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RUSSIAN EQUITY RESEARCH: OIL & GAS

Russian tire manufacturers

Nizhnekamskshina, Omskshina, Yarshina

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Fair values for Russian tire makers: we recommend all three as Sells

We are initiating coverage on the three largest traded Russian tire makers. We recommend Nizhnekamskshina (NKSH RU) as a Sell with a fair value of USD 0.9 per share and a 12% potential downside, Omskshina (OMSH RU) as a Sell with a fair value of USD 26.8 and a 14% potential downside, and Yarshina (YASH RU) as a Sell with a fair value of USD 0.07 per share and a 93% potential downside.

As imports increase and international tire makers command a larger share of the market, squeezing domestic tire makers margins, Russian manufacturers are moving into the low price segment of the market

With increasing imports pushing Russian tire manufacturers into the lower price segment of the market, margins are being squeezed and producers are finding themselves without the free cash flow needed for capital expenditures. We consider Nizhnekamskshina the best-positioned company among the three covered in this report as a number of large automobile manufacturers account for a significant portion of revenue. However, a tolling scheme leaves the company without a fundamental upside.

Both Yarshina and Omskshina are overleveraged, with 2009 estimated net debt to EBITDA of 4x for OMSH and over 20x for YASH

Both YASH and OMSH are highly leveraged, with an estimated 2009 net debt/EBITDA of 4x for OMSH and over 20x for YASH. However, we do not see significant bankruptcy risk for either company as most of the debt was issued by parent company Sibur, or its affiliates. As a consequence, we consider the debt to be a quasi-equity instrument, leaving minorities lower equity value. The net debt position decreases our DCF-based fair value for OMSH by 55% and YASH by 99%

Summary valuation and financials

	Nizhnekamskshina	Omskshina	Yarshina
Bloomberg	NKSH	OMSH	YASH
Rating	Sell	Sell	Sell
Fair value (per common share), USD	0.9	26.8	0.07
Bid price, USD	0.9	25.0	0.75
Offer price, USD	1.1	37.0	1.05
Mid price, USD	1.0	31.0	0.9
Shares outstanding, mn	63,731	1,011	10,045
Market capitalization, USD mn	63	31	9
EV, USD mn	139	64	209

Source: RTS, Bloomberg, IFC Metropol estimates

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Investment summary and conclusions

In this report we initiate coverage of Russia's three largest traded tire producers. Using a DCF valuation, we established a fair value of USD 0.9 per share for Nizhnekamskshina (NKSH RU), assuming a 12% downside; of USD 26.8 per share for Omskshina (OMSH RU), assuming a 14% downside; and USD 0.07 per share for Yaroslavsky tire plant (YASH RU), assuming a 93% downside. We rate all three companies as Sells.

Figure 1:
Fair values and recommendations for Russian tire companies

Name	Ticker	Bid price	Offer price	Mid price*	FV	Upside/downside	Recommendation
Nizhnekamskshina	NKSH RU	0.9	1.09	1.0	0.9	-12%	Sell
Omskshina	OMSH RU	25.0	37.0	31.0	26.8	-14%	Sell
Yarshina	YASH RU	0.75	1.05	0.9	0.07	-93%	Sell

Source: RTS, IFC Metropol estimates

The outlook for the Russian tire market does not favor domestic producers, in our view

As tire imports increase and international manufacturers build tire plants in Russia, domestic producers face growing challenges. Consumers are increasingly switching from inexpensive Russian-produced tires to imports or foreign brands manufactured in Russia. The latest available data from 9M 2009, when Russian real disposable income was flat y-o-y, data on tire sales does not show consumers switching to cheaper tires. We estimate that the market share of inexpensive tires (with an average price of USD 35-60 per tire) was about 45% in terms of sales volume vs. 46% in 2008. Russian tire manufacturers mainly produce tires for the least expensive segment of the market, and we do not anticipate any increase in demand in this segment.

At the same time, we anticipate that competition will increase in the premium segment of the market. According to our estimates, by 2012 major international tire manufacturers are planning to begin production at new domestic facilities with volume constituting approximately 23% of overall tire consumption in Russia in 2009. Increased domestic production by international manufacturers will likely lead to squeezing out Russian tire producers, in our view.

Nizhnekamskshina, the largest Russian tire producer, utilizes a tolling arrangement that is value destructive for minority shareholders, in our view

In our opinion, Nizhnekamskshina, Russia's largest tire manufacturer, is the most well-positioned manufacturer of the three covered in this report, with a significant corporate customer base and leadership in the manufacture of Russian heavy truck tires. The most significant negative factor impacting the company is the tolling arrangement which has left the company with a net loss and almost zero cash flow since 2006. We do not believe the tolling arrangement will be discontinued in the foreseeable future as it is one of the principal mechanisms of control utilized by the majority shareholder, Tatneft. In our opinion, only discontinuing the tolling arrangement would provide a positive driver for the stock. As long as tolling continues, we are likely to recommend the stock as a Sell.

Yarshina's high debt burden leaves no value for minorities, according our analysis

Since 2005, the Yaroslavsky tire plant (Yarshina) has been engaged in renovating its manufacturing facilities and switching production from inexpensive tires to the mid-range "B" segment of the market. Without assessing the efficiency of capital expenditures, we note that Yarshina's 9M 09 net debt totaled RUB 5.9bn, or about 20x estimated 2009 EBITDA. We estimate that the net debt decreases the fair value by 99%, essentially eliminating the company's entire value.

However, almost 100% of Yarshina's debt was issued by its parent company, Sibur Russia Tire Holding. Consequently, we consider the debt as quasi-equity, which actually dilutes any minority shareholding and leaves minorities with no value even should Yarshina begin to generate free cash flow, which we optimistically assume as the base case in our DCF model.

With considerable debt and the highest potential production from its automobile tire JV not consolidated on the balance sheet, Omskshina also fails to offer value to minorities

Omskshina is in a similar position to Yarshina in terms of debt. Net debt for 9M 09 was about RUB 1bn, which is close to 4x estimated 2009 EBITDA. As with Yarshina, the majority of the debt was issued by Sibur, also Omskshina's parent company. As a result, the net debt decreases our DCF-based fair value by 55%.

Omskhina is associated with joint venture Matador-Omskshina, which produces automobile tires. Under RAS, Omskshina does not consolidate this entity, accounting for the JV on its balance sheet as a long-term investment. Therefore, minority shareholders do not share in the value of the JV. Omskshina itself specializes in the low-margin truck tire segment, which brings little margin or cash flow to minorities.

