



Andrew Kucherov
Analyst
Metals&Mining
+7 (495) 2874407,
ext. 216
a.kucherov@grandiscapital.ru

Ticker MICEX	TRMK
Mcap, USD mn	2557
EV, USD mn	6113
Number of common shares, mn.	938
Free float	22.4%

Common shares	Buy
Target price by the end of 2012, USD	3.83
Current price	2.73
Upside	40%

Financials, USD mn			
	2011	2012E	2013E
Revenue	6754	6440	7118
EBITDA	1050	1096	1084
Net profit	380	391	386

Margins, %			
	2011	2012E	2013E
EBITDA margin	16%	17%	15%
Net profit margin	6%	6%	5%

Multiples			
	2011	2012E	2013E
EV/S	0.9	0.9	0.9
EV/EBITDA	5.8	5.6	5.6
P/E	6.7	6.5	6.6

TMK: a major beneficiary of growth in the oil and gas sector

BUY

TMK - one of the world's leading manufacturers of steel pipes. The company supplies more than 70% of its products to the oil and gas sector. TMK is one of the leading producers of steel pipes for the oil and gas sector and a key supplier to Russian oil companies.

This year we expect a significant increase in Russian oil companies' expenses for maintenance and development of their oil fields. In 2012 total CAPEX of Russian oil companies is expected to grow by 25-30% y/y. This increase is associated not only with the necessity to upgrade oil refineries, but also the need to support existing fields, and depreciation of infrastructure - which is already high. (As an indicator of the state of the industry consider the most recent spill at TNK-BP pipelines, which revealed the dilapidated state of pipelines due to a lack of investment in their maintenance). TMK may therefore become one of the major beneficiaries of increased capital expenditures by oil companies this year.

Drilling activity in the U.S. is close to pre-crisis levels. Over the past two years drilling activity in the U.S. has increased significantly. According to Baker Hughes, the total number of rigs has risen by 65% since 2010 and is close to pre-crisis peaks. This fact allows us to be optimistic about prospects in the North American market for steel pipes for oil and gas applications.

An increase in the share of high value added products - the key to a long-term partnership with end-user customers and company competitiveness. TMK's investment strategy seeks to increase sales of its high value-added pipes and premium connections, allowing expansion of its presence in the market for complex drilling projects - including offshore. TMK is one of the leading producers of premium connections in the Russian and the U.S. shale oil & gas markets. These steps will significantly increase the competitiveness of the company's finished products, reduce sales price volatility and strengthen long-term relationships with end-user customers.

This year TMK's profits are expected to return to previous levels or at least remain the same as last year. Although we expect the Russian major steel making companies to show lower profits this year due to the reduction in the average steel products prices y/y, TMK EBITDA will remain unchanged compared to last year. This is due to the fact that TMK is mainly focused on the oil and gas sector, sells high value-added products, and that price dynamics are now more stable. Hence we estimate that the average selling price for TMK steel pipes will decline by 4.2% y/y in 2012 compared to a 10-15% reduction in the prices for steel strips and tube billet.

We are initiating our coverage of TMK with a BUY recommendation and a Target Price of USD3.83 by the end of 2012, implying a 40% upside potential.



Shareholder structure

Shareholder *	Number of shares	Share, %
MK Steel Ltd. (incl. affiliated companies) **	653,264,243	69.68%
OAO «TMK» subsidiaries	2,914,540	0.31%
TMK Bonds S.A. ***	71,505,956	7.63%
Free float****	209,901,355	22.38%
	937,586,094	100.00%

