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## NLMK: A Quality Asset at an Attractive Price

### BUY

Ticker NYSE	NLMK
Mcap, USD mn	13 232
EV, USD mn	16 165
Number of common shares, mn.	5993
Free float	11%

<b>Common shares</b>	<b>Buy</b>
Target price by the end of 2011, USD	3.54
Current price	2.21
Upside	60%

<b>Financials, USD mn</b>			
	2011E	2012E	2013E
Revenue	11664	14044	16312
EBITDA	2362	2807	3446
Net profit	1348	1460	1953

<b>Margins, %</b>			
	2011E	2012E	2013E
EBITDA margin	20%	20%	21%
Net profit margin	12%	10%	12%

<b>Multiples</b>			
	2011E	2012E	2013E
EV/S	1.4	1.2	1.0
EV/EBITDA	6.8	5.8	4.7
P/E	9.8	9.1	6.8

<b>Dividends, USD per share</b>			
<b>for the year</b>	2011E	2012E	2013E
Common shares	0.056	0.073	0.121

**NLMK metal products sales should grow significantly in the next two years.** According to our estimates, commissioning of the new blast furnace #7 at the main site in Lipetsk, the long rolled mill in Kaluga, as well as the consolidation of SIF assets in the U.S. and Europe, will allow NLMK to increase its steel products sales by the end of 2013 by 37% compared to sales volumes in 2011.

**This year we project EBITDA to grow by more than 18% y-o-y** thanks to an increase in sales from new steelmaking capacities.

**The operating margin will be stable in spite of a rapid growth in cash costs.** Full vertical integration in iron ore as well as the introduction of modern technologies to improve the efficiency of steel production will enable NLMK to maintain its operating profitability even with rapid growth of the fixed and variable costs of prices of finished products.

**NLMK's financial leverage is one of the lowest in the sector.** By our estimates, the company's Net debt/EBITDA ratio will not exceed 1.2X at the end of 2011. Given that an acceptable Net debt/EBITDA ratio is 3.0X in the sector; NLMK has the ability to raise more than USD4 bn on DCM. As a result the company has a high degree of financial stability, and can become an active player in M&A.

**From the highs at the beginning of 2011 NLMK shares fell more than 55% and are, in our opinion, heavily oversold.** Currently NLMK trades at 5.8X of the EV/EBITDA<sub>2012</sub> multiple (we use the Grandis Capital EBITDA 2012 estimate). We see the EV/EBITDA<sub>2012</sub> multiple fair value as 7.5X. The high quality of steel assets, prospects for significant growth in financial performance, as well as high financial stability, combined with a significant overselling of NLMK shares will be the key drivers of the growth of the company's stocks.

Our estimate of the fair value of NLMK shares is a weighted average between estimates made by DCF and multiples methods.

*We are initiating our coverage of NLMK with a BUY recommendation and Target Price of USD3.54 by the end of 2012, implying 60% upside potential.*

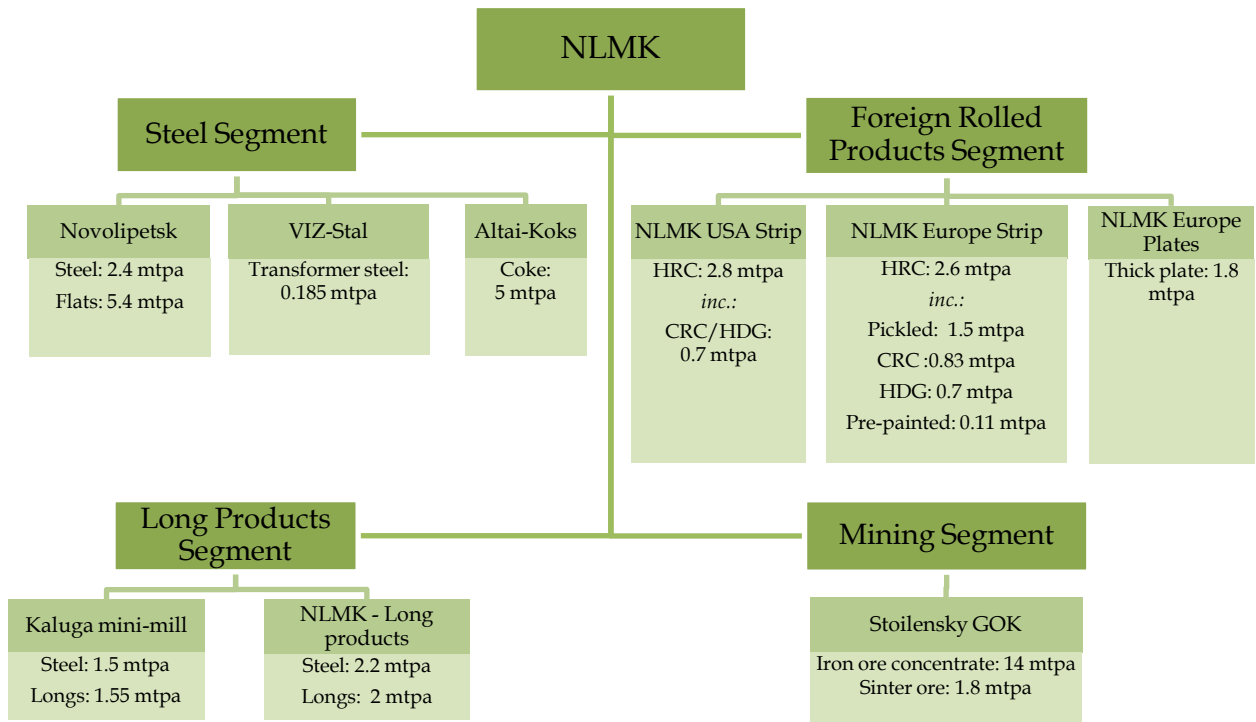


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### Company Description



Source: NLMK

NLMK's business model consists of four segments – the steel segment, the foreign rolled products segment, the long products segment, and the mining segment.