Risks

Our assessment of the impact of imports could be conservative

We anticipate an increasing competition in the Russian tire market, principally from international tire manufacturers building production capacity in Russia between now and 2012.

Production from such facilities could equal as much as 23% of the 2009 Russian tire market. However, given challenging economic conditions both in Russia and globally, international manufacturers could cancel or postpone these plans.

Potentially, such delays could result in market share gains for domestic tire producers. That said, we currently have no information indicating such delays, and based on the gradual economic recovery we are seeing, we do not believe that delays are likely. Moreover, we continue to see Russian consumers switching to more expensive tires. Only worsening economic conditions would be likely to dampen this trend, and further deterioration in the economic environment would decrease total tire consumption, still adversely impacting Russian tire manufacturer revenues.

The principal risk to our valuation is that competition from international producers will be less than we have anticipated.

Increasing import duties for tires could give a short-term boost to domestic tire producer revenues

Russian tire producers have reportedly asked the government to increase import duties on tires. In 2009, NKSH and Sibur Russian Tires (SRT) asked the government to increase duties for both passenger and truck tires by 10 ppts. Although a decision has yet to be made, we believe the government should be eager advance protectionist measures for the industry. However, we argue that a duty would offer only short-term relief since we expect significant new foreign-owned production between 2010 and 2012 and a concomitant deterioration in market share for Russian tire manufacturers.

Russian tire market: major players and market profile

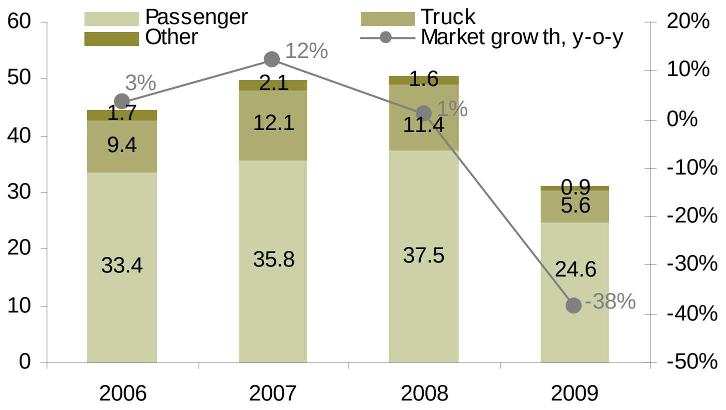
Market overview

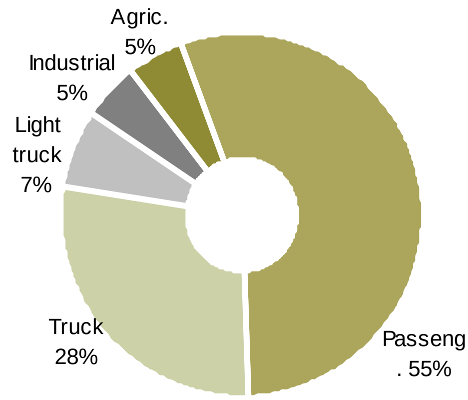
According to Sibur Russian Tires, tire sales in Russia fell by almost a 38% y-o-y in rouble terms in 2009, totaling RUB 98bn. In USD terms, the decrease was sharper, dropping by half to USD 3.1bn from USD 6.1bn in 2008. Having decreased by 38% y-o-y in absolute terms (in line with the rouble market), tire sales totaled just 31mn units in 2009, or well below the figures seen throughout the past seven years. As an indication, the Russian market was valued at USD 5.8bn (50mn tires) in pre-crisis 2007, and had been expanding at a CAGR of 18% between 2003 and 2007 in dollar terms. In volume terms, the CAGR for the same period was 7%, led by the agricultural and industrial tire segments (9%), and followed by the passenger car segment (8%).

We estimate real disposable income growth will lead to Russian consumers switching to more expensive foreign brand tires

Prior to the economic crisis, the number of cars on the road in Russia increased at a CAGR of 5% between 2003 and 2007, pushing up demand for tires. At the same time, real disposable income increased, leading to premiumization in the tire market.

Figure 2:
Russian tire market in mn units sold (left graph) and tire sales structure in monetary terms in 2008 (right graph)

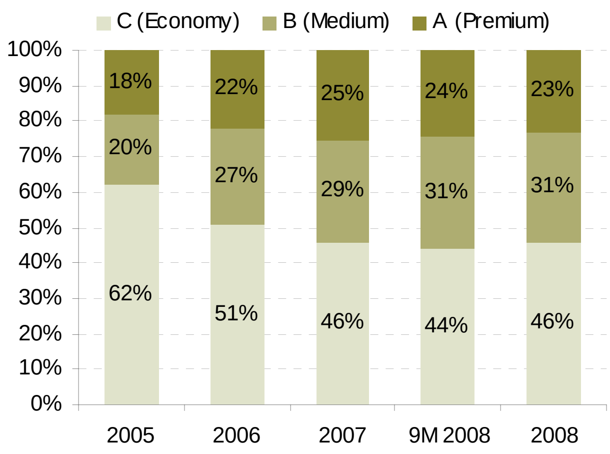


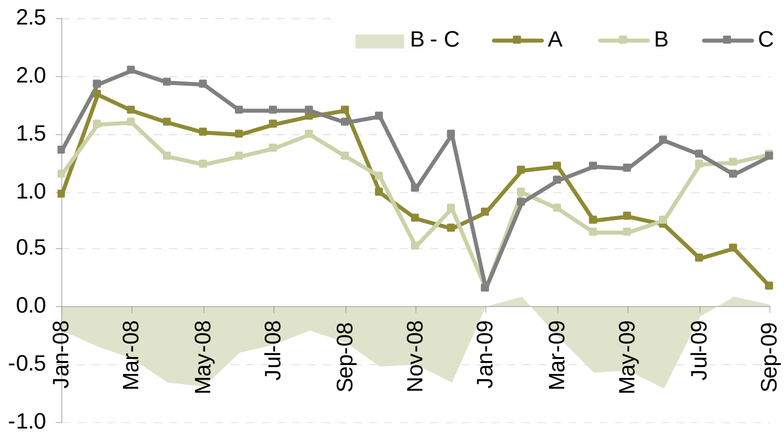


Source: SRT, IFC Metropol estimates

Between 2005 and 2007, the combined share of premium (Class A) and branded (Class B) tires, currently represented predominantly by high and medium-quality international brands and Russian brands Amtel, Matador, Kama-Euro, and Cordiant, increased to 54% from 38% at the expense of non-branded (Class C) tires produced in Russia and other CIS countries (Figure 3). This trend was especially pronounced in the automobile tire segment, where the share of branded tires doubled over 2004-06. Importantly, RDI growth positively impacted not only replacement tire (TR) demand, but also original equipment (OE) sales of branded tires. Between 2003 and 2008, sales of domestically produced cars fell from 900k to 700k vehicles annually as sales of locally-assembled foreign cars increased from 200k to 600k annually. Falling demand for domestically produced automobiles resulted in a concomitant decline in demand for domestically produced tires.