* as of 31 December, 2011

** 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.

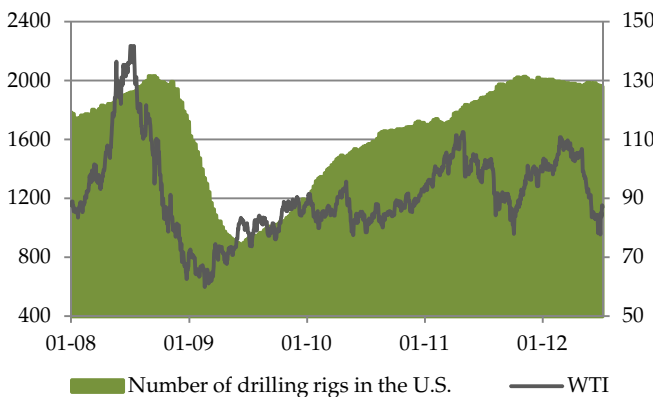
Market Trends and Outlook

Drilling activity in the U.S. has increased significantly over the past two years. According to Baker Hughes, the total number of rigs has risen by 65% since 2010. This indicates a substantial increase in demand for steel pipe products for oilfield services companies in North America.

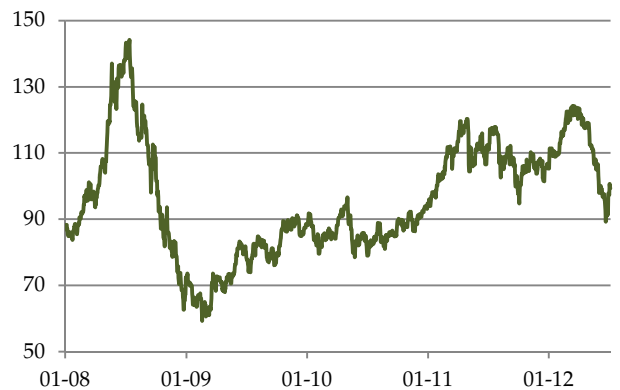
Oil prices have fluctuated dramatically over the past 2 1/2 years - WTI fluctuated in the range of 80-110 \$/bbl. and Brent corrected highly in the 1st half of 2012 after the growth in 2010-2011.

However, we expect oil quotes to stabilize and gain back some of ground lost in the 2nd half of 2012.

The dynamics of the total number of drilling rigs in the U.S. and WTI price, \$/bbl



The dynamics of Brent price, \$/bbl

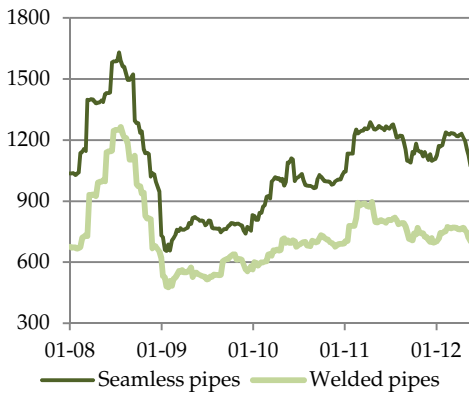


Source: Bloomberg

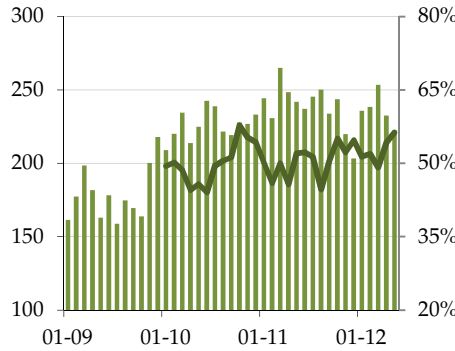


There is a growing demand for oil and gas pipes in the Russian market – since 2010 the average monthly demand for this type of pipes has increased by 10-12%. TMK’s share of this market is about 50%.

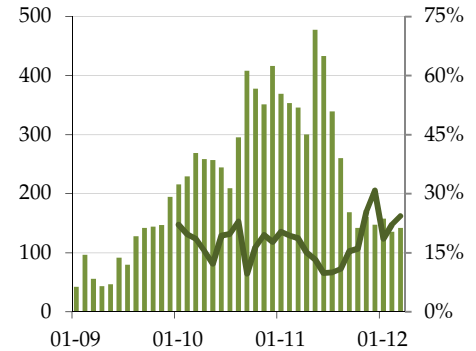
Industrial seamless and welded pipes price dynamics, \$/tonne



Dynamics of oil and gas pipes consumption in Russia and TMK share in this market, th. tonnes



Dynamics of LDP consumption in Russia and TMK share in this market, th. tonnes



Source: Metal-Expert

Although we expect the Russian major steel making companies to reduce their financials this year due to the reduction in the average price of steel products y/y, the EBITDA of TMK should remain unchanged relative to the previous year. This is due to the fact that TMK is mainly focused on the oil and gas sector and, in fact, sells high value-added products with a more stable price dynamic. Thus we estimate that the average selling price for TMK steel pipes will decline by 4.2% y/y in 2012 compared to 10-15% reduction in the prices for steel strips and tube billet.



