METALS & MINING

METROPOL INVESTMENT FINANCIAL COMPANY | RUSSIAN EQUITY RESEARCH | **6 OCTOBER 2004**

CASTING NEW IDEAS

Bloomberg:
GMKN RU, CHMF RU, NLMK RU, NTMK RU, MECH RU, ZSMK RU, MAGN RU,UELM RU, VSMO RU, CHZN RU

Reuters
GMKN.RT, CHMF.RT, NLMK.RT, NTMK.RT, MECH.RT,ZSMK.RT, MAGN.RT,UELM.RT, VSMO.RT. CHZN.RT

INITIATION OF COVERAGE

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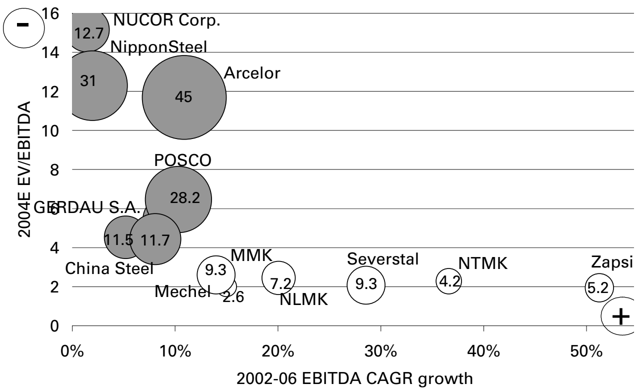
Exhibit 1
Russian and Global Steel Producers: EV/EBITDA Versus EBITDA 2002–6E CAGR



Note: Size of bubble indicates relative 2003 rolled steel production.
Source: IBES, Metropol

Exhibit 2
Russian Metal Sector: Ratings and Target Prices

Ticker	Company	Rating	Share Price	Target Price	% Up/ Down	Mkt Cap US$ mn
GMKN	Norilsk Nickel	BUY	$65	$82	26	13,900
CHMF	Severstal	BUY	$203	$260	28	4,481
NLMK	Novolipetsk Steel	BUY	$1.11	$1.27	14	6,645
MMK	Magnitogorsk Steel	BUY*/ HOLD	$0.50	$0.50	0	5,315
MECH	Mechel	BUY	$180	$235	31	570
NTMK	Nizhny Tagil	HOLD	$0.87	$0.95	9	1,140
ZSMK	Zapsib	BUY	$108	$140	28	1,460
UGMK	Uralelectromed	BUY	$60	$100	67	304
VSMO	VSMPO	BUY	$89	$150	69	1,064
CHZN	Chelyab. Zinc	BUY	$40	$210	600	26

**We rate MMK a trading Buy before privatization of a state stake this year, but long-term HOLD.*
Priced as of 05.10.2004
Source: Bloomberg, Metropol research

Global steel prices likely to remain high in 2004–5

Global economic recovery, 85% capacity utilization and China steel import growth at 15% 2004–7 CAGR continue to push prices towards $500-$600/ton. Indian demand looks set to support global steel prices through 2005.

Russian GDP growth to boost domestic steel consumption

Russian steel producers expect strong domestic consumption on the back of a projected doubling in Russian GDP by 2012, offsetting a decline in exports to China.

Norilsk Nickel: becoming a global player

Norilsk Nickel is positioning itself as a world-class integrated metals & mining company. We believe consolidation of Norilsk's gold assets could add as much as $2 bn to its valuation.

Three top picks in non-ferrous

VSMPO – a dynamic titanium producer with a leading global market position.
Uralelectromed – the core asset of second-largest copper producer UGMK.
Chelyabinsk Zinc – a play on possible consolidation with UGMK.

TABLE OF CONTENTS

INVESTMENT SUMMARY

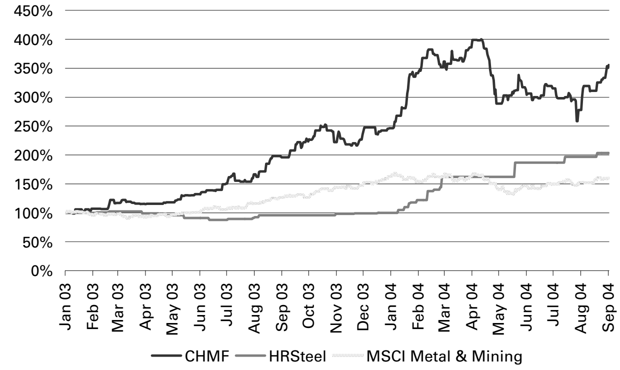
BENEFITING FROM HIGH METALS PRICES

Exhibit 3
Russian Metals Sector: Ratings and Target Prices

Ticker	Security Name	Rating	Share Price	Target Price	Potential Up/Down-side (%)
GMKN	**Norilsk Nickel**	BUY	$65	$82.00	26
CHMF	**Severstal**	BUY	$203.00	$260.00	28
NLMK	**Novolipetsk Steel**	BUY	$1.11	$1.27	14
MMK	**Magnitogorsk Steel**	BUY*/ HOLD	$0.50	$0.50	0
MECH	**Mechel**	BUY	$180	$235.00	31
NTMK	**Nizhny Tagil Steel**	HOLD	$0,87	$0.95	9
ZSMK	**Zapsib**	BUY	$108	$140	28
UGMK	**Uralelectromed**	BUY	$60	$100	67
VSMO	**VSMPO**	BUY	$89	$150	69
CHZN	**Chelyabinsk Zinc**	BUY	$40	$210	600

**We rate MMK a trading Buy before privatization of a state stake this year, but long-term HOLD. Priced as at 05.10. 2004*
Source: Bloomberg, Metropol research

Exhibit 4
Severstal Share Price Performance Versus MSCI World Metal Index and World Hot Rolled Steel Price



Source: Bloomberg

Russia's metals & mining industry should benefit from high global steel and metal prices in 2004–5 as a result of high demand from China and gradual global economic recovery. We believe Russian metals companies are inexpensive relative to their emerging and developed market peers, with strong growth potential and healthy operating margins. Our top picks in the ferrous industry are Severstal, Novolipetsk Steel Plant (NLMK), Mechel and Zapsib. In non-ferrous, we prefer Norilsk Nickel, VSMPO and UGMK.

FERROUS METALS INDUSTRY

Russian steel sector: from collapse to prosperity

The Russian steel industry was hit hard by the economic slump in the first half of the 1990s, which caused domestic consumption to drop sharply. By 1996, only 50–60% of capacity was in use. Rolled steel output dropped from 90 million tons to 36 millions tons between 1990 and 1994. The collapse of the Soviet Union and the disruption of connections between the Soviet republics also caused a sharp decline in steel consumption. A number of steel enterprises went bankrupt. Unable to continue subsidizing the industry, the government announced plans to privatize the sector. During privatization, which lasted from 1994 to 1997, the shares of most steel enterprises were consolidated either by metals sector financial-industrial groups or metals traders (see chronological breakdown in Appendix 2). Except for the UK metals holding Glencore, few foreign companies took an interest in the sector's privatization, as political instability and weak corporate governance made investment in the sector risky. Consolidation of the industry is now complete. The six main players are Severstal, MMK, NLMK, EvrazHolding and Mechel Steel Group. Ruble devaluation in 1998 and steel price growth in 2002–4 have helped Russian steel companies raise the funds to modernize and increase their presence in foreign markets, bringing Russia's total steel production to some 60 million tons in 2003. The sector enjoys low average production costs of only $165/ton (compared with a global average of $220/ton, and an emerging markets average of $175/ton), selling some 60% of total output abroad. Most Russian steel producers have iron ore and coking coal assets that give them access to the raw materials they require, forming completely integrated production companies. Currently, companies have begun to turn more to the capital markets as a source of long-term investment. Nearly every company in the sector has taken significant steps to improve corporate governance and become more open to the capital markets, including publication of IAS financial statements, achieving international credit ratings, beginning to pay dividends, issuing ADRs and holding regular analyst meetings. Several larger companies have also begun seeking acquisition targets abroad. Most of these have been in the US or EU, and serve as entry points that avoid export duty, such as Severstal's acquisition of Rouge Industries and NLMK's stake in Dansteel. Some companies are also considering joint ventures with foreign partners, such as Severstal's JV with Arcelor, Severgal.

Severstal: Russia's most liquid and open steel producer.

We initiate coverage of Severstal with a BUY recommendation and a 12-month target price of $260, or 28% potential upside from the current price. We consider Severstal the best pick in the Russian steel industry for liquidity, growth and corporate governance. The company has made good progress in sourcing its own raw iron ore and coke resources, and now buys only 20% and 35% of its iron and coke, respectively. Severstal reported a 32% 2003 EBITDA margin and good growth perspectives, with 15% compound annual EBITDA growth in 2002–5, on our estimates. We believe the company should be revalued from a low 2003 EV/EBITDA of 5.1, approaching the emerging markets ferrous metals industry average of 7. The company has recently acquired 100% of US steel producer Rouge Industries, gaining access to American auto producers.

NLMK: most profitable and proactive. Among Russia's second-tier ferrous metals producers, our favorite stock is NLMK Steel. We initiate on the company with a BUY recommendation and a 12-month price target of $1.27, for some 14% potential upside to the current price. NLMK is the most profitable and least expensive stock in the sector, with a projected 2004 EV/EBITDA of 2.4 and a 2004 PE of 5.1, on our estimates. One drawback in holding the stock is that the company plans no new share offerings in the medium term, so its low stock liquidity is likely to continue.

Mechel: inexpensive, and planning an ADR in 2004. We initiate coverage of Mechel Steel Works, Russia's seventh-largest steel producer, with a BUY recommendation and a 12-month price target of $235. We see as much as 47% upside potential to the current market price, based on our DCF estimates. We view the company as attractively undervalued, offering cheap access to Mechel Steel group. Mechel Steel Works is part of Mechel Steel Group, accounting for more than 50% of total group sales. The company is currently trading on a 2003 EV/EBITDA of only 4, and, we believe, has strong growth prospects. In addition to its extensive Russian assets, Mechel Steel Group owns interests in several metallurgical plants in Eastern Europe, and is preparing for a Level I US ADR.

Zapsib: dynamic and undervalued asset. We are initiating coverage of Zapsib with a speculative BUY rating and a fair value of $140/share, for some 28% potential upside to the current market price. Zapadno-Sibirsky Metallurgical Plant (Zapsib) is the largest subsidiary of EvrazHolding by output, with 43% of the holding's total production. It is 93% owned by EvrazHolding, and has a very low 0.5% free float. On the positive side, we believe Zapsib should benefit from dynamic growth in demand for long products in Russia and worldwide. The company has recently modernized its assets and technologies, and plans capex of some $460 million in 2004–7 for further modernization. Zapsib's location in Western Siberia means it is close to its biggest export market, China, helping the company to control transport costs. Zapsib has announced plans to start producing hot- and cold-rolled sheet in 2006–8, extending its production mix to higher-value-added products. The company is currently trading on a 2003 EV/EBITDA of only 5.9 and a strong 2002–5 EBITDA CAGR of 131%.

NON-FERROUS METALS INDUSTRY

Norilsk Nickel: dynamic and undervalued. We initiate coverage of Norilsk Nickel with a BUY recommendation and a 12-month target price of $82. We see 26% upside potential to the current market price, based on our DCF calculations. We project a 14% CAGR for sales in 2002–5. The company had a 2003 EBITDA margin of 37%, combined with an attractive valuation compared with international peers. We expect the company to show strong earnings growth in 2004. Through recent acquisitions, the company appears to be positioning itself close to international diversified peers with interests in nickel, copper, precious metals and utility assets.

VSMPO: high-profile titanium producer. We initiate coverage with a BUY recommendation on VSMPO, with a 12-month target price of $150, implying 72% upside potential from the current market price. VSMPO is Russia's largest titanium producer. The company produces titanium sponge, titanium profiles and spare parts for the aerospace, defense and automobile industries, and has direct long-term contracts with foreign consumers such as Boeing and Airbus. The company also has good earnings growth potential. We project 37% compound annual EBITDA growth in 2002–5, which we expect to be a period of recovery in the global aerospace industry.

Uralelectromed — number two Russian copper producer. We initiate on Uralelectromed with a BUY recommendation and a 12-month price target of $100. This implies 67% potential upside to the current market price. Uralelectromed is the largest subsidiary of Ural Mining Company (UGMK), Russia's second-largest copper producer. We consider Uralelectromed a cost-effective way to gain access to the holding company. Uralelectromed accounts for roughly 50% of total UGMK earnings, and is the holding's major subsidiary for copper rod production. In 2003, Uralelectromed produced more than 330 tons of copper.

Uralelectromed — a tradable share offering access to UGMK. Uralelectromed has attracted investors as the only part of UGMK with a liquid stock. The company is inexpensively valued, currently trading at a 2003 EV/EBITDA of only 4.2. UGMK Holding plans a London ADR this year, which we believe could lead to a re-rating of the subsidiary's stock, too, as UGMK ADRs are likely to be placed at an attractive valuation, with an EV/EBITDA of around 6, on our estimates.

UGMK consolidation to benefit Uralelectromed shareholders. UGMK management in 2003 announced plans to transfer all its assets into a common share. (Please see UGMK Structure in the Company Profiles section at the end of this report.) We believe Uralelectromed shareholders stand to benefit from the consolidation process.

Exhibit 5

Norilsk Nickel and International Diversified Metal & Mining Stocks: Relative Valuations, 2002–2005E

	Recommendation	Current price	Target price	M Cap $m	P/E				EV/EBITDA				P/S				2002-05 EBITDA CAGR
		$US	$US		02	03E	04E	05E	02	03E	04E	05E	02	03E	04E	05E	
Norilsk Nickel	**Buy**	**65.0**	**82.0**	**13,903.8**	**24.2**	**17.2**	**10.5**	**8.5**	**13.3**	**7.2**	**5.1**	**4.7**	**4.6**	**2.7**	**2.2**	**2.4**	**14%**
Newmont Mining Corp		45.5		16,577.5	110.2	60.2	57.2	51.8	20.7	15.1	15.5	16.9	6.0	5.3	4.9	4.5	7%
AngloAmerican		24.3		35,647.5	20.4	21.3	20.3	19.1	7.8	7.2	6.9	8.0	2.3	2.3	2.3	2.2	1%
BHP Billiton		20.8		38,802.5	34.4	31.0	28.3	25.5	10.5	9.9	9.7	10.6	2.3	2.1	2.1	2.0	1%
RIO Tinto		108.7		37,429.9	64.4	43.9	40.7	34.0	18.2	15.0	14.5	17.8	4.4	4.1	3.9	4.1	1%
Falconbridge		24.0		4,300.1	86.0	22.1	13.2	15.1	18.7	10.0	7.2	9.0	2.8	2.1	1.5	2.0	28%
IncoLtd		39.1		7,150.1	25.3	19.5	18.3	17.0	16.3	14.2	11.7	13.5	3.5	3.1	2.6	2.5	8%
Lonmin		19.8		2,793.7	15.1	13.3	11.2	9.8	8.3	6.8	6.2	6.8	4.0	3.6	3.4	3.2	7%
Inter metal and mining aver					**66.3**	**39.0**	**34.9**	**32.3**	**18.5**	**14.9**	**13.7**	**15.5**	**4.0**	**3.6**	**3.3**	**3.3**	
Disc/premium GMK to intr.peers					**174%**	**127%**	**231%**	**280%**	**39%**	**107%**	**170%**	**227%**	**-12%**	**32%**	**51%**	**36%**	

Note: E indicates estimates. All are IBES estimates, except for Norilsk Nickel figures, which are Metropol research estimates