Figure 3:
Russian tire market by quality segments (% of tires sold – left graph, mn tires per month – right graph)*





* Segments breakdown: A – premium, B – 'value for money', C – lower.

1) Prices per tire. Passenger: C – USD 35-60, B – USD 60-90, A – USD 90-160;

2) Truck: C – USD 120-280, B – USD 310-390, A – USD 470-630

Source: SRT, IFC Metropol estimates

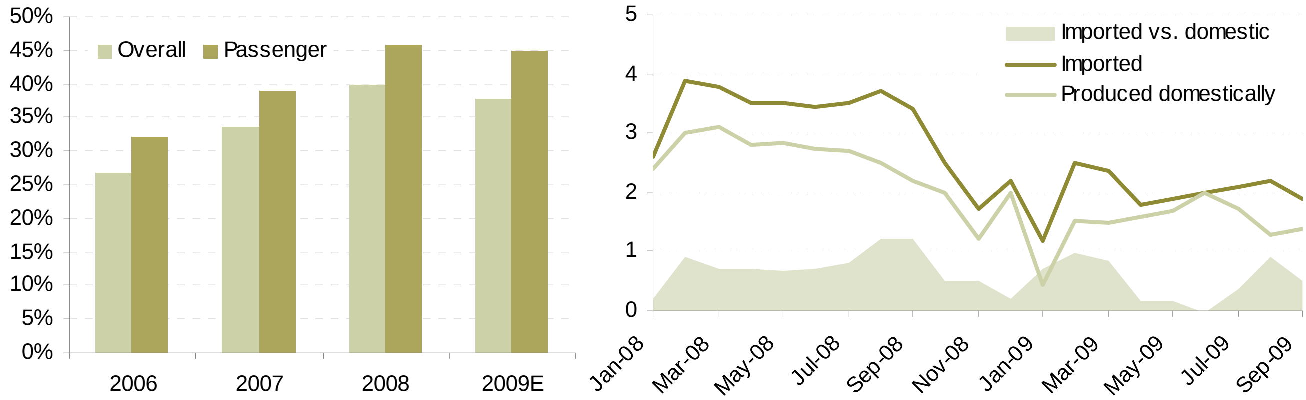
Even flat real disposable income in 9M 09 did not reverse the trend of increasing premiumization in the Russian tire market

Data from SRT shows market share for the economy (C) segment rising slightly to 46% in 2008, while the most recently available data, for 9M 09, shows market share stabilizing at 45%. However, we believe that there are no sustainable signs of reversal in the 'premiumization' trend. In 9M 09, RDI was flat y-o-y, potentially suggesting migration of demand from the premium to lower priced segments. We believe that only in the face of declining RDI would we see the economy segment holding its own against the premium and mid-range segments, and a declining RDI would be likely only in a W-shaped recession scenario, which we consider relatively unlikely. Our current in-house forecast for RDI is 3% growth in 2010 and more than 4% annual growth until 2016.

As far as producer segmentation is concerned, the most attractive premium and B+ (branded upper division) segments are currently dominated by international tire makers, whereas local brands are focused primarily on the non-branded and 'value-for-money' segments (i.e. C, B- and B). This market landscape can be partially explained by the technological capabilities of Russian tire producers, their traditional orientation toward Russian car makers, and the tax regime. Import duties on passenger car and truck tires are 20% and 15% respectively, with a EUR 7 minimum threshold per tire. The duty, while having little impact on the demand for premium tires, is damaging to cheap imports from Ukraine, Belarus and China.

Nonetheless, the percentage of imported passenger car tires in domestic sales increased to 46% in 2008, approaching 48% during the pre-crisis 9M 08, compared to 32% in 2006 (Figure 4).

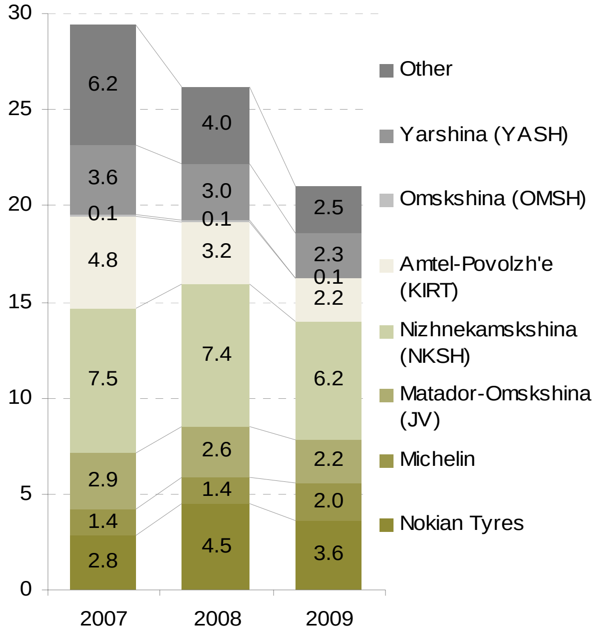
Figure 4:
Percentage of tire imports (left graph) and import vs. domestic production in mn tires per month (right graph)

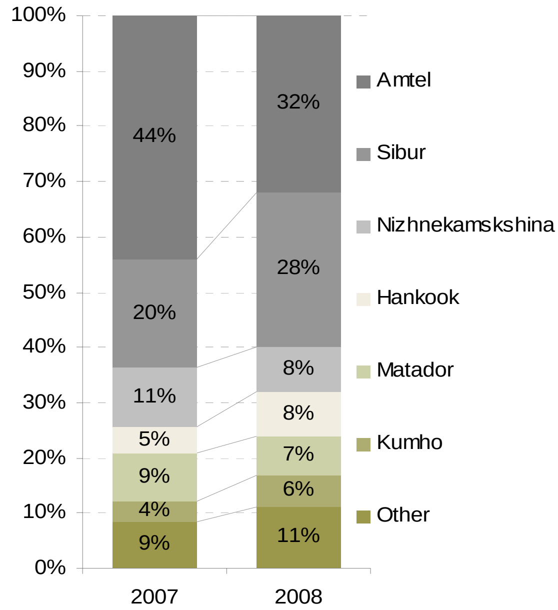


Source: SRT, IFC Metropol estimates

Notably, the Russian 'big three' (SRT, Amtel and Nizhnekamskshina) tire makers were losing their combined market share in the key B-segment to South Korean and Taiwanese producers. For instance, the group's share in the segment decreased in value terms from 75% in 2007 to 68% in 2008 (Figure 5).