Market peers comparison

Since in 2010 TMK shares are down 30%, while the RTS index has not changed.

In comparison with its major counterparts, Tenaris and Vallourec, TMK is in line with overall trends - Tenaris shares have fallen by 20% and Vallourec by 40%.

Comparative dynamics of TMK, Tenaris and Vallourec since the beginning of 2010



Comparative dynamics of TMK and RTS index since the beginning of 2010



Source: Bloomberg

If we look at the dynamics of TMK shares since 2008, the company shares have dropped 65% since the beginning of 2008.

Dynamics of TMK shares since the beginning of 2008, USD per share



Source: Bloomberg



Valuation

We estimate the fair value of TMK shares as a weighted average between estimates made by discounted cash flows (DCF) and the multiples method.

- *Discounted cash flow valuation (DCF)*

We construct our DCF model to include 2016. We assume the terminal growth rate to be 3.0% and the discount rate WACC to be 12.3%. Using the DCF method we estimate the fair value price of TMK shares by the end of 2012 to be USD3.35 per share.

USD mn	2009	2010	2011	2012E	2013E	2014E	2015E	2016E
Revenue	3461	5579	6754	6440	7118	7603	7901	8211
EBITDA	328	942	1050	1096	1084	1221	1218	1209
margin %	9%	17%	16%	17%	15%	16%	15%	15%
EBIT	8	600	684	760	746	885	883	874
Taxes	2	132	151	167	164	195	194	192
NOPAT	6	468	534	593	582	690	689	682
+ Depreciation	320	343	366	337	338	336	335	335
- CAPEX	-395	-314	-402	-355	-359	-304	-316	-340
Change in working capital	558	-527	-156	116	-115	-74	-50	-53
FCF	489	-31	341	691	446	648	658	624

WACC Calculation	
Terminal growth rate	3.0%
Cost of Equity	14.5%
After tax cost of debt	7.2%
Debt/(Debt+Equity)	30%
WACC	12.3%
DCF	2458
Terminal value	6899
Discounted terminal value	4335
Total DCF	6793
Net Debt of 31/03/12	3647
Equity value (common shares)	3145
Number of common shares, mn	938
Target price, \$	3.35

Sensitivity analysis									
		Discount rate (WACC)							
		0	10.8%	11.3%	11.8%	12.3%	12.8%	13.3%	13.8%
Terminal growth rate (%)	4.5%	6.09	5.42	4.83	4.32	3.87	3.47	3.17	
	4.0%	5.53	4.93	4.42	3.96	3.56	3.20	2.93	
	3.5%	5.04	4.51	4.05	3.64	3.27	2.95	2.70	
	3.0%	4.61	4.14	3.73	3.35	3.02	2.72	2.50	
	2.5%	4.23	3.81	3.44	3.10	2.79	2.52	2.32	
	2.0%	3.90	3.52	3.18	2.87	2.59	2.33	2.15	
	1.5%	3.60	3.26	2.94	2.66	2.40	2.16	1.99	

