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Raspadskaya: Should deliver high growth rates

BUY

Ticker MICEX	RASP
Mcap, USD mn	2 661
EV, USD mn	2 706
Number of common shares, mn.	781
Free float	16%

Common shares	Buy
Target price by the end of 2012, USD	5.15
Current price	3.41
Upside	51%

Financials, USD mn			
	2011	2012E	2013E
Revenue	726	916	998
EBITDA	324	433	451
Net profit	135	232	219

Margins, %			
	2011	2012E	2013E
EBITDA margin	45%	47%	45%
Net profit margin	19%	25%	22%

Multiples			
	2011	2012E	2013E
EV/S	3.7	3.0	2.7
EV/EBITDA	8.4	6.2	6.0
P/E	19.6	11.5	12.2

Dividends, USD per share			
for the year	2011	2012E	2013E
Common shares	0.17	0.18	0.18

The prospects for a significant increase in coking coal production are still on track. At the beginning of 2011 Raspadskaya declared quite ambitious plans to increase its annual coking coal production – it planned to mine 8.5 mn. tonnes of coking coal in 2011 and to achieve a level of 18.5 mn. tonnes per year by 2015. The actual results were much more modest – in 2011 the company produced 26% less than the planned volume.

This year Raspadskaya plans to mine 10.5 mn. tonnes which implies more than 60% y-o-y growth. In our view it is unlikely the company's 2012 production plan to be implemented due to the technical difficulties and weak demand for coking coal in 1H12. We expect Raspadskaya coking coal production to grow 26% y-o-y this year and to increase to 12.5 mn. tonnes in 2016. This is two times higher than the quantity mined in 2011.

The high level of EBITDA margin still one of its main competitive advantages. In 2011 the company's EBITDA margin was 45% - one of the highest levels in the sector. Raspadskaya's high level of EBITDA margin is associated with both the high quality of the company's coking coal assets and its efficient production facilities. This year we estimate Raspadskaya EBITDA margin level to be 47% and expect the margin to increase to 58% by 2015 due to significant growth in coal mining volumes.

Growth in production will ensure an increase in free cash flow. According to our estimates, due to an increase of 26% y-o-y in coal mining in 2012, the share of fixed costs in total production costs will decline. This will trigger an increase in EBITDA of 34% y-o-y in 2012. We note that the growth estimate of 34% y-o-y in EBITDA was made assuming a 2.8% y-o-y increase in Raspadskaya's realized prices for coking coal in 2012.

A doubling of coking coal production by 2016 will make it possible to increase EBITDA by more than two times compared with our estimates for 2012. Thus, from 2012 – 2016 we see Raspadskaya's EBITDA annual growth rate at about 22%. This growth will ensure a steady increase in the free cash flow generated by the company and make Raspadskaya shares even more attractive to investors.

Current low rates of production growth – the major concern. Failure to meet previously announced production plans for 2011 and rather weak operating results in the 1st quarter this year greatly disappointed investors. A recent buy-back program conducted by the company supported Raspadskaya quotes in the beginning of the year. The cessation of this program is one of the major risks for Raspadskaya stocks in our view. In this regard we expect the fundamental demand for Raspadskaya stock to return as soon as we see clear signs of acceleration in coking coal production. In our opinion, this will not take place earlier than the beginning of the second half of 2012.

We are initiating our coverage of Raspadskaya with a BUY recommendation and a Target Price of USD5.15 by the end of 2012, implying a 51% upside potential.



Shareholder Structure

Shareholders*	Share, %
Corber Enterprises Ltd.	73.8%
Treasury shares	10.0%
Free float	16.2%

Corber Enterprises Ltd., shareholders	Share, %
Adroliv Investments Ltd. (is beneficially owned by G. Kozovoy and A. Vagin)	50%
Mastercroft Mining Ltd. (is beneficially owed by Evraz Group S.A.)	50%

* Grandis Capital estimates

The major shareholders of Raspadskaya are the owners of Evraz and the company management. Over the last nine months there were several reports in the media about the intentions of Raspadskaya's major shareholders to sell their stake in Raspadskaya. We see this event as unlikely until a return to full production following an accident at the mine. Thus, we do not expect a change in shareholder structure before the end of the year.

