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Research Update:

Russian Pipe Maker TMK Outlook Now Stable On Improved Liquidity; Upgraded To 'ruA-'; Long-Term Rating Affirmed At 'B'

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Research Update:

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Overview

- Russia-based pipe manufacturer OAO TMK has issued RUB5 billion in three-year ruble bonds and has increased the amount of long-term committed credit lines at its disposal.
- Liquidity has therefore improved, and we now consider it "less than adequate".
- Moreover, operating performance is improving.
- We are therefore revising our outlook on TMK to stable from negative, affirming the long-term credit rating at 'B', and raising the national scale rating from 'ruBBB+' to 'ruA-'.
- The stable outlook reflects our expectation of stable operating and financial performance in 2011 and gradually improving credit metrics.

Rating Action

On Nov. 19, 2010, Standard & Poor's Ratings Services revised its outlook on Russia-based pipe manufacturer OAO TMK to stable from negative and affirmed its long-term corporate credit rating on TMK at 'B'. At the same time, the Russia national scale rating was raised to 'ruA-' from 'ruBBB+'. The outlook is now stable.

Rationale

The outlook revision, the raising of the national scale rating, and the affirmation of the long-term rating reflect the improvement in TMK's liquidity, as well as a stabilization in its operating and financial performance.

We have changed our assessment of TMK's liquidity from "weak" to the better "less than adequate" based on TMK's successful issuance of three-year ruble bonds in the amount of Russian ruble (RUB) 5 billion ($160 million) and an increase in the amount of long-term committed lines that can be used to refinance substantial maturities in 2011. We further expect the management to proactively address upcoming maturities in the second half of 2010 and in 2011 by issuing long-term debt.

We further note TMK's improved financial and operating performance in the first six months of 2010 based on a 58% increase in pipe sales volumes compared with the same period of 2009 and better margins thanks to price appreciation and higher capacity utilization. We expect that the company's performance in the second half of 2010 should be supported by depreciation of steel and scrap prices.

In the first half of 2010, the company generated EBITDA of $415 million (EBITDA margin of 16%) and its fully adjusted ratio of debt to EBITDA has improved to 4.4x on an annualized basis. Free operating cash flow (FOCF) was negative, however, due to working-capital outlays related to improved business activity, maintenance capital expenditures, and high interest expense. In our credit scenario based on largely stable pipe prices and raw material costs, we anticipate that TMK will generate neutral to slightly positive FOCF in the next 12-18 months and its credit metrics will gradually improve.

The ratings continue to reflect our view of TMK's business risk profile as "fair" and its financial risk profile as "highly leveraged". TMK's fair business risk profile reflects the cyclicality of the steel pipe industry, which is underlined by TMK's very weak performance in 2009 on the back of the global economic downturn and exposure to Russian country risks. In our view, these weaknesses are only partly offset by TMK's robust market positions and diversity of operations. We consider that TMK's financial risk profile is constrained by high leverage and still "less-than-adequate" liquidity, although it is improving. On the positive side, we note the company's demonstrated access to financing from Russian state-owned banks.

Liquidity

We now consider TMK's liquidity as "less than adequate". This is based on the estimated ratio of potential sources of liquidity to potential uses of liquidity of about 1x, as well as demonstrated access to financing from Russian banks. We further note that the company has substantial uncommitted lines from banks, which we do not, however, include in our analysis.

The key sources of liquidity include:

- Long-term committed credit lines of about $360 million; and
- Cash flow from operations of about $500 million (according to our conservative credit scenario).

We further anticipate the company will sign about $230 million of additional long-term committed lines in the next several weeks.

The key potential uses of liquidity include:

- Debt maturities of about $700 million until the end of 2011 (taking into account the extension of loans from Sberbank); and
- Capital expenditures of about $200 million.

We note, however, that TMK has about $1.2 billion of debt maturing in 2012 and the company would need to proactively address it in 2011 in order to maintain "less-than-adequate" liquidity.

TMK is subject to covenants under its 2011 Eurobond that limit its debt-to-EBITDA ratio to 3.5x and are tested semiannually. These are incurrence rather than maintenance covenants, however, and will only restrict further borrowings (except for permitted indebtedness) if breached.

TMK is further subject to maintenance covenants under several of its bank loan agreements that limit the debt-to-EBITDA ratio to 5x and are also tested semiannually. The company has a waiver for a breach that occurred on June 30, 2010. We consider that the headroom for Dec. 31, 2010, is moderate. We expect, however, that even if the covenants are breached, TMK should be able to receive waivers from its key relationship banks (as was the case in 2009 and the first half of 2010).

Recovery analysis

The $187 million 10% loan participation note due 2011 issued by TMK Capital S.A. is rated 'B', in line with the corporate credit rating on TMK. The recovery rating on this instrument is '4', indicating our expectation of average (30%-50%) recovery in the event of a payment default. The $412.5 million guaranteed convertible bonds due 2015, issued by TMK Bonds S.A. are rated 'B' with a recovery rating of '4'.

Recovery prospects are supported, in our view, by the company's substantial asset base and our belief that the company would reorganize in the event of a default. We have pushed back the year of default under our hypothetical scenario from 2011 to 2012 to reflect TMK's ongoing refinancing efforts and the reduced level of debt maturities in 2011. Other aspects of our recovery analysis remain unchanged.

We believe that recovery prospects are limited by TMK's complex capital structure, which includes an extensive array of debt facilities with differing security and guarantee arrangements. Our stressed enterprise value of the company at default is $2.9 billion. Recovery prospects for the rated instruments are nominally higher than the 30%-50% range but the recovery rating of '4' factors in our expectation that the company's capital structure will evolve as near-term maturities are refinanced. We believe this could lead to increased levels of debt ranking ahead of the rated instruments.

For full details please see "OAO TMK Recovery Rating Profile," published Sept. 14, 2010.

Outlook

The stable outlook reflects our expectation of stable operating and financial performance in 2011 and gradually improving credit metrics.

The ratings could come under pressure if liquidity deteriorates again as 2012 maturities approach, unless the company refinances them proactively. A new downturn in the pipe market could also pressure the ratings.

Ratings upside could follow further important improvements in liquidity and positive FOCF generation leading to debt reduction and stronger credit metrics. The fully adjusted ratio of funds from operations to debt at about 15%-20% would be commensurate with the 'B+' rating.

Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Methodology And Assumptions: Standard & Poor's Standardizes Liquidity Descriptors For Global Corporate Issuers, July 2, 2010
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- OAO TMK Recovery Rating Profile, Sept. 14, 2010

Ratings List

CreditWatch/Outlook Revision; Ratings Affirmed

	To	From
OAO TMK		
Corporate Credit Rating	B/Stable/--	B/Negative/--

Upgraded

	To	From
OAO TMK		
Russia national scale rating	ruA-	ruBBB+
Senior Unsecured (1 issue)	ruA-	ruBBB+

Ratings Affirmed

TMK Bonds S.A.	
Senior Unsecured(1)	B
Recovery Rating	4
TMK Capital S.A.	
Senior Unsecured(2)	B
Recovery Rating	4

(1)Guaranteed by OAO TMK. (2)Supported by OAO TMK.

Additional Contact:
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Complete ratings information is available to RatingsDirect subscribers on the Global Credit Portal at www.globalcreditportal.com and RatingsDirect subscribers at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow (7) 495-783-4011.