Figure 5:
Russian passenger car tire output in mn tires (left graph) and sales breakdown in Segment B (right graph)

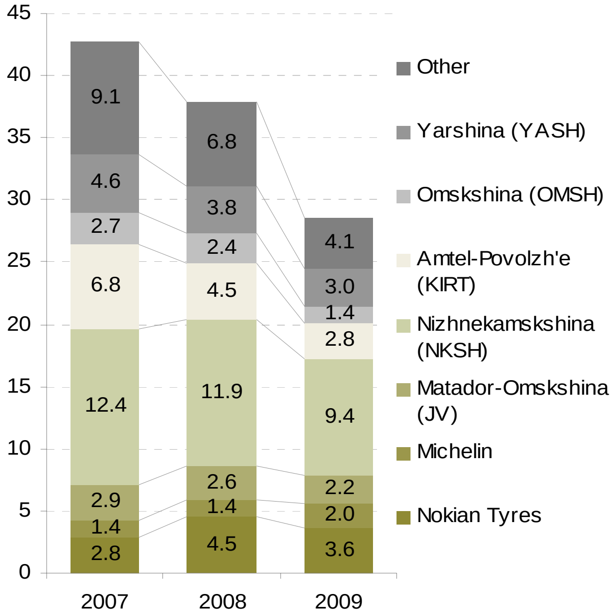


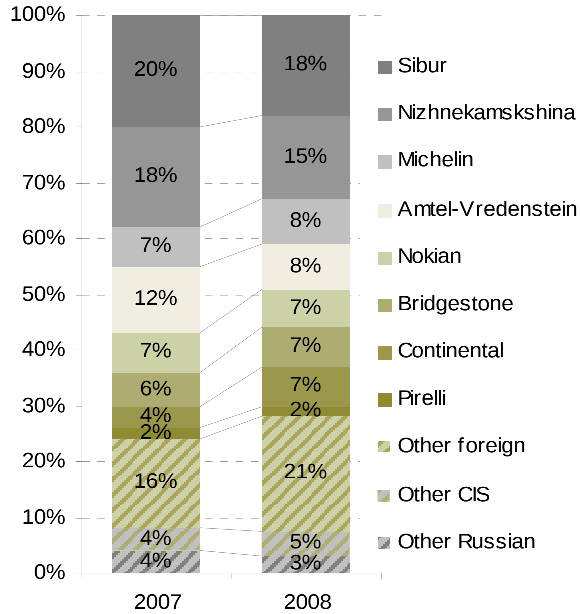


Source: Company data, SRT, Spark and IFC Metropol estimates

With international manufacturers expanding their production facilities in Russia, the discouraging outlook for domestic tire makers is becoming more profound. Since 2004, when Nokian Tires (Vsevolozhsk) and Michelin (Davydovo) began production in Russia, their combined output reached 5.9mn tires (or 23% of passenger car tire production in Russia) in 2008 and decreased only slightly to 5.5mn tires in 2009 (Figure 5), implying a 26% share in production, according to our estimates. We do not account for the 50:50 Matador-Omskshina joint venture, which produced 2.2mn passenger tires in 2009. At the same time, combined share of Nizhnekamskshina, Yarshina, Omskshina and Amtel-Povolzh'e in production was falling gradually, having declined to 51% in 2009 from 54% in 2007 (Figure 5). Including non-passenger car tires, the share also declined from 62% to 58% over the period (Figure 6).

Figure 6:
Russian tire output by producers in mn units (left graph) and market breakdown by major players in value terms





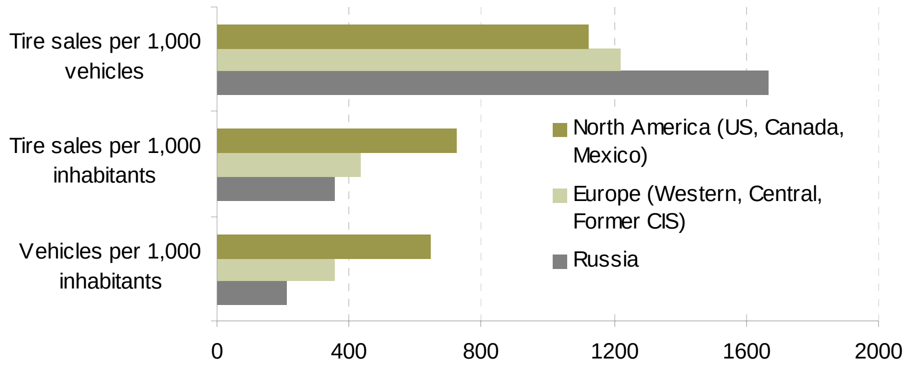
Source: Company data, SRT, Spark and IFC Metropol estimates

Beyond 2010 we anticipate a significant increase in domestic production by foreign companies

Formerly, international manufacturers such as Bridgestone, Continental, Goodyear, Pirelli, Michelin, Nokian and Yokohama planned to either establish or expand tire production facilities in Russia. Specifically, Nokian aimed to increase production in Vsevolozhsk to 10mn tires annually by 2011, Michelin targeted a 4mn increase in capacity at its Davydovo plant, and Goodyear planned initiate production at a 5mn unit per annum plant by 2011-2012 as well. The underlying logic was the significant growth potential offered by the Russian market due to the long distances and harsh weather conditions involved in travelling by road in the country. With the availability of cheap labor and raw materials (synthetic rubbers, for instance), and due to existing import duties, localized production would significantly enhance margins, and offer a platform for expansion into the markets of the Former Soviet Union and Central Asia.

The situation remains relatively unchanged. With expected growth in the number of cars on the road, market 'premiumization' (as discussed above) and higher-than-the-global-average tire consumption per vehicle (Figure 7), Russia still seems to be a very lucrative target. In November 09, Michelin announced plans to double its passenger car tire capacity in Davydovo to 4mn, and to open a facility this year for retreading commercial vehicle tires, which is a precursor to local truck tire production, in our view. In March 2010 Yokohama started construction of the 3.5mn per annum automobile tire plant (1.5mn at the first stage, with a possible 2mn tire increase) in the Lipetsk region, which is scheduled to start in 2011.

