

## Standard & Poor's Expects To Resolve CreditWatch Neg Placement On Pipe Producer TMK After IPO

### Rationale

On Oct. 23, 2006, Standard & Poor's Ratings Services kept its 'B+' long-term corporate credit rating on Russia-based steel pipe producer OAO TMK on CreditWatch with negative implications, after TMK's core shareholder, Dmitriy Pumpyanskiy, increased his stake in the company to 100% from 67%.

The ratings were originally placed on CreditWatch on Sept. 4, 2006, pending clarification of the company's eventual balance sheet structure.

The shareholder transaction is largely financed (directly or indirectly) by TMK, which increases the company's leverage and short-term debt. The parent company, TMK Steel Ltd. (beneficially owned by Mr. Pumpyanskiy), recently raised a \$780 million loan from TMK as well as \$470 million in bank debt, which we believe it will repay primarily from TMK's dividends or through a sale of TMK stock. To finance the loan to TMK Steel, TMK issued a \$300 million Eurobond through its finance vehicle TMK Capital S.A. in September 2006 and raised \$475 million in bank debt. The parent plans to sell about 20% of TMK stock at the IPO scheduled for early November 2006. If the IPO proceeds help to refinance a significant part of transaction-related debt at the company and parent levels by the end of 2006 (which is the company's plan), the rating is likely to be affirmed. Otherwise, the rating could be lowered, likely by one notch, reflecting higher leverage and exposure to refinancing risks.

The ratings on TMK continue to reflect the company's ambitious capital expenditure plans, improving but volatile margins, limited liquidity, and short track record as a combined group. These factors are offset by TMK's robust market positions and the currently favorable market fundamentals for seamless and large-diameter welded pipes. At

**Primary Credit Analysts:**

Elena Anankina  
Moscow  
(7) 495-783-4130  
elena\_anankina@  
standardandpoors.com

**Secondary Credit Analysts:**

Tatiana Kordyukova  
Moscow  
(7) 495-783-4131  
tatiana\_kordyukova@  
standardandpoors.com

Trevor Pritchard  
London  
(44) 20-7176-3737  
trevor\_pritchard@  
standardandpoors.com

Additional Contact: Industrial  
Ratings Europe  
CorporateFinanceEurope@  
standardandpoors.com

**Publication Date**

23, 2006

June 30, 2006, TMK had debt of \$710 million (adjusted for finance leases, postretirement benefits, and guarantees).

TMK has a large \$1.2 billion capital expenditure program aimed at facility modernization. This will limit free operating cash flow generation in the next two-three years. Margins are improving, but remain volatile and fundamentally depend on the steel cycle and capital expenditure fluctuations in the oil and gas industry. The company's margins could also be affected by increasing competition in the coming years.

On the positive side, TMK enjoys a strong market position, with more than 42% of Russia's pipe production and a diversified asset base of four plants in Russia and two smaller ones in Romania. The company is particularly strong in seamless pipes for the oil and gas industry. This is the most profitable segment, with high demand due to growing capital expenditures in the oil and gas sector. In the first half of 2006, EBITDA was \$393 million, representing a 25% margin on sales.

### *Liquidity*

TMK's liquidity is weak. The company has high liquidity requirements to finance the shareholder transaction and to support its ongoing capital expenditure program. At June 30, 2006, short-term debt stood at \$418 million, versus \$49 million in cash and financial assets and \$110 million in unutilized bank lines. The recently placed \$300 million helped to finance part of the shareholder transaction. The IPO scheduled for November 2006, if successful, will largely refinance debt related to the shareholder transaction.

Under the company's current plans, both the IPO and the Eurobond will be essential for refinancing. TMK has adequate access to external financing because there is currently investor demand for Russian securities in both the domestic and external markets, and because the company is now consolidated. Like any emerging market issuer, however, TMK is subject to fluctuating demand for emerging market debt.

### *Recovery analysis*

TMK's \$300 million 8.5% Eurobond due in 2009 was issued by TMK Capital S.A., a special-purpose vehicle supported by TMK, which has on-lent the proceeds to TMK. The rating is preliminary, and the final rating is subject to receipt and review of final documentation and legal opinions. The 'B+' issue rating reflects our corporate credit rating on TMK and is based on our expectation that noteholders, through the trustee, will get access to the company and that the issue will bear guarantees from the key operating subsidiaries.

TMK has two Russian ruble (RUR) bond issues outstanding, which are rated 'ruA+':

- RUR3 billion, due in March 2009, with put options in March 2007; and
- RUR5 billion, due in February 2011, with put options in February 2008.

A significant part of the group's debt is located at the operating subsidiary level, and the guarantees issued by operating subsidiaries on the Russian ruble bonds are partial. This raises potential structural subordination issues. Given the company's centralized liquidity management and uncertainties due to the weaknesses of Russia's legal and judicial systems, however, at this stage we do not differentiate between the ratings on such bonds and the corporate credit rating.

## **Ratings List**

OA0 TMK

Corporate credit rating      B+/Watch Neg/—

*Standard & Poor's Expects To Resolve CreditWatch Neg Placement On Pipe Producer TMK  
After IPO*

Russia national scale rating ruA+/Watch Neg

Senior unsecured debt ruA+/Watch Neg

TMK Capital S.A.

Senior unsecured notes\* B+/Watch Neg

\*Support from OAO TMK.

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at [www.ratingsdirect.com](http://www.ratingsdirect.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com); under Credit Ratings in the left navigation area, select Find a Rating, then Credit Ratings Search.

Published by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. Executive offices: 1221 Avenue of the Americas, New York, NY 10020. Editorial offices: 55 Water Street, New York, NY 10041. Subscriber services: (1) 212-438-7280. Copyright 2007 by The McGraw-Hill Companies, Inc. Reproduction in whole or in part prohibited except by permission. All rights reserved. Information has been obtained by Standard & Poor's from sources believed to be reliable. However, because of the possibility of human or mechanical error by our sources, Standard & Poor's or others, Standard & Poor's does not guarantee the accuracy, adequacy, or completeness of any information and is not responsible for any errors or omissions or the result obtained from the use of such information. Ratings are statements of opinion, not statements of fact or recommendations to buy, hold, or sell any securities.

Standard & Poor's uses billing and contact data collected from subscribers for billing and order fulfillment purposes, and occasionally to inform subscribers about products or services from Standard & Poor's, our parent, The McGraw-Hill Companies, and reputable third parties that may be of interest to them. All subscriber billing and contact data collected is stored in a secure database in the U.S. and access is limited to authorized persons. If you would prefer not to have your information used as outlined in this notice, if you wish to review your information for accuracy, or for more information on our privacy practices, please call us at (1) 212-438-7280 or write us at: [privacy@standardandpoors.com](mailto:privacy@standardandpoors.com). For more information about The McGraw-Hill Companies Privacy Policy please visit [www.mcgraw-hill.com/privacy.html](http://www.mcgraw-hill.com/privacy.html).

Analytic services provided by Standard & Poor's Ratings Services ("Ratings Services") are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. Credit ratings issued by Ratings Services are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of credit ratings issued by Ratings Services should not rely on any such ratings or other opinion issued by Ratings Services in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or by the underwriters participating in the distribution thereof. The fees generally vary from US\$2,000 to over US\$1,500,000. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications.