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Chelyabinsk Pipe Works (CHEP)

Interesting alternative to TMK

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In the run-up of Chelyabinsk Pipe Works' IPO we have compared it with the key competitor – TMK. We believe Chelyabinsk Pipe is a worthy alternative to TMK and an interesting speculative theme in the Russian pipe sector, being unfairly neglected by the market

Chelyabinsk Pipe is the perfect speculative play. The stock trades cheaper in comparison with TMK based on EV/EBITDA and EV/Output, while debt leverage and even large diameter pipe market position are similar. Meanwhile, Chelyabinsk Pipe demonstrates higher cash costs with EBITDA per ton is almost in line with TMK, by our estimates. The main risk for Chelyabinsk Pipe is low liquidity. However, it may increase due to potential IPO. We estimate the stock's target price at \$3.0/share implying a 50% upside. We recommend Chelyabinsk Pipe as a speculative bet.

Chelyabinsk Pipe vs TMK

	Chelyabinsk Pipe	TMK
Market capitalization, \$ mn	966	3,892
Net debt, \$ mn	2,095	3,504
Net debt/EBITDA	11.5	10.7
EV, \$ mn	3,061	7,447
Pipe production in 2010, mn t	1.7	3.7
- including LDP	0.6	0.6
EV/EBITDA	7.0	8.1
EV/Output	1,800	2,013
EV/S	1.1	1.4
EBITDA/t	256	249
Cash costs, \$/t	1,002	1,131
EBITDA margin, 2010E	16%	17%

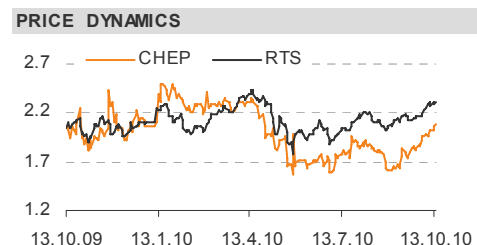
Source: company data, TKB Capital estimates

Chelyabinsk Pipe Works		
	Common	Preferred
Ticker	CHEP	-
Recommendation	BUY	-
Price, \$	2.0	-
Target price, \$	3.0	-
Upside/downside, %	50%	-

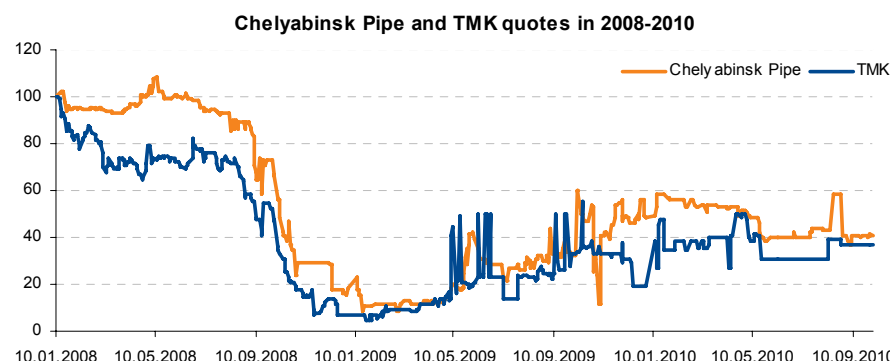
SHARE DATA		
	CHEP RX	
	Common	Preferred
# of shares outstanding, mn	472	-
EV, \$ mn	3,061	-
MC, \$ mn	966	-
MIN 12 mnth., \$	1.57	-
MAX 12 mnth., \$	2.50	-
Shares per GDR	-	-

SUMMARY FINANCIALS, \$ mn			
IFRS	2009	2010E	2011E
Revenue	1,769	2,760	3,588
EBITDA	182	435	532
Net income	-140	108	185
EPS, \$	-0.30	0.23	0.39
Rev. growth, %	-42.0	56.0	30.0
EPS growth, %		-176.8	71.8
EBITDA margin, %	10.3	15.8	14.8
Net margin, %	-7.9	3.9	5.2