Market prices as of 05.10.2004
Source: IBES, Metropol

Exhibit 6

Russian and Global Steel Stocks: Relative Valuations, 2002–2005E

	Recommendation	Current price	Target price	Mcap.$bn	P/E				EV/EBITDA				P/S				2002-05 EBITDA CAGR
		US $	US $		02	03E	04E	05E	02	03E	04E	05E	02	03E	04E	05E	
NTMK	Hold	0.87	0.95	1,139.7	558.7	15.4	4.3	3.4	10.6	5.2	2.3	1.9	1.4	1.1	0.7	0.7	75%
Zapsib	Buy	109.00	140.00	1,459.2	neg	neg	3.1	3.0	27.8	5.9	2.2	2.0	2.0	1.3	0.7	0.7	138%
Mechel	Buy	180.00	235.00	569.2	28.0	6.8	3.3	5.7	7.7	4.6	2.2	3.3	1.0	0.6	0.5	0.6	43%
Severstal	Buy	203.00	260.00	4,481.1	neg	7.6	3.3	4.7	15.5	5.1	2.1	3.2	2.0	1.4	0.9	1.1	15%
NLMK	Buy	1.11	1.27	6,645.8	19.6	10.8	5.1	6.6	10.1	5.6	2.4	3.6	3.9	2.6	1.6	1.8	17%
MMK	Hold/SpecBuy	0.50	0.50	5,315.1	46.2	8.6	5.6	6.6	11.7	4.5	2.6	3.8	2.6	1.7	1.2	1.4	12%
Average Russia					**93.2**	**8.2**	**4.1**	**5.0**	**13.9**	**5.1**	**2.3**	**3.0**	**2.2**	**1.5**	**0.9**	**1.1**	
GRUPO IMSA		21.8		1,364.7	9.2	9.0	7.8	7.4	5.9	5.5	5.2	4.9	0.6	0.6	0.6	0.6	7%
GERDAU S.A.		17.3		1,968.1	11.8	10.6	9.4	8.3	3.6	3.3	3.1	2.8	0.8	0.8	0.8	0.8	7%
POSCO		39.8		13,004.8	15.3	14.3	13.9	14.8	6.3	5.9	5.7	6.0	1.1	1.1	1.0	1.0	1%
China Steel		1.0		9,829.5	21.0	18.9	17.2	16.1	15.3	13.8	12.8	12.2	3.4	3.2	2.9	2.7	7%
NUCOR Corp.		96.8		7,569.8	46.7	44.5	36.0	30.3	17.6	16.9	16.0	14.5	1.9	1.9	1.5	1.4	6%
United Steel		40.8		4,209.5	neg	34.8	31.2	29.0	neg	14.5	13.1	13.8	4.0	3.9	0.5	0.5	2%
Nippon Steel		2.4		16,144.3	neg	neg	161.0	129.2	18.0	13.3	11.7	14.0	6.6	5.1	1.1	1.1	11%
Arcelor		12.7		6,780.8	neg	23.4	21.2	22.6	5.5	3.8	3.6	4.3	2.3	2.0	0.2	0.2	8%
Corus Group		9.4		4,178.0	neg	neg	27.5	13.1	35.6	6.6	5.6	5.3	13.5	2.5	0.3	0.3	78%
Thyssen Krupp		16.3		8,375.4	38.8	33.5	29.9	27.0	4.8	4.2	3.8	4.2	2.1	1.8	0.2	0.2	1%
Emrg Mkts average					**14.3**	**13.2**	**12.1**	**11.7**	**7.8**	**7.1**	**6.7**	**6.5**	**1.5**	**1.4**	**1.3**	**1.3**	
Dvlp Mkts average					**14.2**	**22.7**	**51.1**	**41.9**	**13.6**	**9.9**	**9.0**	**9.3**	**5.1**	**2.9**	**0.6**	**0.6**	
Disc/prem to Emrg					**-85%**	**61%**	**192%**	**133%**	**-44%**	**39%**	**191%**	**118%**	**-30%**	**-3%**	**40%**	**19%**	
Disc/prem to Dvlp					**-85%**	**176%**	**1138%**	**737%**	**-2%**	**92%**	**290%**	**215%**	**135%**	**96%**	**-33%**	**-40%**	

Note: E = estimates. All Russian companies are Metropol estimates; all others are from IBES.
Priced as of 05.10.04
Source: IBES, Metropol

Exhibit 7

Russian and Global Small-Cap Non-Ferrous Metal Stocks: Relative Valuations, 2002–2005E

	Recommendation	Current price	Target price	M Cap $m	P/E				EV/EBITDA				P/S				2002-05 EBITDA CAGR
		$US	$US		02	03E	04E	05E	02	03E	04E	05E	02	03E	04E	05E	
VSMPO-Avisma	Buy	89.0	150.0	1,064.1	24.3	11.1	7.7	6.0	10.7	7.4	5.1	3.8	3.7	2.6	1.9	2.7	37%
UGMK	Buy	60.0	100.0	304.3	neg	6.2	3.7	6.2	19.0	4.2	2.6	3.4	0.9	0.6	0.4	0.8	80%
Chelyabinsk Zinc	Buy	40.0	210.0	25.5	1.4	1.8	1.3	1.5	1.2	1.1	0.8	1.5	0.3	0.2	0.2	1.0	-1%
Russian Non-ferrous aver					**12.9**	**6.3**	**4.2**	**4.6**	**10.3**	**4.2**	**2.8**	**2.9**	**1.6**	**1.1**	**0.8**	**1.5**	
Peru Copper		51.7		4,133.8	68.2	52.7	42.6	37.6	21.5	15.5	16.7	18.1	6.2	6.0	5.7	5.5	9%
Titanium metals		80.0		254.4	neg	neg	10.1	8.5	28.7	25.3	13.1	9.5	0.7	0.7	0.6	0.7	40%
Boliden AB		0.8		134.6	7.8	79.2	5.4	5.0	9.9	15.5	7.6	8.8	0.1	0.1	0.1	0.1	2%
Compania de Minas Buenave		23.8		1,377.5	12.3	11.0	9.5	8.5	10.3	9.7	9.9	10.3	7.3	6.3	5.1	4.3	0%
Lonmin		19.8		2,793.7	15.1	13.3	11.2	9.8	8.3	6.8	6.2	6.8	4.0	3.6	3.4	3.2	7%
Inter metal and mining small-cap aver					**42.3**	**43.6**	**26.8**	**24.7**	**21.5**	**19.8**	**15.6**	**15.8**	**4.2**	**3.8**	**3.5**	**3.3**	
Disc/prem Rus small-capnon-fer to intr.peers					**229%**	**589%**	**536%**	**437%**	**109%**	**370%**	**449%**	**452%**	**161%**	**238%**	**316%**	**116%**	

Market prices as of September 1, 2004
Prices as of 05.10.04
Note: E = estimates. All figures for Russian stocks are Metropol research estimates; the rest are from IBES.
Source: IBES, Metropol research

OUR MODEL PORTFOLIO

Exhibit 8

Metropol Russian Metals Sector Model Portfolio

Security Name	Rating	Price (US$)	Target Price (US$)	+/- Pot'l (%)	Mcap (US$ mn)	Portf. Weight (%)
Norilsk Nickel	BUY	65	82	26	13,900	30
Severstal	BUY	203	260	28	4,481	20
Novolipetsk Steel	BUY	1.11	1.27	14	6,645	22
Mechel	BUY	180	235	31	570	5
Zapsib	BUY	108	140	28	1,460	5
Uralelectromed	BUY	60	100	67	304	5
VSMPO	BUY	89	150	69	1,064	10
Chelyabinsk Zinc	BUY	40	210	600	17	3

Market prices as of 05.10. 2004
Source: Bloomberg, Metropol research

Exhibit 9

Russian Metals Sector: Upcoming Events

Company and Event	Expected Time	Probability
Norilsk Nickel		
PMG metal reserves disclosure.	Sept.–Nov. 2004	High
Sukhoi log gold deposit auction.	2005	High
Publication of 2Q04 IAS.	December 2004	High
ADR placement in US.	Nov.–Dec. 2004	Medium
Severstal		
1:25 share split and MICEX listing.	Sept.–Nov. 2004	High
ADR placement in US.	Nov.–Dec. 2004	Medium
Mechel Steel Group		
ADR listing in US. Publication of 2003 IAS.	Nov.–Dec. 2004	High
VSMPO		
Publication of 2002–3 IAS. ADR placement in UK.	Sept.–Nov. 2004	Medium
UGMK		
ADR placement in US	Nov.–Dec. 2004	Medium

Source: Company data, Metropol research

Norilsk Nickel, Severstal, NLMK and VSMPO: our first-tier picks. Among Russia's more liquid metal & mining stocks, we believe Norilsk Nickel, Severstal, NLMK and VSMPO are set to provide the best appreciation potential in 2004. Among the second-tier, we prefer Mechel, Uralelectromed and Chelyabinsk Zinc, based on their low relative valuation and high growth potential. While some other second-tier metal plays may also provide attractive upside potential, thanks to high nickel and copper prices, we believe the risks of poor corporate governance and low liquidity outweigh their potential benefits. Most second-tier metals stocks are quoted subsidiaries of larger holdings. Therefore, realizing their revaluation potential in most cases depends on the consolidation terms offered by core shareholders. These stocks always pose the risk that their holding companies could offer less attractive consolidation terms for minorities, or postpone consolidation indefinitely. As a result, these stocks are naturally riskier than the blue chips.

Portfolio methodology

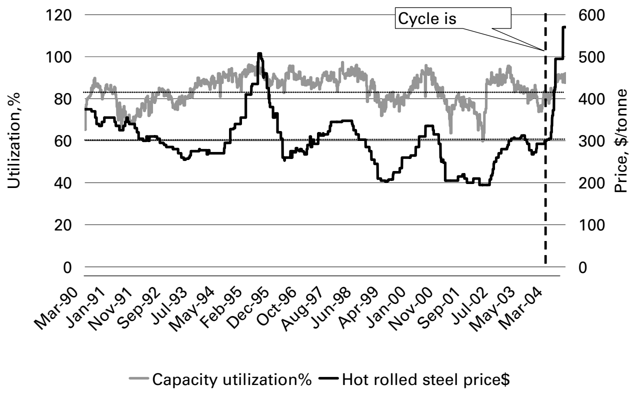
For our portfolio, we choose companies with over 20% upside potential, on our calculations. We give a higher weight to companies with high liquidity and market capitalization.

FERROUS METALS

CHINA DEMAND TO BUOY STEEL PRICES

Exhibit 10

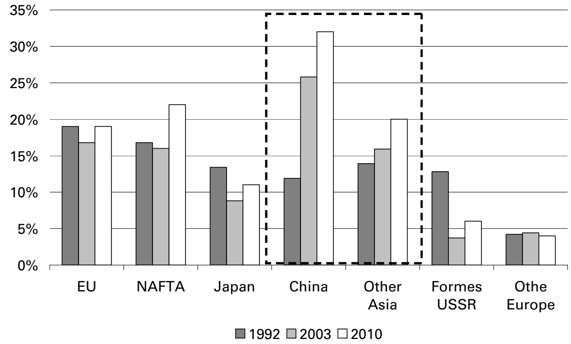
World Steel Prices (US$/ton) and Capacity Utilization (%), 1990–2004



Source: IISI

Exhibit 11

World Steel Consumption by Country, 1992–2010 (%)



Source: IISI

According to the International Iron & Steel Institute (IISI), world crude steel production will reach 975.2 million tons in 2004, with 85% capacity utilization. The IISI projects output breaking through 1 billion tons annually by 2006 (Exhibit 10). Since 1998, apparent world steel consumption has exceeded production by some 25 million tons on average annually, rising to 50 million tons in 2003 due to high Chinese imports. Chinese demand has grown at 56% CAGR in 2001–3. These figures indicate a drawdown in world steel inventories of over 100 million tons. China has become the world's largest consumer of crude steel, buying some 26% of total annual consumption.

Steel cycle, pricing and capacity utilization. On the back of rising Chinese steel demand, hot rolled steel prices reached $500/ton in early 2004, their highest level since 1995 (Exhibit 10). The commodity's last price growth cycle was in 1998–2000, when hot rolled steel traded in the range of $200–$350/ton at average capacity utilization of 85%. The highest recent steel price growth cycle, 1993-1995, saw hot rolled steel selling in the range of $270–$500/ton, again at average capacity utilization of 85%. IISI data suggest that the current price growth cycle began in 2002, and is likely to continue through 2005. IISI estimates that world prices for hot rolled steel will average some $300–$400/ton during this period, with high capacity utilization, continuing Asian demand growth and world economic recovery.

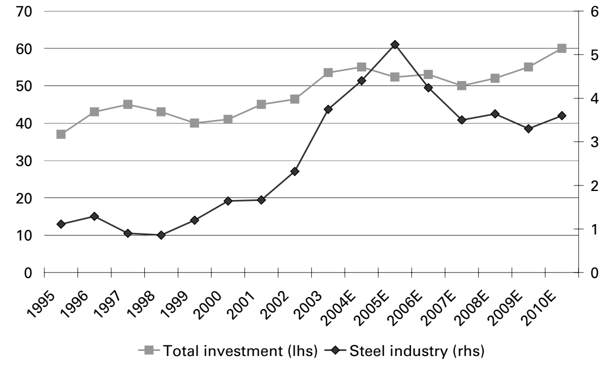
Chinese demand disrupting cyclical steel price growth. China's booming economy grew 11% in 2003, with a further 8% growth expected in 2004 and increasing steel imports creating a deficit of some 32 million tons in 2003, and a further 30 million ton deficit in 2004 (Exhibit 19), according to IISI. IISI estimates that China is likely to achieve steel production sufficient to meet domestic demand by 2006–7, with the addition of some 20–25 million tons of annual steel production coming online. According to ISII, China consumed 12% of world steel production in 1992, while by 2003 this figure had soared to 27%. IISI estimates that by 2010, China will consume more than 33% of total world steel production (Exhibit 11). The US and EU are also large consumers, accounting for 17% and 15% of total global steel consumption, respectively, in 2003. According to IISI, China's steel imports grew from 27.3 million tons in 2002 to 47 million tons in 2004, for a 2-year CAGR of 32% (Exhibit 12). IISI estimates that steel prices will remain high in 2004–5, with average capacity utilization of 85% — an abnormal situation — and start declining in 2006–7, when China begins covering its import deficit as new domestic capacity comes on-stream.

High iron ore and coke prices keep steel prices high. Booming Chinese steel production in 2003–4 has made the major raw materials for steel scarce. Iron ore prices have grown from $22/ton in 2003 to $40/ton in 2004, while coke coal prices soared from $60/ton in 2003 to $150/ ton in 2004 (Exhibit 28). China will almost double imports of iron ore in 2004 to 13 million tons, on IISI's estimates. China's iron ore import volumes may reach 20 million tons by 2006, according to IISI. China's coal import volumes rose 10 times in 2003–4, to 100 million tons. At the same time, prices of imported coke soared from $60/ton in 2002 to $165/ton in 2004. China may increase coke import volumes to $150–$180 million tons in 2006 as new production facilities come into operation.

Exhibit 12
China: Rolled Steel Import Dynamics, 2001–4

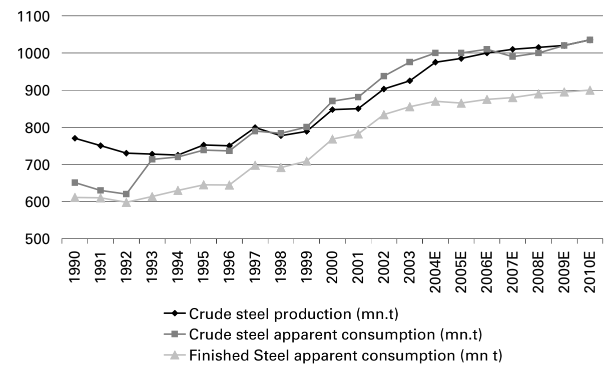
Source: IISI

Exhibit 13
China: Foreign Direct Investment (US$ bn)



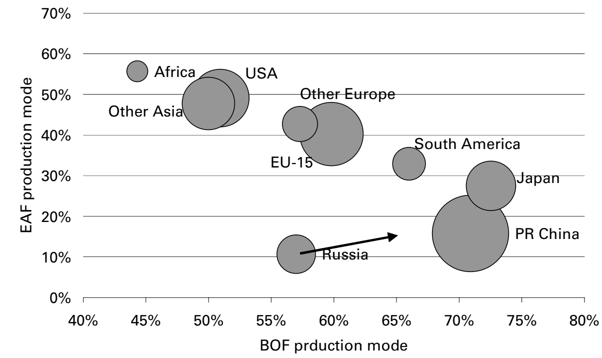
Source: OECD, World of China statistics

Exhibit 14
World Crude Steel Production and Apparent Consumption, 1990–2010E (mn t)



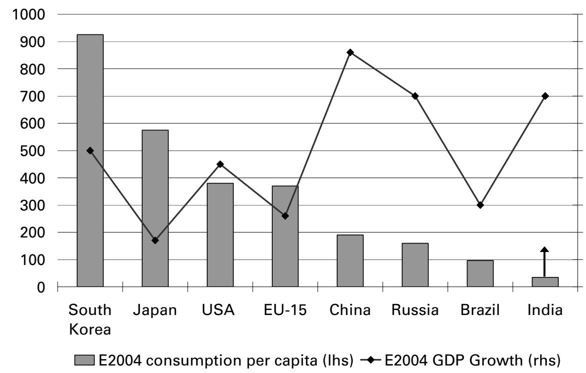
Apparent steel consumption: Crude steel production + imports-exports
Source: IISI

Exhibit 15
World Steel Output by Mode of Production (%)



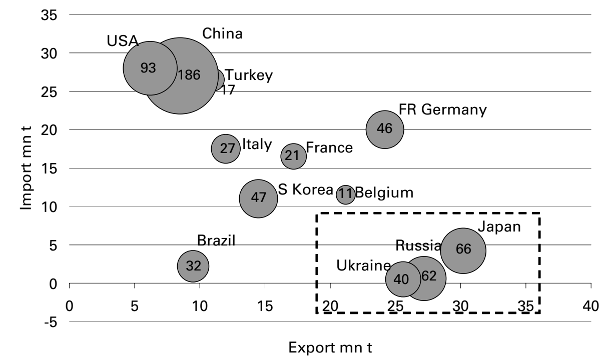
BOF-Basic oxygen furnace, EAF-electric arc furnace
Source: IISI

Exhibit 16
World GDP Growth and Steel Consumption Per Capita, 2004E



E = IISI estimates
Source: IISI, Metropol

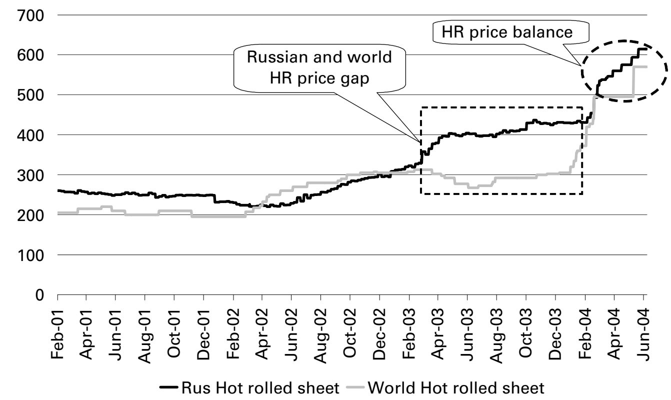
Exhibit 17
World Steel Export and Import, 2003 (mn t)



Note: Size of bubble indicates relative production volume (mn t).
Source: IISI

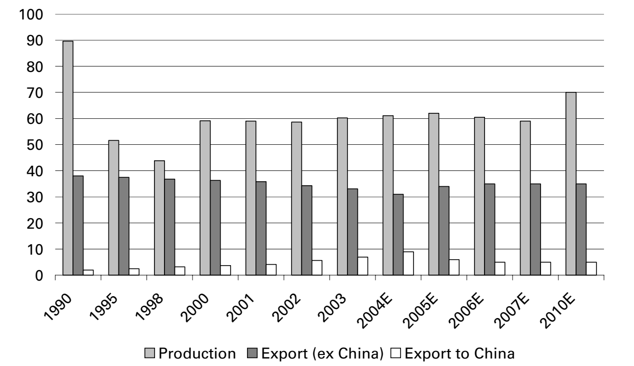
RUSSIAN STEEL INDUSTRY

Exhibit 18
Russian and International Hot-rolled Steel Prices, 2001–4E (US$/t)



E = estimates. World steel price estimates for 2004 supplied by IISI.
***Source:* Metaltorg, Metropol research**

Exhibit 19
Russian Crude Steel Production and Export, 1990–2010E (mn t)



E = IISI estimates *Source: IISI*

Russian steel production reached 62 million tons in 2003. Russia's steel production contributes 10% of the country's GDP. Russia is the world's fourth-largest crude steel producer, at 62 million tons in 2003, and the second-largest crude steel exporter, at 28 million tons (after Japan). Traditionally, Russia has exported some 45–50% of its total annual crude steel production (Exhibit 19). In 2003, exports rose over 6%, to 28 million tons, mostly on increased Chinese demand. The combination of rising Chinese demand and a construction boom at home has created a shortage of steel in the Russian domestic market.

Domestic steel prices reach international levels. In 2H02, domestic steel prices soared due to a domestic shortage and continuing export demand, rapidly eliminating the discount to international prices. With the exception of certain 'long' products (grids, beam channels, etc.), most exportable products sell domestically at prices very close to international levels. In Russia, hot rolled steel sheet prices have reached $457/ton, with cold rolled sheet at $530/ton (Exhibit 18). We expect domestic steel prices to remain in line with international prices. Another powerful driver for the rise in domestic steel prices is growth in ore prices and transportation tariffs. Russian steel producers raised domestic steel prices from 1 April 2004 by some 20–35%, following a 25–40% increase in early January.

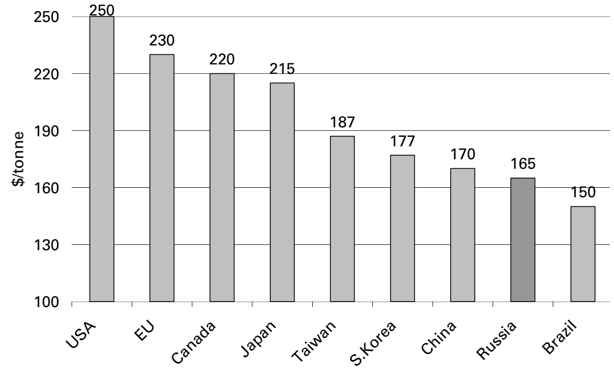
Domestic sales: more profitable in 2003, could continue in 2004. During 2003, domestic steel prices grew some 20–30% faster than export prices on average (Exhibit 18), as domestic steel producers raised prices more rapidly than EU producers. During the first five months of 2004, export and domestic steel prices evened out. Domestic sales have higher margins at existing prices, due to lower transport and logistic services costs. Most domestic steel is sold on an ex-works basis (the buyer pays all costs, collecting the goods from the seller's premises), while exports are sold on a CIF basis ('cost, insurance, freight – the producer pays all these costs, including expensive sea shipment costs).

Domestic sales mainly for Oil & Gas, Construction. Unlike EU, US and Japanese consumers, Russian domestic consumption of steel products is concentrated in the oil & gas and construction sectors (Exhibit 23). The oil & gas sector mainly uses steel pipes for drilling and shipping both oil and gas. A construction boom in Russia beginning in 2003 has generated a strong demand for long products. Multi-sector machinery (used particularly in the food, pharmaceuticals and ship-building industries) uses stainless, galvanized steel, as does the automobile industry. Higher-grade hard steel, which traditionally commands the strongest demand in developed countries, makes up only a small part of domestic consumption in Russia, as its production requires additional investment in technology and equipment. Russian producers' rolled steel generally sells below world average prices (Exhibit 29). We see this as the reason why Russian steel producers are less motivated to produce high-grade steel products, and instead produce more long steel and slabs for export.

Russian producers expect price declines in 2006. A number of Russian steel producers, including Severstal and EvrazHolding, are projecting domestic steel price declines beginning in 2006, as Chinese demand tapers off. These companies project prices falling most sharply for hot rolled steel and steel slabs sold to China and other Asian markets, as well as for long products sold on the domestic market. On the other hand, we see EU and US prices for hot- and cold-rolled flat steel and slabs as more stable, as prices are fixed over a longer period. We see

Exhibit 20

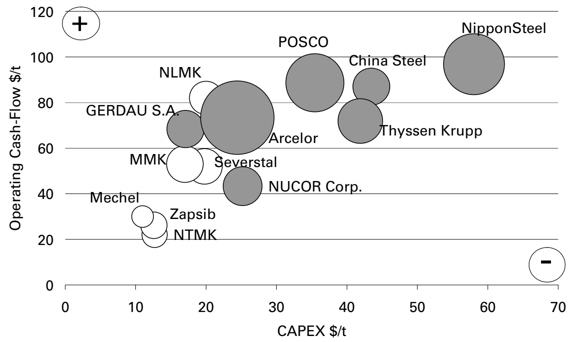
Hot Rolled Steel: Global Production Cost Comparison (US$/t)



Source: Brook hunt

Exhibit 21

Russian and Global Steel Producers: Capex Versus Operating Cash-flow, 2004E



Source: Bloomberg, Metropol

Russian steel companies oriented toward the EU and US markets as winners in a falling price environment in 2006–7. Based on IISI and Russian company projections, we see domestic hot rolled sheet and long steel prices falling to $360/ton in 2005, and to $300/ton in 2006. At the same time, Russian steel producers project strong domestic consumption on the back of an estimated doubling in Russian GDP by 2012, offsetting a decline in exports to China of 7.3 million tons.

China market a core consumer for Russian steel. China is Russia's most dynamic export market for steel. We expect Russian producers to increase steel exports to China by 6.5%, to a peak of 9 million tons in 2004, or some 32% of total Russian exports. We expect exports to begin declining in 2005, especially for hot-rolled steel, as Chinese producers bring new facilities on-line (Exhibit 19). Nevertheless, we see fairly stable demand for Russian steel from China for another 3–5 years, at 5 million tons annually. The OECD projects Chinese economic growth beginning to slow in 2005–6 due to several factors, including revaluation of the yuan and restriction of direct investments in the steel sector to prevent overproduction (Exhibit 13). Among Russian steel producers, NTMK, Zapsib and MMK are the most sensitive to possible Chinese demand slowdown, with more than 45% of their total exports sold to China, on average.

Russian steel producers competitive. Russian steel producers are not nearly as efficient or modern as either their developed or emerging market peers. Nevertheless, even without substantial investment in new technology and equipment, we believe they will continue to earn strong returns in the foreseeable future. Thanks to cheap labor and energy costs, Russia continues to produce crude steel for only $165/ton (Exhibit 20), less expensively than any other market but Brazil. We estimate that the sector will be cash-flow positive for years to come. Russian steel producers have the following advantages:

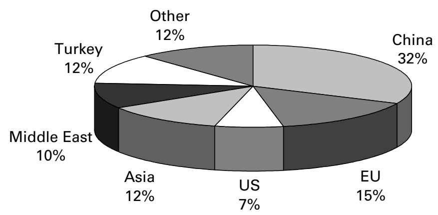
- Labor costs of only $20/ton, compared with an average of $50/ton in Developed Europe and the US.
- Low fuel expenses, at only $30/1000m3 of gas, compared with an average cost of $50/1000m3 for most other emerging market producers and $120/1000m3 in developed markets. We expect this advantage to diminish by 2007.
- Low electricity tariffs – only $0.019 per kWh on average, compared with $0.04/kWh in EM and $0.05 in developed markets.
- Low scrap metal costs – only $30/ton, compared with $50/ton in EM and $70/ton in developed markets.

On the other hand, Russian steel producers have certain disadvantages to their peers in other markets:

- Low efficiency and productivity (Exhibit 27).
- Growing raw materials prices. Iron ore and coke prices are slowly approaching world levels of some $55/ton for iron ore and $60/ton of coke.
- Rising transport and logistics costs.

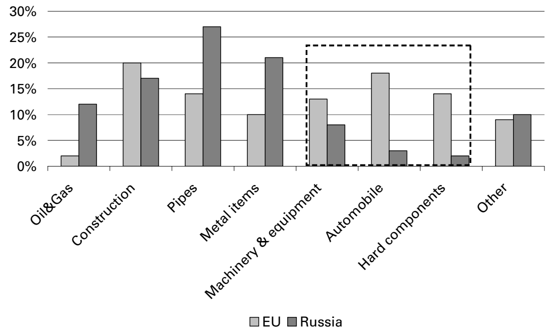
Capex investment: from OHF to BOF. In terms of both technology and productivity, Russian steel producers still lag behind EM peers such as South Korea, China and Brazil, which consume less crude steel and pig iron per ton of production than their Russian peers. At the same time, the Russian sector's low $20/ton of average capex still generates a healthy $50/ton worth of operating cash flow (Exhibit 21). Over the next decade, we expect the sector to begin modernizing, though it is not certain that this process will be steady or even particularly effective. Russian steel producers have begun actively to replace

Exhibit 22
Russian Steel Export: Regional Structure, 2003



Source: Metaltorg

Exhibit 23
Russian Domestic Steel Consumption by Industry as Percent of Total Consumption, 2003 (%)



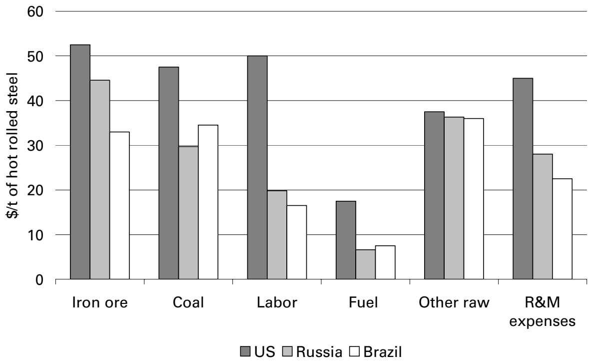
Source: Metaltorg

OHF (open hearth furnace) with more efficient BOF (basic oxygen furnace) technology. We project that producers will continue modernizing in the medium-term, bringing BOF production to some 65% of total Russian steel output by 2007 from the current 57% (Exhibit 15). EAF (electric arc furnace) technology, which is more efficient than OHF production, accounts for only 10% of total Russian production, compared with 40–50% in the US and EU. Russian steel producers still prefer traditional energy-intensive production technologies based on iron ore and coal to those utilizing scrap metal. Overall, we expect the productivity and efficiency gap between Russian and world producers to continue to narrow over the next 5–10 years (Exhibits 27–28) .

Consolidation of Russian steel producers. The Russian steel industry is in the process of consolidation. The sector has traditionally had a low concentration of companies. Today, vertical integration and self-supply of raw materials are the main priorities for Russia's steel producers. By investing in iron ore and coke coal reserves, a number of leading producers aim to hedge themselves against growing raw materials prices. Horizontal consolidation is beginning, but is likely to proceed slowly, in our view. Russian steel producers are actively searching for external acquisition opportunities. The sector is cash-rich, with the Big Three holding some $5–$8 billion in cash. Russian producers see foreign acquisition as an efficient way to overcome export tariffs and to extend their product mix. Global steel players, including LNM group, Posco and Arcelor, have said they would be interested in setting up JVs with Russian steel producers. These global players say they would like to produce value-added steel products such as automotive and high-grade galvanized steel products in partnership with Russian companies. We expect to see a growing number of such JVs developing over the next decade, and see the trend as a positive one for the Russian metals sector, as developed-market JV partners should help to introduce new technologies and management practices to Russia.

Exhibit 24

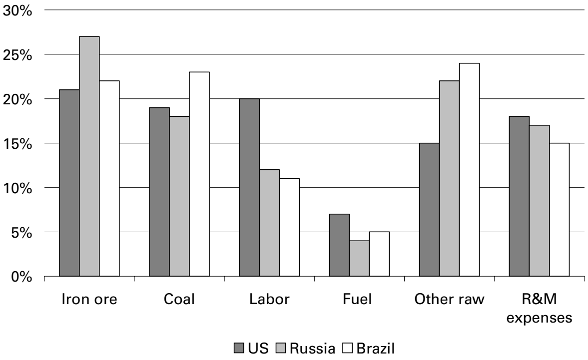
Russia, US and Brazil: Hot Rolled Steel — Direct Costs Comparison (US$/t)



Total cost: US $250/t, Russia $165/t, Brazil $150/t
Source: Severstal, Metropol research

Exhibit 25

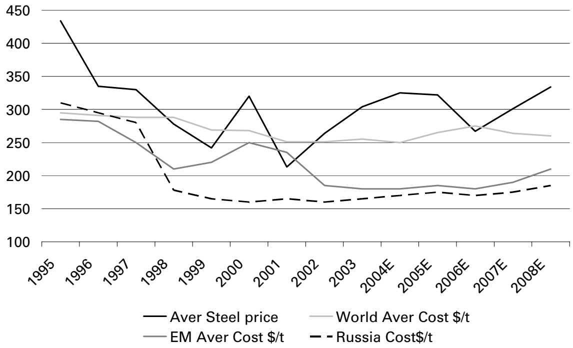
Russia, US and Brazil: Steel Production Cost Structure, 2003



Source: Severstal, Metropol research

Exhibit 26

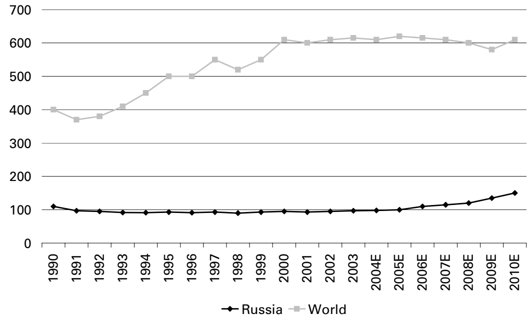
World Steel Sector: Profitability, 1995–2008E ($/t)



Source: IISI

Exhibit 27

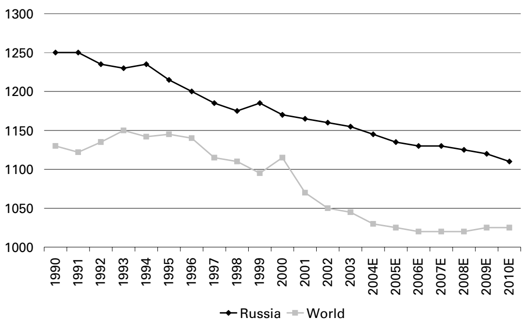
Russian and Global Steel Industry Productivity, 1990–2010E (t/employee)



Note: 'World' is an average of productivity levels in the US, Japan, the EU and South Korea.
Source: IISI

Exhibit 28

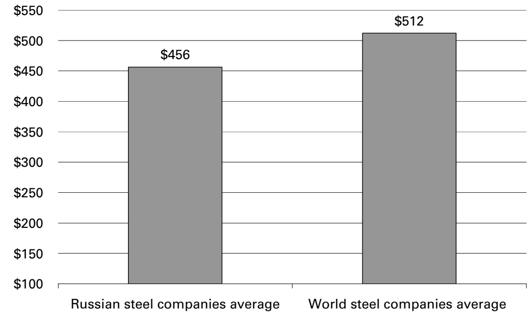
Russian and World Crude Steel and Rolled Product Output, 1990–2010E



Note: 'World' includes combined output of US, Japan, EU, South Korea
Source: IISI

Exhibit 29

Russian and World Rolled Product: Average Realized Price in 2004E (Total Sales/Total Rolled Steel Production)



Note: 'World' includes combined output of US, Japan, EU, South Korea
Source: IISI

Exhibit 30

Russian Steel Producers by Product Type and Output, 2003

2003	Crude Steel Production (mn t)	Rolled Product Output (mn t)	Production 02-07E CAGR (%)	Product Type	Sales (US$ mn)	EBITDA (US$ mn)	Net Profit (US$ mn)	EBITDA Margin (%)	Net Profit Margin (%)
MMK	11,250	9,455	7	Flat/Long	3,047	992	631	33	21
Severstal	10,500	8,800	5	Flat/Long	3,200	1,012	503	32	18
NLMK	9,350	8,100	13	Flat	2,562	1,017	615	40	24
Zapsib	5,900	5,300	10	Long	1,028	220	120	21	11
NTMK	5,400	4,700	3	Long	1,040	222	65	21	6
Mechel	4,000	2,698	9	Long/Flat/Specialty	918	153	93	17	10

Source: Company data, Metropol research

IRON ORE AND COKE COAL ASSETS

Exhibit 31

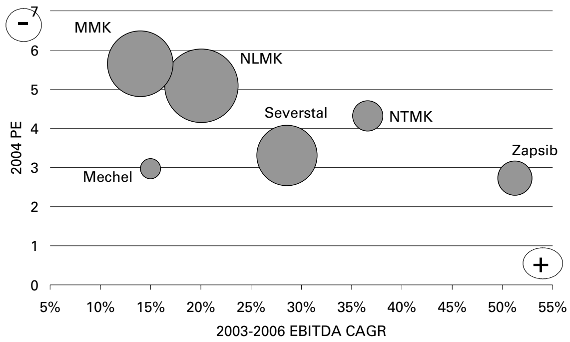
Russian Steel Sector: Ownership and Use of Iron Ore and Coal Assets, 2003

	Iron Concentrate Production (tons)	Share of Total Production (%)	Fe (%)	Location	Main Customers	Export as Share in Total Prod'n (%)	Controlling Shareholder
Concentrate and Pellet							
Lebedinsky GOK	18,750	25	68	Center	MMK, Mechel, NLMK, OEMK	38.2	Gazinvest
Mikhailovsky GOK	15,550	18	65	Center	MMK, Mechel, NLMK, Nosta	19	Metalloinvest
Stoylensky GOK	12,800	15	67	Center	NLMK, Mechel, NTMK	9.2	NLMK
Korelsky Okatysh	8,150	13	67	Northwest	Severstal	33.6	Severstal
Kachkanarsky GOK	7,900	11	59	Urals	EvrazHolding, Mechel	n/a	EvrazHolding
Olenegorsky GOK	4,000	5.2	62	Northwest	Severstal	n/a	Severstal
Kovdorsky GOK	4,000	5.2	63	Northwest	Severstal	n/a	MDM
Korshunovsky GOK	2,100	2.4	62	Siberia	ZSMK, Mechel	n/a	Mechel
KmaRuda	1,750	2.0	66	Center	NLMK	n/a	NLMK
Agglomerate							
Vysokogorsky GOK	2,100	2.45	55	Urals	EvrazHolding	n/a	EvrazHolding
Sheregeshskoye	1,500	1.85	52	Siberia	EvrazHolding	n/a	EvrazHolding
Bogoslovskoye	1,500	1.85	50	Urals	EvrazHolding	n/a	UGMK
Irbinskoye RU	1,200	1.67	50	Siberia	EvrazHolding	n/a	EvrazHolding
Coking Coal	(mn tons)						
Yuzhny Kuzbass	6.3	15			Mechel, MMK	15	Mechel
Kemerovo	1.9	7			NLMK	10	NLMK
KuzbasUgol	2.0	12			Severstal	n/a	Severstal
VorkutaUgol	3.2	13			Severstal	n/a	Severstal
YuzhnyKuzbassUgol	7.7	15			EvrazHolding	n/a	EvrazHolding
Other Producers	10.6	10				25	

Source: Company data, Metropol research

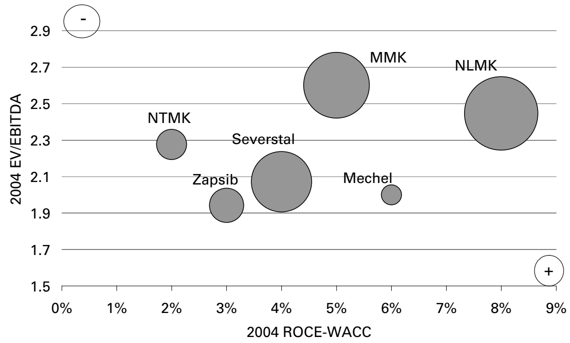
STEEL INDUSTRY: OUR THREE TOP PICKS

Exhibit 32
Russian Steel Industry: 2004 PE Versus 2002–6 EBITDA CAGR



Note: Size of bubble indicates relative market cap.
Source: Metropol research

Exhibit 33
Russian Steel Sector: 2004 EV/EBITDA Versus 2004 ROCE-WACC



Note: Size of bubble indicates relative market cap.
Source: Metropol research

SEVERSTAL

Severstal: high liquidity, good EV/EBITDA, high projected growth. We are initiating coverage of Severstal with a BUY recommendation and a 12-month price target of $260. We consider Severstal the best stock in the Russian steel industry, for its liquidity, growth prospects, and inexpensive valuation. Severstal has a good mix of highly-profitable products, and is Russia's third-largest steel producer. We expect the company to show strong financial results in 2004. We project EBITDA margin at 39% in 2004 and an attractive valuation, at a 2004 EV/EBITDA of 2.1. We also project strong 3-year compound annual EBITDA growth of 15% in 2002–5. We project 2004 revenue growth of 40.7%.

Strong ongoing results bode well for full-year. Severstal announced 2003 full-year dividends of $14.13 per common share, for a 9.4% dividend yield. We expect the company to pay full-year 2004 dividends of $8/share, for a yield of 6% and a payout ratio of 25% of IAS net profit. Severstal also pays quarterly interim dividends, which we believe should help to support share price growth long-term. Severstal has also reported strong 2003 IAS results, beating market expectations. Sales rose 41% YoY to $3.2 billion, while net profit rose 209% YoY to $590 million.

GDR program should boost liquidity. The company's GDR program, launched earlier this year on 11% of ordinary shares, should help to boost liquidity. We expect the company to extend the GDR program to 20% of shares outstanding by the end of this year.

US acquisition means better access to overseas markets. Severstal is also working to expand access to foreign markets. Acquisition of American steel producer Rouge Industries should help to increase Severstal's access to the US market.

Mordashov stake a potential risk factor. On the negative side, Severstal is still controlled by a single shareholder, Alexey Mordashov, who holds a 17% stake. We believe his sizeable stake in Severstal is a risk factor for minority shareholders, as he has the power to contravene other shareholders' interests if he sees fit.

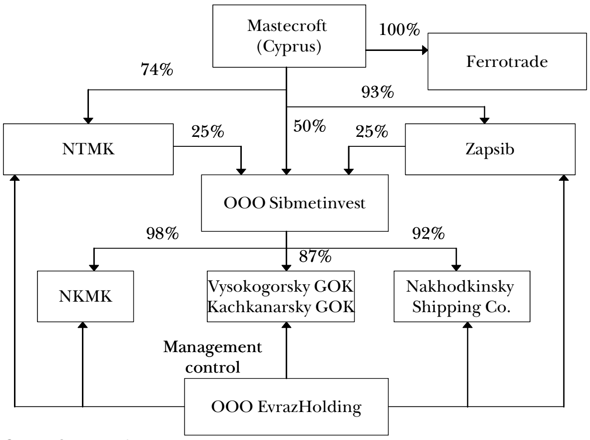
Non-core assets an added burden to the bottom line. Severstal has several non-core assets that we consider unprofitable and an unnecessary burden on the company, such as Severstal Avto, which produces Volga cars and light trucks, Severstal Trains, which produces locomotives used on Russia's domestic railroad network, and several subsidiaries that offer transportation and logistics services. So far, the company has given no indication of plans to spin these off. We would see such a move as a positive trigger for the stock.

NOVOLIPETSK STEEL PLANT

NLMK: our favorite steel stock. Novolipetsk Steel Plant (NLMK) is Russia's fourth-largest steel producer. We are initiating coverage of the company with a BUY recommendation and a target price of $1.27. NLMK is the cheapest and most profitable of Russia's steel producers, on our estimates.

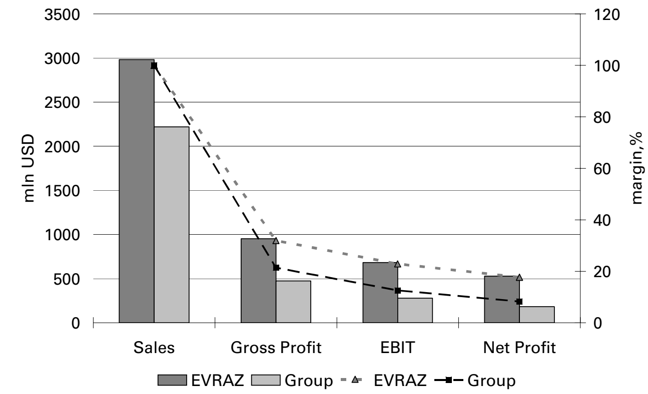
Inexpensive valuation, high margins. NLMK has a low 2004 EV/EBITDA of only 2.4, compared with a global emerging markets average of 6.6, on our estimate. The company produces high-value products, including cold-rolled and galvanized steel sheet for the European and US markets. The company uses a flexible production process that allows it to increase sales of higher-priced products such as steel slab and pig iron during periods of consumption growth. NLMK's recent acquisition of Russia's third-largest iron ore producer Stolensky GOK means that NLMK should now be fully supplied with iron ore for the foreseeable future. We believe the acquisition

Exhibit 34
EvrazHolding: Corporate Structure



Source: Company data

Exhibit 35
EvrazHolding: Profitability of Group Versus Subsidiaries, 2003 (Indicates Extent of Transfer Pricing)



Note: 'Group' includes Nizhny Tagil, Zapsib and Novokuznetsk steel work plants. Lines indicate profit margin. Source: Company data

should allow the company to reduce production costs by 15–20% in the next 2–5 years.

High-quality management team. CEO Vladimir Lisin made his name as an active player in restructuring the Russian aluminum sector in the early 1990s, and come to NLMK after acquiring a major stake in the company in 1995. We believe he is a well-connected long-term industry player with strong political lobby possibilities. The team he has assembled looks set to help modernize the company. Most importantly, they appear to us to be more attuned to shareholder concerns than many other management teams in the sector.

Strong expansion plans likely to succeed. Management has recently announced ambitious acquisition plans. NLMK has said it plans to acquire several long product steel plants in Eastern Europe in order to create horizontal integration, which we believe should boost shareholder value. The company has said it envisions a 2–5 year timeframe for completing integration, which we believe is a realistic goal.

Low liquidity could remain a drag on the share price. NLMK management plans no share offerings in the near future, so we expect its share liquidity to remain low. However, we see huge potential for a re-rating, should liquidity, information flow and corporate governance begin to improve.

EVRAZHOLDING

EvrazHolding: largest Russian crude steel producer. EvrazHolding consists of three enterprises: Nizhny Tagil Metallurgical Plant (NTMK), Western Siberian Metallurgical Plant (Zapsib), and Novokuznetsk Metallurgical Plant. EvrazHolding controls a 75–95% stake in each of the three enterprises. EvrazHolding is the biggest vertically-integrated metallurgical holding in Russia, producing a total of 12,300 tons annually of rolled steel and metal semi-finished products for the construction and machine-building sectors, with annual sales of over $2.5 billion. Through its subsidiary NTMK, EvrazHolding has a domestic monopoly in rail production. Its main export markets are China and neighboring Asian countries, which buy some 40% of the company's exports. The company makes about 55% of total revenues from exports.

EvrazHolding has no traded stock. However, investors can gain access to the company through two of its subsidiaries, NTMK and Zapsib, each of which is traded on RTS. EvrazHolding has made clear that it is not interested in developing its position in the equity markets in the near future. The company is not considering an international IPO, nor does it see any need to boost the market cap of its subsidiaries. Nevertheless, the company has taken several steps towards becoming more investor-friendly, including publishing IAS financials for the holding and each of its subsidiaries since 2001, and holding regular analyst presentations.

Transfer pricing shrinks subsidiaries' profits. We describe the company here because we consider it an important presence in the sector. We believe the holding's management is likely to continue drawing value out of the subsidiaries. Also, the subsidiaries have no set dividend policy. Management has said it plans to keep subsidiary dividends flat in absolute terms. We believe any investment in EvrazHolding subsidiary shares should be treated as highly speculative, with an investment horizon long enough to play on ultimate consolidation into the holding.

EvrazHolding is controlled by CEO Alexander Abramov an excellent turnaround manager with strong abilities to rescue bankrupt steel producers. So far, we are skeptical about the likelihood that portfolio investors will benefit from investments in the subsidiaries he controls through

EvrazHolding. We would need to see a radical change in the structure of both holding and subsidiaries before we would be likely to turn positive on NTMK or Zapsib.

M&A strategy centered on cost-cutting and self-supply. Management has announced some details of the company's M&A strategy. EvrazHolding will concentrate on acquiring iron ore and coal mining assets (GOKs), as well as adding to its portfolio of transport and general infrastructure assets in Western Siberia, in order to reduce costs and ensure stability of production. The company recently acquired Russia's fourth-largest iron ore mining company, Kachkanarsky GOK, and also holds a controlling stake in Nakhodkinsky Shipping company. According to the company its acquisition program cost more than $300 million over the last five years.

NIZHNIY TAGIL METAL PLANT

NTMK: rapidly-growing steel producer, limited upside. We are initiating coverage of NTMK with a HOLD and a fair value of $0.95/share. Nizhny Tagil Metallurgical Plant (NTMK) is one of the three subsidiaries of EvrazHolding, and the largest maker of long products in Russia. EvrazHolding owns 74% of the company, which has a free float of 5%. Currently, NTMK is trading at a 2003 EV/EBITDA of 5.2 and a 2003 PE of 15.4.

We believe NTMK should benefit from rapidly-growing demand for long products in Russia and abroad. The company has completed several technological and equipment upgrades, and hopes to improve EBITDA margins in 2004–5 from 23% in 2003, to 33–28%.

Monopoly supplier to Russia's railroads; good access to coal resources. NTMK holds a monopoly over supply of rails for Russia's railroads. The company controls access to high quality coal and to 75% of the iron ore it needs, which should enable the company to control operating costs.

Large capex required. The bulk of NTMK's core assets are outmoded and depreciated. The company will require large capital outlays in coming years to replace obsolete equipment and technology. We estimate these capital needs at some $200 million in the next three years.

High price dependence. NTMK is highly sensitive to changes in domestic steel prices and Chinese demand. The company sells more than 55% of its steel output domestically, compared with a 45% sector average; most of its exports is to China.

Poor corporate governance. Some 74% of shares are controlled by the holding company's management through three offshore holding companies: Tradeline Enterprises Ltd (35%), Ferroblast Overseas (30%) and General Refractories Ltd (11%). (Please see details of the ownership structure in the 'Company Profiles' section at the back of this report.) All substantial management decisions are taken by EvrazHolding President Alexander Abramov. We see NTMK as particularly vulnerable to transfer pricing risks, as well as, potentially, consolidation risks. Up to now, Abramov has conducted a value-negative policy towards the holding's subsidiaries. We would expect this to continue. In the case of full consolidation into the holding, we would not be surprised if NTMK minority shareholders ended up with a poor deal.

WESTERN SIBERIAN METAL PLANT

Zapsib: an inexpensive and quickly-growing asset

We are initiating coverage of Zapsib with a BUY rating and a fair value of $140/share. Zapadno-Sibirsky Metallurgical Plant (Zapsib) is the largest subsidiary of EvrazHolding by output, with 43% of total production in 2003. The company is 93%-owned by EvrazHolding, and has a very low free float of 0.5%.

Capex plans should help to capitalize on strong demand. On the positive side, we believe Zapsib should benefit from dynamic growth in demand for long products in Russia and worldwide. The company has recently modernized its assets and technologies, and plans additional capex of some $460 million during 2004–7 to modernize its technologies.

West Siberia: good location. Zapsib is located in Western Siberia, a convenient location close to its biggest export market, China, which purchased some 55% of the company's total exports last year. Proximity to its largest customer means lower transport costs.

Zapsib to increase 2005 long product output by 15%
EvrazHolding CFO Alexander Frolov has announced that Zapsib, Evrazholding's main production subsidiary, will increase long product output by 10% in 2005 to 5.2 mn tons, up from 4.8 mn in 2004. The company will use pig iron produced by another EvrazHolding subsidiary, KMK (Kuznetsky Metal Plant) located close to Zapsib in Western Siberia. The holding enjoys strong slab demand from China. With its convenient location and available production capacity, Zapsib may easily be able to increase production by some 10–15% in five months, according to Frolov. We have raised our 2005 production forecast for Zapsib from flat to +10%.

Plans for higher-value output. Zapsib has announced plans to start producing rolled sheet products in 2006–8 to extend its production mix with higher-value-added hot- and cold-rolled sheet steel.

Cheap valuation and good growth perspectives. Zapsib represents a good buying opportunity in the Russian steel industry, in our view. We consider investment in Zapsib to be a good way to gain cheap access to EvrazHolding. Zapsib has an attractive valuation, with a 2004 EV/EBITDA of 1.9, and strong growth prospects. We project 2002–5 EBITDA CAGR at 138%.

High price sensitivity, both on the domestic market and for exports, primarily to China. Zapsib exports more than 55% of its output to China, making it particularly sensitive to pricing risks in that market.

High transfer-pricing risks. Because it is 94%-owned by EvrazHolding, Zapsib is particularly vulnerable to transfer-pricing risks within the holding. In addition, a number of the holding's general credit liabilities are secured by Zapsib's assets. In the event of troubles at the holding, Zapsib — and its minority shareholders — would suffer.

Poor corporate governance policy. EvrazHolding's large stake in the company is a continuing risk for Zapsib's minority shareholders. In order for us to reconsider our recommendation on the company, we would need to see a more investor-friendly management at the holding, as well as better transparency of financial flows between the subsidiaries and the holding.

