



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

July 6, 2006

The Russian LDP market

Industry
review

Pipes with big prospects

Analyst:

Nikolay Saperov

saperovn@sovlink.ru

VYKSA PIPE: BUY

UPSIDE: 44%

TARGET PRICE \$1,310

STOCK DATA

Ticker	vsmz	MCap (US\$ mn)	1,712
Shares Ords	1,882,199	Free Float, %	9
Shares Pref	-	Free Float (US\$ mn)	154
Bid Ords (US\$)	895	Offer Ords (US\$)	930
Bid Prefs (US\$)	-	Offer Prefs (US\$)	-

PERFORMANCE 2005

Sales (US\$ mn)	1,358	Gross profit	430
EBITDA(US\$ mn)	220	Net income	99
EBITDA margin, %	16	Net margin, %	7

CHELYABINSK PIPE: BUY

UPSIDE: 30%

TARGET PRICE \$1.9

STOCK DATA

Ticker	CHEP	MCap (US\$ mn)	699
Shares Ords	472,382,880	Free Float, %	16
Shares Pref	-	Free Float (US\$ mn)	111
Bid Ords (US\$)	1.45	Offer Ords (US\$)	1.48
Bid Prefs (US\$)	-	Offer Prefs (US\$)	-

PERFORMANCE 2005

Sales (US\$ mn)	722	Gross profit	151
EBITDA(US\$ mn)	108	Net income	23
EBITDA margin, %	15	Net margin, %	3

- The Russian pipe industry is going through considerable changes. Leading its growth are large-diameter pipes (LDP), where volume increased by 33.4% over 2005 compared to the 10.6% growth of the pipe industry in general.

- The large pipeline projects of Gazprom and Transneft—the North-Europe Pipeline (NEP) and the Eastern Siberia-Pacific Ocean (ESPO)—should provide steady demand for LDP until 2011.

- According to our estimates, Russian consumers will need about 2 mn tons of LDP in 2006.

- Large-diameter high-pressure pipe is the most interesting line of LDP market development, in our opinion. Russian pipe plants such as Vyksa Pipe and Izhorisk Pipe are beginning to produce this type of pipe, as Gazprom's demand is shifting to Russian producers from its traditional foreign suppliers in Germany, Ukraine, and Japan.

- Traded LDP producers Vyksa Pipe and Chelyabinsk Pipe can improve their market positions by producing pipes with higher technological quality than their competitors, Ukraine's Volzhsk Pipe and Kharzisk Pipe.

- Vyksa Pipe controls 22% of the LDP market and has substantial prospects due to launching production of 1,420-mm single-seam LDP, which are in high demand by Gazprom for construction of the underwater part of NEP.

- Chelyabinsk Pipe is the main 530-1,220-mm LDP producer and has a strong market position, which could be improved by increasing capacity to meet the demands of the ESPO project.

Tel.: +7 495 967 1300

Fax: +7 495 967 1311

research@sovlink.ru



ALJBA ALLIANCE



The Russian LDP market

- The Russian pipe industry is going through considerable changes. Leading its growth is large-diameter pipes (LDP), where volume increased by 33.4% over 2005 compared to the 10.6% growth of the pipe industry in general. Demand from the largest LDP consumers—Gazprom and Transneft—is shifting towards pipes of new standards. Producers of 1,420-mm single-seam pipes will have the strongest market positions, as this kind of pipe will be used by Gazprom in the underwater part of its NEP project and in the infrastructure of the Shtokmanskoe gas field. Currently, these pipes are produced only by Vyksa Pipe; however, Izhorsk Pipe plans to produce these pipes in 2007.
- The large pipeline projects of Gazprom and Transneft—the NEP and the ESPO—should provide steady demand for LDP until 2011. The implementation of these projects and introduction of protective duties for LDP import will change the market positions of key players drastically, in favor of Russian producers. We believe that over the next five years, the LDP market will demonstrate positive dynamics relative to the whole pipe market.

Russian LDP production development

	2004	2005	2006E	2007E	2008E
Pipes, mn tons	6.1	6.7	6.9	7.1	7.4
LDP, mn tons	1.0	1.3	1.8	2.1	2.4

Source: Sovlink Securities estimates

- According to our estimates, Russian consumers will need about 2 mn tons of LDP in 2006. We expect that demand for LDP in 2006-11 will be 10 mn tons of LDP, suggesting that annual demand for LDP will be no less than 2 mn tons per year until 2011. We expect that LDP production will be 1.76 mn tons in 2006, and that Russian producers will meet the demand of domestic consumers completely from 2007.
- Large-diameter high-pressure pipe is the most interesting line of LDP market development. Russian pipe plants are beginning to actively produce this type of pipe, (Vyksa Pipe, Izhorsk Pipe), as Gazprom's demand is shifting to Russian producers from its traditional foreign suppliers in Germany, Ukraine, and Japan.



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

July 6, 2006

Contents:

Large-diameter pipe information.....4

Terms and abbreviations used in this report.....5

Industry review.....6

Present industry situation8

Prospects of industry development.....11

Industry development forecast.....13

Vyksa Pipe.....15

Chelyabinsk Pipe.....20



Large-diameter pipe information

- Pipes with diameter greater than 508 mm are classified as large-diameter pipes (LDP). LDP are mainly used in the oil and gas industry. Pipes with diameter up to 1,020 mm are used in oil-trunk pipeline construction, while pipes with diameter of 1,020-1,420 mm are used in the construction of gas pipelines. The main raw material in the manufacture of LDP is strip steel in rolls and in slabs. The share of strip steel in LDP manufacturing comes to 70% of the total cost.
- Gazprom and Transneft are the main consumers of LDP in Russia. They require LDP due to the construction of new oil-trunk and gas pipelines and also for the repair of existing pipelines. LDP can be divided into three groups: spiral-seam, single-seam and double-seam. Single-seam pipes have the highest pressure resistance and can be used in underwater oil-trunk and gas-main pipeline construction. Spiral-seam and single-seam LDP are mainly used in overland construction and repair. The LDP market in Russia is a substantial part of the overall pipe market—more than 50% of overall pipe output is LDP.
- The LDP market is oligopolistic and divided between three major plants belonging to three large pipe holding companies—Vyksa Pipe, Chelyabinsk Pipe and Volzhsk Pipe.
- Further LDP demand comes from Transneft and Gazprom, which plan to build oil and gas pipelines for the next few years.



