bloomberg, RTS, RMG estimates

TMK relative valuation

	EV/EBITDA	P / E
Median for peers	7.7	18.0
Applied premium/discount, %	0%	0%
Implied multiples for valuation	7.7	18.0
MCap based on multiples, $m	3 790	4 123
Weight, %	50%	50%
Weighted fair market cap, $m	3 956	
Implied # of GDRs outstanding	218 250 250	
Fair price per GDR, $	**18.13**	

Source: Bloomberg, RMG estimates

Vyksa Steel relative valuation

	EV/EBITDA	P / E
Median for peers	7.7	18.0
Applied premium/discount, %	0%	0%
Implied multiples for valuation	7.7	18.0
Mcap based on multiples, $m	3 213	3 376
Weight, %	50%	50%
Weighted fair market cap, $m	3 295	
# of shares oustanding	1 717 433	
Common fair price, $	**1 918**	

Source: Bloomberg, RMG estimates

TMK valuation

	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Summary									
EPS (GDR), $	0.91	-0.73	1.05	2.16	2.91	2.95	2.68	2.30	1.77
P/BV	2.03	2.42	2.20	1.84	1.51	1.28	1.12	1.02	0.95
P/E	19.55	-24.47	16.92	8.22	6.09	6.00	6.61	7.73	10.02
EV/FCFF	-111.62	12.21	28.68	14.14	8.69	7.72	8.07	8.71	9.87
EV/S	1.31	2.11	1.69	1.38	1.20	1.10	1.03	0.98	0.94
EV/EBITDA	7.02	16.00	7.83	6.22	5.44	5.20	5.37	5.70	6.27
Income Statement, $m									
Revenue	5 690	3 550	4 412	5 420	6 225	6 803	7 243	7 611	7 930
Gross profit	1 438	655	1 225	1 576	1 837	1 963	1 963	1 920	1 831
EBITDA	1 065	467	955	1 201	1 373	1 437	1 392	1 312	1 192
EBIT	817	229	696	925	1 090	1 146	1 094	1 007	880
Net income	198	-158	229	471	636	645	585	501	386
Cash Flow, $m									
Operating income (EBIT)	817	229	696	925	1 090	1 146	1 094	1 007	880
Depreciation&amortization	248	238	259	276	284	291	298	305	312
Capital expenditure	730	240	350	280	130	120	120	120	120
Profitability, %									
EBITDA margin, %	19%	13%	22%	22%	22%	21%	19%	17%	15%
Net margin, %	3%	-4%	5%	9%	10%	9%	8%	7%	5%

Source: Company reports, RMG estimates

FCFF calculation

	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
EBIT, $m	817	229	696	925	1 090	1 146	1 094	1 007	880
less: income tax, $m	110	55	167	185	218	229	219	201	176
plus: DD&A, $m	248	238	259	276	284	291	298	305	312
less: capex, $m	730	240	350	280	130	120	120	120	120
less: NWC, $m	292	-440	177	207	165	119	126	133	138
FCFF, $m	-67	612	261	529	860	969	927	858	758
Discount factor	-	-	*1.00*	*0.89*	*0.80*	*0.71*	*0.63*	*0.56*	*0.50*
Discounted FCFF, $m	**-**	**-**	**261**	**472**	**684**	**688**	**587**	**484**	**382**

Source: Company data, RMG estimates

WACC calculation

Risk-free rate, %	7.0%
Leveraged beta	2.06
Cost of equity, %	17.30%
Cost of debt (after tax), %	8.00%
Debt / equity+debt	56%
WACC, %	**12.11%**

Source: Bloomberg, RMG estimates

DCF fair price calculation

Terminal growth rate, %	3.0%
EBIT margin in terminal period, %	17%
EBIT in 2014, $m	1 181
Cash flow in 2014, $m	897
Discounted value 2010-2016, $m	3 557
PV of terminal value, $m	4 009
Fair EV, $m	7 567
Net debt, $m	3 526
Fair MCap, $m	3 963
Number of GDRs	218 250 250
DCF-based fair price per GDR, $	**18.16**

Source: RMG estimates

TMK final valuation

	DCF	Comparative
Fair price per GDR, $	**18.2**	**18.1**
Weight in final fair price, %	75%	25%
Final fair price per GDR, $	**18.1**	

Source: RMG estimates

Vyksa Steel valuation

	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Summary									
EPS, $	137.92	104.03	109.11	118.14	119.56	112.97	105.14	97.18	89.86
P/BV	0.64	1.31	1.25	1.21	1.18	1.05	0.96	0.88	0.82
P/E	3.26	10.38	9.90	9.14	9.03	9.56	10.27	11.11	12.02
EV/FCFF	-12.17	15.66	10.51	11.00	9.34	6.58	5.42	5.15	4.91
EV/S	0.53	1.10	0.96	0.91	0.87	0.82	0.75	0.69	0.62
EV/EBITDA	2.57	5.43	4.83	4.57	4.38	4.24	3.98	3.74	3.52
Income Statement, $m									
Revenue	2 947	2 414	2 627	2 661	2 631	2 567	2 545	2 529	2 519
Gross profit	853	687	737	744	738	712	693	674	658
EBITDA	607	488	523	527	521	500	482	464	446
EBIT	546	435	460	464	461	441	422	403	386
Net income	237	179	187	203	205	194	181	167	154
Cash Flow, $m									
Operating income (EBIT)	546	435	460	464	461	441	422	403	386
Depreciation&amortization	60	54	63	64	59	59	60	61	61
Capital expenditure	193	151	143	78	63	54	54	54	54
Profitability, %									
EBITDA margin, %	21%	20%	20%	20%	20%	19%	19%	18%	18%
Net margin, %	8%	7%	7%	8%	8%	8%	7%	7%	6%