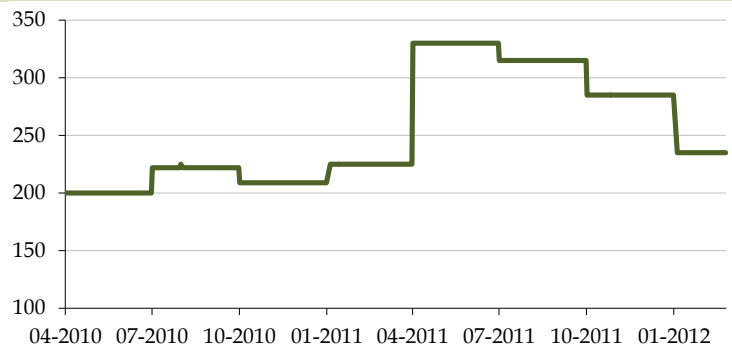
Market Trends and Outlook

There is a downward trend in quotes in the global coking coal market from the third quarter 2011. In our opinion, we will have reached the "bottom" in the market for coking coal in the second quarter of this year. In our financial model, we assume the growth rate in the sales price for Raspadskaya coking coal in 2012 to be 2.8% y-o-y, with a long-term average annual rate of 4%.

Coking coal concentrate, Russia domestic market*, USD per tonne



Hard coking coal, Australia FOB, USD per tonne

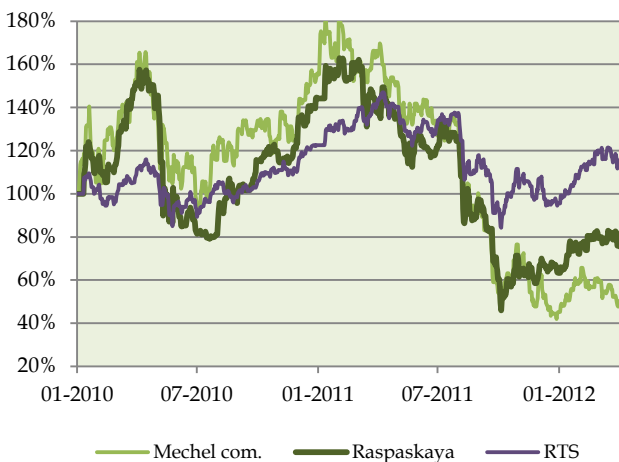


Source: SBB, Metal-Expert

* Average between brands GZH, ZH and KO

Since the beginning of 2010 Raspadskaya shares have decreased by 20%, while the RTS index has risen by 13%.

Comparative dynamics of Mechel, Raspadskaya common shares, RTS index since the beginning of 2010



Dynamics of Raspadskaya shares since the beginning of 2010, USD per share



Source: Bloomberg



Valuation

We estimate the fair value of Raspadskaya shares using a weighted average between estimates made by discounted cash flows (DCF) and multiples methods.

- *Discounted cash flow valuation (DCF)*

We have included 2016 in our DCF model. We assume the terminal growth rate to be 3.5% and the discount rate WACC to be 12.6%. Using the DCF method we estimate the fair value price of Raspadskaya shares at the end of 2012 to be USD7.03 per share.

USD mn		2009	2010	2011	2012E	2013E	2014E	2015E	2016E
Revenue		497	706	726	916	998	1247	1551	1676
EBITDA		255	338	324	433	451	648	895	975
margin %		51%	48%	45%	47%	45%	52%	58%	58%
EBIT		163	189	189	313	325	524	774	854
Taxes		33	38	38	63	65	105	155	171
NOPAT		130	151	151	250	260	420	619	683
+ Depreciation		71	97	125	130	136	138	141	144
- CAPEX		-152	-138	-144	-230	-240	-180	-191	-202
Change in working capital		-22	35	-14	-26	-17	-38	-46	-21
FCF		28	146	117	125	139	339	523	604

Расчет WACC	
Terminal growth rate	3.5%
Cost of Equity	14.5%
After tax cost of debt	7.0%
Debt/(Debt+Equity)	25%
WACC	12.6%
DCF	1258
Terminal value	6868
Discounted terminal value	4272
Total DCF	5530
Net Debt of 31/12/11	45
Equity value (common shares)	5485
Number of common shares, mn	781
Target price, \$	7.03

		Sensitivity Analysis						
		Discount rate (WACC)						
		11.1%	11.6%	12.1%	12.6%	13.1%	13.6%	14.1%
Terminal growth rate (%)	5.0%	10.35	9.52	8.81	8.20	7.66	7.19	6.76
	4.5%	9.65	8.93	8.31	7.76	7.28	6.85	6.47
	4.0%	9.05	8.41	7.86	7.37	6.94	6.55	6.20
	3.5%	8.52	7.96	7.47	7.03	6.63	6.28	5.95
	3.0%	8.07	7.56	7.12	6.72	6.36	6.03	5.73
	2.5%	7.66	7.21	6.80	6.44	6.11	5.81	5.53
	2.0%	7.30	6.89	6.52	6.18	5.88	5.60	5.35

