

Khartsyzsk Pipe

Strong 3Q results and increased output suggest positive trend

Transneft order to help fill order book through 2011

In September, Khartsyzsk Pipe announced its first sale of large-diameter pipe to Russia's Transneft for the Eastern Siberia – Pacific Ocean oil pipeline.

According to the Transneft, the order is due to an existing deficit of LD pipe in Russia that may continue into 2011. We see a high probability that Khartsyzsk will continue deliveries to Transneft through 2011. Approximately 400,000-500,000 mt of LD pipe (70% of Khartsyzsk's annual capacity) will be required for the project.

Exports to EU set to begin next year

Last month, Khartsyzsk Pipe became the first producer in CIS granted a license to supply LD pipe to Gaz de France, which buy pipe for EU oil & gas projects. Khartsyzsk has an advantage over European peers due to its approximately 20% lower cost base. We believe Khartsyzsk will begin shipping pipe to the EU in 2011 (for more details see our June 2010 report).

38% m-o-m rise in production expected for November

Parent company Metinvest anticipates that Khartsyzsk's monthly output will be total more than 40,000 mt (up 38% m-o-m) for November and 50,000-60,000 mt in late 2010 – early 2011. We expect output to increase 66% q-o-q in 4Q10 to 135,000 mt (45,000 mt per month on average).

Earnings grew 151% in 3Q to USD 11 mln

In 3Q, Khartsyzsk Pipe boosted its earnings by 151% q-o-q to USD 11.1 mln (vs. USD 4.4 mln in 2Q and a loss of USD 5.6 mln in 1Q). We expect net profit of USD 30.3 mln in 4Q and USD 40.2 mln (USD 0.015 or UAH 0.12 per share for FY 2010). Khartsyzsk has a five-year history of paying dividends and we expect the company to continue channeling profits to key shareholders in 2011.

Valuation: Target price USD 0.32 for upside of 110%

Though we lower our previous 2010 forecast by 10%-20%, we reiterate our 2011 figures (net income of USD 116 mln) and 12M target price of USD 0.32 (UAH 2.5). We believe strong production and financial results from the company in late 2010 – early 2011 will be a liquidity trigger, especially ahead of dividend distribution.

Report date	30 Nov 2010
Bloomberg	HRTR UK
Recommendation	BUY
Price (29 Nov 10), USD	0.15
12M price target, USD	0.32
No of shares, mln	2,598.50
Market Cap, USD mln	389,7
52-week performance	-23%
52-week range, USD	0.25/0.14
Free float, %	2%
Free float, USD mln	8.2

Source: Concorde Capital, Bloomberg

Key financial and operational figures

	1Q10	2Q10	3Q10	4Q10E	FY2010E	FY2011E
Net sales, 000 USD	23,277.6	85,065.2	110,287.3	183,359.4	401,989.5	627,600.0
EBITDA, 000 USD	-2,550.3	9,708.7	18,952.7	45,839.9	71,950.9	160,000.0
EBITDA margin, %	n/m	11.4%	17.2%	25.0%	17.9%	25.5%
Net income, 000 USD	-5,592.6	4,429.2	11,138.9	30,254.3	40,229.8	116,000.0
Net income margin, %	n/m	5.2%	10.1%	16.5%	10.0%	18.5%
Production (000 mt)	21.7	70.3	81.2	135.0	308.2	550.0

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