SOVLINK
YOUR FIRST CALL – FOR THE SECOND TIER

July 6, 2006

Terms and abbreviations used in this report

LDP—Large-diameter pipes

LDP 1420—1,420-mm diameter pipes

High-pressure LDP—Large-diameter pipes which are able to sustain pressure up to 250 atmospheres and are used in the construction of the underground parts of oil and gas pipelines

SRM—Steel-rolling mill

Strip steel—The main raw material for manufacturing LDP

DNV—Det Norske Veritas, the Norwegian engineering company that worked out the standards for the underwater parts of oil and gas pipelines

ESPO—Eastern Siberia-Pacific Ocean pipeline (Transneft)

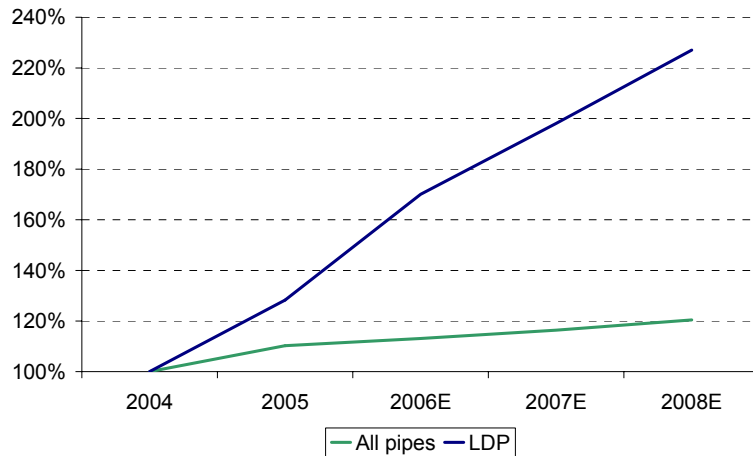
NEP—North-European pipeline (Gazprom)



Industry review

- The Russian pipe industry has substantial prospects for development: the construction of oil and gas pipelines (NEP and ESPO) should boost demand for LDP (530-1,420-mm welded pipe) and significantly change the alignment of forces in the market.

Russian pipe and LDP industry growth, % chg. from 2004



Source: Sovlink Securities estimates

Demand factors for LDP

- The construction of new oil-trunk and gas-main pipelines, i.e. ESPO and NEP (about 1.4-1.5 mn tons per year)
- Repair works at Gazprom and Transneft, i.e. replacing parts of facilities with a high level of deterioration (about 0.35-0.4 mn tons per year)
- Regional demand from the other consumers of LDP, mainly medium-sized oil companies (0.2 mn tons per year).

**Description of main pipeline projects**

- Big pipeline projects, first of all the ESPO and NEP—which are being implemented by Transneft and Gazprom, respectively—should provide strong demand for LDP through 2011. In the next five years, the LDP market will outstrip the general pipe market.

Key Russian pipeline projects

Oil pipelines	Length, km	Customer	Pipe diameter, mm	Timeframe	Demand for LDP 2006-08E, '000 tons
ESPO (first stage)	2,430	Transneft	1,067-1,220	2005-07	1,230
ESPO (second stage)	2,000	Transneft	1,067	2008-11	260
Kstovo-Yaroslavl-Kirishi-Primorsk	1,000	Transnefteproduct	530	2006-08	200
gas pipelines					
NEP (overland part)	917	Gazprom	1,420	2005-09	560
NEP (underwater part)	1,189	Gazprom	1,067-1,420	2007-11	480
Bovanenkovo-Yamburg-Center	852	Gazprom	1,420	2007-11	100

Source: Gazprom, Transneft, FDPI, Expert magazine

- The main suppliers for the national pipeline construction projects will be Russian companies: about 70% of the market belongs to them.

ESPO

- The Eastern Siberia–Pacific Ocean Pipeline (ESPO) is a project of Transneft and assumes the export of 56 mn tons of oil to the Asia-Pacific region annually. The pipeline goes through seven regions of the Russian Federation and measures 4,130 km. The main part of the demand from Transneft consists of 1,220-mm pipes.

NEP

- Gazprom's North-European Pipeline is a joint project with Germany's BASF and is to go through the Baltic Sea from Vyborg up to shore of Germany. The project measures 917 km on Russian Federation land, and will stretch for 1,189 km underwater. The underwater part of the project requires high-quality single-seam pipes able to sustain high pressure. Among Russian producers, only Vyksa Pipe produces such pipes, although Izhorsk Pipe will produce them from 2007. The total investment in the project will amount to \$5.7 bn.



Present industry situation

The LDP market in Russia is mostly controlled by three main plants:

- Volzhsk Pipe, which belongs to Pipe Metallurgical Company (TMK)
- Vyksa Metallurgical Plant, which belongs to Unified Metallurgical Company (OMK)
- Chelpipe Plant, which belongs to Chelyabinsk Tube-rolling Plant (ChTPZ)

Top-tier players in the Russian LDP market

	Holding company	Country	Capacity (all LDP, '000 tons)	1,420-mm pipe capacity ('000 tons)	Type of LDP 1,420 mm	LDP production, 2005, '000 tons
Vyksa Pipe	OMK	Russia	1,582	570	longitudinal single-seam	426
Chelyabinsk Pipe	ChTP	Russia	980	-	-	387
Volzhsk Pipe	TMK	Russia	600	600	Spiral-seam	515
Izhorsk Pipe *	Severstal	Russia	450	450	longitudinal single-seam	-
Kharzisk Pipe	Donets Basin industry alliance	Ukraine	820	620	longitudinal double-seam	280**
Total in Russia			3,612	1,620		1,328