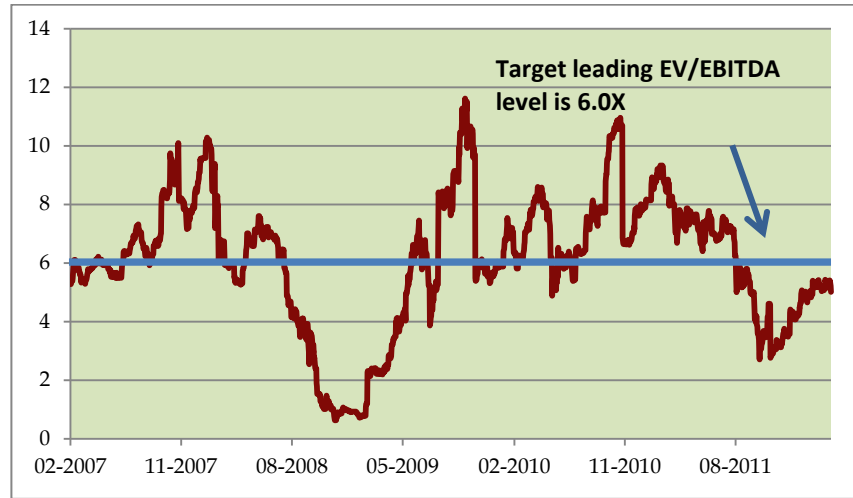
Source: Company Data, Grandis Capital estimates



- *Multiples Valuation*

As a basic multiplier, we propose using the leading EV/EBITDA (EBITDA is a Bloomberg consensus for the first estimated fiscal year).

Raspadskaya: leading EV/EBITDA estimates



Source: Bloomberg, Grandis Capital estimates

Historically, the market priced Raspadskaya's value in terms of leading EV/EBITDA 6.0X.

- *Final Valuation*

Taking into account our estimates of the Raspadskaya fair value made by the multiples and DCF methods **our target price for the company's stock at the end of 2012 is USD5.15 per share - that implies a 51% upside potential to the current price.**

Raspadskaya: final valuation

Valuation method	EV fair value estimate, USD mn.	Net Debt as of 31.12.2011, USD mn.	Market capitalization fair value estimate, USD mn.	Common share fair price estimate, USD per share
Multiples method, leading EV/EBITDA 6.0X	2600	45	2555	3.27
DCF method valuation	5530	45	5485	7.03
The average between the estimates by DCF and multiples methods	4065	45	4020	5.15

Source: Company Data, Grandis Capital estimates



Raspadskaya: Grandis Capital EBITDA and Target Price Estimates vs. Bloomberg Consensus

	EBITDA, USD mn	TP, USD/share
Bloomberg consensus, median	559	4.89
Bloomberg consensus, average	562	5.21
Grandis Capital estimates	433	5.15
difference vs median	-22%	5%
difference vs average	-23%	-1%

