

Vyksa Pipe

COMPANY NOTE

HOLD

Upside: +21.7 %
Target Price: \$1,657

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Stock data

Ticker	VSMZ	M.Cap, \$ mn	2,564
Shares Ords	1,882,199	Free Float, %	9%
Shares Prefs	-	Free Float, \$ mn	231
Bid Ords, \$	1,346	Offer Ords, \$	1,378

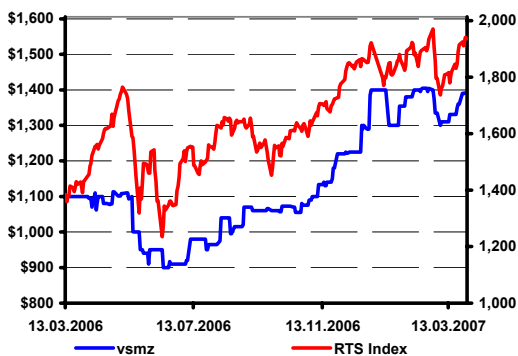
Market performance

		1 month	6 months
Absolute	Ords	2.59%	27.94%
Relative to RTSI	Ords	-7.90%	0.65%
Price range, \$			
High	Ords	1,369	1,420
Low	Ords	1,327	1,060

Financials, 2007E

Revenue, \$ mn	2,111	P/S	1.52
EBITDA, \$ mn	245	EV/EBITDA	14.10
Net Income, \$ mn	113	P/E	28.47

VSMZ's market performance



Source: RTS, Sovlink Securities

Fairly valued

- Vyksa Pipe manufactured 1,536 mn tonnes of pipes in 2006 (an increase of 53% relative to 2005). More than half (843 mn tonnes) of its production consisted of large-diameter pipes (LDPs). The company controls 35.7% of the LDP market (as opposed to 22% in 2005) and plays a significant role in the Russian pipes market with a market share of over 20% (compared to 14.9% in 2005). It also plays an influential role in the railway wheels market.

- The company obtains two-thirds of its revenues from its pipe business, while railway production comprises approximately one-third of its sales. Nonetheless, the railway sector provides stability to the company due to its long-term contracts, which are based on steady prices and volumes.

- The pipe sector is growing fast as a result of increasing local market consumption. The Russian oil & gas industry needs huge volumes of pipes in order to guarantee stable transportation of its production both abroad and to local consumers. This has led to the initiation of ambitious ductwork projects. Vyksa Pipe is the only 1,420-mm pipe manufacturer being used for the surface part of the North European Gas Pipeline (NEGP) project operated by Gazprom. The company has also started producing pipes, which meet DNV standards applicable to sub-sea pipelines.

- Vyksa's investment programme is aimed at strengthening its market position in all segments and especially in the LDP sector. Investments of over \$285 mn scheduled for 2007 will be directed towards the modernization of medium and large diameter pipes' facilities. Apart from this investment programme, OMK, the holding company that owns Vyksa, also plans to build a plant near Nizhny Novgorod, which will produce semi-finished products for Vyksa Pipe.

- The company's financial results have continued to be positive. Its net income and EBITDA margins for 2006 are over 11% and 16% respectively. These levels correspond to the average global levels of its peers. Its liquidity level is also in line with the industry, with a current ratio of 1.57 against an industry average of 1.64.

- The company has significantly strengthened its positions in capital markets in the past year. Its capitalization has grown impressively and has erased the valuation gap with other leading pipe producing companies. This is the main reason why we are revising its valuation. We value Vyksa Pipe using both peer analysis and a DCF model. Both of these instruments led us to conclude that the current price of the company is close to its fair value.

- Based on our new estimates, we consider the fair value of Vyksa Pipe at \$3,120 mn or \$1,657 per share, implying 21.7% upside potential. Although we have increased our target from our previous \$1,310, we downgrade our rating from **BUY** to **HOLD** on share price performance.