Source: Company data

* - planned production capacity is expected in 2007

** - mentioned volume of export in Russia

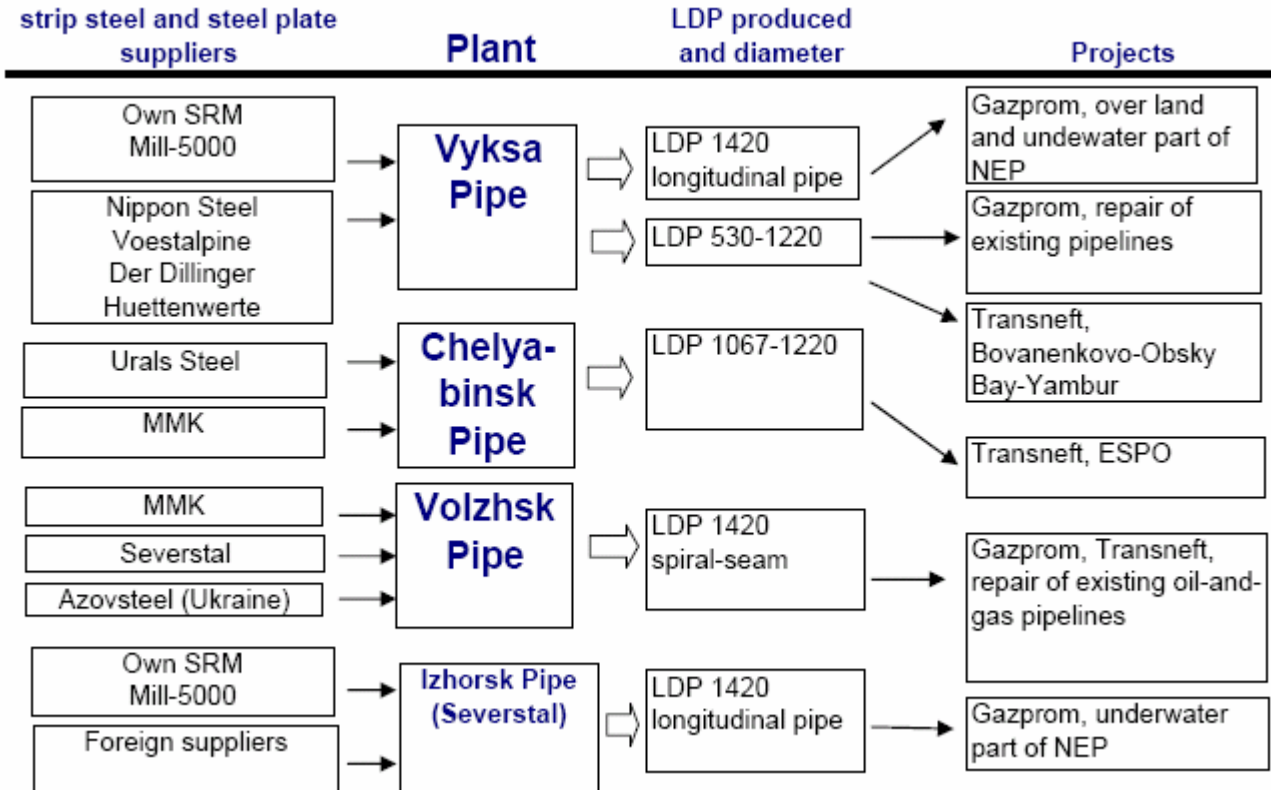
- Ukraine's Kharzisk Pipe Plant is an important foreign player on the Russian LDP market.
- In 2007, Severstal is expected to put its Izhorsk Pipe into operation. Its capacity is to be 450,000 tons per year and its production will be fully concentrated on producing 1,420-mm LDP.

Industry regulation

- The government is currently considering setting an 8% duty above the usual import duty on LDP. At the end of 2004, the validity of a three-year pipe import purchasing agreement with Ukraine expired, and Ukraine refused to negotiate a new agreement in 2005. Without the agreement, the Russian market remained open for Ukrainian imports, which led to dumping on the pipe market. As a result, in June 2006 the Ministry of Economic Development and Trade (MEDT) offered to impose protective duties, which will help the Russian pipe producers.



Supply and demand structure of Russian pipe plants



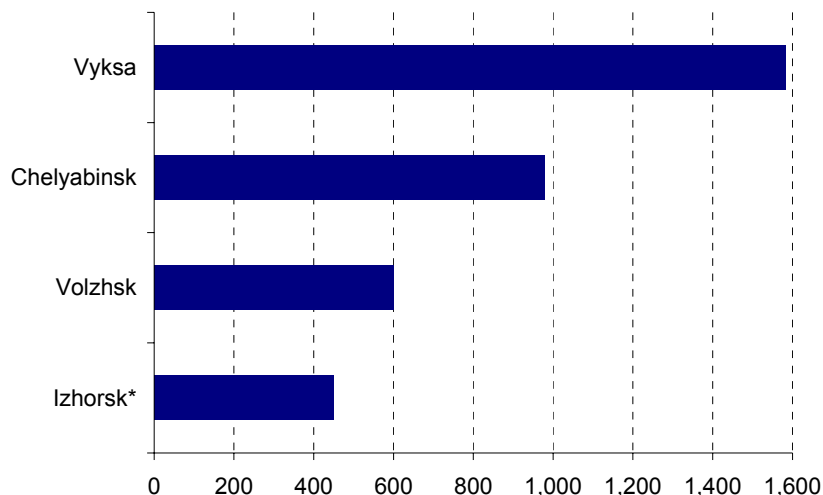
Source: Sovlink Securities estimates

- The main raw material for LDP production is strips (steel billet). Izhorsk Pipe is in the most favorable situation vis a vis raw material provision, and it is not reaching its planned high-pressure LDP 1,420 production capacity. Further, Izhorsk Pipe’s owner Severstal also owns the Mill-5000 rolling foundry complex, which is able to provide the factory with the entire desired volume of raw materials. Earlier, strips produced by this complex were delivered to Vyksa Pipe. It is likely that from this year strips supplied to Vyksa Pipe will be reduced or aborted, which is why Vyksa Pipe announced plans to build its own rolling foundry complex in June, 2006. Magnitogorsk Iron & Steel (MMK) provides Chelyabinsk Pipe and Volzhsk Pipe with steel billet mainly for LDP 1420 production. LDP 1420 production requires wide steel plates, which Russian producers put out with small volumes. As such, plants producing single-seam LDP 1420 have to purchase wide steel plates from foreign suppliers. Thus, producers that have their own strip manufacture (Vyksa Pipe and Izhorsk Pipe) should take strong competitive positions.

- The total capacity of Russian LDP producers is 3.6 mn tons per year (including the capacity of Izhorsk Pipe), which significantly surpasses the demand of Russian companies, which we estimate at 2 mn tons. Thus, we expect tight market competition for access to Russia’s main LDP consumers and the exclusion of foreign producers (i.e. Ukraine, Japan, and Germany) from the market. Foreign producers are likely to come under pressure in 2007, when Russian LDP production meets the quantity demanded.



LDP plant capacities, 2006E, mn tons



* We use our 2007 forecast for Izhorsk Pipe, as its LDP production line is not scheduled to open until then.