Source: Bloomberg, Grandis Capital estimates

Raspadskaya Multiples vs. Main Peers

Company	Ticker	Mcap USD mn	USD mn	P/E			EV/EBITDA			EV/Sales		
				2011	2012E	2013E	2011	2012E	2013E	2011	2012E	2013E
Mechel*	mtl us	4248	12768	5.5	3.9	3.8	5.7	4.5	4.3	1.0	0.9	0.8
Raspadskaya*	RASP RX	2661	2706	19.6	11.5	12.2	8.4	6.2	6.0	3.7	3.0	2.7
KTK	KBTK RX	568	650	8.0	6.1	4.6	4.9	4.0	3.2	0.8	0.7	0.6
Average				11.0	7.2	6.9	6.3	4.9	4.5	1.8	1.5	1.4
Severstal	chmf rx	13537	17626	6.7	7.2	6.9	4.5	4.6	4.4	1.1	1.0	1.0
NLMK*	nlmk rx	12322	15255	8.9	8.4	6.3	6.7	5.4	4.4	1.3	1.1	0.9
MMK	magn rx	5018	7858	neg	12.1	8.4	5.5	4.8	4.2	0.8	0.8	0.7
Evraz*	evr ln	7531	13975	16.3	9.0	7.8	4.8	5.2	4.9	0.9	0.8	0.8
Average				10.7	9.2	7.3	5.4	5.0	4.5	1.0	0.9	0.8
BHP	BHP US	174218	179777	7.9	9.0	8.3	4.9	5.0	4.4	2.5	2.4	2.2
Teck	TCK US	20717	23304	8.2	8.9	8.1	4.2	4.6	4.1	2.0	2.0	1.9
Alpha	ANR US	3219	5601	9.0	neg	5.94	4.6	4.8	4.3	0.8	0.7	0.7
Anglo American	AAL LN	47050	48191	8.1	8.2	7.1	3.7	3.7	3.1	1.5	1.4	1.2
Xstrata	XTA LN	51608	60030	9.2	9.1	7.5	5.2	5.1	4.3	1.8	1.7	1.6
Rio Tinto	RIO LN	104186	115735	6.7	7.3	6.6	4.2	4.4	4.0	1.9	1.9	1.8
Peabody	BTU US	7433	13291	6.8	9.3	6.6	6.0	5.8	4.8	1.6	1.5	1.3
Walter	WLT US	3774	5971	9.5	13.2	8.3	6.9	7.6	5.7	2.3	2.1	1.8
Patriot	PCX US	534	782	neg	neg	neg	4.8	5.5	4.0	0.3	0.4	0.3
Average				8.2	9.3	80.8	4.9	5.1	4.3	1.6	1.6	1.4

Source: Bloomberg
* Grandis Capital estimates

**Raspadskaya: IFRS Financials and Estimates, USD mn.**

P&L	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E
Sales	784	1200	497	706	726	916	998	1247	1551	1676
Operational expences	314	333	242	368	402	482	547	599	657	700
Depreciation&Amortization	134	118	71	97	125	130	136	138	141	144
Operating profit	355	685	163	189	189	313	325	524	774	854
EBITDA	470	868	255	338	324	433	451	648	895	975
Net interest expences	26	14	13	10	11	22	51	52	51	47
Other expences (income)	0	0	0	-105	0	0	0	0	0	0
Profit before taxes	329	671	150	284	177	291	274	472	723	806
Profit tax	89	139	33	40	42	58	55	94	145	161
Minority interest	1	0	1	0	0	0	0	1	1	1
Net profit	239	531	117	245	135	232	219	377	578	644
BS	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E
Cash and cash equivalents	82	72	28	165	180	114	83	133	247	393
Accounts receivable	67	128	165	93	104	124	136	169	211	227
Inventories	51	56	44	77	84	97	110	120	132	140
Other current assets	37	140	164	182	93	109	121	143	169	182
Property, plant and equipment	1479	1361	1410	1530	1462	1562	1666	1708	1758	1816
Other non-current assets	10	5	38	28	54	58	62	64	65	68
Total assets	1726	1761	1850	2075	1978	2064	2178	2337	2582	2827
Accounts payable	38	44	48	44	48	55	62	68	75	80
Short-term debt	39	37	28	8	304	364	364	364	364	364
Other current liabilities	26	18	34	29	394	174	195	196	181	147
Long-term debt	308	314	303	304	1	241	241	241	241	241
Other non-current liabilities	245	163	162	186	169	75	84	84	78	63
Equity	1070	1184	1275	1504	1062	1155	1231	1382	1642	1932
Total liabilities and equity	1726	1761	1850	2075	1978	2064	2178	2337	2582	2827
Cash flow statement	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E
Operating profit	355	685	163	189	189	313	325	524	774	854
Income tax expense	89	139	33	40	42	58	55	94	145	161
Depreciation and amortization	134	118	71	97	125	130	136	138	141	144
Change NWC	-43	-60	-22	35	-14	-26	-17	-38	-46	-21
Operating CF	328	584	221	308	233	359	389	530	724	815
CAPEX	-166	-284	-152	-138	-144	-230	-240	-180	-191	-202
Other investing CF	6	-120	-56	9	100	-364	0	0	0	0
Operating CF net of Investing CF	168	180	12	179	189	-234	150	350	533	613
Change in total debt inflow	-11	4	-19	-19	-7	300	0	0	0	0
Interest expences	26	14	13	10	11	22	51	52	51	47
Dividends	95	158	7	0	135	139	142	226	318	354
Other financing outflow	2	22	16	13	20	0	0	0	0	0
Free CF	33	-11	-43	136	15	-96	-44	71	165	212

Source: Company Data, Grandis Capital estimates



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