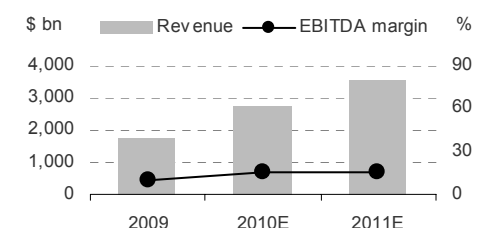
SUMMARY VALUATIONS			
	2009	2010E	2011E
P/E	-6.89	8.96	5.22
EV/EBITDA	16.83	7.03	5.75



Source: MICEX, RTS. TKB Capital estimates



Source: RTS



Source: TKB Capital estimates

Chelyabinsk Pipe vs TMK: the winner is Chelyabinsk Pipe

Debt burden in line with TMK. Chelyabinsk Pipe's net debt stood at \$2.1 bn at the end of 2009. Its Net debt/EBITDA was 11.5. TMK had \$3.5 bn net debt in 2009 and its Net debt/EBITDA was equalled 10.7. With comparable debt, Chelyabinsk Pipe trades at a 15% discount to TMK on 2010E EV/EBITDA

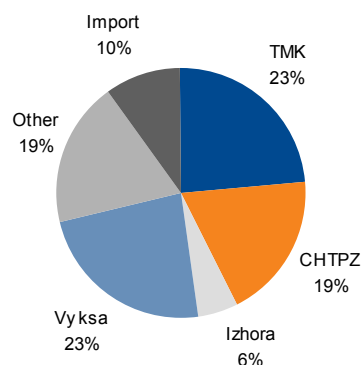
Debt leverage of Chelyabinsk Pipe and TMK, as of end-2009

	Chelyabinsk Pipe	TMK
Long-term debt	674	2,214
Short-term debt	1,547	1,537
Cash	126	244
Investments	-	4
Total debt	2,221	3,752
Net debt	2,095	3,504
Net debt/EBITDA	11.5	10.7

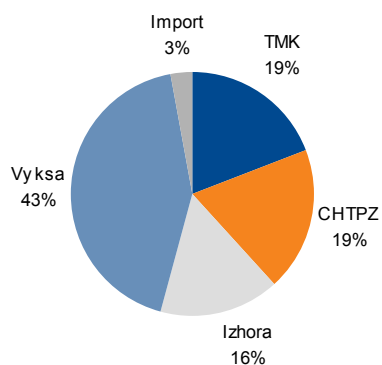
Source: company data, TKB Capital estimates

Equal market shares. Chelyabinsk Pipe and TMK hold equal positions the large diameter pipes (LDP) domestic market. We note that LDP is the most profitable type of pipes. Each of the companies has about 19% on LDP market in Russia in 1H10. Chelyabinsk Pipe has a larger LDP share in its product mix compared to TMK: 38% and 28%, respectively. Based on 2010E EV/Output and EV/Sales, Chelyabinsk Pipe trades at 12% and 25% discounts respectively to TMK.

Russian pipe market structure, 1H10



Russian LDP market structure, 1H10

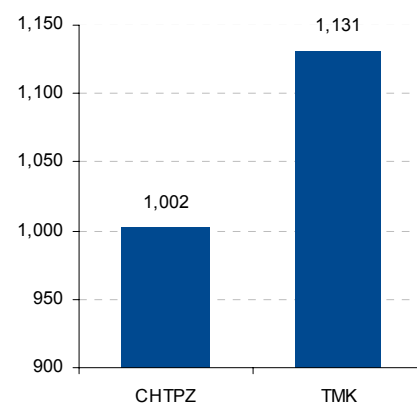


Source: company data, TKB Capital estimates

New LDP workshop doubled the production capacities. This year Chelyabinsk Pipe launched a new LDP workshop "Height 239" having capacity of 600,000 tons of 508-1,420 mm diameter pipes. Thus, the company's capacities have increased two-fold. The key supplier of heavy plates to the new shop should be Mill 5000 of MMK, which is only 300 km away from Chelyabinsk Pipe.

Comparable low cash costs. According to our estimates, in 2009 Chelyabinsk Pipe's average cash costs accounted for \$1,002 per ton of pipe that is 11% lower those of TMK. We expect this trend to continue in 2010-2011.

