



CONCORDE CAPITAL

Ukraine / Pipes

Khartsyzk Pipe

Solid dividends expected after AGM on June 25

June 17, 2010

Current price: UAH 1.3 / USD 0.16
12M Target: UAH 2.5 / USD 0.32

BUY

Andriy Gerus

ga@concorde.com.ua
+380 44 391 5577

At its June 25 AGM, Khartsyzk Pipe's shareholders will be deciding on 2009 dividend distribution. We expect the company will pay UAH 0.6-1 bln in dividends (UAH 0.23-UAH 0.41/sh), given that it paid dividends in the preceding four years (dividend yield at 17%-32% at current price). The expected dividends should be a strong catalyst to the stock price in the short-term. Additionally, we expect the pipe maker will have strong order book in 2H10-2012 that will support the stock's value in the long term. Our 12M target price of UAH 2.5 (\$0.32) implies a solid 100% upside. BUY.

Tickers

Bloomberg HRTR UK

Market information

Market price, USD 0.16
MCap, USD mln 415.0
52Wk Hi/Lo, USD 0.25/0.14
No of shares, mln 2,598.5
Free float 2.0%
Free float, USD mln 8.3

Shareholders

Metinvest Holding 98.00%
Other 2.0%

Strong 2009 financials: Sales up 30%; EBITDA mgn 20%, net mgn 12%

Thanks to orders for gas pipeline Central Asia – China, Khartsyzk Pipe reported solid financials in 2009: sales grew 29.5% yoy to UAH 4.8 bln, EBITDA margin comprised 19.8%, and net margin came to 12.2%, according to UAS. At the same time, other Ukrainian pipe companies, Interpipe Nyzhnyodniprovsky and Novomoskovsk Pipes, posted negative EBITDA.

in USD mln	2009	2010E	2011E
Sales	620	465	628
EBITDA	122	88	160
margin, %	19.8%	19.0%	25.5%
Net income	76	56	116
margin, %	12.2%	12.0%	18.5%

Source: Company data, Concorde Capital

Favorable outlook for order book in 2011-2015

We have a positive view on Khartsyzk Pipe's capacity utilization in 2H10-2012, as we believe that the company will be able to supply its large diameter pipes for construction of several new pipeline projects. Khartsyzk already supplied pipes for initial stages of construction of a number of those projects and is well positioned to be a contractor this time. Additionally, given that Russian pipe makers are now focused on Nord Stream, we think that Khartsyzk has high chances to participate in several projects for transporting gas to and within Europe. We conservatively estimate that over 2011-2015 the company's order book can comprise more than \$5 bln (see Appendix for project details).

As the pipe maker's financial dynamics reflects timing of orders in its order book, we forecast the company's sales to decrease in 2010 and then to recover in 2011-2012. For this year, we project a 25% yoy drop in sales to USD 465 mln due to lack of orders in 1Q10, when output was down 79% yoy. We expect the company's EBITDA margin to slightly decrease to 19.0% and net income margin to 12% in 2010. In 2011, we estimate Khartsyzk Pipe should grow its top line 35% yoy to \$628 mln and preserve high margins.

UAH 1.5-2.0 bln dividend payout expected in 2010

Khartsyzk Pipe (as well as Pivnichny and Centralny Iron Ore, the other Metinvest-owned companies with a tiny free float of up to 2%), has a 4-year history of paying dividends. Last year, Khartsyzk paid out ~100% of its 2008 profit as dividends, a total of UAH 1.3 bln, or UAH 0.49/share (div yield of 50%). We expect the company to continue channeling profits to its key shareholder, Metinvest, which, at the same time, would benefit minority shareholders. We estimate this year Khartsyzk will allocate UAH 0.6-1.0 bln for dividends (entire 2009 income or entire retained earnings), which translates into UAH 0.23-0.41/share (div yield of 17%-32% at current market price).

Target price of UAH 2.5 offers 100% upside.

Comparative valuation, based on 2011E multiples, indicates 60-200% upside potential. We recommend BUY with a target of UAH 2.5 (\$0.32) per share, an upside of 100%.