MAGNITOGORSK METAL PLANT

MMK: not yet officially trading on RTS. We are initiating coverage of Magnitogorsk Metal Plant with a short-term trading BUY on the stock, but a long-term HOLD rating. (We would recommend purchase of the stock prior to sale of a state stake later this year anywhere below $0.50/share.) We have a long-term fair value for the stock of $0.50/share. MMK is Russia's largest flat rolled steel producer, with output of 9.4 million tons in 2003. Its shares are not traded on the RTS. However, it is currently trading on the RTS Board, a listing for illiquid companies, in a range of around $0.40–$0.50/share. This level is in line with our fair value estimate of $0.47.

The company is controlled by management, which owns over 53% of shares through shell companies (ZAO IK RFZ, MEKOM, REMEK and ZAO A-Capital) Another 16% of shares are controlled by Mechel Steel Group, while a further 17.8% state-owned stake is slated for privatization later this year. We believe the stock may present arbitrage opportunities before this point, when the sale price of the state stake will be fixed. Before sale of the state-owned stake, we would BUY the stock anywhere within a range of $0.40–$0.50/share. However, on long-term fundamentals, we rate the company HOLD.

Adequate transparency; reliable bond rating. MMK has published IAS results audited by KPMG since 1998. In 2003, MMK issued a $300 million Eurobond. This paper was rated 'Stable' B+ by S&P. The company also has an extended ruble bond program. MMK has a low debt/equity ratio of 12% compared with an international average of 50%.

Progress in modernizing assets. MMK has spent over $500 million on capex in 2002–4. The company has almost finished an extensive modernization program that aims to replace obsolete OHF equipment and technology to increase production efficiency.

We see operating underperformance continuing. Historically, MMK has underperformed industry peers Severstal and NLMK on operating and financial results. We expect this trend to continue in 2004 despite good 2003 results. We project MMK's 2004 EBITDA margin at 27%, compared with 30% for Severstal and 40% for NLMK.

Poor raw materials resources means pricing risk. MMK is poorly supplied with iron ore and coal resources. As a result, the company faces raw materials pricing risks, and has trouble controlling its operating expenses efficiently.

Uncertainties over privatization medium-term. The State Property Fund has yet to clarify the exact timing of privatization of a 16% stake in the company. The target date is sometime later this year. However, we believe the sale could be postponed. We expect to see uncertainty in the secondary market until the sale has been completed. We also feel that the company's corporate governance issues are unlikely to abate until the stock is officially traded on RTS.

MECHEL STEEL PLANT

Initiating with a BUY on MECH. We initiate coverage with a BUY recommendation on MECH, with a 12-month price target of $235, implying 31% upside potential to the current market price.

Mechel: good access to steel assets; US offering a potential opportunity. Mechel Steel Group is the holding company that controls Chelyabinsk Metallurgical Plant (generally referred to as Mechel for short). Mechel (MECH, $180), which trades on the RTS, is the holding's core asset, and accounts for 50% of the holding company's total group sales. MECH is 70%-owned by Mechel Steel Group. Mechel Steel Group has said it plans IPO for the holding in the US in 2004 through level 3 ADR. We expect MECH's local RTS price to increase in connection with the holding's IPO, which is scheduled to complete by the end of this year. Mechel Steel Group – the holding – expects to receive some $200–$350 million from the IPO, which should raise total market cap to above $1 billion, on our estimates.

Mechel Steel group US ADR Level 3

According to official SEC filings presented on Mechel Steel Group's website, the company is ready to place 10% of its shares (some 13.8 mn) in a Level 3 ADR on the New York Stock Exchange in December this year. The ADRs will be worth three times the face value of each ordinary share of Mechel Steel Group. The company has also published US

Exhibit 36

Mechel Steel Group: Product Profile

Asset	Product	2003 Prod '000 t
Mechel	Rolled steel products, specialty steel	2700
COST (Romania)	Rolled steel products	450
Beloretsky steel	Steel hardware	700
Vyartsyl Steel	Steel hardware	55
Lutvinian	Steel hardware	10
S.C.Industria Sarmai (Romania)	Steel hardware	n/a
Mechel Zeljezara (Croatia)	Steel pipes	8
Yuzhny Kuzbass	Coal	13 000
Korshunovsky GOK	Iron ore	1500
Yuzharalnickel	Nickel	15

Source: Company data

GAAP accounts for 2003 and 1H 2004. The Level 3 ADR should attract far more interest from American investors.

Better access to foreign markets. After cancellation of a US-Russian steel anti-dumping agreement that expired in July, we believe Mechel and other small Russian steel producers will have better chances to the US steel market. As a result, MECH could increase sales to the US to up to $150–$200 million annually, on our estimates.

Mechel: very low EV/EBITDA. Mechel represents a good buying opportunity in the Russian steel industry. Investment in MECH is a good way to gain access to Mechel Steel Group. MECH has an attractive valuation, with a 2004 EV/EBITDA of 2.2 and strong growth prospects. We estimate 2002–6 EBITDA CAGR at 43%.

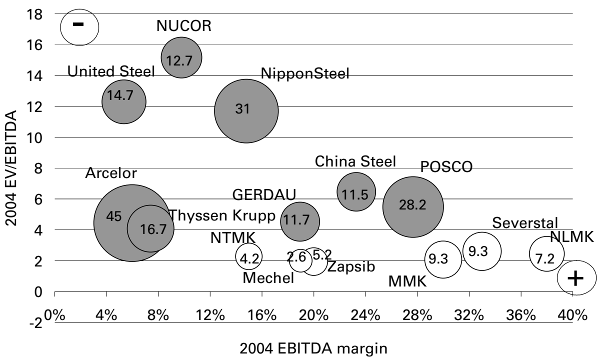
MECH is Russia's leading producer of stainless and specialty steel products, with output that meets EU standards. The company has a monopoly on production of specialty steel in Russia after its acquisition of the country's second-largest specialty steel producer, Izhstal.

Mechel controls 100% of the high quality iron ore and coke resources it needs. The company has recently modernized its assets and technologies, and plans to invest an additional $460 million in modernization in 2004–7.

Lower profitability than its peers. Russian domestic stainless steel prices remain low due to weak demand. MECH has weaker margins than those of Severstal or NLMK. The company reported a 2003 EBITDA margin of 15% (according to Russian Accounting Standards), compared with 32% for Severstal and 40% for NLMK.

Exhibit 37

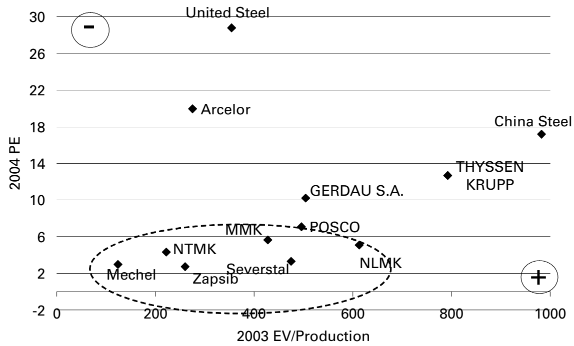
Russian and Global Steel Producers: EV/EBITDA Versus EBITDA Margin, 2004



Note: Size of bubble indicates relative 2003 rolled steel production.
Source: IBES, Metropol research

Exhibit 38

Russian and Global Steel Producers: P/E Versus EV/Production, 2003



Source: Metaltorg, Metropol research

Russian steel producers: cheaper than world averages. In general, Russia's steel producers look inexpensive compared with both their developed and emerging market peers. Our four top picks in the sector, Severstal, NLMK, Mechel and Zapsib, all have strong 2003 EBITDA margins of around 15–40%, and relatively cheap valuations. We consider NLMK, Severstal, Mechel and Zapsib and to be the most attractive, with 2004 projected EV/EBITDA of 2.4, 2.1, 2.2 and 1.9, respectively. Some European producers, such as France's Arcelor and Germany's Thyssen Krupp, also look inexpensive on EV/EBITDA measures, but these producers' EBITDA margins are much lower, at only 7% on average, while their 2003 P/Es are higher, at over 20. The Russian producers trade at 2003 P/Es of only 8.1 on average, compared with average P/Es of around 13 for their global emerging market peers, and around 21 for steel producers in developed markets.

We consider Severstal and NLMK to be suitable benchmarks for the Russian steel industry because of their high production volume (more than 40% of total Russian crude steel production). We consider NLMK to be the most attractive company in the sector, thanks to its high profitability and low valuation. The company had a 2003 EBITDA margin of 40%; we project a 2004 EBITDA margin of 48%, the highest in global steel universe, on our estimates. We consider Mechel and Zapsib to be second-tier stocks with deservedly low valuations. The companies are trading on projected 2004 EV/EBITDAs of only 2.2 and 1.9, respectively, perhaps the lowest in the entire global steel sector. Mechel is also cheap on production measures, at an EV/production multiple of just $160, compared with a world steel producers' average of $600.

Exhibit 39

Russian and Global Steel Stocks: Relative Valuations, 2002–2005E

	Recommendati on	Current price	Target price	Mcap.$bn	P/E				EV/EBITDA				P/S				2002-05 EBITDA CAGR
		US $	US $		02	03E	04E	05E	02	03E	04E	05E	02	03E	04E	05E	
NTMK	Hold	0.87	0.95	1,139.7	558.7	15.4	4.3	3.4	10.6	5.2	2.3	1.9	1.4	1.1	0.7	0.7	75%
Zapsib	Buy	109.00	140.00	1,459.2	neg	neg	3.1	3.0	27.8	5.9	2.2	2.0	2.0	1.3	0.7	0.7	138%
Mechel	Buy	180.00	235.00	569.2	28.0	6.8	3.3	5.7	7.7	4.6	2.2	3.3	1.0	0.6	0.5	0.6	43%
Severstal	Buy	203.00	260.00	4,481.1	neg	7.6	3.3	4.7	15.5	5.1	2.1	3.2	2.0	1.4	0.9	1.1	15%
NLMK	Buy	1.11	1.27	6,645.8	19.6	10.8	5.1	6.6	10.1	5.6	2.4	3.6	3.9	2.6	1.6	1.8	17%
MMK	Hold/SpecBuy	0.50	0.50	5,315.1	46.2	8.6	5.6	6.6	11.7	4.5	2.6	3.8	2.6	1.7	1.2	1.4	12%
Average Russia					**93.2**	**8.2**	**4.1**	**5.0**	**13.9**	**5.1**	**2.3**	**3.0**	**2.2**	**1.5**	**0.9**	**1.1**	
GRUPO IMSA		21.8		1,364.7	9.2	9.0	7.8	7.4	5.9	5.5	5.2	4.9	0.6	0.6	0.6	0.6	7%
GERDAU S.A.		17.3		1,968.1	11.8	10.6	9.4	8.3	3.6	3.3	3.1	2.8	0.8	0.8	0.8	0.8	7%
POSCO		39.8		13,004.8	15.3	14.3	13.9	14.8	6.3	5.9	5.7	6.0	1.1	1.1	1.0	1.0	1%
China Steel		1.0		9,829.5	21.0	18.9	17.2	16.1	15.3	13.8	12.8	12.2	3.4	3.2	2.9	2.7	7%
NUCOR Corp.		96.8		7,569.8	46.7	44.5	36.0	30.3	17.6	16.9	16.0	14.5	1.9	1.9	1.5	1.4	6%
United Steel		40.8		4,209.5	neg	34.8	31.2	29.0	neg	14.5	13.1	13.8	4.0	3.9	0.5	0.5	2%
Nippon Steel		2.4		16,144.3	neg	neg	161.0	129.2	18.0	13.3	11.7	14.0	6.6	5.1	1.1	1.1	11%
Arcelor		12.7		6,780.8	neg	23.4	21.2	22.6	5.5	3.8	3.6	4.3	2.3	2.0	0.2	0.2	8%
Corus Group		9.4		4,178.0	neg	neg	27.5	13.1	35.6	6.6	5.6	5.3	13.5	2.5	0.3	0.3	78%
Thyssen Krupp		16.3		8,375.4	38.8	33.5	29.9	27.0	4.8	4.2	3.8	4.2	2.1	1.8	0.2	0.2	1%
Emrg Mkts average					**14.3**	**13.2**	**12.1**	**11.7**	**7.8**	**7.1**	**6.7**	**6.5**	**1.5**	**1.4**	**1.3**	**1.3**	
Dvlp Mkts average					**14.2**	**22.7**	**51.1**	**41.9**	**13.6**	**9.9**	**9.0**	**9.3**	**5.1**	**2.9**	**0.6**	**0.6**	
Disc/prem to Emrg					**-85%**	**61%**	**192%**	**133%**	**-44%**	**39%**	**191%**	**118%**	**-30%**	**-3%**	**40%**	**19%**	
Disc/prem to Dvlp					**-85%**	**176%**	**1138%**	**737%**	**-2%**	**92%**	**290%**	**215%**	**135%**	**96%**	**-33%**	**-40%**	

Note: E = estimates. Russian steel sector estimates provided by Metropol research. All other stocks are IBES estimates.

Market prices as of 051.10.2004

Source: IBES, Metropol

MAJOR ASSUMPTIONS

Exhibit 40

Russian Steel Sector: Macro Assumptions Affecting Sector Growth, 2003–2010E

	2003	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Macro Data[1]								
GDP Growth (%)	6.9	5.5	5	5	5	5	5	5
RUR CPI Inflation (%)	12.4	10.0	8	7	6	5	4	3
RUR/USD, End of Period	29.45	28.50	29.00	30.74	32.28	33.57	34.58	35.27
Real RUR Appreciation	18.3	10.9	3.5	-2.3	-2.2	-2.1	-2.1	-2.0
Production[2]								
Total Russia Steel Production (mn t)	60.2	61.1	62.0	61.2	60.3	61.5	62.0	62.5
% of Total World Output	6.5	6.4	6.3	6.1	5.9	6.1	6.2	6.5
Russia Steel Export	27.7	26.9	26.0	25.7	25.3	26	26.7	27
% of Total World Exports	10	12	11	9	8	10	10	11
Export to China	6.9	7.3	7.0	6.2	5.8	5.5	5.5	5.5
% of Total Russian Steel Exports	25.0	27.0	26.9	24.1	22.9	21.2	20.6	20.4
Domestic Consumption	32.5	34.2	35.9	35.5	34.9	35.5	35.3	35.5
Domestic Consumption Growth (%)		5.2	5.1	-1.2	-1.6	1.6	-0.6	0.6

	2003	2004(E)	2005(E)	2006(E)	2007(E)	2008(E)	2009(E)	2010(E)
Steel Prices (US$/ton)[2]								
Hot Rolled	320	450	420	350	300	250	270	250
Cold Rolled	415	500	450	375	320	300	320	300
Average Russian Steel Sector Production Costs (US$ Per Ton of Product Produced)[1]								
Hot Rolled	167	186	186	172	164	165	167	172
Iron Ore	22	25	25	22	20	20	20	20
Coal Ore	17	22	22	20	20	20	20	22
Scrap Metal	37	40	35	30	27	25	25	25
Transport to Export Markets	20	21.2	25	26	27	28	30	30
Labor Costs	27	32	32	30	30	30	27	28
Fuel and Energy	22	23.6	25	22	20	21	20	20

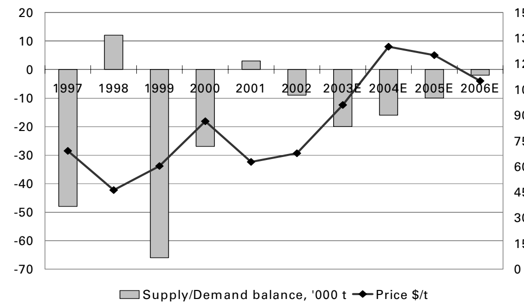
Source: 1. IISI 2. Metropol research, Bloomberg Macro consensus,

NON-FERROUS INDUSTRY

6 OCTOBER 2004

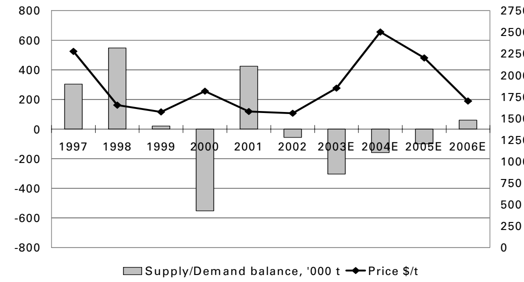
METAL PRICES ON UPWARD TREND

Exhibit 41
World Nickel Market: Supply and Pricing Dynamics, 1997–2006E



Source: GFMS

Exhibit 42
World Copper Market: Supply and Pricing Dynamics, 1997–2006E



Source: GFMS

Metals prices look set to remain high through 2005. We see global metals prices remaining on an upward trend through 2005, continuing to benefit the Russian non-ferrous sector.

Factors supporting strong metals prices in 2004–6:

- Global economic recovery
- Weak US dollar
- Strong market growth in Asia (particularly China)

We project nickel prices remaining high through 2005 on growing stainless steel demand. Stainless steel production accounts for 75% of total global nickel consumption (Exhibit 44). Strong global steel demand helped nickel prices remain resilient in 2003 and early 2004 (Exhibit 41). World stainless steel production grew 10.4% in 2003, to some 23 million tons. IISI projects growth continuing, at 13%, to 26 million tons, in 2004, and 12%, to 29.2 million tons, in 2005 (exhibit 45). The precious metals research consultancy GFMS projects a further 5–9% production growth in 2004–5. It also expects to see the market heading towards a 16,000 ton deficit in 2004, and a further 10,000 ton deficit in 2005. However, the research group sees prices beginning to decline from $13,000/ton in 2005 to $11,000/ton into 2006.