Operating cash costs in 1H10, \$/t



Source: company data, TKB Capital estimates

Potential IPO

The company considers the placement of its shares and GDRs. According to some newswires, Chelyabinsk Pipe plans to make an IPO in the medium term. The placement would dramatically improve the company's liquidity and may result in strong stock performance. Meanwhile, Chelyabinsk Pipe should resolve its debt issues in order to attract investors and to make a successful IPO.

IPO details (according to Interfax)

At the end of September, 2010 the Federal Financial Markets Service of Russia (FFMS) gave the company a permission to place 237 mn shares on an international stock exchange. Also, FFMS registered 427 mn additionally issued shares of Chelyabinsk Pipe. Hence, the company is able to place up to 50% of its additional issue. No details on the timeframe are available.

2010 financial forecasts and comparative valuation

EBITDA to grow more than two times in 2010. According to our estimates, in 2010 Chelyabinsk Pipe would show considerable financial improvements thanks to stronger pipe demand and domestic prices. We estimate the company's revenue in 2010 to set at \$2,760 mn, EBITDA at \$435 mn and net profit at \$108 mn. We expect EBITDA margin to increase by 6 ppt y-o-y to reach 16%.

Key financials in 2007-2010

	2007	2008	2009	2010E	%
Revenue	3,153	3,070	1,769	2,760	56%
EBITDA	464	-66	182	435	139%
Net income	256	-372	-140	108	-177%
EBITDA margin	15%	neg.	10%	16%	
Net margin	8%	neg.	neg.	4%	

Source: company data, TKB Capital estimates

Chelyabinsk Pipe's target price is \$3.0/share. We derived the company's target price based on 2010E EV/EBITDA and EV/Output multiples comparative analysis. According to our estimates, the Chelyabinsk Pipe trades with 15% and 12% discounts respectively to its main rival, TMK. We assigned the weight of 90% to EV/EBITDA and 10% to EV/Output. As a result, we received Chelyabinsk Pipe's target price at \$3.0/share implying a 50% upside.

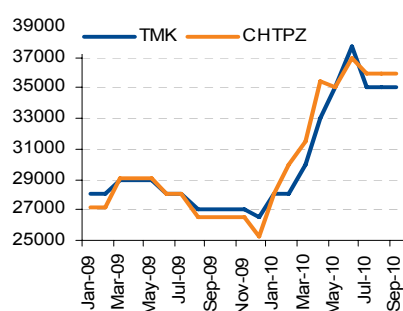
Comparative valuation

	TMK	Chelyabinsk Pipe
2010E EV/EBITDA	8.1	7.0
2010E EV/Output	2,013	1,800
Weight	90%	10%
Estimated Market Cap		1,408
on EV/EBITDA		1,417
on EV/Output		1,327
Target price		3.0
Upside		50%

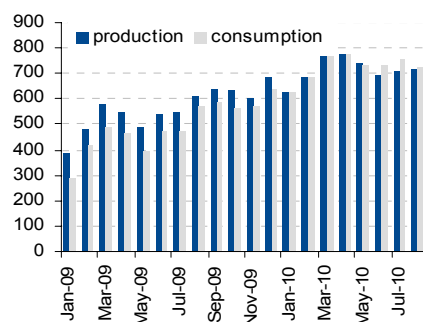
Source: company data, TKB Capital estimates

Chelyabinsk Pipe Group includes two divisions: pipe and oilfield services. Pipe division represents by two plants – Chelyabinsk Pipe Works and Pervouralsk Pipe Works. Oilfield services division is represented by Rimera.

TMK and CHTPZ domestic realized prices, 2009-2010 (RUR/t)

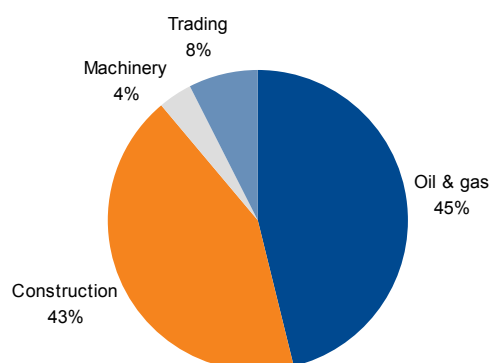


Russian pipe output and demand in 2009-2010, Kt



Source: company data, Metal expert, TKB Capital estimates

Domestic market pipe consumption structure



Source: company data, TKB Capital estimates

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