Figure 7:
Tire consumption in different regions



Source: Michelin, IFC Metropol estimates

New capacities additiona may account for 23% of overall tire consumption in Russia in 2009

Overall, excluding other potential start-ups (for example, the delayed 4.2mn tire per annum plant planned by Pirelli in Togliatti), these additions plus Nokian's 1.5mn tire spare capacity would constitute 23% of overall tire consumption in Russia in 2009. We believe this probable supply overhang does not bode well for local producers, regardless of the fact that the main investments are planned in the A and B+ segments. In our view, lower production costs in Russia (for example, Nokian estimates the cost per tire is EUR 5-10 less than in Eastern Europe, or 4-8% lower) would provide majors with enough pricing flexibility to move into lower segments. Moreover, nothing prevents them from creating an ad hoc brand for Russia targeted toward the B and B- segments.

This, in combination with rising competition from branded tires produced by Kumho, Hankook, Nexen (all South Korean) and Maxxis (Taiwan), is the major threat for Russian tire makers in our view, potentially leaving them alone in the stagnating and least attractive C segment. To underline the producers' own outlooks, Nokian, for example, expects the Russian tire market to grow at a CAGR of 4% in volume terms over 2008-14 (7.5% in EUR) and the A and B segments to expand by 9.6% and 11.5% respectively, while the segment C is projected to shrink by 2.6%.

We estimate international producers manufacturing locally would be in a better position than either local producers or importers

In the current environment, we believe that companies offering a recognizable brand name, a superior price to quality ratio, modern technology, fully developed distribution chains and close ties with local manufacturers should occupy relatively strong market positions. We believe that Nizhnekamskshina and SRT meet these criteria.

Manufactured at Yarshina (YASH) and Omskshina-Matador JV, Cordiant is a well-positioned brand in segment B and has been recognized as the best option in terms of price/quality by various industry publications. This SRT-owned plant also produces Tyrex solid metal cord (SMC) tires. We note that recently tire producers have predicted this segment to be the fastest growing segment in the coming years. Tatneft commenced production the 1.2mn unit per annum SMC plant in Nizhnekamsk in 2009, which could potentially fulfill 70% of the Russian demand for SMC tires.

Nizhnekamskshina (NKSH) produces the well-known Kama-Euro brand in the B-segment. NKSH has undergone modernization to replace diagonal tire production by radial-ply. By March 2010, of the total 8mn unit annual car and light truck tire production capacity at NKSH, almost 3 mn units of capacity was for Kama-Euro tire production. Despite a slump in Avtovaz passenger car output (Kama-Euro's major OE consumer), the B- segment looks attractive to us both in the long run (given migrating demand from C) and in the short term (due to consumer inflow from the B and B+ segments as a result of declining RDI).

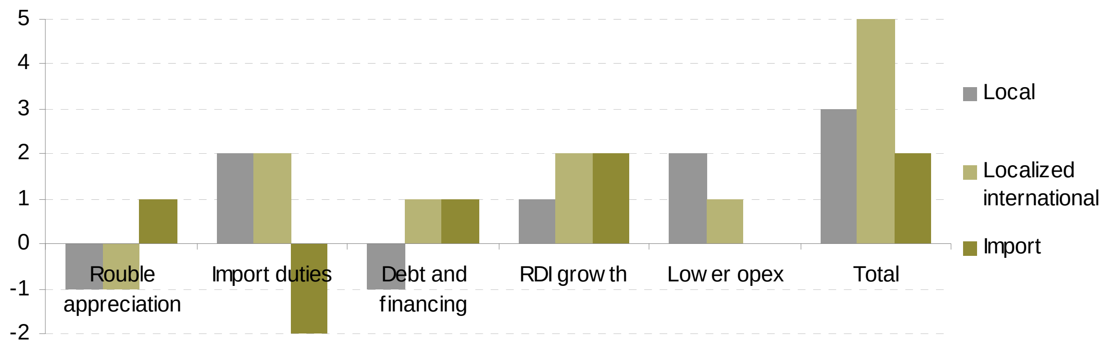
We also believe that the regulatory environment should offer a substantial competitive buffer for local producers. In 2009, NKSH and SRT asked the government to increase import duties by 10 ppts for both passenger car and truck tires. Although a decision has yet to be made, we believe that the government should be eager to take supportive actions to protect the competitive position of domestic tire manufacturers.

Business environment factors support our view that local producers are in better shape than importers

As far as other factors are concerned, we believe that local producers, both Russian and international manufacturers, are in better shape than importers. Despite stringent financing conditions, expected market 'premiumization' and rouble appreciation going forward[1], lower production costs and the regulatory environment should help well-developed companies to sustain their competitive advantage. Nevertheless, the bottom line is that international manufacturers who produce locally will be in the best position to benefit from this environment, leaving Russian manufacturers isolated in the B- and B segments. Even in the best-case scenario, we would expect Russian tire markers to rally on possible recovery in automobile production in the short-term, but then to grow only slightly with gradually declining market share in the long run.

Figure 8 depicts our assessment of key factors in the business environment and their impact on tire manufacturers. Although we offer no quantitive assessment of impact, we rank the impact of these factors from -2 to 2, concluding that localized international producers are better positioned than both domestic Russian tire makers and importers.

Figure 8:
Key business environment factors and impact on producers



Source: IFC Metropol estimates

[1] In fact, the recent rouble devaluation has not had a considerable impact, since the currencies of the Eastern European states (Poland, Romania, Slovakia), where the major production plants are located, devalued to the same extent on average.

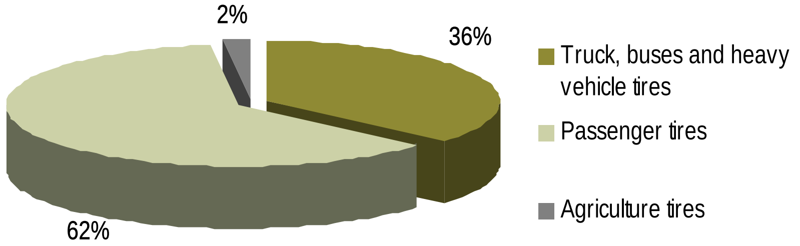
Nizhnekamskshina

Company profile

Description

Nizhnekamskshina is the largest tire plant in Russia, commanding a 39% market share in terms of tires produced in 3Q 09, according to our estimates. Nizhnekamskshina is controlled by the Tatar government and Tatneft, and is effectively managed by Tatneft through its petrochemical subsidiary Tatneft-Neftekhim.