- **The Steel segment** consists of the main site in Lipetsk (with a steelmaking capacity of 12.4 mtpa, flat-rolled products - 5.4 mtpa), the VIZ-Stal Plant with transformer steel capacity of 0.185 mtpa, coke production capacities of a total of 7.5 mtpa (the Altai-coke plant has a capacity of 5 mtpa, and the coke capacity of the main site is 2.5 mtpa).
- **The Long products segment** includes the Nizhneserghinsky hardware-metallurgical plant which produces steel and long products, the Ural Precision Alloys Plant for the production of wire products (Sverdlovsk region), the Kaluga mill for the production of long rolled steel products (NLMK expects to commission the Kaluga mill in two stages - 0.9 mtpa of steel products by the end of 2012 and another 0.6 mtpa in 2013), and the NLMK Vtorchermet scrap metal network. By the end of 2013 total steel capacity in the long products segment is expected to reach 3.7 mtpa and long rolled products 3.55 mtpa.
- **The Mining segment** includes Stoilensky GOK in the Belgorod region, and Stagdok in the Lipetsk region which produce iron ore (production capacity is 14 mtpa of iron ore concentrate and 1.8 mtpa of sinter ore).
- **The Foreign rolled products segment** integrates flat rolled steel plants in the U.S. with a total capacity of 2.8 mtpa, plants for flat steel products in Europe with a total capacity of 2.6 mtpa as well as assets in Europe which produce thick plates with a total capacity of 1.8 mtpa.



### Shareholder Structure

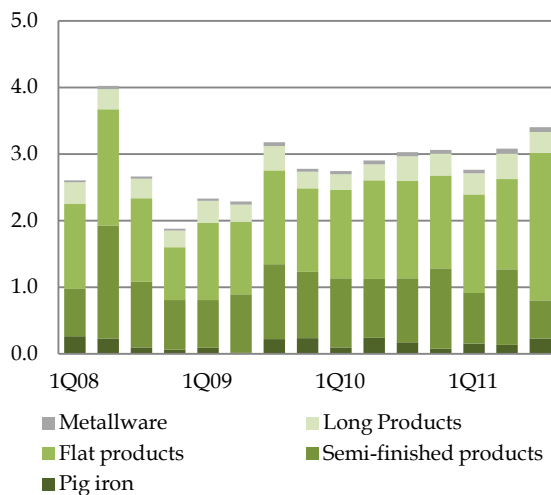
The major NLMK shareholder is Vladimir Lisin who holds 86% of the company's shares. NLMK free float is 11% of shares.

Shareholders	Share, %
FLETCHER GROUP HOLDINGS LIMITED *beneficially owned by Vladimir Lisin, Chairman of the Board of Directors of NLMK	85.54
Companies beneficially owned by NLMK managers	3.17
Free float	11.29

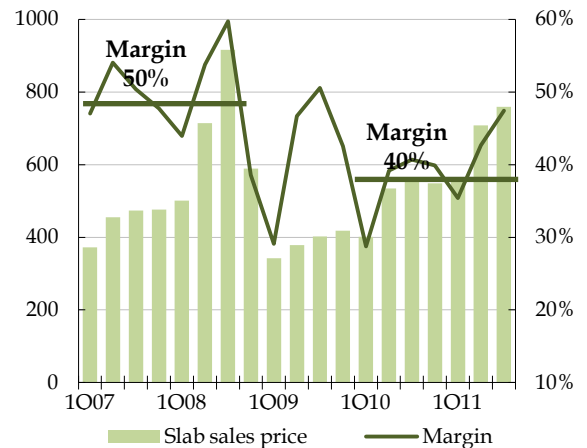
Source: NLMK

### NLMK: Sales Structure and Operating Profit Margin

Sales structure by volume, mn t



Slab sales prices vs. slab cash costs, USD per tonne



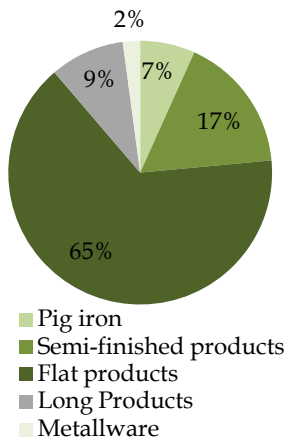
Source: NLMK, Grandis Capital estimates

NLMK has one of the most efficient steel-making capacities in the Russian steel sector - before the crisis, the company's operating profit from steel products sales (the ratio of net cash income from the sale to the selling price) at NLMK was about 50%. Post-crisis operating profit decreased to 40%.

In the last two years NLMK's average quarterly steel product sales were about 3 million tonnes. In 2009 - 2010 NLMK's sales pattern was the following - semi-finished products accounted for about 35% of total sales, flat-rolled steel 45% , bars 10%, pig iron 5%, and hardware 2%.



### NLMK, Sales Structure by Volume in 3Q11.

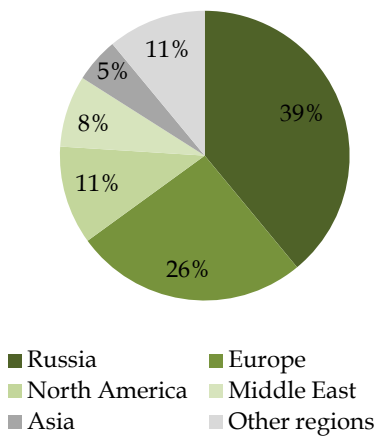


Source: NLMK

Due to the consolidation of SIF assets at the end of 2Q11, NLMK third party semi-finished product sales in the 3Q11 decreased by 18%, while sales of flat-rolled products increased by 18% (before the consolidation NLMK sent its semi-finished products to SIF). The share of pig iron, wire and bars sales has not changed significantly.

In 3Q11 the company sales of HRC accounted for 27% of total sales, while high value-added flat products accounted for 39%.

### NLMK, Revenue Structure by Region in 3Q11.



Source: NLMK

The major NLMK markets by region are Russia and Europe, which account for about 39% and 26% of sales respectively.

The North American market for NLMK products is about 11%. The remaining 24% is distributed between the Middle East, Asia and other countries.