FLASH NOTE

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Appendix

Potential demand for Khartsyzk large diameter pipes[†]

Project	Timing	Potential revenue
2 nd stage of gas pipeline Central Asia – China	May – Oct 2010	~\$250 mln
2 nd stage of oil pipeline Eastern Siberia – the Pacific Ocean	Jan – Nov 2010	~\$300 mln
Gas pipeline Spain – France	2010 - 2011	~\$150 mln
Gas pipeline France – Belgium	2010 - 2011	~\$150 mln
Gas pipeline Algeria - Italy	2010 - 2011	~\$100 mln
Modernization of Ukrainian gas transportation system	2011 - 2014	~\$2.5 bln
South Stream (Russia – Italy, Austria)	Nov 2010 – 2015	~\$5 bln
Nabucco (Turkmenistan, Azerbaijan - Germany)	2011 – 2014	~\$5 bln
Total potential revenue	2010 - 2014	~13.5 bln

[†] On top of that, Khartsyzk Pipe's annual sales on the spot market total \$100-300 mln

Peer valuation

	Mcap USD mln	EV/S			EV/EBITDA			P/E		
		09	10E	11E	09	10E	11E	09	10E	11E
UKRAINE										
Khartsyzsky Pipe Plant	415.0	0.6	0.9	0.6	3.2	4.5	2.5	5.2	7.1	3.4
DEVELOPED MARKETS										
Tenaris SA-ADR	20,311.1	2.4	2.4	1.6	8.3	8.8	5.4	17.3	16.5	10.8
National Oilwell Varco Inc	14,477.1	1.4	1.0	0.9	6.0	4.2	4.2	10.8	9.4	10.9
Vallourec	9,203.6	1.1	1.8	1.4	3.7	9.3	5.7	6.8	18.9	10.4
Tmk-GDR	3,273.8	1.9	1.3	1.0	15.3	7.3	5.1	n.m.	16.5	7.1
Maruichi Steel Tube Ltd	1,668.4	1.1	0.8	0.7	5.8	5.4	4.3	13.8	17.0	15.8
Maharashtra Seamless Ltd	563.2	1.6	1.5	1.2	6.7	5.5	5.0	10.9	9.4	8.9
Tubacex SA	361.5	0.6	1.1	0.9	4.3	12.5	6.7	4.7	33.8	8.8
Average		1.4	1.4	1.1	7.1	7.6	5.2	7.0	17.4	10.4
HRTR price										
Implied by DM peers avg., USD/share		0.35	0.27	0.28	0.34	0.26	0.32	0.20	0.37	0.46
Upside/Downside to Developed avg.		127%	63%	73%	122%	68%	109%	34%	144%	204%

Sources: Bloomberg, Company data, Concorde Capital estimates

Concorde Capital, Head office

2 Mechnikova Street, 16th Floor
Parus Business Centre
Kyiv 01601, Ukraine
Tel.: +380 44 391 5577
Fax: +380 44 391 5571

www.concorde.ua

Concorde Capital

4 Fourth Lesnoy Pereulok, 5th Floor
Capital Plaza
Moscow 125047, Russia
Tel.: +7 495 642 87 15
Fax: +7 495 225 85 00

office@concorde.com.ua

CEO

Igor Mazepa im@concorde.com.ua

Head of Sales & Trading

Alexander Shnir ash@concorde.com.ua

International Sales & Trading

Anastasiya Nazarenko an@concorde.com.ua
Marina Martirosyan mm@concorde.com.ua
Rostyslav Shmanenko rs@concorde.com.ua
Marina Damaskina md@concorde.com.ua

Domestic Sales & Trading

Yuriy Pilipenko up@concorde.com.ua
Alisa Tikhomirova at@concorde.com.ua

Director of Research

Andriy Gostik, CFA ag@concorde.com.ua

RESEARCH

Strategy

Andriy Gostik, CFA ag@concorde.com.ua

Metals & Mining

Andriy Gerus ga@concorde.com.ua

**Utilities (Telecom, Energy),
Machinery**

Yegor Samusenko syg@concorde.com.ua

Oil & Gas

Andriy Gerus ga@concorde.com.ua
Ruslan Patlavskyy rp@concorde.com.ua

Real Estate, Consumer-related

Andriy Gostik, CFA ag@concorde.com.ua
Ruslan Patlavskyy rp@concorde.com.ua

Economics, Financial services

Mykyta Mykhaylychenko mms@concorde.com.ua

Fixed Income

Andriy Gerus ga@concorde.com.ua
Mykyta Mykhaylychenko mms@concorde.com.ua

Politics

Brad Wells bw@concorde.com.ua

Editor

Brad Wells bw@concorde.com.ua

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