Figure 9:
NKSH 2008 output structure, % of total 11.9mn of tires



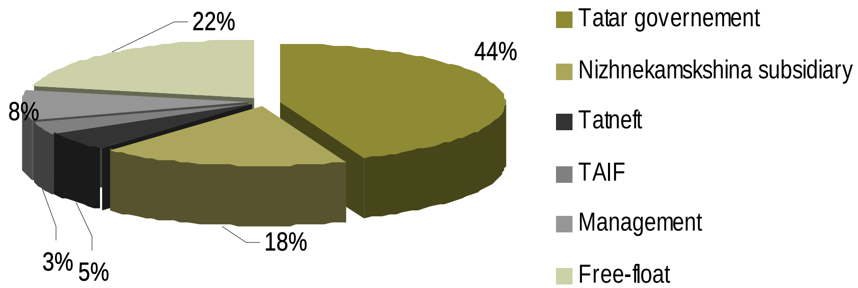
Source: Company data.

NKSH is the largest truck tire producer in Russia, occupying 42% of the truck tire market. The company has a close relationship with KAMAZ and is still the truck manufacturer's major tire supplier. At the beginning of 2010 after NKSH introduced new solid metal cord production KAMAZ representatives said that they would stay with NKSH in the nearest future.

NKSH has also 2mn tires per annum capacities for producing passenger car tires using Pirelli technology under the KAMA-Euro brand.

Shareholder structure

Figure 10:
NKSH shareholder structure, %



Source: Company data, IFC Metropol estimates.

Most recent RAS results: 9M 09

Figure 11:
NKSH 9M 09 RAS Income statement summary, RUB mn

	9M 08	9M 09	% Change y-o-y
Revenues	5,665	4,973	-12%
Operating expenses	-5,202	-4,706	-10%
Gross operating profit	463	267	-42%
EBITDA	627	416	-34%
EBITDA margin	11%	8%	
Net income	67	-70	-204%
Net income margin	1%	-1%	

Source: Company data, IFC Metropol estimates

Investment drivers

Cancellation of tolling arrangements

Since 2006, NKSH has operated under a tolling arrangement. Tatneft subsidiaries furnish raw materials to be processed into tires, and also sell the finished products. The company does not own either the raw materials or the finished products, getting just tiny refining margin, which has not been enough for NKSH to be profitable since 2006. NKSH made RUB 326mn in total from 2006 to 3Q 09. Although we do not believe that the tolling arrangement will be cancelled, discontinuance would be a strong driver for NKSH shares.

Investment risks

The tolling arrangement is value destructive, in our view

As we mentioned above, NKSH is located near KAMAZ and not far from the AVTOVAZ car plant, and is the principal supplier of tires to the plant. According to the company, now that it has implemented solid metal-cord tire production, it fulfills almost 100% of KAMAZ tire orders. According to our estimates, AVTOVAZ sources about half of its total tire demand from NKSH.

We believe that over the long term the possible increase in truck and car output could be a driver for NKSH. At the same time, we do not believe NKSH minorities will see any reasonable gains. The tolling arrangement leaves NKSH with zero free cash flow and in the best case zero net income, even in an expansionary environment. We do not see any investment drivers for NKSH unless the tolling arrangement is discontinued.

Significant short-term debt presents little risk given that it was issued by Tatneft

According 9M 09 RAS financial statements, NKSH has short-term debt of RUB 2.1bn, or almost 3.5x 2010 estimated EBITDA. But almost all the short-term debt is promissory notes payable to controlling shareholder Tatneft. We don't believe that Tatneft will demand payment unless payment could be made without significant damage to NKSH cash flow. Therefore, we do not consider the debt to be a significant risk.

Financial forecast and valuation

Financial outlook

As noted above, NKSH manufactures tires under a tolling arrangement, receiving an average tolling fee of about RUB 620 per tire produced (calculated based on 2008 revenues and production). We expect a significant 10% rebound in 2010 revenues, but attribute this rebound to the low base effect.

We assume that the tolling arrangement will continue, and forecast that NKSH will increase the tolling fee in line with PPI inflation. We emphasize that cancellation of the tolling scheme would give a major boost to NKSH revenues and margins. Our alternative valuation assumed fair value of about USD 3 per share should tolling end in 2011, which suggests almost 285% upside to the current price. But we reiterate our view that this scenario is unlikely.

Valuation summary

Using the DCF approach, we value NKSH at USD 0.9 per share, which assumes a 12% downside to the current mid price and leads us to issue a Sell recommendation.

Figure 12:
NKSH DCF summary

NPV of projected FCF	2,034
Perpetual growth rate	3.00%
Terminal value	1,959
Net debt	2,222
Total fair value	1,771
Common shares out, 000	63,731
Fair value, RUB	28
Fair value, USD	0.9

Source: Company data, IFC Metropol estimates

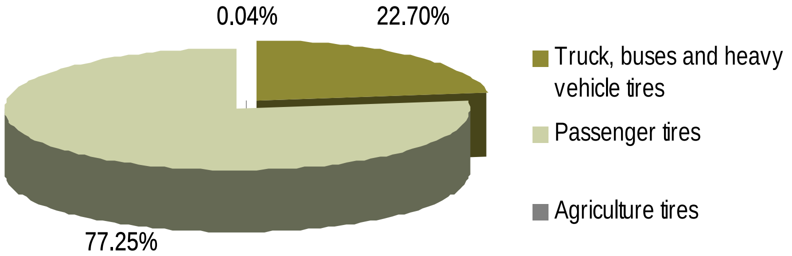
Yarshina

Company profile

Description

Yaroslavl tire plant (Yarshina, or YASH) is one of the oldest Russian tire plants, founded in 1932. In 9M 09, YASH had a 12% market share in terms of tires produced. YASH is owned by Russian petrochemical holding Sibur and is part of Sibur Russia Tires holding.

Figure 13:
YASH 2008 output structure, % of total 3.8mn of tires



Source: Company data.

The company's main brands are Yarshina and Cordiant. The majority of tires produced by YASH are in the economy segment. In 9M 09, the average revenue per tire was just slightly above RUB 1,000, according to our estimates. That compares to about RUB 750 per tire at NKSH, which works under a tolling arrangement. These figures are not directly comparable due to the difference in production structure. Larger and more expensive heavy truck tires account for a greater portion of production at NKSH. Nevertheless, the YASH average revenue per tire is just 33% higher than that of NKSH, indicating the majority of tires produced are in the cheapest segment.