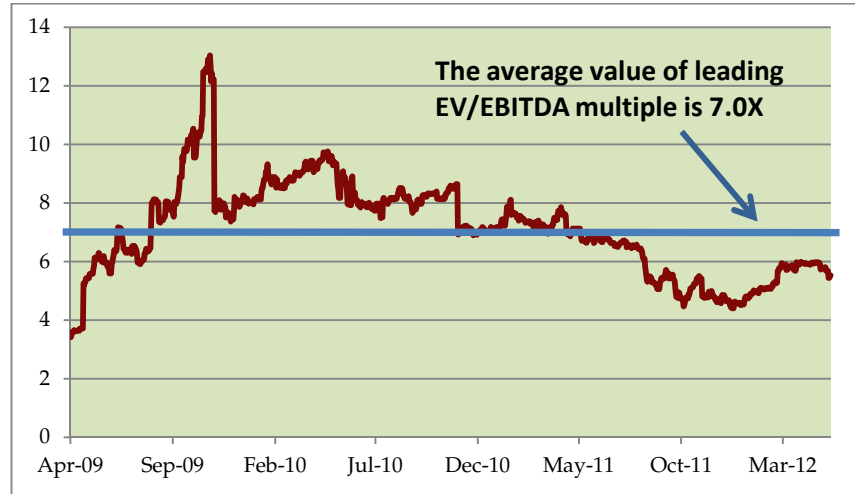
Source: Company Data, Grandis Capital estimates



- *Multiples valuation*

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

TMK: leading EV/EBITDA estimates



Source: Bloomberg, Grandis Capital estimates

Historically, the market priced TMK value in terms of leading EV/EBITDA 7.0X.

- *Final valuation*

Taking into account our estimates of the TMK fair value made by the multiples and DCF methods **our target price for the company's stock at the end of 2012 is USD3.83 per share - that implies a 40% upside potential to the current price.**

TMK: final valuation

Valuation method	EV fair value estimate, USD mn.	Net Debt as of 31.03.2012, USD mn.	Market capitalization fair value estimate, USD mn.	Common share fair price estimate, USD per share
Multiples method, leading EV/EBITDA 7.0	7675	3647	4028	4.30
DCF method valuation	6793	3647	3145	3.35
The average between the estimates by DCF and multiples methods	7234	3647	3587	3.83

Source: Company Data, Grandis Capital estimates

TMK: Grandis Capital EBITDA and target price estimates vs. Bloomberg consensus

	EBITDA, USD mn	TP, USD/share
Bloomberg consensus, median	1119	4.69
Bloomberg consensus, average	1144	4.62
Grandis Capital estimates	1 096	3.83
difference vs median	-2%	-18%
difference vs average	-4%	-17%

Source: Bloomberg, Grandis Capital estimates



TMK multiples vs. main peers

Company	Ticker	Mcap USD mn	EV USD mn	P/E			EV/EBITDA			EV/Sales		
				2011	2012E	2013E	2011	2012E	2013E	2011	2012E	2013E
Severstal	chmf rx	12058	16160	6.1	8.0	7.6	4.2	5.0	4.8	1.0	1.0	1.0
NLMK*	nlmk li	10333	13266	7.6	7.1	5.3	5.8	4.7	3.9	1.1	0.9	0.8
Evrz*	evr ln	5572	12016	12.1	6.7	5.7	4.1	4.4	4.2	0.7	0.7	0.7
MMK	magn rx	3442	7373	25.2	20.0	9.7	5.2	5.3	4.4	0.8	0.7	0.7
Average				12.7	10.4	7.1	4.8	4.9	4.3	0.9	0.9	0.8
TMK	trmk rx	2557	6113	6.7	6.5	6.6	5.8	5.6	5.6	0.9	0.9	0.9
Tenaris	TS US	21787	21463	16.6	12.4	10.6	8.9	7.2	6.3	2.2	1.9	1.7
Vallourec	VK FP	4964	6510	9.7	15.2	10.4	5.4	6.3	4.9	1.0	0.9	0.8
Average				13.1	13.8	10.5	7.1	6.7	5.6	1.6	1.4	1.3