Copper prices to peak in 2004 on continuing deficit. Copper is currently the most volatile metal on the LME, due to supply disruptions in early 2004. GFMS believes that the market is heading towards a 300,000 ton deficit in 2004, and another 160,000 ton deficit in 2005, thanks to continuing strong Chinese demand. GFMS sees China's construction boom and sharp growth in the utility and construction sector supporting demand, with copper prices remaining strong throughout 2004. The consultancy estimates a price of some $2,350/ton through 2004, declining quickly in 2005 on fast supply growth and Chinese economic slowdown (Exhibit 42).

Gold to benefit from weak dollar, but falls to $350/oz by 2006. World gold prices rose strongly in 2002–3 on the back of terrorism, war, and a weak US dollar. GFMS projects low US interest rates keeping the dollar weak, and gold prices high in 2004, but expects prices to begin falling below $400/oz after 2005 on higher interest rates and renewed US economic growth.

Platinum prices = gold price + Japanese economy. Platinum prices have a strong correlation with the gold price, as well as with the Japanese economy, world's largest auto exporter, as the metal is used as a catalyst in auto engines. GFMS's projections of continuing growth in the Chinese auto industry and recovering American car production suggest to us that platinum prices will remain high at least through 2005. Platinum recently rose to a historical high of over $900/oz, on expectations of stronger consumption by Japanese auto producers. GFMS projects average platinum prices remaining at some $850/oz in 2004, declining slowly towards $800/oz in 2006 along with a falling gold price.

Palladium hits $300/oz. Next level at $400/oz? Like platinum, palladium is used as a catalyst in automobile engines, so car-producing economies are the principal drivers of demand for the metal. We see the following main factors driving the palladium price in the medium term: the recovering Japanese economy, which accounts for a third of global consumption; the narrowing spread between platinum ($902/oz) and palladium; and continuing demand from China. Palladium prices broke through $300/oz from a low of $180/oz in Dec 2002. GFMS projects prices for the metal peaking at around $400/oz in 2005.

Exhibit 43

World Stainless Steel and Nickel Prices, 1Q92–1Q04 (US$/ton)

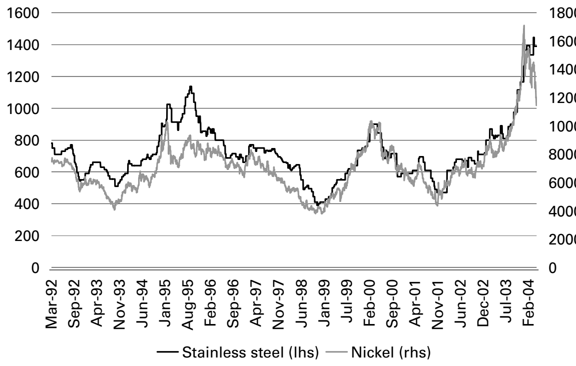
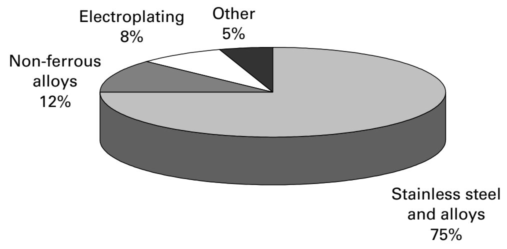


Exhibit 44

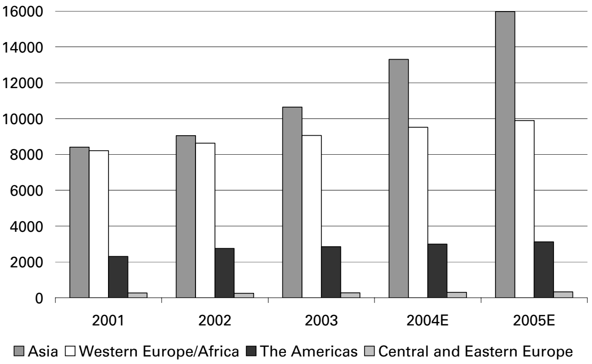
World Nickel Demand, 2003 (%)



Source: IISI

Exhibit 45

World Stainless Steel Production, 2001–2004E (000 tons)



E = IISI estimates
Source: IISI

Exhibit 46

Russian Non-ferrous Metals Sector: Macro Assumptions, 2003–2010E

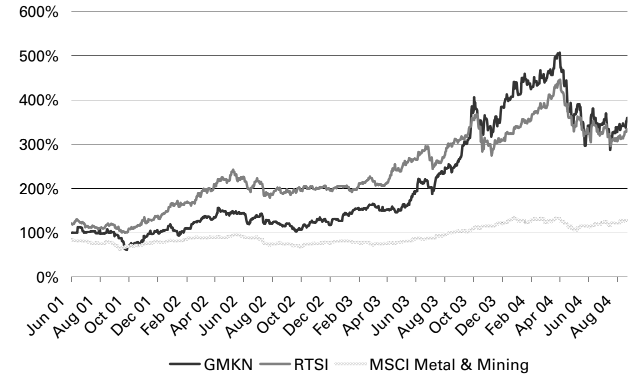
	2003	**2004(E)**	**2005(E)**	**2006(E)**	**2007(E)**	**2008(E)**	**2009(E)**	**2010(E)**
Macro Data								
GDP Growth (%)	6.9	5.5	5.0	5.0	5.0	5.0	5.0	5.0
RUR CPI Inflation (%)	12.4	10.0	8.0	7.0	6.0	5.0	4.0	3.0
RUR/USD, End Of Period	29.5	28.5	29.0	30.7	32.3	33.6	34.6	35.3
Real RUR Appreciation (%)	18.3	10.9	3.5	-2.3	-2.2	-2.1	-2.1	-2.0
Metals Prices								
Nickel (US$/t)	12,700	13,500	13,000	11,000	8,500	8,000	8,000	8,000
Copper (US$/t)	1,765	2,700	2,600	2,000	1,750	1,600	1,600	1,600
Zinc (US$/t)	670	850	800	750	700	700	700	750
Platinum (US$/oz)	780	820	800	750	650	700	750	750
Palladium (US$/oz)	210	250	270	270	250	200	200	200
Gold (US$/oz)	400	390	350	320	300	280	280	280
Norilsk Nickel: Production Costs								
On-mine Costs (US$/t)	1,675	2,041	1,837	1,594	1,496	951	917	920
Smelting Costs (US$/t)	691	1,172	1,184	1,080	1,068	954	825	850
Treatment & Refining (US$/t)	401	578	606	637	668	613	548	550
Nickel (Direct Cost, US$/t)	**2,767**	**3,791**	**3,627**	**3,312**	**3,232**	**2,518**	**2,290**	**2,320**

Source: Bloomberg macro consensus estimates, Metropol research

BECOMING A GLOBAL PLAYER

Exhibit 47

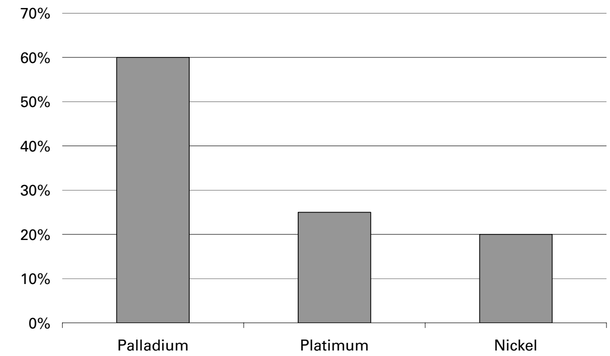
Norilsk Nickel: Share Price Performance Versus RTS and MSCI World Metal Index, 2001–4



Source: Bloomberg

Exhibit 48

Norilsk Nickel: Share in World Non-Ferrous Output, 2003 (%)



Source: Company data

Norilsk Nickel is Russia's most significant metal and mining company. The holding controls over 60% of world palladium production, 26% of platinum production, and 20% of nickel production (Exhibit 48). Sales of nickel and copper are the company's major earnings drivers, accounting for 57% and 16% of total sales, respectively. We consider Norilsk Nickel to be a 'rising star' of the global diversified metal & mining industry. The company has consistently shown strong profitability, with a 2003 EBITDA margin of 37%, net margin of 16%, and compound-annual EBITDA growth of 14.5% in 2002–6. By valuation, Norilsk is among the cheapest companies in the sector. We project a 2004 EV/EBITDA of 5.1, compared with a global sector average of 13.7, and a forward 2004 PE of 11, compared with a global sector average of 35. We project strong financial results for the company in 2004, with sales of $6.4 billion and net profit of $1.3 billion, on our estimates. The company maintains a low debt/equity ratio, at only 13%, compared with an international sector average of 50%.

Becoming more investor-friendly. Norilsk Nickel recently published 2001–3 IAS results. The company has started issuing IAS results on a quarterly basis in an effort to boost transparency. The company has also introduced a new corporate governance charter, and announced a long-term strategic development plan through 2017. Norilsk Nickel paid for the first half of 2003 dividends of $1.43 per share, implying a dividend yield of 2.5%, in line with the global average, but paid no second half 2003 dividends. We expect the company to pay generous dividends again in 2004, of some $1.70–$2.00 per share, on our estimates, raising the dividend yield above 3%. The company's policy has been to distribute at least 25% of net profit as dividends each year.

Best stock liquidity in the sector. Norilsk is probably the most liquid stock in the Russian metals sector. Its Level 1 ADR, launched in 2000, has led to a free float of some 26%, of which 18% trades via the ADR.

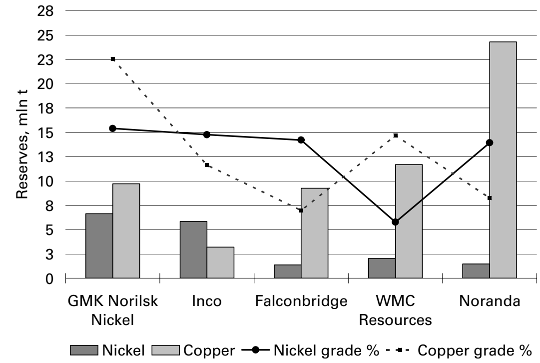
Precious metal reserves disclosure could increase market cap. In its 2003 annual report, the company presented partial reserves data audited according to international standards by Micon International. Earlier this year, the company announced plans to disclose further details of its fully-audited resource base. The company's proved reserves data are roughly in line with market estimates, which projected a 35-year mine life for the company's nickel and copper reserves. The company's probable reserves data are impressive, in our view, confirming Norilsk Nickel's solid reserve base. The company has not yet published data on its platinum and palladium reserves, though it is an important player in these segments, too. We believe the company may release data on its reserves of these metals this fall or winter. We would consider release of the reserves data to be a sign of increasing transparency.

Increasing efficiency through better cost control. In our view, despite a rise in costs in 2003 mostly due to mining and other operating investments, Norilsk Nickel has demonstrated good control over its operating expenses and has potential for further reducing direct costs. In order to gain access to cheaper power, the company has recently acquired stakes in Krasnoyarskenergo and NorilskGazprom. The company also owns a 90% stake in Krasnoyarsk River Shipping, through which it is able to transport 80% of sales (by value) of its own output. The company has announced plans for 20% staff reductions through 2010. Reorganization of its global trading system should also help to reduce costs, as well as bring the company closer in line with global standards.

Weaker-than-expected 2003 results, but bad news now priced in. Norilsk Nickel issued full-year 2003 IAS results in August. The results came in generally in line with our

Exhibit 49

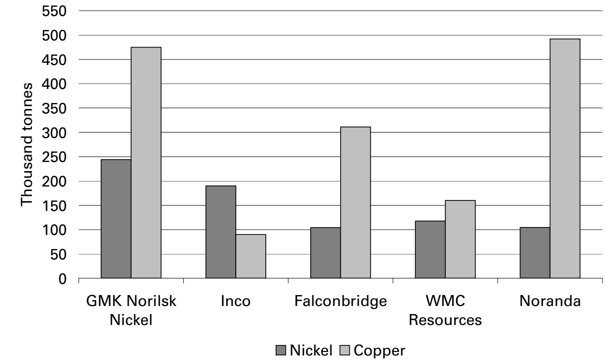
Norilsk Nickel and Global Peers: Nickel and Copper Reserves, 2003



Source: Company data, Bloomberg, Metropol research

Exhibit 50

Norilsk Nickel and Global Peers: Nickel and Copper Production, 2003 (000 tons)



Source: Company data, Bloomberg, Metropol research

expectations. EBITDA margin fell to 37%, according to the company, compared with a consensus estimate of 42%. The company also announced a weak net margin at 16%, down from 19% a year ago, and compared with a consensus estimate of 25% in 2003. The company sold significant nickel stocks in 1Q03, when nickel prices were low, bringing its average 2003 nickel revenues 9.5% below market levels, to some $9,500/ton.

Nevertheless, we expect the company to report good 2004 results due to higher average nickel prices of $13,500/ton, which should lead to higher operating margins, on our estimates. In particular, we expect 2004 sales according to IAS of $6.4 billion, with net profit of $1.4 billion. The company has reported that 2004 nickel sales are likely to be some 20% lower YoY, at around 250,000 tons. We estimate that this could mean a 17% reduction in the company's total nickel revenues for 2004. The company has said it may show significant write-offs connected to its newly-acquired subsidiary StillWater Mining, due to continuing low palladium prices. Total write-offs connected to Norilsk StillWater could amount to some $300 million, mostly related to write-down of the subsidiary's existing palladium reserves according to SEC standards. We believe the write-offs are unlikely to affect the holding company's cash position, and consider the move a necessary accounting procedure. We expect StillWater Mining to return to profit in 2004, justifying Norilsk Nickel's investment in the company.

The palladium story. Norilsk Nickel is world's largest palladium producer, with more than 60% of total world production. In 2000, when prices averaged $900/oz, palladium accounted for more than 20% of total sales. At the current price of $240/oz, palladium accounts for just 10% of total sales. At the same time, palladium mining costs stabilized at $285–$300/oz. In 2003, Norilsk Nickel sold about 2.9 million ounces of palladium at an average market price of $190/oz, making a net loss of $100 per/oz, or a total loss of $290 million, raising direct costs by 64%. We project losses on palladium of $210 million in 2004, at an average sales price of $220/oz, including StillWater Mining.

Declining nickel production in 2004–6E. Norilsk Nickel has announced it will fall short of its 2004 nickel production target by 5.2%. The company earlier had planned to produce 250,000 tons of nickel in 2004, compared with 239,000 tons in 2003 (+4.6%). However, the company's Taymyr branch, in the Russian Far North, announced that it planned to cut production from 132,000 tons in 2003 to 125,000 tons in 2004. We believe that this fall in output could reduce Norilsk Nickel's sales by some $143 million in 2004, based on an average nickel price of $13,000/ton. Norilsk's Taymyr branch produces over 80% of the holding's total own nickel production. The main reason for the production fall is depletion of easily-accessible nickel ore. Norilsk Nickel plans to invest more than $400 million in the Taymyr branch in 2004 to improve recoverability of ore in the region and to replace worn out equipment, enabling the branch to grow faster in 2006–10. The company projects nickel production remaining flat in 2005, at 240,000 tons. We see this news as negative for the company, as lower production this year indicates that Norilsk will be unable to profit from current record-high metals prices into realized profits.

Norilsk subject to export licensing requirements and quotas. Like many other Russian exporters, Norilsk Nickel must obtain export licenses for some of its products. Export of PGMs are also subject to quotas set by the state. Any reduction in quotas could disrupt the company's export sales. The company is currently exporting under a five-year palladium export quota granted in 2002.

Russian oligarch risk: is Potanin next? We see the Yukos case as a sign of possible future attacks against other oligarch-owned companies. The investment community and local media have discussed the possibility that Vladimir Potanin who ownes 28% of Norilsk Nickel could become the next target. The Russian Securities Comission still has not concluded an investigation into the allegedly illegal transfer of company assets from OAO Norilsk Nickel to its subsidiary Norilsk Mining Company in 2000. There is potential for further investigation of Norilsk Nickel's privatization. However, we see this as a remote possibility, and are not pricing it into our valuation of the company.

Shareholder Structure: pros and cons. Norilsk Nickel is majority-owned by management. CEO Mikhail Prokhorov holds 28% of the company, while Interros President Vladimir Potanin holds a 28% share. Interros CEO Andrey Klishas serves as Norilsk's Board Chairman. UBS Brunswick acts as nominee for the 18% of the shares traded abroad via a GDR through the London Stock Exchange. Virtually all of these shares are held by foreign portfolio investors. Sberbank holds 6% of Norilsk.