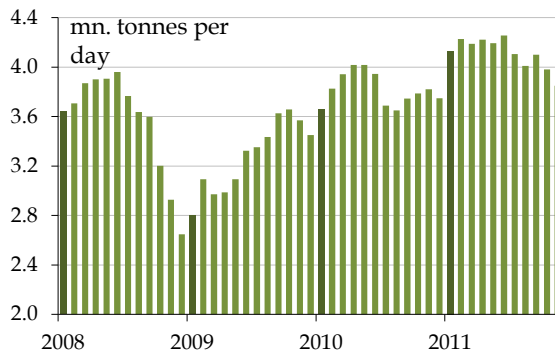


### Market Trends and Outlook

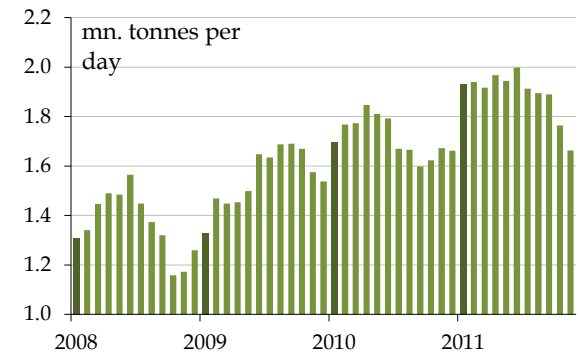
In the first half of 2011, the global demand for steel products reached a historical high, with 4.2 million tonnes of steel in average daily production. China, which accounts for more than 45% of world steel production and consumption, drove most of this growth. The slowdown in economic growth in China in the second half of 2011 resulted in a decline in the global demand for steel products and steel production.

As a result, daily average steel production in China in November 2011 decreased by 17% compared to the maximum in the beginning of 2011, and global average daily steel production of steel fell by 11%.

**World Average Daily Steel Production**



**China Average Daily Steel Production**

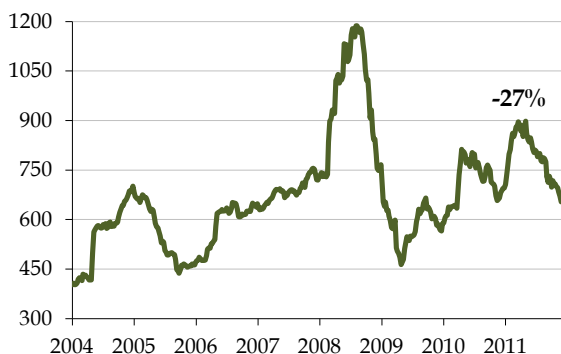


Source: World Steel, SBB

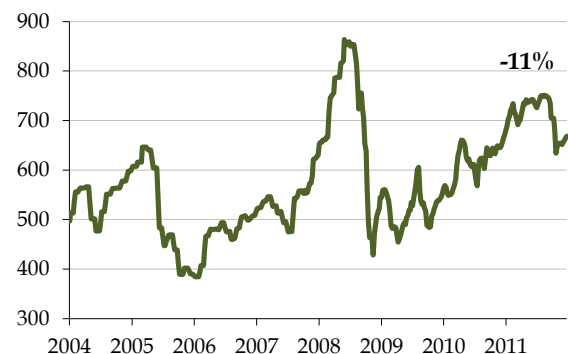
The global decline in the demand for steel products had a negative impact not only on the consumption, but also on selling prices.

From the middle of 2011 China domestic HRC prices decreased by 11%; the reduction in prices in Europe during this period was more significant and reached 27%. The debt crisis in Europe has become a major factor in a significant decrease in prices in Europe compared to China.

**Europe HRC, USD per Tonne**



**China HRC, USD per Tonne**



Source: World Steel, SBB

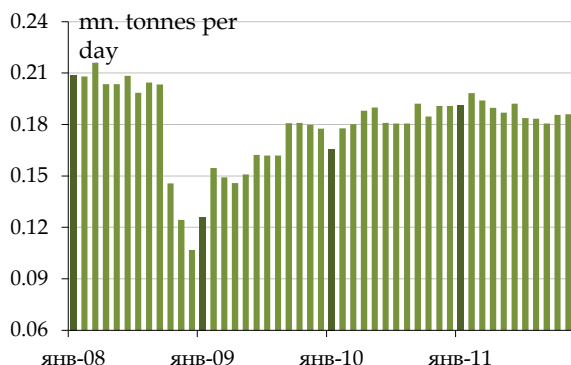


Russian average daily steel production has been stable at 0.18-0.2 million tonnes level since the end of 2009.

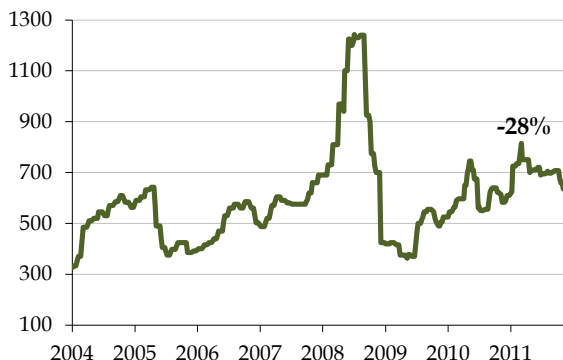
Domestic prices for rolled steel in Russia are determined mainly by the export quotes in the major Russian sea ports. We use FOB Black Sea quotes as indicators of Russian domestic prices for steel rolled products.

Since the end of March 2011 Russian HRC Black Sea FOB quotes followed European trends and decreased by 28%.

**Russia Average Daily Steel Production**



**Russia HRC Black Sea FOB, USD per Tonne**



Source: World Steel, SBB

Over the last seven years the average growth rate of Russian FOB semi-finished products quotes was 5% per year and HRC was 4% per year (the highest growth rate for steel products was seen in 2007-2008). In the 2009 crisis the decline was more than 45% y-o-y, however in 2010-2011 there was a post-crisis recovery in quotes.

**Russia HRC Black Sea FOB**

USD per tonne	2004	2005	2006	2007	2008	2009	2010	2011	CARG 2004-2011
Semi-finished products	441	363	417	493	751	365	529	629	5%
change,%		-18%	15%	18%	52%	-51%	45%	19%	
HRC	517	482	501	584	903	459	610	699	4%
change,%		-7%	4%	16%	55%	-49%	33%	15%	

Source: SBB, Grandis Capital estimates

- In 2012, we forecast further growth in prices for metal products, due to rising steel consumption in developing countries, particularly in China. However, we assume a slowdown in the growth of steel prices compared to 2011 rates. We estimate 2012 semi-finished products will increase 7% y-o-y, and HRC price growth will be increase 9% y-o-y. For the years 2013-2016 we assume the same 4% y-o-y growth rates in semi-finished and HRC quotes, which generally correspond to the average growth rate in the 2004-2011 period.