Source: Bloomberg
* Grandis Capital estimates

**TMK: IFRS financials and estimates, USD mn.**

P&L	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E
Sales	4179	5690	3461	5579	6754	6440	7118	7603	7901	8211
Operational expenses	3273	4687	3140	4636	5703	5344	6034	6382	6683	7002
Depreciation&Amortization	140	248	313	301	336	337	338	336	335	335
Operating profit	765	755	8	600	684	760	746	885	883	874
EBITDA	908	1006	328	942	1050	1096	1084	1221	1218	1209
Net interest expenses	90	263	404	412	271	254	232	223	204	186
Other expenses (income)	-24	184	31	3	-131	-15	0	0	0	0
Profit before taxes	699	308	-427	185	544	521	514	662	679	688
Profit tax	192	110	-103	81	159	125	123	159	163	165
Minority interest	19	-1	-8	0	5	5	5	6	6	0
Net profit	487	199	-316	104	380	391	386	497	510	523
BS	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E
Cash and cash equivalents	89	143	244	158	231	515	571	936	1297	1635
Accounts receivable	541	758	580	720	772	711	786	840	873	907
Inventories	782	1176	926	1208	1418	1214	1371	1450	1519	1591
Other current assets	239	217	227	184	204	180	201	214	223	233
Property, plant and equipment	2712	3322	3403	3387	3348	3366	3387	3355	3335	3340
Other non-current assets	313	1452	1301	1205	1160	1166	1173	1162	1155	1157
Total assets	4676	7068	6681	6862	7132	7152	7490	7957	8402	8863
Accounts payable	400	808	921	878	1053	904	1021	1080	1131	1185
Short-term debt	1033	2216	1537	702	599	549	519	519	519	519
Other current liabilities	285	716	164	94	54	50	54	55	56	57
Long-term debt	506	994	2214	3170	3188	3138	3068	3068	3068	3068
Other non-current liabilities	346	423	326	410	414	389	419	425	433	443
Equity	2107	1910	1519	1607	1825	2121	2409	2810	3195	3590
Total liabilities and equity	4676	7068	6681	6862	7132	7152	7490	7957	8402	8863
Cash flow statement	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E	2016E
Operating profit	765	755	8	600	684	760	746	885	883	874
Income tax expense	192	110	-103	81	159	125	123	159	163	165
Depreciation and amortization	140	248	313	301	336	337	338	336	335	335
Change NWC	-386	-81	558	-527	-156	116	-115	-74	-50	-53
Operating CF	321	740	852	386	787	1088	846	988	1005	991
CAPEX	-662	-840	-395	-314	-402	-355	-359	-304	-316	-340
Other investing CF	93	271	-496	43	25	0	0	0	0	0
Operating CF net of Investing CF	-247	171	-39	115	410	733	487	684	689	652
Change in total debt inflow	505	1671	541	120	-85	-100	-100	0	0	0
Interest expenses	90	263	404	412	271	254	232	223	204	186
Dividends	145	224	0	0	47	95	98	96	124	127
Other financing outflow	0	0	0	0	27	0	0	0	0	0
Free CF	-69	52	96	-71	75	284	57	365	360	338

Source: Company Data, Grandis Capital estimates



OOO Grandis Capital Investment Company

6 Puteisky Tupik, Moscow, 105064
tel.: +7 495 287 44 07, fax: +7 (495) 287 44 07
www.grandiscapital.ru, info@grandiscapital.ru

Financial Markets

Mikhail Kozakov
Director of the Department
M.Kozakov@grandiscapital.ru

Anton Makarov
Deputy Head of Department
A.Makarov@grandiscapital.ru

Analytical Division

Dmitry Terekhov
Senior Analyst
D.Terekhov@grandiscapital.ru

Ksenia Anoshina
Analyst
K.Anoshina@grandiscapital.ru

Andrey Kucherov
Analyst
A.Kucherov@grandiscapital.ru

Sales

Dmitry Shatsky
Sales
D.Shatskiy@grandiscapital.ru

Customer Relations

Ekaterina Kharchenko
Head of
E.Kharchenko@grandiscapital.ru

Exchange Operations

Maxim Bersenev
Head of
M.Bersenev@grandiscapital.ru

Mikhail Kan
Senior Trader
M.Kan@grandiscapital.ru

Portfolio Investments

Dmitry Ivanov
Head of
D.Ivanov@grandiscapital.ru

Andrey Tolstousov
Asset Manager
A.Tolstousov@grandiscapital.ru

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