

Natural Resources and Energy
 EM Steel
 Equity – Russia

Russian Steel

2Q12: Good things pass quickly

- ▶ **Russian steelmakers have reported a strong improvement of financial results in 2Q or 1H 2012, in line with expectations**
- ▶ **Taking into account reported 1H12 and flat outlook (at best) for 2H12 we highlight the risk of consensus downgrades**
- ▶ **Lower raw material and steel prices in 3Q will negatively impact companies across the sector; 2010-2011 seasonality of 2Q being the best is so far on track in 2012**

Improvements in 2Q12, good things pass quickly

Fairly strong sequential improvement in 2Q12 across the sector. In line with NLMK, the first Russian steelmaker to report an impressive improvement in EBITDA margin from 14% in 1Q12 to 18% in 2Q12, Evraz, MMK and Severstal have also reported healthy margins for the quarter. We calculate Evraz's 2Q EBITDA was up 32% q-o-q to USD665m, an increase in EBITDA margin from 13% in 1Q12 to 18% in 2Q12. Severstal has reported broadly the same improvement: from 15% to 18%. Even MMK, which has the lowest level of upstream integration and the lowest contribution from mining (which became practically negligible in 2Q12, at USD5m out of total USD369m EBITDA) reported an improvement in margin from 12% in 1Q12 to 15% in 2Q12.

3Q outlook: flat volumes, lower prices. The guidance which has been provided so far looks fairly consistent: flat steel volumes q-o-q in 3Q12, weak steel prices with some rebound in 4Q12 possibly, but subject to an improvement in the global economy. NLMK has provided the most detailed guidance, which could be used as a read-across for MMK and Severstal, given their similar product mix: 3Q12 revenue is expected to fall 5-10% sequentially, with EBITDA margin at 16-18% (slightly down from 18.3% in 2Q12). We note that a margin rebound in 2Q, followed by margin deterioration for the remaining two quarters of the year is a trend already witnessed in 2010 and 2011. Severstal's guidance whereby 2H12 should be broadly in line with 1H12 would imply a reversal of this trend.

Possible risk to 2012e consensus. Severstal reported 1H12 EBITDA of USD1,226m and guided for 2H12 broadly in line with 1H12, implying 2012 EBITDA at USD2.5bn in line with our current forecast, but 11% below consensus at USD2.7bn. As we argued in our most recent publication, we believe that there is a risk consensus EBITDA numbers will be revised downward ([Russian steel: A very bumpy recovery](#), 23 August 2012).

Positive catalysts in 4Q12. We expect a re-bounce in raw material prices, as the price of iron ore should be supported at the marginal cost level of USD120/t over the medium term, while China should return to the seaborne iron ore market from a temporary withdrawal and we also expect an increase of steel prices towards year-end 2012 on the expectations of a steel re-stocking in China in 1Q13.

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Summary of 2Q/1H12 reported results vs. HSBC and consensus estimates, USDm

	Reporting date	2Q12e HSBC	2Q12e Cons	1Q12a	2Q12e HSBC/ Cons	2Q12e HSBC/ 1Q12a	3Q12 guidance
Evrast*		1H12a	1H12e	2H11a			
Revenue, USDm	30-Aug-12	7,619	7,648	8,020	0%	-5%	flat q-o-q volume
EBITDA, USDm		1,175	1,055	1,269	11%	-7%	
Net income, USDm		-50	114	190	-144%	-126%	
EBITDA margin, %		15%	14%	16%	2%	0%	
Mechel							
Revenue, USDm	na	2,912	na	2,950	na	-1%	
EBITDA, USDm		373	na	463	na	-19%	
Net income, USDm		43	na	218	na	-80%	
EBITDA margin, %		13%	na	16%	na	-3%	
MMK*		2Q12a					
Revenue, USDm	28-Aug-12	2,516	2459	2,425	2%	4%	flat q-o-q volume
EBITDA, USDm		369	346	293	7%	26%	
Net income, USDm		-49	-41	15	20%	-427%	
EBITDA margin, %		15%	14%	12%	1%	3%	
NLMK*		2Q12a					
Revenue, USDm	9-Aug-12	3,257	3218	3,094	1%	5%	5-10% lower revenue q-o-q
EBITDA, USDm		596	584	432	2%	38%	
Net income, USDm		278	221	173	26%	61%	
EBITDA margin, %		18%	18%	14%	0%	4%	16-18% EBITDA margin
Raspadskaya		1H12e		2H11a			
Revenue, USDm	na	275	na	349	na	-21%	
EBITDA, USDm		84	na	144	na	-41%	
Net income, USDm		-11	na	-94	na	-89%	
EBITDA margin, %		31%	na	41%	na	-11%	
Severstal*		2Q12a					
Revenue, USDm	29-Aug-12	3718	3701	3,679	0%	1%	2H12 results to be similar to 1H12
EBITDA, USDm		664	654	562	2%	18%	
Net income, USDm		155	249	427	-38%	-64%	
EBITDA margin, %		18%	18%	15%	0%	3%	
TMK							
Revenue, USDm	31-Aug-12	1,799	1687	1,659	7%	8%	
EBITDA, USDm		336	287	277	17%	21%	
Net income, USDm		130	93	103	40%	26%	
EBITDA margin, %		19%	17%	17%	2%	2%	

Note: Half -yearly numbers for Evraz and Raspadskaya; *represents actual numbers
Source: Company data, HSBC estimates

Russian steel: summary of stock ratings and target price

Company	Bloomberg code	Closing price	Target price	Rating
Evrast	EVR LN	GBP2.3	GBP3.5	Overweight (V)
Mechel	MTL US	USD5.8	USD10.6	Overweight (V)
MMK	MMK LI	USD3.8	USD3.2	Underweight (V)
NLMK	NLMK LI	USD17.3	USD19.0	Neutral (V)
Raspadskaya	RASP RM	USD2.2	USD3.5	Overweight (V)
Severstal	SVST LI	USD11.7	USD13.1	Neutral (V)
TMK	TMKS LI	USD13.2	USD18.5	Overweight (V)

Source: Bloomberg, HSBC estimates; Note: closing price as on 29 August 2012

Disclosure appendix

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