CREATING A $2 BN GOLD COMPANY

Exhibit 51
Norilsk Nickel and World Peers: Gold Production (Avg Gold Price at $350/oz)

	Output $ bn	Mcap $ bn	Sales $ bn	Prodn Cost US$/oz	Proven Resv ($ bn)	P/ Prod	P/ Resv	P/S
Newmont	2.97	17.3	3.10	234	28.45	5.83	0.61	5.58
Anglogold Ashanti	2.05	10.8	2.56	213	23.37	5.26	0.46	4.22
Barrick Gold	1.97	11.3	2.25	247	28.55	5.73	0.40	5.02
Gold Fields	1.62	5.70	1.82	208	27.83	3.51	0.20	3.13
Placer Dome	0.96	6.80	1.45	234	16.85	7.10	0.40	4.69
Harmony Gold	0.79	3.90	0.78	233	16.70	4.94	0.23	5.00
Norilsk Nickel	0.45	2.00	0.40	180	16.14	4.49	0.12	5.00
Buenaventura	0.36	1.25	0.32	156	5.29	3.51	0.24	3.91
Kinross	0.32	2.30	0.29	285	3.94	7.13	0.58	8.07
Average				**221**		**5.28**	**0.36**	4.96

Source: Norilsk Nickel, GFMS, Metropol research

Exhibit 52
Norilsk Nickel: Gold Mining Assets

Gold reserves	Proved rsvs mn oz	2003 Prod'n (000 oz)	Bought at $/oz	Cost $mn	Share (%)
Taymyr	7	122	n/a	n/a	100
Polyus	21	815	14	286	100
Matrosov Mining	8	0	9	34	51
Lenzoloto	11	12	28	156	51
Int'l Average			45		
Total	47	966			
Total (t)	1,658	31			
Sukhoi Log	30	n/a	n/a	1,100	

Source: Company, Metropol

Norilsk Nickel's total gold production reached 966,000 ounces (31 tons) in 2003. The company has said it will produce some of 6.5 million ounces (209 tons) by 2010, which would amount to some 30% of the company's total sales at current prices. Norilsk Nickel has said it will report audited reserve data later this year. According to partial information released by the company so far, Norilsk Nickel has proven gold reserves of around 47 million ounces (1.4 thousand tons) of gold.

Russian gold industry: young and fast-growing Russia's gold industry is among the most dynamic and promising in the world. With over 30,000 tons of gold deposits in the Far East, and mining costs of only $177/oz (compared with a world average of $210/oz), Russia is world's third-largest gold producer (Exhibit 54). Russia has increased gold production from 110 tons in 1998 to 177 tons in 2003, and may reach 300 tons by 2010.

Consolidation: key to growth. Norilsk Nickel has recently announced plans to consolidate its gold assets into its subsidiary Polyus, the company's core gold producer, to create an integrated gold mining company controlled by the holding. The holding would buy a new issue of shares worth $500 million to capitalize the newly-consolidated subsidiary. Previously, the gold assets had been held through several unconnected subsidiaries, also wholly-owned by Norilsk. We see consolidation of the assets as a positive move, which we believe has potential further to increase the value of the holding's gold assets, partly because gold mining companies currently trade at higher average valuations than diversified metal & mining companies. (For example, Anglo American trades at a 2003 EV/EBITDA of 7.1, with a PE of 21, while its gold mining subsidiary Anglogold trades on an EV/EBITDA of 11.6, with a PE of 22) We estimate that Polyus could be worth some $2 billion, or 12% of the Norilsk's total market cap of $11 billion, on the basis of Mcap/Reserves and Mcap/Production multiples.

Getting cheap gold reserves.
Norilsk Nickel owns a number of gold assets, including:

- **Matrosov** (Natalka Gold Deposit, Magadan region), acquired for only $2.3/oz, compared with an international average of $50/oz.

- **Lenzoloto** is based in Irkutsk region, producing 11,000 ounces, with proved reserves of 11 million oz. This company's infrastructure would form the basis for Norilsk's possible operation of Sukhoi Log gold deposit, with proved reserves of 30 million oz.

- **Polyus,** which holds 50% of the company's total gold reserves, makes up some 75% of Norilsk's total produced gold, and will form the base for consolidation of all the company's gold assets within Russia.

Sukhoi Log deposit is crucial. Sukhoi Log is the largest gold deposit in Irkutsk region, with total gold reserves exceeding 30 million ounces, according to the Ministry of Natural Resources. The Ministry has announced plans to auction off the deposit this fall. If it wins – and we believe Norilsk has a good chance – acquisition of the deposit would bring Norilsk's total gold reserves to 118 million ounces, which would make it one of the world's ten largest gold mining companies. We believe that Norilsk Nickel can count on strong support from the Governor of Irkutsk Region in the auction. We also believe the company has all the necessary infrastructure to start developing the deposit. If foreign companies are allowed to participate in the auction, we would expect strong competition from international gold producers interested in Russian gold assets, such as Barrick Gold and Newmont Mining. Rusal, in our view, will not be a real competitor, as the company is engaged in acquiring

Exhibit 53
Global Gold Industry: Average Cost Versus Production Growth, 2003

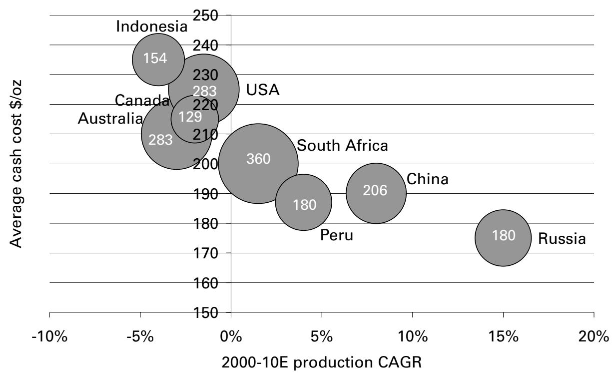
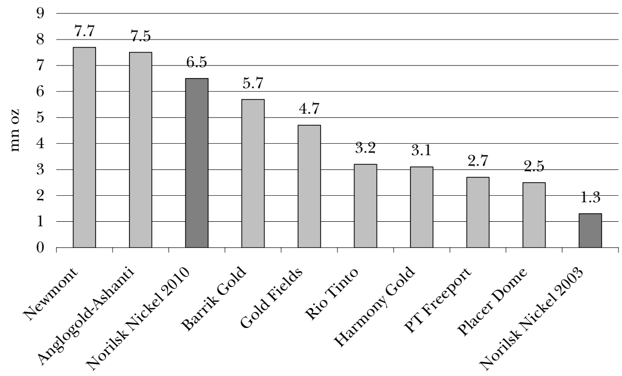


Exhibit 54
Norilsk Nickel and Global Gold Producers: Annual Output, 2003 (mn oz)



Source: IISI, IBES, Metropol research

alumina assets in Russia and abroad, and has little gold mining experience.

Norilsk acquires 20% Gold Fields stake. Through its London-based subsidiary Norimet, Norilsk Nickel purchased 98.5 million common shares, or a 20% stake, in South Africa's Gold Fields Ltd., the world's fourth-largest gold mining company, in May 2004. Norilsk paid the equivalent of $1.16 billion in cash to Anglo American Plc, acquiring that company's 20% stake in Gold Fields at 7% below current market value.

We see the acquisition as positive for Norilsk – Gold Fields is attractively valued, on our calculations. The South African company has:

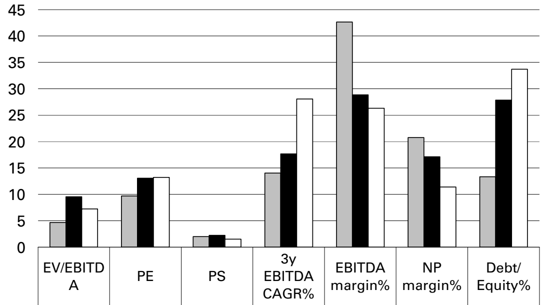
- 2003 EV/EBITDA of 7.6, compared with the gold-mining sector average of 11.7;
- Mcap/Production of 3.5, in line with the sector average; and
- Mcap/Reserves of 0.20, compared with a sector average of 0.38.

Acquisition of the stake gives Norilsk Nickel access to Gold Fields' unique gold-mining technologies, as well as a presence in South Africa. Norilsk Nickel continues to build an internationally-diversified metals holding company.

DYNAMIC AND INEXPENSIVE

Exhibit 55

Norilsk Nickel, Inco and Falconbridge: Relative Valuation, 2004

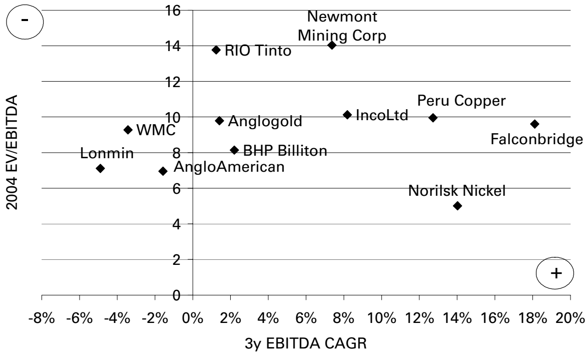


	EV/EBITDA	PE	PS	3y EBITDA CAGR%	EBITDA margin%	NP margin%	Debt/ Equity%
Norilsk Nickel	5	10	2	14	43	21	13
Inco	10	13	2	18	29	17	28
Falconbridge	7	13	2	28	26	11	34

Source: IISI, IBES, Metropol research

Exhibit 56

Norilsk Nickel and Global Metals & Mining Stocks: 2004 EV/EBITDA Versus 2002–5 EBITDA CAGR



Source: IBES, Metropol

We consider Norilsk Nickel to be one of world's most attractive global diversified metal and mining producers, with an inexpensive valuation and strong growth prospects. We expect 2004 to be a year of record earnings for the company, with metal prices remaining high. Exhibit 53 compares Norilsk Nickel with Canadian nickel producers Inco and Falconbridge, which produce a relatively similar range of products. On 2004 EV/EBITDA multiples, Norilsk trades at an EV/EBITDA of only 4.6, less than half the price of Inco (which trades at an EV/EBITDA of 10, according to IBES) and Falconbridge (which trades at an EV/EBITDA of 10, according to IBES). Norilsk trades on a forward 2004 PE of 9.5, on our estimates, while Inco trades at 15 and Falconbridge at 20, based on IBES estimates. Norilsk also has high margins – its 2004 EBITDA margin was 39%, with a net margin of 19%, compared with 14% and 9% respectively, for Inco and Falconbridge. As Exhibit 56 shows, Norilsk also looks very attractive compared with a range of other global comparables. Moreover, we believe the company has potential to increase profitability even further as it begins to control its energy and transport costs more effectively.

Low debt/equity and strong growth = expansion potential. Norilsk has a low debt burden, with a debt/equity ratio of only 13%, compared with 34% for Inco and Falconbridge and an international average of 50%. The company also has strong growth prospects, with 3-year compound annual EBITDA growth of some 14.5%, on our calculations, compared with a global industry average of 6%. The company's 2.5% dividend yield is in line with the global industry average. The potential to increase borrowings if necessary, as well as expected strong EBITDA growth mean strong expansion potential in the medium term. We expect the company to outperform the MSCI Metal and Mining index, and to perform well compared with other world metal and mining stocks.

Exhibit 57

Norilsk Nickel and International Diversified Metal & Mining Stocks: Relative Valuations, 2002–2005E

	Recommendation	Current price	Target price	M Cap $m	P/E				EV/EBITDA				P/S				2002-05 EBITDA CAGR
		$US	$US		02	03E	04E	05E	02	03E	04E	05E	02	03E	04E	05E	
Norilsk Nickel	**Buy**	**65.0**	**82.0**	**13,903.8**	**24.2**	**17.2**	**10.5**	**8.5**	**13.3**	**7.2**	**5.1**	**4.7**	**4.6**	**2.7**	**2.2**	**2.4**	**14%**
Newmont Mining Corp		45.5		16,577.5	110.2	60.2	57.2	51.8	20.7	15.1	15.5	16.9	6.0	5.3	4.9	4.5	7%
AngloAmerican		24.3		35,647.5	20.4	21.3	20.3	19.1	7.8	7.2	6.9	8.0	2.3	2.3	2.3	2.2	1%
BHP Billiton		20.8		38,802.5	34.4	31.0	28.3	25.5	10.5	9.9	9.7	10.6	2.3	2.1	2.1	2.0	1%
RIO Tinto		108.7		37,429.9	64.4	43.9	40.7	34.0	18.2	15.0	14.5	17.8	4.4	4.1	3.9	4.1	1%
Falconbridge		24.0		4,300.1	86.0	22.1	13.2	15.1	18.7	10.0	7.2	9.0	2.8	2.1	1.5	2.0	28%
IncoLtd		39.1		7,150.1	25.3	19.5	18.3	17.0	16.3	14.2	11.7	13.5	3.5	3.1	2.6	2.5	8%
Lonmin		19.8		2,793.7	15.1	13.3	11.2	9.8	8.3	6.8	6.2	6.8	4.0	3.6	3.4	3.2	7%
Inter metal and mining aver					**66.3**	**39.0**	**34.9**	**32.3**	**18.5**	**14.9**	**13.7**	**15.5**	**4.0**	**3.6**	**3.3**	**3.3**	
Disc/premium GMK to intr.peers					**174%**	**127%**	**231%**	**280%**	**39%**	**107%**	**170%**	**227%**	**-12%**	**32%**	**51%**	**36%**	

Note: E indicates estimates. All are IBES estimates, except for Norilsk Nickel figures, which are Metropol research estimates
Market prices as of 05.10. 2004.
Source: IBES, Metropol

OTHER METALS IDEAS

THREE STRATEGIC NON-FERROUS PICKS

Exhibit 58

Russian and Global Small-Cap Non-Ferrous Metal Stocks: Relative Valuations, 2002–2005E

	Recommendation	Current price	Target price	M Cap $m	P/E				EV/EBITDA				P/S				2002-05 EBITDA CAGR
		$US	$US		02	03E	04E	05E	02	03E	04E	05E	02	03E	04E	05E	
VSMPO-Avisma	Buy	89.0	150.0	1,064.1	24.3	11.1	7.7	6.0	10.7	7.4	5.1	3.8	3.7	2.6	1.9	2.7	37%
UGMK	Buy	60.0	100.0	304.3	neg	6.2	3.7	6.2	19.0	4.2	2.6	3.4	0.9	0.6	0.4	0.8	80%
Chelyabinsk Zinc	Buy	40.0	210.0	25.5	1.4	1.8	1.3	1.5	1.2	1.1	0.8	1.5	0.3	0.2	0.2	1.0	-1%
Russian Non-ferrous aver					**12.9**	**6.3**	**4.2**	**4.6**	**10.3**	**4.2**	**2.8**	**2.9**	**1.6**	**1.1**	**0.8**	**1.5**	
Peru Copper		51.7		4,133.8	68.2	52.7	42.6	37.6	21.5	15.5	16.7	18.1	6.2	6.0	5.7	5.5	9%
Titanium metals		80.0		254.4	neg	neg	10.1	8.5	28.7	25.3	13.1	9.5	0.7	0.7	0.6	0.7	40%
Boliden AB		0.8		134.6	7.8	79.2	5.4	5.0	9.9	15.5	7.6	8.8	0.1	0.1	0.1	0.1	2%
Compania de Minas Buenave		23.8		1,377.5	12.3	11.0	9.5	8.5	10.3	9.7	9.9	10.3	7.3	6.3	5.1	4.3	0%
Lonmin		19.8		2,793.7	15.1	13.3	11.2	9.8	8.3	6.8	6.2	6.8	4.0	3.6	3.4	3.2	7%
Inter metal and mining small-cap aver					**42.3**	**43.6**	**26.8**	**24.7**	**21.5**	**19.8**	**15.6**	**15.8**	**4.2**	**3.8**	**3.5**	**3.3**	
Disc/prem Rus small-capnon-fer to intr.peers					**229%**	**589%**	**536%**	**437%**	**109%**	**370%**	**449%**	**452%**	**161%**	**238%**	**316%**	**116%**	

Note: E = estimates. All figures for Russian stocks are Metropol research estimates; the rest are from IBES.
Market prices as of 05.10. 2004
Source: IBES, Metropol research

URALELECTROMED

Uralelectromed: Russia's second-largest copper producer. We initiate coverage of Uralelectromed with a BUY recommendation and a target price of $100, or 67% upside potential to the current market price. Uralelectromed is the largest subsidiary of UGM Holding (Uralskaya Metal and Mining Company), accounting for 56% of total group sales. The company produces 330 thousand tons of copper annually, and exports more than 60% of total production. UGMK is Russia's second-largest copper producer after Norilsk Nickel. UGMK Holding has interests in copper, iron ore mining, heavy machinery and construction. Total group sales in 2003 exceeded $1 billion. The holding has said it plans a London IPO in 2004–5.

High copper prices in 2004–5 should boost earnings. We project Uralelectromed's earnings at $762 million in 2004, with a 80% 3-year CAGR in 2002–5. The company is cheap by valuation, trading at a 2004 EV/EBITDA of 2.6 and a PE of 6.2, on our estimates.

Uralelectromed to increase copper production to 450,000 tons by 2007. Uralelectromed has announced plans to increase copper production to a record 450,000 tons by 2007 following installation of new smelting capacity. This increase will bring Uralelectromed's production very close to that of Norilsk Nickel, Russia's largest copper producer, with output of 478,000 tons in 2003. According to Uralelectromed's technical director, Constantin Plekhanov, Uralelectromed will increase copper production by 13.3% in 2004, to 340,000 tons, and to 380,000 tons in 2005. Uralelectromed also plans to increase production of copper wire rods to 355,000 tons by 2007, from 235,000 tons in 2003.

Consolidation of UGMK a potential risk to minorities. UGM management has announced plans to begin consolidating UGMK into the holding as early as later this year. The company has not yet clarified the consolidation terms. Although we believe that the process should result in a stronger company longer-term, we see some potential risks for minority shareholders of UGMK. First, the process could get bogged down. Continuing uncertainty could weigh down the stock price, in our view. We also see a risk that minority shareholders of UGM's subsidiary could be diluted or otherwise lose some of their investment value if the holding offers an unfair conversion ratio. However, this risk is mitigated by Uralelectromed's cheap valuation, in our view. There could even be some surprise on the upside if the holding offered favorable conversion terms. The process will also include full consolidation of all of the holding's 15 other subsidiaries. Consolidation should at the very least make the company's accounts more transparent.