Source: Company data

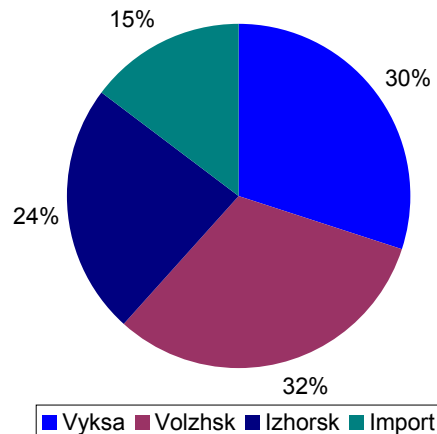
- The industry is currently producing at 30%-40% of capacity. At the same time, demand from the main pipe consumer—Gazprom—is shifting. The underwater portion of the NEP requires pipes that are able to sustain pressure of 250 atmospheres and have a wall width of 48 mm. Vyksa Pipe was the first Russian company to introduce production of this type of pipe (single-seam) and now the company enjoys a favorable situation. However, the new facilities at Severstal's Izhorsk Plant are also to produce single-seam LDP 1420.
- There are substantial changes in pipe producers' market profiles. First of all, Gazprom is removing old "Soviet technologies" from its purchases. These technologies are used by Volzhsk Pipe and Kharzisk Pipe: the former produces spiral-seam pipes, while the latter makes double-seam pipes that cannot sustain pressure of more than 84 atmospheres.
- Thus, currently only Vyksa Pipe can produce pipes for underwater lines capable of sustaining pressure of 210 atmospheres, but by end-2006/early 2007, Izhorsk Plant will be able to as well. However, Vyksa Pipe can still be regarded as monopolist on high-pressure LDP—in April 2005, Vyksa Pipe launched a new line producing 1,420-mm pipes with wall width of 48 mm and able to sustain pressure up to 250 atmospheres.
- Chelyabinsk Pipe only produces 530-1,220 mm pipes. The plant's market share is 20% and it is the main supplier of LDP for the ESPO project, which uses 1,067-1,220-mm pipes.
- Volzhsk Pipe's market share is 28%, and produced 515,000 tons in 2005. The company produces spiral-seam pipes, which have a lower technological quality than single-seam and double-seam pipes. The plant's spiral-seam pipes are mainly used in the construction of the overland portion of the NEP and for the repair of existing oil and gas pipelines.



Prospects of industry development

- Large-diameter high-pressure pipe is the most prospective line of LDP market development. These are single-seam pipes, as double-seam and spiral-seam pipes cannot sustain pressure over 210 atmospheres. Russian pipe plants such as Vyksa Pipe and Izhorsk Pipe have introduced production of these pipes, and demand from Gazprom is shifting from traditional foreign suppliers (from Germany, Ukraine and Japan) to Russian producers.
- We expect a struggle for market share and receiving contracts from Gazprom and Transneft, because the capacities of the main producers are half the expected internal demand. One of the reasons for the low utilized capacity is insufficient internal demand relative to potential producing power (in industry it reaches 50%-60% on average).
- LDP 1,420 mm will be the main sector affected by the struggle, since Ukrainian imports were the only source for Russian customers (Kharzisk Pipe).

LDP 1,420 capacity distribution



Source: Company data

- In Russia, production of LDP 1420 started at TMK, where production of spiral-seam pipes began in 2003. However, these pipes do not satisfy Gazprom's demand for single-seam pipes, used in underwater construction. The manufacture of high-pressure LDP was started by OMK in 2005, by starting the production of single-seam pipes at Vyksa Pipe with capacity of 570,000 tons. In the beginning of 2006, Vyksa Pipe declared plans to expand production from 0.5 mn tons to 1.5 mn tons by 2009.
- In 2007 a new player will enter the LDP 1,420 market, Severstal's Izhorsk Pipe, with initial capacity 0.45 mn tons per year.
- Chelyabinsk Pipe (part of the ChTPZ Group) holds a stable position on the market. The plant does not produce LDP 1,420, but is one of the main producers of 1,067-1,220-mm diameter pipes. The company recently rebuilt its facilities, which allowed it to produce pipes with wider walls (up to 20 mm), which sustain higher pressure.



SOVLINK
YOUR FIRST CALL – FOR THE SECOND TIER

July 6, 2006

Risks

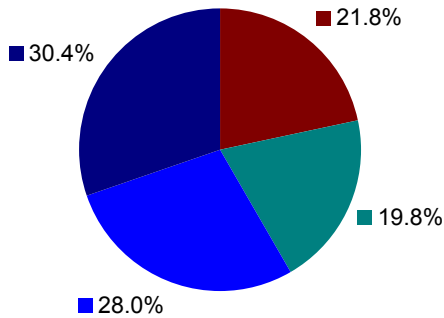
- One of the main resources used in LDP construction is steel intermediates. The main producer of LDP 1,420 in Russia—Vyksa Pipe—has to import most of its steel intermediates, because Russian producers manufacture wide steel plates in limited quantities. However, in July 2006, OMK announced plans to construct its own Mill-5,000 with 1.2 mn tons capacity to fully supply its LDP needs.



Industry development forecast

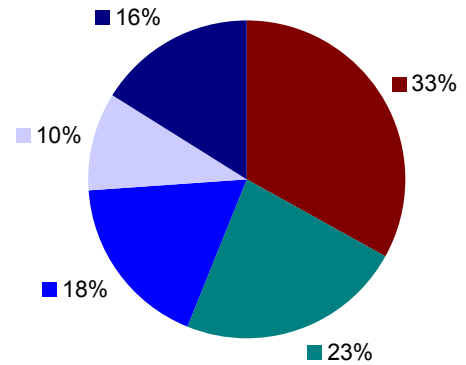
- We forecast that by 2008 the pipe industry structure could change due to strong competition on the LDP market.

LDP market share, 2005



■ Vyksa ■ Chelyabinsk ■ Volzhsk ■ Import

LDP market share, 2008E



■ Vyksa ■ Chelyabinsk ■ Volzhsk ■ Import ■ Izhorsk

Source: Sovlink Securities estimates

- Vyksa Pipe currently has the best competitive position on the market, as in 2005 it introduced a new facility for LDP 1,420 and plans to engage its capacity of 0.6 mn tons per year in 2006. The factory's main competitive advantage, which it plans to realize by end-2006, is the production of pipes for underwater facilities according to DNV's standards for the construction of the North-European Pipeline's underwater section. Vyksa Pipe is now the sole manufacturer of 1,420 pipes that meet these standards. From 2007, Izhorsk Pipe is to start producing similar pipes, and we expect it to have a 16% share of the LDP market by 2008.

- Chelyabinsk Pipe is the main producer of 1,020-1,220 mm pipes in Russia, and its position in the LDP market remains stable. At the same time, the company does not have facilities for LDP 1,420 production. We expect that its share of the LDP market will increase slightly from today's 20% to 23% by 2008 due to the modernization of its 1,020-1,220-mm pipe production and maximum load for building the ESPO.