**Russia HRC Black Sea FOB estimates**

USD per tonne	2011	2012E	2013E	2014E	2015E	2016E
Semi-finished products	629	670	700	730	760	790
change,%		7%	4%	4%	4%	4%
HRC	699	759	790	822	853	884
change,%		9%	4%	4%	4%	4%

Source: SBB, Grandis Capital estimates



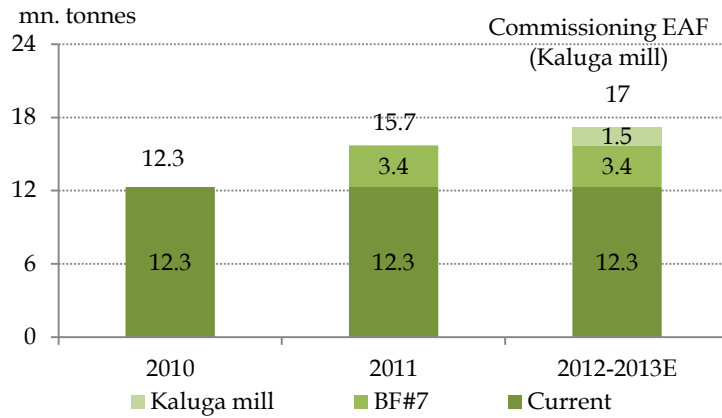
In our NLMK financial model we assume semi-finished and HRC growth rates to be equal to the growth rates of Russian Black Sea FOB quotes (this is a base assumption in our financial model).

### *Prospects for NLMK Development*

1. In the second half of 2011 NLMK completed the implementation of one of its major investment projects –the commissioning of a new blast furnace (#7) on the main site in Lipetsk, resulting in an increase of NLMK’s consolidated steel capacity from 3.4 million tonnes to 15.7 million tonnes a year. In addition to the launch of the BF#7 NLMK also commissioned the following:
  - A new converter which will allow for a 36% increase in steelmaking capacity at the Lipetsk site - up to 12.4 mtpa.
  - A new 4 mtpa RH vacuum degasser which will allow the company to ensure a supply of high quality slabs to its rolling assets both in Russia and in Europe;
  - The revamping of a 2.5 mtpa continuous casting machine (CCM-8). The objective of the CCM-8 reconstruction project was to increase output, expand the product mix and ensure a consistently high quality of concast slabs for further conversion into flats. With its CCM-8 revamp NLMK has become the first Russian steelmaker to produce slabs with thicknesses of up to 355 mm for further conversion into thick plate, including at NLMK’s subsidiaries in Europe, DanSteel and Clabecq.
  - A new 2 mtpa ladle furnace (LF). As a result, NLMK will be able to expand its product mix and improve quality by reducing the amount of nonmetallic inclusions and sulfur in its products.
  - A 150 MW Recovery Cogeneration Plant which will increase Novolipetsk (NLMK’s Lipetsk site) generation capacity by 45% to 482 MW, bringing the level of energy self-sufficiency up from 47% to 56%.
2. **In the 2012-2013 Kaluga mill is expected to be commissioned.** As a result NLMK steel making capacities will grow by 1.5 mtpa to 17 mtpa by 2013, long rolled capacities are expected to grow by 1.55 mtpa.



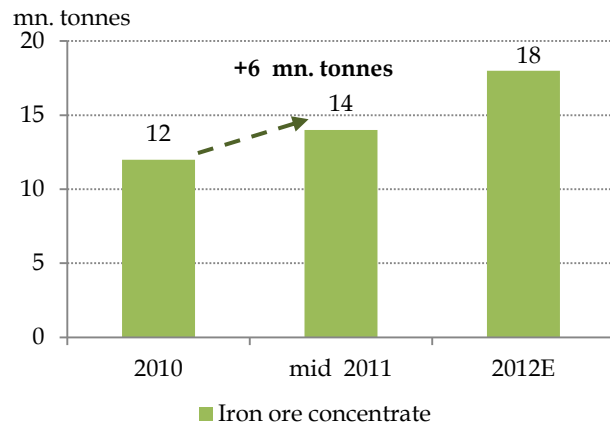
### NLMK: Crude Steel Capacity



Source: NLMK

- By the end of 2011 total NLMK mining segment iron production capacities had reached 14 mtpa. **The company aims to increase its iron ore concentrate making capacities to 18 mtpa by 2014** through the launch of a pelletizing plant with capacity of 6 mtpa.

### NLMK: Iron Ore Concentrate Capacity

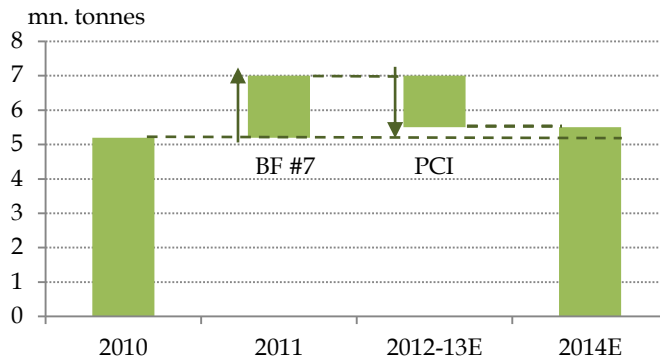


Source: NLMK

- The implementation of Pulverized coal injection (PCI) technology at Blast Furnace (BF) operations at the main site in Lipetsk.** Due to the commissioning of BF#7 NLMK main site coke consumption increased by a third to 7 mtpa. Pulverized coal injection (PCI) technology will reduce NLMK coke and natural gas consumption by 20-30% and 70-80% respectively per one tonne of pig iron production. As a result NLMK coke consumption will decrease to 5.4 mtpa by 2014.



**NLMK: Coking Coal Concentrate Consumption**



Source: NLMK

5. By 2014 production capacity for HRC at the main site in Lipetsk will increase by 0.4 mtpa and CRC by 0.3 mtpa.
6. Plans to develop greenfield coal deposits – Zhernovskoe (3.6 mtpa of coking coal concentrate with grade Gzh (Zh), launch 2014-2015) и Usinskoe (2.7 mtpa of coking coal concentrate with grade Zh/2Zh, launch from 2017). Vertical integration in coking coal will allow NLMK to secure its raw materials supply chain and control its production costs.
7. In addition NLMK plans to decrease its level of investment activity. (Major investment projects are completed or nearing completion.) These steps will make possible a significant increase in free cash flow in the near future and the payment of high dividends.