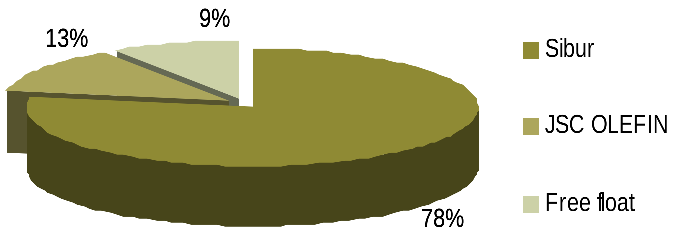
From 2004-2007, YASH also worked under a tolling arrangement. Following the cancellation of the tolling arrangement in 2007, revenues doubled over the prior year's figure. However, YASH has produced no net income since 2006.

In 2007-2009, the company continued with its capital expenditure program. We estimate that in 2007-2008 YASH generated about RUB 0.4bn in EBITDA and spent about RUB 3.7bn on CAPEX. This caused a huge increase in net debt. According to our estimates, at the end of 9M 09 net debt was at RUB 5.9bn, or about 20x projected 2009 EBITDA.

At the same time, almost 100% of the debt was issued by the parent company, Sibur Russian Tires Holding. As a result, we don't see significant bankruptcy risk.

Shareholder structure

Figure 14:
YASH shareholder structure, %



Source: Company data, IFC Metropol estimates.

YASH, as well as other SIBUR-owned tire companies, is directly owned by Sibur-Russian Tires. We have no reliable information about the ownership of JSC Olefin, but taking into consideration the fact, that all analyzed Sibur companies are partially owned by JSC Olefin, we assume this is the company related to Sibur or its management. YASH is fully controlled by Sibur.

Most recent RAS results: 9M 09

Figure 15:
YASH 9M 09 RAS Income statement summary, RUB mn

	9M 08	9M 09	%Change y-o-y
Revenues	3,819	2,648	-31%
Operating expenses	-3,958	-2,756	-30%
Gross operating profit	-139	-108	-22%
EBITDA	152	201	32%
EBITDA margin	4%	8%	

Source: Company data, IFC Metropol estimates

Investment drivers

Increase in import duties could potentially be a short-term driver

As we noted above, Sibur and Nizhnekamskshina has asked the government to increase import duties on tires. Potentially, YASH could one of the main beneficiaries of this decision, as the majority of its production is in the C segment. Given a potential increase in import duties, customers could potentially switch to less expensive Russian tires. But, as we have noted above, we see import duties as a short-term driver only as we expect a number of foreign producers to initiate production in Russia.

Sibur Russian Tires Holding could be sold to a foreign investor

In 2005, Sibur's General Director commented that by the end of 2007, Sibur Russian Tires Holding could be sold to foreign investor, either directly or via an IPO. This has not happened, but we continue to see it as a possibility. We do not believe that a deal is likely over the next three years given the current economic environment, particularly following Amtel's bankruptcy and availability of its assets for sale. Nevertheless, any potential news of Sibur's intention to sell or IPO its tire assets could be a speculative driver for YASH stock.

Investment risks

The parent company can exercise control via the significant outstanding debt

As we mentioned above, Yarshina's 9M 09 net debt was about RUB 5.8bn, or about 20x 2009 projected EBITDA. We emphasize that almost 100% of the debt was issued by Sibur Russian Tires Holding, the parent company. As a result, assuming that Sibur is not planning for YASH to go bankrupt, we do not see significant risk of such an occurrence.

At the same time, even with a drastic reduction in capex from 2010, we estimate that the company would need at least seven years to repay the debt. Without some type of debt write-off agreement, it would be illogical for any entity except Sibur to invest in YASH. We believe that the large debt is Sibur's way of controlling YASH. The simple fact suggesting such a state of affairs is that YASH, a company with net debt/ EBITDA of 20x, issued a RUB 800mn loan to another Sibur company, Omskshina, in 2009

We estimate that the net debt reduces the company's fair value by almost 99%, making its shares nearly valueless even under the most optimistic financial forecast scenario.

Financial forecast and valuation

Financial outlook

As we noted above, the company is engaged in considerable capital spending that has resulted in negative free cash flow of about RUB 4.2bn and caused a critical situation with leverage. We have little information regarding the company's planned production and planned increase in revenue per tire. Thus, we apply an extremely optimistic scenario, assuming a 13% EBITDA margin in 2010 and going forward rather than the historical EBITDA margin of 3-5%. This assumption, combined with the optimistic estimate that starting in 2010 the company will perform maintenance capex of just RUB 80-100mn per annum, would see the company generate at least RUB 365mn of free cash flow.

We underline that even in this hypothetical and, probably, overly optimistic scenario; YASH shares have little value, in our opinion.

Valuation summary

Using a DCF approach and the optimistic assumptions described above, we value YASH at USD 0.07 per share, which assumes a 93% downside to the current mid price and leads us to issue a Sell recommendation.

Figure 16:
YASH DCF summary

NPV of projected FCF	3,067
Perpetual growth rate	3.00%
Terminal value	2,824
Net debt	5,871
Total fair value	20
Common shares out, 000	10,045
Fair value, RUB	2
Fair value, USD	0.07

Source: Company data, IFC Metropol estimates

Omskshina

Company profile

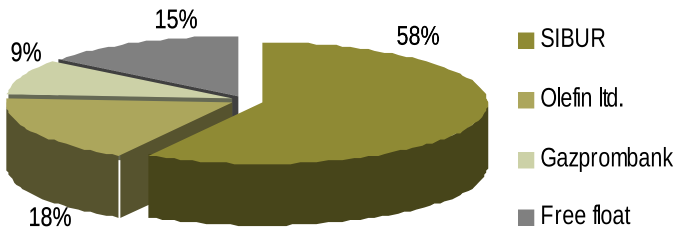
Description

As we noted above, Omskshina is associated with the joint venture Matador-Omskshina. In reality, Omskshina gains little from this JV. In 2005, all passenger car tire production capacities were turned over to the JV Matador-Omskshina. As a result, we estimate that currently minorities receive value only through truck tire production. Truck tires revenues account now for about 87% of total OMSH revenues, and truck tire manufacturing is the plants principal activity.

Omskshina is one of the largest truck tire producers in Russia, producing 1.4mn tires in 2009. OMSH is also one of the principal victims of the recession in Russian tire industry, in our view. As truck production and sales fell even more significantly than passenger car sales, truck tire consumption decreased accordingly. According to our estimates, in 2009 OMSH tire production decreased by 42% y-o-y, the highest drop among the three companies covered in this report.

Shareholder structure

Figure 17:
OMSH shareholder structure, %



Source: Company data, IFC Metropol estimates.

As with YASH, OMSH is directly owned by Sibur, with additional control probably exercised by Olefin and Gazprombank. However, we believe OMSH is fully controlled by Sibur.