- Industry changes and a demand shift in the LDP 1,420 sector towards single-seam pipes could negatively effect VPP's position on this market. We expect the company's market share to decrease from 28% in 2005 to 18% in 2008. VPP now produces spiral-seam LDP 1,420, which are of a lower technological quality than straight-seam pipes, produced at Vyksa Pipe and Izhorsk Pipe. However, if straight-seam pipes are used in the underwater sections of pipelines, demand for spiral-seam pipes should come from the need to repair existing surface lines.

- We expect foreign producers' market share to decrease significantly by 2008, from 30% in 2005 to 10%). Earlier, LDP 1,420 pipes were imported mainly from Ukraine, where the main producer is Kharzisk Pipe.





SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

July 6, 2006

-
- Straight-seam LDP 1,420 pipes were purchased from Japanese and German producers. Imports from Japan were linked with pipeline construction projects on Sakhalin that are coming to their end now. The Russian gas industry bought such pipes from Japanese plants Nippon Steel, JFE, Sumitomo and also from Germany's Europipe. Russia's Vyksa Pipe has become the seventh producer of this pipe in the world, providing the construction of the NEP with LDP 1,420 from November 2005. Izhorsk Pipe is to start production by the end of 2006.
 - Ukrainian spiral-seam LDP 1,420 is technologically worse than the straight-seam pipes produced by Russia's Vyksa Pipe and Izhorsk Pipe, which is why we expect a decrease in the share of Ukrainian imports.

Perspectives after 2011

- In 2011, the main projects of Gazprom and Transneft that provide demand for LDP should be finished—the construction of the ESPO and the underwater part of the NEP are to be done. At this time, we expect Russian producers will diversify their sales due to new construction in Central Asia, the Caspian region and shelf fields. However, in the next five years we can expect active growth of the LDP market provided by construction of oil and gas pipelines
- Despite the fact that the traded shares of Russian producers (Vyksa Pipe and Chelyabinsk Pipe) have risen significantly since the beginning of this year, we believe they still have immense growth potential and the market capitalization of these firms can significantly increase in the near term.



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

July 6, 2006

Vyksa Pipe

COMPANY NOTE

BUY

UPSIDE: 44 %

Target Price: US\$1,310

Analyst:

Nikolay Saperov

saperovn@sovlink.ru

STOCK DATA

Ticker	vsmz	MCap (US\$ mn)	1,712
Shares Ords	1,882,199	Free Float, %	9
Shares Pref	-	Free Float (US\$ mn)	154
Bid Ords (US\$)	895	Offer Ords (US\$)	930
Bid Prefs (US\$)	-	Offer Prefs (US\$)	-

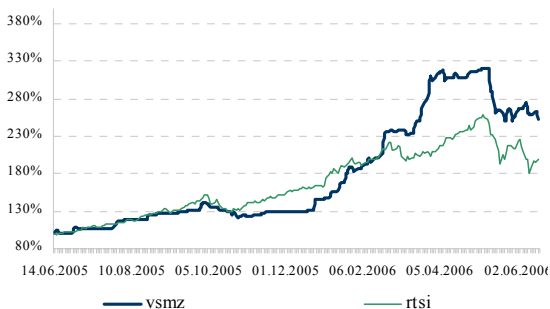
MARKET PERFORMANCE

		1 month	6 months
Absolute	Ords	-5%	50%
	Prefs	-	-
Relative to RTSI	Ords	1%	44%
	Prefs	-	-
Price range (US\$)			
	High	950	1,102
	Low	860	581
High	Prefs	-	-
	Low	-	-

PERFORMANCE 2005

Sales (US\$ mn)	1,358	Gross profit	430
EBITDA(US\$ mn)	220	Net income	99
EBITDA margin, %	16	Net margin, %	7

VSMZ RELATIVE PERFORMANCE



Source: RTS, Sovlink Securities

- Vyksa Pipe controls 14.6% of the Russian pipe market. At the same time, it is one of the biggest Russian producers of large-diameter pipes (LDP), controlling 22% of this market. Vyksa Pipe has a well-diversified business, and also has a strong position on the railway wheel market.

- Vyksa Pipe will benefit from the reorientation of Russia's main LDP consumers towards high-quality pipes that are capable of sustaining extreme pressure. In 2005, the company began producing single-seam LDP 1,420 pipes, which are necessary for the underwater part of Gazprom's North-European Pipeline (NEP) project. These pipes have substantial technological advantages over double-seam and spiral-seam pipes, produced by VMP's nearest competitors—Volzhsk Pipe and Ukraine's Kharzisk Pipe. Vyksa Pipe is currently a monopolist in the production of high-pressure LDP; however, in 2007 Severstal's Izhorsk Pipe is to begin production of this kind of pipe.

- This year, VMP's parent company Unified Metallurgical Company (OMK) plans to produce 1.4 mn tons of different pipes, 40% over its 2005 level. This growth in production will generally be due to increasing LDP production. In 2006 Vyksa Pipe will supply LDP to two large projects—Gazprom's NEP and Transneft's ESPO. From 2007, Vyksa Pipe will be one of the suppliers of single-seam LDP 1,420 for the underwater part of the NEP.

- The main part of LDP production costs (up to 70%) comes from wide-rolled steel sheet strips. In June 2006, OMK announced that it would build its own rolling mill-5000, with capacity of 1.2 mn tons, in order to meet its own LDP production needs.

- We estimate the fair value of Vyksa Pipe using a DCF model and multiples. We took the average values for its foreign peers, which have similar levels of sales. We arrive at a fair value of \$2,466 mn for the whole company, or \$1,310 per share, which suggests 44% upside potential.

Tel.: +7 495 967 1300

Fax: +7 495 967 1311

research@sovlink.ru



ALJBA ALLIANCE



Pipe segment

- OMK, which holds 91% of Vyksa Pipe's shares, controls approximately 17% of the Russian pipe market as a whole, and 22% of the LDP market. In 2006-07, Vyksa Pipe will have a range of possibilities: the plant is currently a monopolist in the market of high-pressure LDP 1,420, where production started in 2005. This year, Gazprom substantially increased its purchases of LDP 1,420 from Vyksa Pipe and lowered its reliance on imports from Ukraine's Kharzisk Pipe. In the future, when protective import duties are introduced, we expect an even greater decline of imports and increase of supplies from Russian LDP plants.
- Volzhsk Pipe, which is a direct competitor of Vyksa Pipe, produces spiral-seam LDP, which have worse technological characteristics than single-seam pipes. The market positions of LDP producers are now being changed: we expect that Vyksa Pipe's share will increase, while Volzhsk Pipe's and imports will fall. In 2006 Vyksa Pipe is to supply LDP for two of Russia's largest pipelines—NEP and ESPO. From 2007, the company is to be one of the suppliers of single-seam LDP 1,420 for the underwater part of the NEP project.