*Operating Highlights*

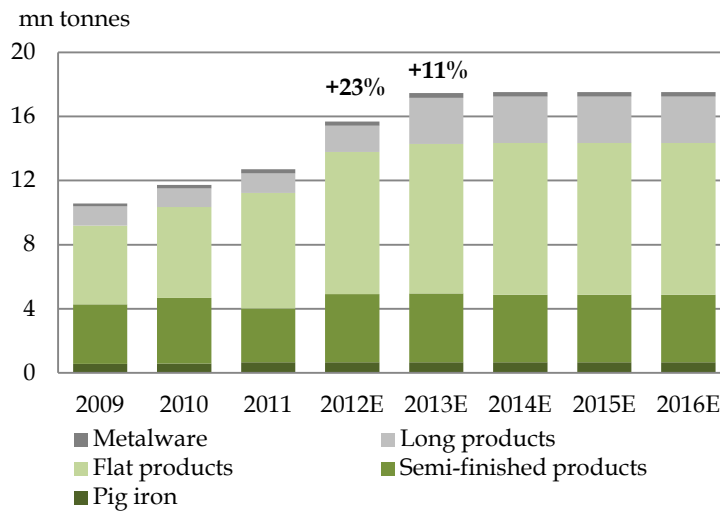
We see NLMK’s main achievement in 2011 is a commissioning of BF# on the Lipetsk site. The company steel making capacities have increased by 3.4 mtpa. As a result of the commissioning of BF#7 last year NLMK will significantly increase its output of semi-finished products this year, in our opinion. We estimate NLMK’s main site semi-finished products growth this year in the range of 1.5 – 2.0 mn. tonnes y-o-y. At the same time NLMK will increase its steel products not through the growth of semi-finished products sales, but increasing its flat rolled output.

In 2011 NLMK completed consolidation of SIF which comprises rolling assets located in Europe and the US with a total capacity of over 5.5 mtpa. We expect NLMK to increase semi-finished products deliveries to SIF this year. This step will guarantee the company main site and mining asset full capacity utilization (these facilities generate the main company’s operating cash flow) and increase in profit margins from steel rolled product sales.

We estimate slab growth to be 1.5 – 2.0 mn tonnes y-o-y in 2012 from the Lipetsk site, of which more than 900 tons will be sold to foreign rolled subsidiaries, and the remaining 0.6 - 1.0 million tonnes will be realized on the open market.



**NLMK: Steel Products Sales**



Source: NLMK, Grandis Capital estimates

In 2012 NLMK steel products sales will increase by 3.0 mn. tonnes to 15.7 mn. (growth 23% y-o-y). The main contribution to this growth (about 1.9 million tonnes of flat products) will come from newly consolidated SIF assets. The plant in the Kaluga region in 2012 will increase its sales of long products by 400 th. tonnes.

There will be further growth in steel products sales in subsequent years. Full ramp up of new capacities will increase NLMK sales by 11% y-o-y in 2013. As a result, NLMK's steel sales will reach about 17.5 mtpa, which we view as a long-term level. Thus, by the end of 2013, NLMK's sales will increase by 37% compared with 2011.

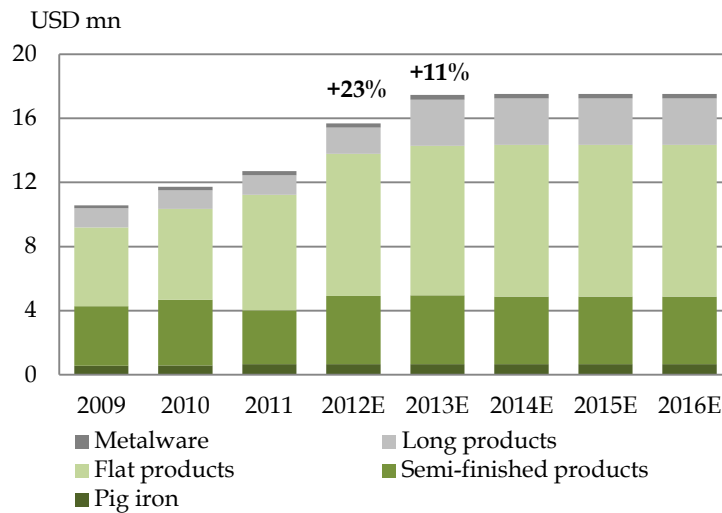


### Financials

In 2012-2014 there will be significant growth in NLMK’s operating profit. According to our estimates in 2012 the company EBITDA will increase by 19% y-o-y to USD2.8 billion. The main contribution to this growth will be made by the Steel segment.

In the 2013-2014 period an increase in EBITDA will be ensured with increased sales of iron ore concentrate from the Mining segment (by 2014 the company plans to ramp up a new pellets plant with capacity of 6 mtpa).

**NLMK: EBITDA Estimates and Margins**



Source: NLMK, Grandis Capital estimates

According to our estimates in 2012-2016 the company EBITDA margin will be in the range of 20-24%. Thus, the increase in NLMK product sales will provide a relatively stable level of operating profitability against outstripping growth in fixed and variable costs.

At this moment NLMK has one of the lowest financial leverages in the Russian steel sector. By the end of 2012 we estimate Net Debt/EBITDA ratio will be less than 1.2X.

