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

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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

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

OAO TMK	
Corporate credit rating	B+/Watch Neg/—

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.

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