Strategy

- Having entered the market of high-pressure LDP 1,420, Vyksa Pipe should solve its problem with strip supplies. As the company does not have own strips production, it has to buy raw materials from Severstal and foreign suppliers. However, once Severstal starts LDP 1.420 production at its Izhorsk Plant next year, raw material supplies to VMP may decrease drastically. As a result, OMK decided to build its own rolling mill-5,000 to produce LDP 1,420. The project is to cost \$0.8-1 bn, with production capacity of 1.2 mn tons per year. Building its own rolling mill will allow the company to become independent from strip steel suppliers.

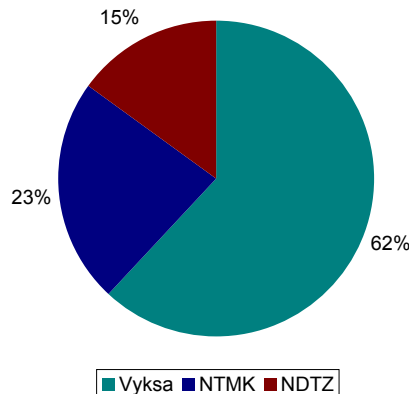
Railway wheels segment

- In addition to pipes, Vyksa Pipe also produces railway wheels, which make up 32% of its sales. This segment remains the most stable in company's business, owing to long-term contracts with Russian Railways. Modernizing its railway-wheel mill improved the quality of metal for wheel production substantially, and made it possible to export wheels to EU countries.

Railway wheels market

- The railway wheels market has three main producers: Russia's Vyksa Pipe and Nizhny Tagil Iron & Steel (NTMK) and Ukraine's Nizhnednepetrovsky Pipe (NDTZ).

Railway wheel market share



Source: Company data



- Demand comes from three major companies—Russian Railways and by the state-owned railway companies of Ukraine and Kazakhstan. Russian Railways consumes more than half of Vyksa Pipe's railway wheels.
- Vyksa Pipe is the leading company in this sector—in 2002-04 the demand growth rate of railway wheels was 17.3% per year on average.

1Q06 manufacturing performance

	1Q05	1Q06	% chg. y-o-y
Pipe production, '000 tons	207.0	327.0	58%
LDP production, '000 tons	56.0	163.7	192%

Source: Company data

- This year Vyksa Pipe intends to increase the production of pipe grades by 40% relative to 2005, up to 1.4 mn tons. The main production growth will be provided by LDP, which it plans to produce 950,000 tons of (double its 2005 output).

Financial results, 2004-06E, \$ mn

	2004	2005	2006E
Sales	1,010.2	1,358.0	1,833.5
EBITDA	214.7	220.0	440.7
Net profit	127.4	99.0	292.4
EBITDA margin, %	21%	16%	24%
Net margin, %	13%	7%	16%

Source: Company data



Valuation

DCF model

• In evaluating Vyksa Pipe's fair value by the DCF method, we base our model on our expected increase of the company's market share of LDP and from stable growth on the railway wheels market. According to the company's forecast and its 1Q06 results, we believe that sales will reach \$1,833 mn this year, while net income will hit \$292 mn. Looking at the company's future cashflows, we assume the company grows its sales in the pipe segment faster than the pipe market in general, and will grow in line with the railway wheel market.

DCF Summary, \$ mn

	2005	2006E	2007E	2008E	2009E	2010E
Revenues	1,358	1,833	2,034	2,156	2,328	2,515
Gross profit	430	484	519	496	552	614
EBITDA	220	441	473	448	499	555
Net profit	99	292	316	296	329	366
EBITDA margin, %	16%	24%	23%	21%	21%	22%
Net margin, %	7%	16%	16%	14%	14%	15%
NI	99	292	316	296	329	366
Amortization	41	55	61	65	70	75
Capex	207	105	32	32	32	32
FCFF	(67)	243	345	328	367	410
FCFF discounted		207	252	205	196	187

Source: Sovlink Securities estimates

DCF target value calculation

WACC	17%
Terminal growth rate	6%
NPV of forecasted years, \$ mn	1,047
NPV of terminal value, \$ mn	1,800
Fair EV, \$ mn	2,847
Net debt, \$ mn	303
Fair M.Cap, \$ mn	2,544
Number of ordinary shares	1,882,199
Number of preferred shares	n/a
Fair value per ordinary share, US\$	1,351
Fair value per preferred share, US\$	n/a
Upside potential	57%

Source: Sovlink Securities estimates

• According to our DCF model, Vyksa Pipe's fair value (without taking debt into consideration) is \$2,544 mn, which corresponds to a share price of \$1,351 and implies 57% growth from current prices.



Peer comparison

Vyksa Pipe multiples

	2005	2006E
P/S	1.26	0.93
P/E	17.30	5.86
EV/EBITDA	9.16	4.57
P/BV	3.43	3.11
EV/S	1.48	1.10

Source: Sovlink Securities estimates

Peer comparison valuation, 2005

	P/S	P/E	P/BV	EV/EBITDA	EV/S
Tube Investments of India	0.99	12.99	2.50	16.56	0.94
Armtec Infrastructure Income	1.15	14.57	2.16	9.80	1.21
Tubacex SA	1.44	24.45	3.17	10.77	1.32
YLI Holdings BHD	2.05	13.59	1.17	15.26	3.78
Maruichi Steel Tube LTD	2.41	20.86	1.26	11.14	2.09
Average	1.61	17.29	2.05	12.71	1.87
Vyksa Pipe	1.26	17.30	3.43	9.16	1.48
Upside/downside	28%	0%	-40%	39%	26%
Weights	30%	10%	20%	20%	20%
Weighted upside					13%

Source: Bloomberg, Sovlink Securities estimates

Valuation summary

	Upside	Weight	Average
Multiple valuation	13%	30%	
DCF valuation	57%	70%	
Fair Mcap, \$mn			2,466
Target price, \$			1,310
Upside potential, %			44%

Source: Sovlink Securities estimates

- Combining our valuations, we use a weight of 70% for our DCF estimate and 30% for our peer comparison estimate. We believe that the DCF method is better suited for valuation purposes given the LDP market, whose dynamics will be determined by the huge pipe construction projects. **Thus, we assess the fair value of Vyksa Pipe at \$2,466 mn, which corresponds to a share price of \$1,310 and suggests potential upside of 44%. We rate the company a Buy.**