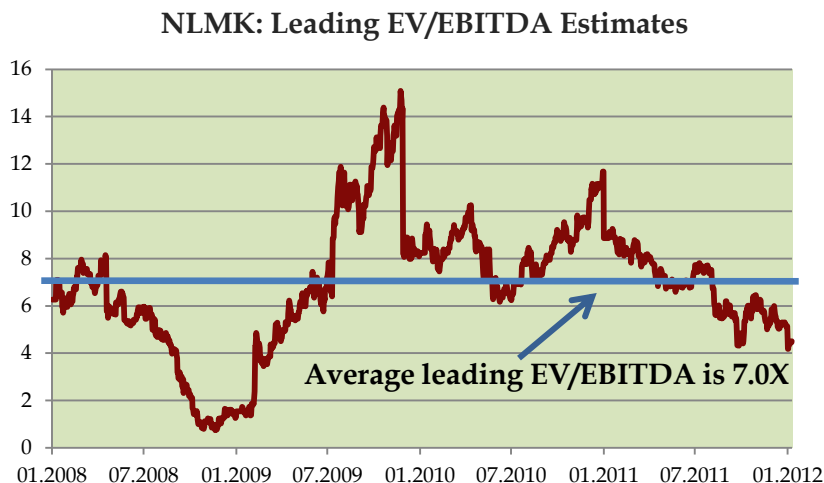


### Valuation

We estimate the fair value of NLMK shares as a weighted average between estimates made by discounted cash flows (DCF) and multiples methods.

- *Multiples valuation*

As a basic multiplier, we propose using the leading EV/EBITDA (EBITDA is a Bloomberg consensus for the first estimated fiscal year).



Source: Bloomberg, Grandis Capital estimates

Historically, the market priced NLMK's value in terms of leading EV/EBITDA is 7.0X.

**NLMK: EBITDA Bloomberg consensus vs. actual results**

USD mn	2008	2009	2010
Bloomberg consensus	4969	1948	2479
Actual results	4538	1444	2348
difference	9%	35%	6%

Source: Bloomberg, NLMK, Grandis Capital estimates

In 2008 the average Bloomberg consensus for the company EBITDA was higher than the actual value by 9%, in 2009 the consensus was 35% higher, in 2010 the difference was reduced to 6%.

In 2011 the average Bloomberg consensus for NLMK EBITDA was USD3.2 bn (at the end of 2011 EBITDA consensus was USD2.8 bn). Given the fact that, for the first 9 months of 2011, EBITDA of NLMK was USD1.9 bn (3Q11 EBITDA amounted to USD478 mn), we expect EBITDA in 2011 to be USD2.36 bn. We see the current Bloomberg EBITDA 2011 estimate to be 15% higher than actual value. Thus, over the past 4 years, the market expectations for the company EBITDA were 10-15% higher than the actual value. In this regard, we see leading EV/EBITDA 7.0X as understated and believe estimates should take leading EV/EBITDA 7.5X as the target value.

**NLMK: Multiples Valuation**

Target leading EV/EBITDA multiple	EBITDA2012 estimate, USD mn	EV estimate, USD mn	Net Debt as 30.09.2011, USD mn	Fair equity value estimate, USD mn	TP estimate, USD per share
7.5	2 807	21056	2933	18123	3.02

Source: NLMK, Grandis Capital estimates

Taking into account our target leading EV/EBITDA 7.5X multiple, our estimate of EBITDA in 2012 of USD2.8 bn, and the value 9M11 Net Debt of USD2.9 bn, the company's fair value price made by multiples method is USD3.02 per share.

- *Discounted cash flow (DCF) valuation*

We construct our DCF model to include 2016. We assume the terminal growth rate to be 3.5% and the discount rate WACC to be 12.4%. Using the DCF method we estimate the fair value price of NLMK shares by the end of 2012 to be USD4.1 per share.

**NLMK: Discount Cash Flow Model (DCF)**

USD mn	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
Revenue	6140	8351	11664	14044	16312	17846	18475	19071
EBITDA	1444	2348	2362	2807	3446	4323	4406	4471
margin %	24%	28%	20%	20%	21%	24%	24%	23%
EBIT	891	1794	1650	1962	2576	3439	3516	3579
Taxes	178	359	330	392	515	688	703	716
NOPAT	713	1436	1320	1570	2061	2751	2813	2863
+ Depreciation	553	554	712	845	870	884	890	893
- CAPEX	-1050	-1272	-2005	-1446	-1341	-1015	-939	-916
Change in working capital	317	-527	449	-228	-361	-657	-121	-116
FCF	533	190	476	742	1229	1964	2642	2724

WACC Calculation	
Terminal growth rate	3.5%
Cost of Equity	14.1%
After tax cost of debt	5.6%
Debt/(Debt+Equity)	20%
<b>WACC</b>	<b>12.4%</b>
DCF	6962
Terminal value	31799
Discounted terminal value	19947
Total DCF	26909
Net Debt of 31/12/11	2592
Equity value (common shares)	24317
Number of common shares, mn	5993
<b>Target price, \$</b>	<b>4.06</b>

Sensitivity analysis								
		Discount rate (WACC)						
		10.9%	11.4%	11.9%	12.4%	12.9%	13.4%	13.9%
Discount rate (WACC)	5.0%	6.2	5.6	5.2	4.8	4.5	4.2	3.9
	4.5%	5.7	5.3	4.9	4.5	4.2	3.9	3.7
	4.0%	5.3	4.9	4.6	4.3	4.0	3.8	3.5
	3.5%	5.0	4.6	4.3	4.1	3.8	3.6	3.4
	3.0%	4.7	4.4	4.1	3.9	3.6	3.4	3.3
	2.5%	4.5	4.2	3.9	3.7	3.5	3.3	3.1
	2.0%	4.2	4.0	3.7	3.5	3.3	3.2	3.0

Source: NLMK, Grandis Capital estimates



- *Final valuation*

Taking into account our estimates of the NLMK fair value made by the multiples and DCF methods **our target price for the company's stock at the end of 2012 is USD3.54 per share - that implies a 60% upside potential** to the current price.