Valuation

DCF model

We evaluated the growth potential in Vyksa Pipe's capitalization using the DCF method for the period between 2007-16. We applied the following conditions and assumptions in our analysis:

1. The prevalent interest rate for loans was used to calculate the discount rate for companies, taking into consideration different debt/equity ratios. The standard required rate of return for Russian equities was assumed to be 13% and was applied to calculate the applicable discount rate to the equity portion of the company. The company's Beta rate was calculated relative to the RTS index for 2005-06.
2. The annual growth rates for the main production segments were held constant at 2.5%. This corresponds to average historic growth rates and takes into account the growth in production capacities due to acquisitions.
3. We assume that pipe production costs include the price of 1.0 tonne of steel, and the costs for producing railroad wheels include 1.2 tonnes of steel.
4. We believe that pipe prices will remain steady in the future, moving only slightly towards average historic values.
5. Pipe production costs consist of two different cash streams, expressed in dollars and the rouble equivalent. The calculations of both types of expenses take into account the inflation rates and currency dynamics applicable to each currency.
6. We applied an income tax rate of 24%. However, in some cases, the effective tax rate may differ due to the fact that we have calculated the profit tax according to Russian accounting standards.
7. Our calculations led us to conclude that given the above assumptions, the company's free cash flows would steadily grow. In fact, this will not happen, because cash flows will be redirected to investments in new projects and acquisitions or paid out as dividends. However, in the absence of information regarding the precise nature of such projects and their relative profitability, we have assumed that their profitability level would be equal to the average industry profitability level. In this case, there's no difference between investments made in cash or reinvested as dividends.
8. We assume that as of 2007, investments in PPE will be made at a sufficiently high level, so that their value in dollar equivalent terms will be maintained.

VSMZ: DCF SUMMARY, \$ mn

	2004	2005	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Non-current Assets	332.9	415.3	465.7	468.7	470.9	473.1	475.4	477.6	479.9	482.1	484.4	486.7	489.0
Current Assets	411.0	606.8	1,019.9	1,352.8	1,495.1	1,649.2	1,815.7	1,994.8	2,187.2	2,393.4	2,614.0	2,849.5	3,100.5
Non-current Liabilities	54.9	183.4	231.7	251.6	258.3	265.2	272.3	279.6	287.1	294.8	302.7	310.9	319.2
Current Liabilities	284.3	351.8	648.5	579.0	593.9	609.1	624.8	640.9	657.4	674.4	691.9	709.8	728.3
Total Shareholders' Equity	404.7	486.8	605.4	990.9	1,113.8	1,248.1	1,394.0	1,552.0	1,722.6	1,906.3	2,103.8	2,315.5	2,542.0
Total assets	743.8	1,022.1	1,485.6	1,821.6	1,966.0	2,122.4	2,291.1	2,472.4	2,667.1	2,875.6	3,098.4	3,336.2	3,589.5
Revenues	924.5	1,343.9	2,075.3	2,110.7	2,170.2	2,231.3	2,294.2	2,358.8	2,425.2	2,493.4	2,563.5	2,635.6	2,709.7
Gross profit	281.3	455.4	692.6	724.4	753.1	782.8	813.5	845.2	878.0	911.9	946.9	983.2	1,020.6
Non-operating costs	24.9	43.9	54.5	52.8	54.8	55.5	56.4	57.6	58.6	59.7	60.8	61.9	63.1
EBITDA	113.4	156.5	342.5	172.3	185.3	199.4	213.8	228.8	244.5	260.8	277.8	295.4	313.7
Amortization & Depreciation	25.6	30.2	38.9	44.0	44.2	44.4	44.6	44.8	45.1	45.3	45.5	45.7	46.0
EBIT	87.8	126.2	303.6	128.4	141.2	155.0	169.2	184.0	199.5	215.5	232.2	249.6	267.7
Interest payments	5.8	8.6	20.2	21.4	21.6	22.6	23.7	24.7	25.8	26.9	28.0	29.1	30.3
Net income	70.4	98.1	228.6	113.0	122.9	134.2	145.9	158.0	170.6	183.8	197.4	211.7	226.5
EBITDA margin, %	12.3%	11.6%	16.5%	8.2%	8.5%	8.9%	9.3%	9.7%	10.1%	10.5%	10.8%	11.2%	11.6%
Net Income margin, %	7.6%	7.3%	11.0%	5.4%	5.7%	6.0%	6.4%	6.7%	7.0%	7.4%	7.7%	8.0%	8.4%
Amortization & Depreciation	25.6	30.2	38.9	44.0	44.2	44.4	44.6	44.8	45.1	45.3	45.5	45.7	46.0
Capex	125.3	170.9	170.9	46.2	46.4	46.6	46.9	47.1	47.3	47.6	47.8	48.0	48.3
WC (change)		161.3	117.2	-14.6	10.7	11.0	11.3	11.7	12.0	12.3	12.7	13.0	13.4
FCFF	-29.3	118.7	213.7	96.1	131.4	143.1	155.0	167.4	180.3	193.8	207.8	222.4	237.6
FCFF discounted				89.1	112.9	113.9	114.4	114.5	114.4	113.9	113.2	112.3	111.2

Russian 30-year government eurobond yield	5.60%
Russian equity standard premium	13.00%
Beta	0.44
Required return on equity	8.86%
Cost of debt	9.50%
Cost of debt adjusted for tax	7.22%
Share of liabilities in book value	59.25%
Share of equity in book value	40.75%
WACC	7.89%

Terminal growth rate	2.00%
NPV of forecasted years	1,109.9
NPV of terminal value	1,927.0
Fair EV, \$ mn	3,036.9
Net debt, \$ mn	-178.5
Minority interest, \$ mn	0.0
Fair M.Cap, \$ mn	3,215.4
Fair price, ordinary share, \$	1,708.3

Comparative valuation, 2007E

	P/S	P/E	P/BV	EV/EBITDA	EV/S
Vallourec	1.73	10.04	3.68	5.63	1.63
Mueller Water Products Inc-A	0.81	17.68	1.21	7.66	1.37
Jindal Saw Ltd	0.60	10.94	3.18	7.51	0.75
Tubacex Sa	1.40	18.37	3.20	6.58	1.63
Welspun-Gujarat Stahl Ltd	0.51	12.25	1.64	10.38	0.60
Khartsyzsky Trubny Z	2.96	19.51	5.07	12.81	2.90
Wah Seong Corp Bhd	0.65	15.57	3.24	9.47	0.99
Steel & Tube Holdings Ltd	0.86	13.10	2.79	7.90	0.96
Maharashtra Seamless Ltd	2.47	14.29	2.47	11.51	2.37
Man Industries (India) Ltd	0.43	8.17	1.58	4.39	0.48
Average	1.24	13.99	2.80	8.38	1.37
Vyksa Pipe	1.19	22.33	1.38	13.60	1.11
Fair M.Cap, \$ mn	2,621	1,581	5,107	1,555	3,106
Weights	30%	10%	20%	20%	20%
Weighted M.Cap, \$ mn					2,898

Source: Bloomberg, Sovlink Securities estimates

Valuation summary

	Fair M.Cap, \$ mn	Weight	Average
Multiple valuation	2,898	30%	
DCF valuation	3,215	70%	
Fair M.Cap, \$ mn			3,120
Fair price, ordinary share, \$			1,657
Upside potential, %			21.7%

Source: Sovlink Securities estimates

• Combining our valuations, we use a weight of 70% for our DCF estimate and 30% for our peer comparison estimate. The DCF method provides better valuation estimates for the LDP market, whose dynamics are determined by large pipe construction projects. Based on our new estimates, we consider the fair value of Vyksa Pipe at \$3,120 mn or \$1,657 per share implying 21.7% upside potential. Although we have increased our target from our previous \$1,310, we downgrade our rating from **BUY** to **HOLD** on share price performance.

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

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