Chelyabinsk Pipe

COMPANY NOTE

BUY

UPSIDE: 30 %
Target Price: US\$1.9

Analyst:
Nikolay Saperov
saperovn@sovlink.ru

STOCK DATA

Ticker	chep	MCap (US\$ mn)	699
Shares Ords	472,382,880	Free Float, %	16
Shares Pref	-	Free Float (US\$ mn)	111
Bid Ords (US\$)	1.45	Offer Ords (US\$)	1.48
Bid Prefs (US\$)	-	Offer Prefs (US\$)	-

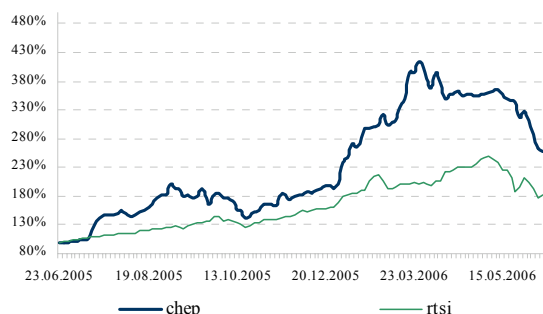
MARKET PERFORMANCE

		1 month	6 months
Absolute	Ords	-21%	0%
	Prefs	-	-
Relative to RTSI	Ords	-24%	-5%
	Prefs	-	-
Price range (US\$)	High	1.88	2.26
	Low	1.4	1.4
	High	-	-
	Low	-	-

PERFORMANCE 2005

Sales (US\$ mn)	722	Gross profit	151
EBITDA(US\$ mn)	108	Net income	23
EBITDA margin, %	15	Net margin, %	3

CHEP RELATIVE PERFORMANCE



Source: RTS, Sovlink Securities

- Chelyabinsk Pipe has a strong market position, with a 20% market share on the Russian pipe market. The company has well-diversified business, producing about 3,600 different kinds of pipes.

- Chelyabinsk Pipe does not have facilities to produce 1,420-mm LDP, but the plant is the main player on the 1,020-1,220 mm pipe market, which are generally in need during oil pipeline construction. Chelyabinsk Pipe is one of the suppliers of these pipes for the ESPO project, and the plant is increasing production due to Transneft's growing demand.

- The company is modernizing its facilities, which will allow it to respond to the increasing demand and export of LDP. In 2005 the plant modernized some facilities, which allowed it to produce more pipes with a thick pipe wall (20 mm)—these pipes can sustain higher levels of pressure.

- In 1Q06 Chelyabinsk Pipe increased its LDP shipments by 26% year-on-year. At the same time, its financial results have increased.

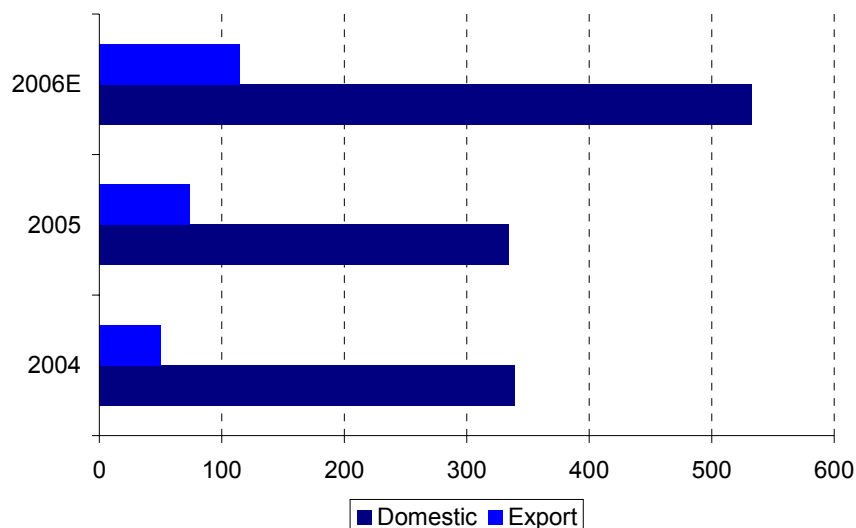
- We estimate the company's fair value by utilizing a DCF model and multiples. We took the average values for its foreign peers, which have similar levels of sales. Our valuation suggests a fair value of \$901 mn or \$1.9 per share, giving 30% upside potential.



Company description

- Chelyabinsk Pipe is one of the largest Russian pipe factories, with production capacity of 1.5 mn tons annually. It is a part of the ChPTZ Group (the group owns 83% of the factory's shares, with the remainder freefloat). The company's main specialization is large-diameter pipes, with sales of 380,000 tons in 2005 (compared to 388,000 tons in 2003), and no-seam hot-rolled pipes.
- The domestic market is key for Chelyabinsk Pipe, as it sold 84% of its pipe production there in 2004.
- Chelyabinsk Pipe is a leader on the LDP 1,020-1,220 mm market, and the main supplier of this kind of pipe for the ESPO project.
- Demand for the company's pipes comes not only from the construction needs at big pipeline projects, but also from oil and gas companies that need to repair outdated infrastructure. The pipeline systems of Gazprom and Transneft are heavily deteriorated and both companies are replacing the most deteriorated parts of their transport lines. The average period of accident-free pipe usage is about 15 years. About 40% of Gazprom's pipelines remain in use for over 20 years. At the same time, about 66% of Transneft's oil pipelines are 20 years or older. In Russia, there are 155,000 km of oil pipeline and 45,000 km of gas pipeline which need to be replaced. Both Gazprom and Transneft plan to spend more than \$1bn per year on the maintenance of existing infrastructure, which should provide Chelyabinsk Pipe with stable orders.
- The company's share of the LDP market—which is now about 20%—could increase to 23% by 2008, due to more active participation in supplying the ESPO.
- In 2006 Chelyabinsk Pipe plans to sell 533,000 tons of LDP to customers, which exceeds last year's figure by 60%.

Chelyabinsk Pipe sales, '000 tons



Source: Company data



Financial results

- In 1Q06, Chelyabinsk Pipe increased its pipe production by 12%, and LDP by 26%. Sales rose 31% year-on-year, while net profit rose over 400%.

Chelyabinsk Pipe 1Q06 results, \$ mn

	1Q05	1Q06	% chg. y-o-y
Sales	158.2	208.0	31%
Gross profit	32.2	55.3	72%
Net profit	4.3	22.6	422%
Pipe production, '000 tons	167.4	187.1	12%
LDP production, '000 tons	83.2	105.2	26%

Source: Company data

- In 2006 the company plans to considerably increase its LDP shipments to Russian customers. Due to a more active partnership with Transneft in its ESPO project, LDP shipments should rise by 40% this year, reaching more than 500,000 tons compared to 388,000 tons in 2005.
- ChPTZ Group's investment program is planning to build an electric furnace steelmaking complex with capacity of 1 mn tons per year, which should fully satisfy Chelyabinsk Pipe's needs in strip steel and steel intermediaries for LDP.