Multiples valuation EV/EBITDA 7.5X, USD per share	Weight 0.5	3.02
DCF valuation, USD per share	Weight 0.5	4.06
<b>Fair value, USD per share</b>		<b>3.54</b>
<b>Upside, %</b>		<b>60%</b>

Source: Grandis Capital estimates



## NLMK: US GAAP financials and estimates, USD mn.

P&L	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
<b>Sales</b>	<b>7719</b>	<b>11699</b>	<b>6140</b>	<b>8351</b>	<b>11664</b>	<b>14044</b>	<b>16312</b>	<b>17846</b>	<b>18475</b>	<b>19071</b>
Operational expences	4313	7139	4770	6088	9353	11237	12867	13522	14069	14600
Depreciation&Amortization	408	499	478	469	661	845	870	884	890	893
Operating profit	2998	4061	891	1794	1650	1962	2576	3439	3516	3579
<b>EBITDA</b>	<b>3336</b>	<b>4538</b>	<b>1444</b>	<b>2348</b>	<b>2362</b>	<b>2807</b>	<b>3446</b>	<b>4323</b>	<b>4406</b>	<b>4471</b>
Net interest expences	-68	117	111	-29	-1	132	128	117	99	73
Other expences (income)	-90	813	358	101	-88	0	0	0	0	0
Profit before taxes	3157	3132	422	1722	1739	1830	2448	3322	3417	3506
Profit tax	837	703	182	391	459	403	539	731	752	771
Minority interest	23	149	26	76	-68	-32	-43	-59	-61	-62
<b>Net profit</b>	<b>2247</b>	<b>2279</b>	<b>215</b>	<b>1255</b>	<b>1348</b>	<b>1460</b>	<b>1953</b>	<b>2650</b>	<b>2726</b>	<b>2797</b>
<b>BS</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011E</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>
Cash and cash equivalents	1155	2168	1699	1171	1230	1492	2132	3213	4728	6315
Accounts receivable	1696	1488	913	1260	1507	1756	2039	2379	2463	2543
Inventories	1236	1556	1134	1580	2182	2260	2588	3005	3126	3244
Other current assets	301	134	131	94	97	106	122	142	147	152
Property, plant and equipment	6450	6826	7316	8382	10551	11152	11623	11753	11802	11825
Other non-current assets	2238	1892	1309	1412	1196	1264	1318	1333	1338	1341
<b>Total assets</b>	<b>13076</b>	<b>14065</b>	<b>12502</b>	<b>13899</b>	<b>16763</b>	<b>18029</b>	<b>19821</b>	<b>21825</b>	<b>23605</b>	<b>25420</b>
Accounts payable	1395	1879	841	1107	1630	1729	1979	2080	2164	2246
Short-term debt	1537	1080	557	526	1031	1031	1031	1031	1031	1031
Other current liabilities	71	21	19	19	34	35	36	36	34	32
Long-term debt	73	1930	1939	2099	2791	2791	2791	2791	2791	2791
Other non-current liabilities	902	431	536	594	1061	1104	1129	1106	1058	1005
Equity	9098	8723	8610	9554	10216	11339	12854	14781	16527	18315
<b>Total liabilities and equity</b>	<b>13076</b>	<b>14065</b>	<b>12502</b>	<b>13899</b>	<b>16763</b>	<b>18029</b>	<b>19821</b>	<b>21825</b>	<b>23605</b>	<b>25420</b>
<b>Cash flow statement</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011E</b>	<b>2012E</b>	<b>2013E</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>
Operating profit	2998	4061	891	1794	1650	1962	2576	3439	3516	3579
Income tax expense	837	703	182	391	459	403	539	731	752	771
Depreciation and amortization	408	499	478	469	661	845	870	884	890	893
Interest expences	-68	117	111	-29	-1	132	128	117	99	73
Change NWC	-113	-959	317	-527	449	-228	-361	-657	-121	-116
<b>Operating CF</b>	<b>2524</b>	<b>2781</b>	<b>1394</b>	<b>1431</b>	<b>2302</b>	<b>2045</b>	<b>2419</b>	<b>2819</b>	<b>3434</b>	<b>3511</b>
CAPEX	-958	-2448	-1050	-1272	-2005	-1446	-1341	-1015	-939	-916
Other investing CF	-310	50	-721	-568	394	0	0	0	0	0
<b>Operating CF net of Investing CF</b>	<b>1256</b>	<b>382</b>	<b>-377</b>	<b>-416</b>	<b>691</b>	<b>599</b>	<b>1078</b>	<b>1804</b>	<b>2495</b>	<b>2595</b>
Change in total debt inflow	1313	1400	-514	129	1197	0	0	0	0	0
Dividends	703	843	2	165	248	337	438	723	981	1009
Other financing outflow	1439	-242	20	43	1254	0	0	0	0	0
<b>Free CF</b>	<b>427</b>	<b>1181</b>	<b>-912</b>	<b>-495</b>	<b>386</b>	<b>262</b>	<b>640</b>	<b>1082</b>	<b>1514</b>	<b>1587</b>