Source: Company reports, RMG estimates

FCFF calculation

	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
EBIT, $m	546	435	460	464	461	441	422	403	386
less: income tax, $m	109	87	92	93	92	88	84	81	77
plus: DD&A, $m	60	54	63	64	59	59	60	61	61
less: capex, $m	193	151	143	78	63	54	54	54	54
less: NWC, $m	432	81	48	138	122	36	-10	-7	-5
FCFF, $m	-128	169	241	219	244	322	354	337	320
Discount factor	-	-	1.00	0.89	0.80	0.71	0.63	0.56	0.50
Discounted FCFF, $m	**-**	**-**	**241**	**196**	**194**	**228**	**224**	**190**	**161**

Source: Company data, RMG estimates

WACC calculation

Risk-free rate, %	7.0%
Leveraged beta	1.21
Cost of equity, %	12.20%
Cost of debt (after tax), %	12.00%
Debt / equity+debt	30%
WACC, %	**12.1%**

Source: Bloomberg, RMG estimates

DCF fair share price calculation

Terminal growth rate, %	2.0%
EBIT margin in terminal period, %	15%
EBIT in 2016, $m	386
Cash flow in 2016, $m	309
Discounted value 2010-2016, $m	1 433
PV of terminal value, $m	1 561
Fair EV, $m	2 994
Net debt, $m	675
Fair Mcap, $m	2 319
Number of shares	1 717 433
DCF-based fair price per share, $	**1 350**

Source: RMG estimates

Vyksa Steel final valuation

	DCF	Comparative
Fair price per share, $	**1 350**	**1 918**
Weight in final fair price, %	75%	25%
Final fair price per common share, $	**1 492**	

Source: RMG estimates

Seversky pipe financials

	2008	2009E	2010E
Revenue	938.5	544.4	714.1
COGS	762.5	500.2	599.9
EBIT	127.8	5.7	78.6
EBITDA	140.1	15.6	90.5
Net income	56.7	-42.0	11.4
Net debt	248.7	358.9	339.0
EBITDA margin	15%	3%	13%

Source: Company data, RMG estimates

Seversky pipe valuation

	EV/EBITDA	P/E
Median for peers	7.7	18.0
Applied premium/discount, %	0%	0%
Implied multiples for valuation	7.7	18.0
MCap based on multiples, $m	354	205
Weight, %	50%	50%
Weighted fair market cap, $m	280	
# of shares oustanding	48 129 120	
Final fair price per share, $	5.8	

Source: Bloomberg, RMG estimates

Sinarsky pipe financials

	2008	2009E	2010E
Revenue	1 071.8	569.6	747.1
COGS	880.7	486.3	620.1
EBIT	121.3	31.6	59.8
EBITDA	134.1	41.6	71.4
Net income	34.0	-2.4	10.1
Net debt	280.7	248.3	234.5
EBITDA margin	13%	7%	10%

Source: company data, RMG estimates

Sinarsky pipe valuation

	EV/EBITDA	P/E
Median for peers	7.7	18.0
Applied premium/discount, %	0%	0%
Implied multiples for valuation	7.7	18.0
MCap based on multiples, $m	312	182
Weight, %	50%	50%
Weighted fair market cap, $m	247	
# of shares oustanding	6 295 555	
Final fair price per share, $	**39.3**	

Source: Bloomberg, RMG estimates

Chelyabinsk pipe group financials

	2008	2009E	2010E
Revenue	2 526.4	1 322.3	1 734.6
COGS	1 941.3	944.9	1 209.9
EBIT	311.3	202.8	306.4
EBITDA	346.5	224.9	334.7
Net income	50.0	6.7	52.9
Net debt	1 960.2	1 838.9	1 736.8
EBITDA margin	14%	17%	19%

Source: company data, RMG estimates

Chelyabinsk pipe group valuation

	EV/EBITDA	P/E
Median for peers	7.7	18.0
Applied premium/discount, %	0%	0%
Implied multiples for valuation	7.7	18.0
MCap based on multiples, $m	827	953
Weight, %	50%	50%
Weighted fair market cap, $m	890	
# of shares oustanding	472 382 880	
Final fair price per share, $	**1.9**	

Source: Bloomberg, RMG estimates

Conclusions and Recommendation

We are optimistic about 2010, expecting general economic recovery and implementation of large-scale pipeline projects by Russian oil & gas majors. Russian pipe producers have modernized their facilities to improve quality and raise production efficiency.

We single out Vyksa Steel as our top pick for its outstanding operational and financial results relative to the industry average. Despite 50% y-o-y decline in rail wheels business, the company's 9M09 revenue increased by 18% in rubles thanks growth of LDP tonnage.

We remain neutral on TMK, finding it to be fairly priced. We expect significant improvement of the company's P&L in 2010 thanks to demand recovery on North American and domestic markets, which will raise capacity utilization. We also remain concerned about high Net debt/EBITDA'09 of 7.5.

We give a SELL recommendation for the TMK subsidiaries, Seversky and Sinarsky pipe plants. They are relatively illiquid and trade at substantial premiums on P/E'10 both to EM and DM peers. We recommend investors to exchange these stocks for TMK itself or Vyksa Steel, which offers more upside.

We give a HOLD recommendation for Chelybinsk Pipe Plant Group, which has a balanced product mix and good exposure to the OCTG and LDP segment.

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