Valuation

DCF model

- In evaluating the company's fair value with the DCF method, we based our model on the assumption that the company will preserve a stable share of the LDP market up to 2010. Based on the company's announcements and our estimates, we forecast a considerable rise of sales in 2006—to \$1,122 mn. In the future, we assume that growth will decrease from 15% in 2007 to the industry average 8% in 2010. From our point of view, the company's current net margin is extremely low for the industry, and thus the company should be able to improve efficiency and raise this. Our model supposes that the company's net margin will increase to 11% by 2010.

DCF summary, \$ mn

	2005	2006E	2007E	2008E	2009E	2010E
Revenues	722	1,122	1,291	1,446	1,590	1,718
Gross profit	151	261	318	375	434	480
EBITDA	108	188	226	271	311	342
Net profit	23	35	65	116	159	189
EBITDA margin, %	15%	17%	18%	19%	20%	20%
Net margin, %	3%	3%	5%	8%	10%	11%
NI	23	35	65	116	159	189
Amortization	22	39	45	58	64	69
Capex	50	70	60	50	50	50
FCFF	(5)	5	50	124	173	208
FCFF discounted		4	36	77	92	95

Source: Sovlink Securities estimates



DCF target value calculation

WACC	17%
Terminal growth rate	6%
NPV of forecasted years, \$ mn	304
NPV of terminal value, \$ mn	913
Fair EV, \$ mn	1,217
Net debt, \$ mn	304
Fair M.Cap, \$ mn	913
Number of ordinary shares	472,382,880
Number of preferred shares	-
Fair value per ordinary share, \$	1.93
Fair value per preferred share, \$	-
Current price, offer, US\$	1.48
Upside potential	31%

Source: Sovlink Securities estimates

- According to our DCF model, the fair value of the company without taking its debt into consideration is \$913 mn, which suggests a fair share price of \$1.93 and implies 31% growth from current prices.

Peer comparison

Chelyabinsk Pipe multiples

	2005	2006E
P/S	0.97	0.62
P/E	30.39	19.87
EV/EBITDA	9.32	5.34
P/BV	2.70	2.33
EV/S	1.39	0.89

Source: Sovlink Securities estimates

Peer comparison valuation

	P/S	P/E	P/BV	EV/EBITDA	EV/S
Tube Investments of India	0.99	12.99	2.50	16.56	0.94
Armtec Infrastructure Income	1.15	14.57	2.16	9.80	1.21
Tubacex SA	1.44	24.45	3.17	10.77	1.32
YLI Holdings BHD	2.05	13.59	1.17	15.26	3.78
Maruichi Steel Tube LTD	2.41	20.86	1.26	11.14	2.09
Average	1.61	17.29	2.05	12.71	1.87
Chelyabinsk Pipe	0.97	30.39	2.70	9.32	1.39
Upside/downside	66%	-43%	-24%	36%	34%
Weights	40%	10%	20%	20%	20%
Weighted upside					25%

Source: Bloomberg, Sovlink Securities estimates



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

July 6, 2006

Valuation summary:

	Upside	Weight	Average
Multiple valuation	25%	30%	
DCF valuation	31%	70%	
Fair M.Cap, \$ mn			901
Target price, \$			1,9
Upside potential, %			29%

Source: Sovlink Securities estimates

- Combining our valuations, we use a weight of 70% for our DCF estimate and 30% for our peer comparison estimate. **Using this, we obtain a fair value for CHPP of \$901 mn, which suggests a fair share price of \$1.9 and implies 30% growth potential. We rate the stock a Buy.**



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

July 6, 2006

STOCK RATING POLICY

STRONG BUY:	Target price offers upside of over 100%; confidence level – high
STRONG BUY (SPEC):	Target price offers upside of over 100%; confidence level – low
BUY:	Target price offers upside of between 25% and 100%; confidence level – high
BUY (SPEC):	Target price offers upside of between 25% and 100%; confidence level – low
HOLD:	Target price offers upside of less than 25%
SELL:	Target price at or below current price levels

SOVLINK LLC

Tel.: +7 495 967 1300

Fax: +7 495 967 1311

Kremlin Embankment 1, building 2,
Moscow 119019, Russia

www.sovlink.ru

research@sovlink.ru

©2006 Sovlink LLC. The information in the enclosed Report (the "Information") is not an advertisement for any security or particular issuer and should not be interpreted as such. The Information is intended solely for the personal use of Sovlink LLC's clients or other parties pre-agreed to with Sovlink LLC. The Information is not intended for use by citizens of the USA or legal entities registered in the USA. Nothing contained in the Information is, or should be interpreted as being information intended for an undetermined audience.

The Information is exclusively of an informational/analytical nature, and should not be interpreted as a recommendation to take any particular investment action. The Information should not be relied upon as a justification for the execution of any transactions, and should not be referred to as such. Sovlink LLC takes no responsibility for any actions taken on the basis of the Information. The enclosed Report does not contain an offer or an invitation to make an offer to buy or sell any securities or any options, futures or other derivatives related to such securities.

This Report does not have regard to any specific investment objectives, financial situation and the particular needs of any specific person who may receive this Information. Investors should seek financial advice regarding the appropriateness of investing in any securities mentioned and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities, if any, may fluctuate and that each security's price or value may rise or fall. Accordingly, investors may earn less than originally invested. Past performance is not necessarily a guide for future performance. Foreign currency exchange rates may adversely affect the value, price or income of any security mentioned in the Report. Please bear in mind that investment activity in emerging markets is very risky, and investors should conduct their own due-diligence prior to making an investment decision.

The individual(s) responsible for the preparation of this Report (the Author(s)), or Sovlink LLC may hold short- and long-term positions in any of the securities mentioned in the Report, and may take part in investment activities with companies mentioned in the Report.

In preparing this Report, the Author(s) assumed that the issuers mentioned in the Report disclose information in the amount and under the procedure stipulated by the securities legislation of the Russian Federation for issuers who publicly place securities.

This Report and the Information is based exclusively on publicly-available information, which is deemed to be reliable, however Sovlink LLC makes no representation that this Information is accurate or comprehensive, and it should not be relied upon as such. Sovlink LLC makes no representation that this Report has been released to all readers simultaneously, nor that Sovlink LLC will update this material on a regular basis, or that it will correct inaccuracies contained in this Report.

Tel.: +7 495 967 1300

Fax: +7 495 967 1311

research@sovlink.ru