Source: NLMK, Grandis Capital estimates



## NLMK multiples vs. main peers

Company	Ticker	MCap USD mn	EV USD mn	P/E			EV/EBITDA			EV/Sales		
				2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E
MMK	magn rx	4779	7619	10.0	8.4	7.2	4.6	4.0	3.7	0.8	0.7	0.6
Evraz	evrz li	8509	15693	7.8	6.2	4.8	4.8	4.6	4.1	0.9	0.9	0.8
Severstal	chmf rx	13377	17466	5.9	6.2	6.1	4.2	4.3	4.2	1.0	1.0	0.9
Mechel*	mtl us	4671	13190	7.9	4.4	4.3	5.8	4.7	4.4	1.0	0.9	0.8
<b>Average</b>				<b>7.9</b>	<b>6.3</b>	<b>5.6</b>	<b>4.9</b>	<b>4.4</b>	<b>4.1</b>	<b>0.9</b>	<b>0.9</b>	<b>0.8</b>
<b>NLMK*</b>	<b>nlmk rx</b>	<b>13232</b>	<b>16165</b>	<b>9.8</b>	<b>9.1</b>	<b>6.8</b>	<b>6.8</b>	<b>5.8</b>	<b>4.7</b>	<b>1.4</b>	<b>1.2</b>	<b>1.0</b>
	premium(discount)				44%	21%	41%	31%	14%	48%	34%	23%
<b>Emerging markets</b>												
Usiminas	usim5 bz	8178	10104	63.5	37.5	14.8	14.6	10.6	6.4	1.5	1.4	1.2
Gerdau	ggr4 bz	14915	22442	14.8	11.7	8.9	8.5	7.5	6.2	1.2	1.1	1.0
CSN	csna3 bz	13398	19332	8.3	9.7	8.5	5.4	5.3	4.6	2.1	2.0	1.8
POSCO	005490 ks	29339	34646	9.2	8.0	7.4	4.9	4.5	4.1	0.6	0.6	0.5
Hyundai	004020 KS	7491	13418	10.6	8.3	7.5	7.6	6.8	6.2	1.0	1.0	1.0
Baoshan Steel	600019 CH	14052	22527	10.1	8.3	6.9	5.4	4.9	4.3	0.6	0.6	0.6
China Steel	2002 TT	14600	16908	19.7	18.4	15.7	8.9	8.7	7.4	1.2	1.2	1.2
Tata Steel	tata is	7221	17679	5.0	7.1	6.2	5.2	6.5	5.5	0.7	0.7	0.7
Steel Authority of India Ltd (India)	SAIL IN	7305	7907	6.0	9.3	7.8	4.2	6.5	4.9	0.8	0.9	0.8
<b>Average</b>				<b>16.4</b>	<b>13.1</b>	<b>9.3</b>	<b>7.2</b>	<b>6.8</b>	<b>5.5</b>	<b>1.1</b>	<b>1.1</b>	<b>1.0</b>
<b>NLMK *</b>	<b>nlmk rx</b>	<b>13232</b>	<b>16165</b>	<b>9.8</b>	<b>9.1</b>	<b>6.8</b>	<b>6.8</b>	<b>5.8</b>	<b>4.7</b>	<b>1.4</b>	<b>1.2</b>	<b>1.0</b>
	premium(discount)				-31%	-27%	-5%	-16%	-15%	27%	9%	1%
<b>Developed markets</b>												
Nippon Steel	5401 jt	16205	31355	13.1	13.2	10.2	5.4	5.8	5.6	0.6	0.6	0.6
JFE Holdings	5411 jt	10559	28463	11.0	105.6	11.2	5.3	6.7	6.1	0.7	0.7	0.7
Nucor Corp.	nue us	13336	15151	18.3	13.4	10.3	7.8	6.5	5.3	0.8	0.7	0.7
ThyssenKrupp	tka gr	12903	16754	10.8	12.6	7.2	3.5	3.9	3.1	0.3	0.3	0.3
United States Steel	x us	4113	7298	204.6	11.1	6.4	7.2	4.8	3.8	0.4	0.4	0.3
ArcelorMittal	mt us	30172	49875	9.0	8.5	5.2	4.9	4.7	3.8	0.5	0.5	0.5
Voestalpine AG	VOE AV	5363	9996	7.7	7.7	7.0	4.5	4.9	4.8	0.6	0.7	0.7
<b>Average</b>				<b>39.2</b>	<b>24.6</b>	<b>8.2</b>	<b>5.5</b>	<b>5.3</b>	<b>4.7</b>	<b>0.6</b>	<b>0.5</b>	<b>0.5</b>
<b>NLMK *</b>	<b>nlmk rx</b>	<b>13232</b>	<b>16165</b>	<b>9.8</b>	<b>9.1</b>	<b>6.8</b>	<b>6.8</b>	<b>5.8</b>	<b>4.7</b>	<b>1.4</b>	<b>1.2</b>	<b>1.0</b>
	premium(discount)				-63%	-18%	24%	8%	1%	149%	112%	88%

Source: Bloomberg  
\* Grandis Capital estimates

We see EV/EBITDA and P/E for 2012 and 2013 as the most reasonable multiples in terms of multiple comparisons for NLMK. Those multiples imply a premium in NLMK valuation compared to its Russian peers.

On the other hand, most of EV/EBITDA and P/E 2012 and 2013 multiples imply a discount on NLMK in comparison with its main peers in developed and emerging markets.



## *Risks*

We see the following risks, which if realized could lead to a decrease in the stock price of NLMK shares:

- **Decline in the world demand for steel products** due to the worsening debt crisis in European countries, recession in U.S. or significant slowdown in the Chinese economy. In particular the share of Europe and the U.S. sales in NLMK total sales accounts for about 40%. Therefore, the reduction in steel consumption in these regions may negatively affect the level of NLMK sales and operating profit.
- **Reduction in domestic steel products demand.** The Russian economy is an export-oriented economy and is highly dependent on the level of demand for raw materials, particularly oil and gas in the international market. Therefore, the level of domestic consumption for steel products is heavily dependent on Russian export revenues. In the case of a decrease in the global demand for raw materials, there will be a reduction in both export earnings and the level of domestic consumption of metal products.
- **Increased political instability in Russia during the presidential elections.** Political instability is perceived negatively by investors, and could significantly reduce the attractiveness of the Russian stock market, in particular, NLMK shares.
- **Presence of high operational risks.** The metallurgical industry is characterized by high operational risks. We can not exclude the possibility of technological accidents at NLMK production facilities and this can have negative impact on both the operational and financial performance of NLMK.

## *Conclusions and Recommendations*

NLMK has one of the most efficient steel-making capacities in the Russian steel sector. According to our estimates, the commissioning of the new blast furnace #7 at the main site in Lipetsk, the long rolled mill in Kaluga, as well as the consolidation of SIF assets in the U.S. and Europe, will allow NLMK to increase its steel products sales by the end of 2013 by 37% when compared to sales volumes in 2011.

Full vertical integration in iron ore as well as the introduction of modern technologies to improve the efficiency of steel production, will enable NLMK to maintain its operating profitability in spite of the rapid growth of fixed and variable costs relative to the prices of finished products.

NLMK financial leverage is one of the lowest in the sector. In our estimates, the company's Net debt/EBITDA ratio for 2011 will not exceed 1.2X. Given that the comfortable Net debt/EBITDA ratio is 3.0X in the sector; NLMK has the ability to raise



more than USD4 bn on DCM. Thus the company has a high degree of financial stability, and can become an active player in M&A.

This year EBITDA will grow by more than 18% y-o-y thanks to an increase in sales from new steelmaking capacities.

From the peaks at the beginning of 2011 NLMK shares fell more than 55% and are heavily oversold in our opinion. Currently NLMK trades at 5.8X of EV/EBITDA<sub>2012</sub> multiple (we use Grandis Capital EBITDA<sub>2012</sub> estimate). We view EV/EBITDA<sub>2012</sub> multiple fair value as 7.5X.

High quality of steel assets, prospects for significant growth in financial performance, as well as high financial stability, combined with a significant overselling of NLMK shares will be the key drivers of growth for the company stocks.

Our estimate of the fair value of NLMK shares is a weighted average between estimates made by DCF and multiples methods.

We are initiating our coverage of **NLMK with a BUY recommendation** and a **target price of USD3.54 by the end of 2012, implying a 60% upside potential.**



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