Most recent RAS results: 9M 09

Figure 18:
OMSH 9M 09 RAS income statement summary, RUB mn

	9M 08	9M 09	%Change y-o-y
Revenues	7,936	4,170	-47%
Operating expenses	(8,023)	(4,028)	-50%
Gross operating profit	-87	142	-263%
EBITDA	30	255	758%
EBITDA margin	0%	6%	
Net income	-106	-63	-41%
Net income margin	-1%	-2%	

Source: Company data, IFC Metropol estimates

Investment drivers

Import duties or a sale by Sibur could be drivers, but a change in accounting for Matador JV would the main driver, in our view

Although we should note that both an increase in import duties or a possible sell by Sibur could drive the stock price, there is another potentially more significant driver. Should Sibur decide to change the structure of its holding in JV Matador-Omskshina and return passenger car tire production capacities to OMSH, this would significantly boost revenues and margins, in our view.

Investment risks

Debt is the main issue – we see no risk of bankruptcy, but it significantly diminishes fair value for minorities

We believe the debt situation at OMSH is not as serious as it is at YASH. We estimate the company's net debt at RUB 1bn, with net debt to estimated 2009 EBITDA of about 4x. Nevertheless, we still estimate net debt accounts for at least 55% of OMSH fair value, thus minorities are probably receiving only half the value they should.

Should OMSH continue to increase its leverage, as was the case in 2009, there is a risk that our fair value could be further decreased.

Financial forecast and valuation

Financial outlook

As noted above, OMSH is active in the low-margin truck tire segment. Its 9M 09 EBITDA was about 5%, compared to 8% for YASH and 10% for NKSH. We estimate going forward that the company's EBITDA margin will not exceed 4% (in 2006-2008 it was between 0% and 2%). Returning car tire production to OMSH would boost revenues and margin, and would likely push our fair value upward.

Valuation summary

Using the DCF approach, we value OMSH at USD 26.8 per share, which assumes a 14% downside to the current mid price and leads us to issue a Sell recommendation.

Figure 19:
OMSH DCF summary

NPV of projected FCF	902
Perpetual growth rate	3.00%
Terminal value	864
Net debt	972
Total fair value	794
Common shares out, 000	1,011
Fair value, RUB	785
Fair value, USD	26.8

Source: Company data, IFC Metropol estimates

Multiples comparison

For completeness, we provide a multiples-based comparison of Russian tire producers with major international peers, using our own estimates for the former and Bloomberg consensus forecasts for the latter. We emphasize that the approach should by no means be regarded as a valuation method, since the companies are too diverse in terms of business structure and operating environment.

Despite the fact that RAS-based figures are, strictly speaking, hardly comparable with reporting under international standards, we nonetheless see a huge gap on EV/EBITDA between Russian tire makers and internationals, with the exception of Nizhnekamskshina, which has an estimated EV/EBITDA of 7.3x for 2009 and 5.7x for 2010 or slightly below the median estimate for majors. However, on the revenue per tire multiple, all three companies underperform their international peers significantly, or by more than a factor of ten.

Figure 20:
Russian tire manufacturers vs. international majors

On March 30th	Revenue per tire, USD/tire			EV/EBITDA (x)			P/E (x)			P/BV		
	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E	2008	2009E	2010E
Russian petrochemicals												
Yarshina	1.6	2.3	1.6	41.6	58.7	11.8	neg	neg	neg	0.2	0.2	0.2
Omskshina	13.7	23.4	19.3	74.0	25.1	18.7	neg	neg	neg	0.6	0.6	0.6
Nizhnekamskshina	5.6	7.2	6.9	5.8	7.3	5.7	neg	neg	neg	2.5	2.4	2.3
Average	7.0	11.0	9.3	40.5	30.3	12.1	n/a	n/a	n/a	1.1	1.1	1.0
Median	5.6	7.2	6.9	41.6	25.1	11.8	n/a	n/a	n/a	0.6	0.6	0.6
International peers												
Michelin				6.0	6.7	5.3	16.0	34.2	12.5			
Bridgestone	190.8	203.3		5.8	6.9	6.3	105.1	266.0	23.0			
Goodyear	108.1	95.9		4.7	8.0	4.7	18.6	neg	54.5			
Pirelli				13.6	9.0	7.2	neg	60.5	14.7			
Nokian				9.5	15.4	11.2	16.5	41.4	19.4			
Hankook				9.2	6.2	6.1	39.1	9.7	9.2			
Kumho				7.9	107.0	9.4	neg	neg	neg			
Average				8.1	22.7	7.2	39.1	82.4	22.2			
Median				7.9	8.0	6.3	18.6	41.4	17.1			

Source: Bloomberg, Companies' data, IFC Metropol estimates

Appendix

Income statement summary forecast

Figure 21:
NKSH income statement summary, RUB mn

	2008	2009E	2010E	2011E	2012E	2013E
Revenues	7,409	6,962	7,658	8,424	9,267	10,193
Operating expenses	6,900	6,588	7,132	7,972	8,630	9,646
EBITDA	724	583	748	705	915	853
EBITDA margin	10%	8%	10%	8%	10%	8%
Operating profit	509	374	526	452	637	547
Net profit	(183)	(70)	350	384	541	465
Net profit margin	-2%	-1%	5%	5%	6%	5%

Source: Company data, IFC Metropol estimates

Figure 22:
OMSH income statement summary, RUB mn

	2008	2009E	2010E	2011E	2012E	2013E
Revenues	9,703	5,560	6,672	7,339	8,073	8,880
Operating expenses	9,753	5,371	6,539	7,192	7,912	8,703
EBITDA	93	273	234	257	283	311
EBITDA margin	1%	5%	4%	4%	4%	4%
Operating profit	(50)	189	133	147	161	178
Net profit	(131)	(84)	69	75	83	91
Net profit margin	-1%	-2%	1%	1%	1%	1%

Source: Company data, IFC Metropol estimates

Figure 23:
YASH income statement summary, RUB mn

	2008	2009E	2010E	2011E	2012E	2013E
Revenues	4,918	3,531	3,884	4,272	4,699	5,169
Operating expenses	5,165	3,675	3,528	3,881	4,269	4,696
EBITDA	145	103	511	562	618	680
EBITDA margin	3%	3%	13%	13%	13%	13%
Operating profit	(247)	(144)	355	391	430	473
Net profit	(312)	(225)	69	75	83	91
Net profit margin	-6%	-6%	2%	2%	2%	2%

Source: Company data, IFC Metropol estimates

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