Access to resources: well-supplied, but low quality. UGMK controls 100% of its copper ore needs through ownership of several copper mines. However, these mines contain relatively low-grade ore, with a copper content of only 0.8–1.0%/ton of ore. We believe these reserves will be enough to supply UGMK for only the next 10–15 years. (By contrast, Norilsk Nickel's rich grade copper reserves contain 2.5%/ton of copper, and should last for another 40 years.) Nevertheless, we do not consider the low ore quality to be a significant negative factor from an investment perspective, because the company's production costs are still sufficiently low to make the share attractive, in our view.

Udokan copper deposit crucial for long-term growth. Udokan is Irkutsk region's largest copper deposit, with total reserves of over 20 million tons, according to the Ministry of Natural Resources. UGMK has said it hopes to win an auction for the deposit this fall. Acquiring the deposit would give UGMK access to high-quality copper resources with a mining life of over 25 years, replacing the low-grade and nearly-depleted deposits UGMK currently utilizes in the Urals region.

Inefficient production. UGMK uses inefficient production technologies based on coke for smelting, with high \$1,200–\$1,300/ton production costs. (Norilsk Nickel, by comparison, uses gas smelting, giving production costs of only \$800–\$850/ton.)

UGMK controls the fuel resources it needs. UGMK has cost-efficient access to the fuel it needs, as it controls several coal mines. However, we believe it may need to acquire further coal assets in the medium term. At the same time, the company suffers from high \$0.018/Kwt electricity tariffs in the Urals region, compared with the Russian average of \$0.012 per Kwt.

Strong management and plans for an ADR bode well for stock price. We believe UGMK's management, under the leadership of CEO Andrei Kazitsyn, is relatively forward-looking. Although as part of a large metals holding the company's financials are not as transparent as they could be, we believe plans for a Level I ADR in 2004–5 should help this to improve. We also believe launch of the ADR should help to boost liquidity and the stock price. We recommend buying the stock before this expected revaluation.

VSMPO-AVISMA

VSMPO: dynamic titanium alloys producer. We initiate coverage of VSMPO with a BUY recommendation and a 12-month target price of \$150/share, implying 69% upside to the current market price. The company has good earnings growth potential, with a 2002–5 EBITDA CAGR of 37%, on our projections, in a period of global recovery in the aerospace industry.

Verkhnyaya Salda Metallurgical Production Association (VSMPO) is the world's largest integrated producer of titanium, aluminum, magnesium and nickel alloys and steels. VSMPO holds some 30% market share in global titanium products supply. VSMPO supplies titanium and metal alloys to over 260 companies from 39 countries worldwide, including Boeing and GM. The company produces titanium products and alloys for the aerospace, energy, chemical and automotive sectors, shipbuilding and construction, and exports more than 80% of total output. VSMPO recently sold a 10% stake to foreign portfolio investors, and has announced plans to issue an ADR later this year.

Output meets world standards. VSMPO produces titanium products that comply with international standards for a wide range of industries. The company also has unique equipment and technology that enables it to meet a wide variety of customer needs.

VSMPO commands a strong resource base. Following its acquisition of Avisma, Russia's largest titanium sponge producer, VSMPO now controls 100% of the titanium sponge supply it requires for production. Avisma exports some 15% of the sponge it produces, contributing some \$50-\$70 million to VSMPO-Avisma's consolidated sales.

VSMPO-AVISMA merger to complete by November 2004. At its recent AGM, VSMPO announced conversion ratios for its merger with Avisma. Every ordinary share of Avisma will be exchanged for two VSMPO shares, while each Avisma preferred share will be exchanged for one VSMPO share. VSMPO will issue an additional 1.3 million ordinary shares in the exchange, generating an acceptable 13% dilution for existing minority shareholders. We think the exchange will be positive for Avisma's existing shareholders, as they will either receive VSMPO shares or be able to sell their Avisma shares at a reasonable price. In our view, the merger of VSMPO and

Avisma will increase VSMPO's investment attractiveness for portfolio investors as the VSMPO-Avisma structure becomes clearer, and will reduce the risks for minority shareholders. In addition, the company has said it may launch a Level I ADR program in London after the merger.

Level I ADR plans this year. Management currently controls over 75% of the company, which has a very low 5–8% free float. However, VSMPO plans to issue a Level I ADR this year on 10–15% of total equity capital, which should help to boost liquidity. Also, ADR reporting requirements should help to improve transparency and corporate governance.

Slower-than-expected recovery in airline and auto sectors could hit growth. We believe slow recovery of the global airline and auto industries would mean slower growth in revenues for VSMPO. IBES projects 2002–5 EBITDA CAGR growth for titanium producers of about 8%, compared with 25% CAGR for steel producers and 15% for aluminum producers.

US import tariff hike on Russian titanium could result in small working capital shortage. The US Ministry of Trade, under pressure from the International Intellectual Property Alliance (IIPA), has announced a 15% hike in tariffs on US imports of Russian titanium in response to unlicensed production of high-tech products in Russia. VSMPO exports 60% of its titanium products to US customers, such as Boeing and GE, in long-term contracts. At the same time, according to VSMPO CEO Victor Breshet, the bulk of the company's titanium exports are to US producers who themselves are export-oriented. The US import duty may be reclaimed on any products that are subsequently exported. We estimate that the tariff hike could still cause a working capital shortfall of some $20–$50 million, as reclaiming the tariff would take time. VSMPO exports some $275 million worth of titanium products to the US.

CHELYABINSK ZINC

Chelyabinsk Zinc: a likely target for UGMK

We initiate coverage of Chelyabinsk Zinc with a BUY recommendation and a price target of $210, implying 600% upside potential from the current market price. This unusually high potential upside represents both the risks and rewards of owning the stock. While we project the share price rising to this level in the next 12 months if all goes well for the company, we also see a fairly high chance that our target will not be met if conditions go against the company. Also, the stock is quite illiquid, and so would not be appropriate for all investors. We see a 60% chance of the company meeting our price target within the 12-month period. Its low liquidity means that it is very sensitive to both buying and selling activity.

ChelZinc produces 2% of global zinc output. Chelyabinsk Zinc Plant is Russia's largest Zinc producer, accounting for 60% of total Russian production and 2% of world production. The company produced 155,000 tons of zinc in 2002. Chelyabinsk Zinc is dependent on ore supplied by mining deposits in the Urals controlled by UGMK. The company has strong cash flows and a healthy balance sheet, in our view. Both Norilsk Nickel and UGMK have expressed interest in acquiring a controlling stake in Chelyabinsk Zinc. We believe the company is very inexpensive at current valuations, trading on a 2003 EV/EBITDA of 1.1 and a historical PE of 1.8, compared with global industry averages of 19.8 and 43.6, respectively.

High projected world zinc prices through 2005, on IISI estimates, should boost ChelZinc's revenues. We forecast 2004 net profit of $24.3 million on revenues of $145 million. We also forecast a strong 3-year CAGR of 4% in 2003–6.

High quality output; modernization nearing completion. ChelZinc produces special high grade zinc of 99.995% purity, which complies with global quality standards. The company has almost replaced all its obsolete equipment with new machinery, thanks to some $300 million in capital expenditures in 2002–4. We believe this investment should help the company to reduce smelting costs.

Lack of ore supplies. Chelyabinsk Zinc does not own its resource base, a factor that we believe could lead to higher production costs in the medium term. The company buys most of the zinc concentrate it needs from European suppliers. Zinc concentrate prices rose 14% in 2003 and another 20% in the first half of 2004. Nevertheless, we project ChelZinc's net profit margins remaining high at 16–18% through 2004–5 .

Low free float means wide spreads. ChelZinc has a very low free float of only 1–2% of total share capital, resulting in a wide bid/ask spread. (The stock commonly trades with a large % spread of some $40/share between the bid and asked prices). The stock's exceedingly low liquidity is obviously a risk factor. However, we would expect to see a rise in liquidity and the share price if a potential strategic investor began showing interest in the company.

Strong domestic competition from CIS producers. ChelZinc faces strong competition from low-cost producers in Kazakhstan and Uzbekistan for the company's principal domestic consumers, including NLMK and Severstal, which use zinc in their production of galvanized flat steel.

Management not focused on ChelZinc's strengths. ChelZinc is controlled by Chelyabinsk Pipe Company (ChTPZ), which holds an 87% stake in the company. However, ChTPZ does not consider ChelZinc a core business. We believe as a result that the company may suffer from poor management and lack of attention to cost-control. ChTPZ management has indicated plans to sell off its stake in ChelZinc.

Potential takeover poses risks to both up- and downside. Chelyabinsk Zinc has a good location close to major European markets, a clear corporate structure and a limited number of minority shareholders. We believe the company could become an acquisition target for a Russian or foreign metals producer.

Tolling schemes: a major weak spot.
The company receives some 50% of revenues from tolling schemes, which we believe could come under scrutiny from the Russian authorities in future. As the company does not control its own raw zinc reserves, it must buy raw materials abroad. As a result, the company sometimes processes third parties' zinc concentrate, returning metallic zinc and taking a commission for smelting. According to a new tolling law accepted by the Russian Government in March, 2004, companies using tolling schemes of this sort must pay VAT on export of the finished product. We believe the new VAT charges could harm ChelZinc's working capital structure.

COMPANY PROFILES

Norilsk Nickel

BUY

Price: $65
Target price: $82

We initiate coverage of Norilsk Nickel with a BUY recommendation and a 12-month target price of $82. We see 26% upside potential to the current market price, and project 14% CAGR for sales in 2002–5. The company had a 2003 EBITDA margin of 37%, and an attractive valuation compared with international peers. We project strong earnings growth in 2004. Through recent acquisitions, the company appears to be positioning itself close to international diversified peers with interests in nickel, copper, precious metals and utility assets. We believe this strategy should help the company to create a more balanced earnings structure.

INVESTMENT DRIVERS

- **Becoming more investor-friendly.** Publication of 2001–3 IAS results, a new corporate governance charter and a strategic development plan indicate improved openness.

- **Precious metal reserves disclosures.** Detailed reports on the company's platinum and palladium reserves, expected later this year, should reveal strong value potential.

- **Increasing efficiency through better cost control.** Recent acquisition of Krasnoyarskenergo, NorilskGazprom and Krasnoyarsk River Shipping, as well as a reorganized global trading system, should help trim costs.

- **Consolidation of gold assets: key to growth.** Plans to consolidate all gold assets into subsidiary Polyus should boost shareholder value, in our view.

INVESTMENT RISKS

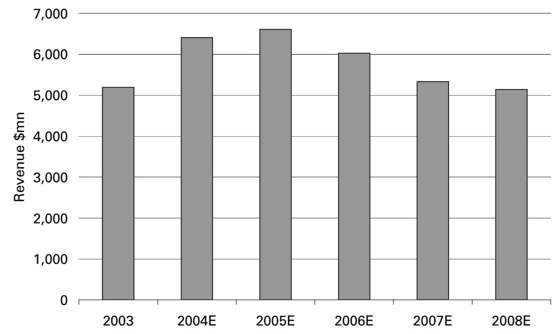
- **Weak palladium price to hit earnings in 2003–4.**

- **We project falling nickel production in 2004–6.**

- **Export licensing requirements and quotas limit revenues.**

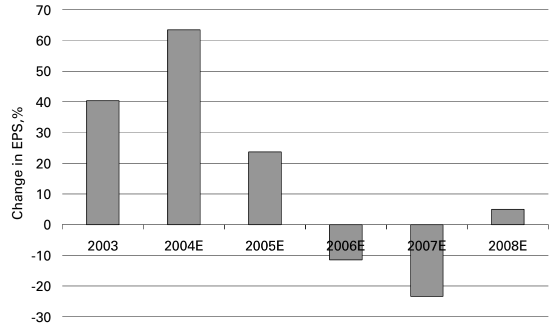
- **Russian oligarch risk: is Potanin next?** There is potential for investigation into Norilsk Nickel's privatization.

Norilsk Nickel: Revenue Projections, 2003–2008E



Source: Metropol

Norilsk Nickel: EPS Projections, 2003–2008E



Source: Metropol

Norilsk Nickel: DCF Summary, 2003–2010E (US$ mn)

PROJECTED CASH FLOWS	2003	2004E	2005E	2006E	2007E	2008E	2009E	2010E	CAGR
Revenue	$5,192.0	$6,410.1	$6,606.9	$6,023.7	$5,333.1	$5,142.1	$5,541.5	$5,950.7	8.5%
Annual Growth	67.8%	23.5%	3.1%	-8.8%	-11.5%	-3.6%	7.8%	7.4%	
EBITDA	1,933.1	2,744.7	3,142.2	2,842.4	2,294.9	2,246.9	2,354.9	2,688.4	10.7%
Annual Growth	61.8%	42.0%	14.5%	-9.5%	-19.3%	-2.1%	4.8%	14.2%	
Margin	37.2%	42.8%	47.6%	47.2%	43.0%	43.7%	42.5%	45.2%	
Unleveraged Net Income	921.6	1,363.8	1,631.2	1,406.4	1,025.4	995.2	1,063.3	1,273.3	12.1%
Annual Growth	80.8%	48.0%	19.6%	-13.8%	-27.1%	-2.9%	6.8%	19.8%	
Margin	17.8%	21.3%	24.7%	23.3%	19.2%	19.4%	19.2%	21.4%	
Plus: Depreciation & Amortization	470.2	580.0	552.9	610.1	667.2	667.2	667.2	667.2	
Less: Capital Expenditures	(466.0)	(550.0)	(750.0)	(850.0)	(750.0)	(700.0)	(750.0)	(750.0)	
Change in Working Capital	(391.5)	(118.0)	(392.0)	(171.5)	256.8	107.5	(144.6)	(142.8)	
Social Expenses	21.0	18.1	18.1	18.1	18.1	18.1	18.1	18.1	
Free Cash Flow	555.3	1,293.9	1,060.2	1,013.0	1,217.5	1,088.0	854.0	1,065.9	9.7%

PRESENT VALUE OF EQUITY	
PV of FCF 2002-2006	$3,789.6
PV of Terminal Value	14,852.8
Enterprise Value	18,642.4
- ST & LT Debt & Taxes Owed	(1,538.0)
- Preferred Equity	-
+ Cash	424.0
Equity Value	17,528.4
Common Shares	213,905
Value Per Share	**$82**

DCF ASSUMPTIONS	
WACC	10.3%
Terminal Growth Rate	5.0%
EBITDA % Plan Realized	100%
Tax Rate	37.0%

WACC	
Risk-free rate (10y Rus)	6.29%
Corporate spread	1%
ERP	6%
Beta	0.75
Cost of Equity	10.8%
Cost of Debt	7.3%
Cost of preferred	9.0%
D/E	8.8%
D/A	8.1%
P/A	0.0%
WACC	**10.28%**

E = Metropol research estimates
Source: Company data, Metropol research

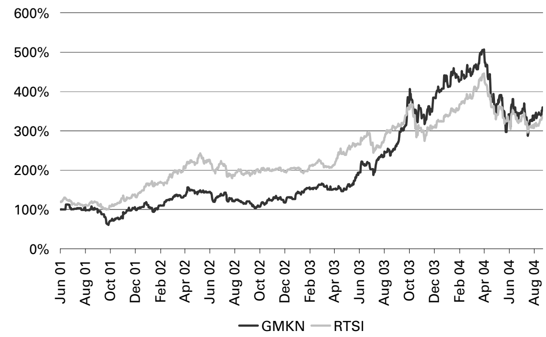
Norilsk Nickel: Production and Financial Data, 2003–2008E

	2003	2004E	2005E	2006E	2007E	2008E
Sales (000 ton)						
Nickel	300	237	244	245	245	245
Copper	480	470	480	489	480	489
Platinum	27	27	26	27	27	26
Palladium	96	103	103	103	103	103
Gold	30	37	55	81	108	130
Total	**933**	**874**	**908**	**946**	**963**	**993**
YoY growth, %	11%	-6%	4%	4%	2%	3%
Product exports, % of prod. output	88%	88%	88%	88%	88%	88%
Income Statement (000 $)						
Revenues	5,192	6,410	6,607	6,024	5,333	5,142
Operating costs	(2,448)	(2,708)	(2,578)	(2,414)	(2,358)	(2,240)
Operating profit	2,744	3,702	4,029	3,610	2,975	2,902
Pretax profit	1,268	2,034	2,522	2,229	1,702	1,727
Net income	**820**	**1,340**	**1,658**	**1,467**	**1,124**	**1,141**
EBITDA	1,933	2,745	3,142	2,842	2,295	2,247
Cash Flow Statement (000 $)						
Operating cash flow	**1,290**	**1,920**	**2,211**	**2,077**	**1,792**	**1,808**
Capex investment	(466)	(550)	(750)	(850)	(750)	(700)
Cash used for investing	**466**	**550**	**750**	**850**	**750**	**700**
Net change in cash	432	1,252	1,069	1,055	1,298	1,215
Free cash flow	**555**	**1,294**	**1,060**	**1,013**	**1,218**	**1,088**
Balance Sheet (000 $)						
Cash & Investments	856	1,350	985	1,025	1,210	1,211
Receiables(net)	640	790	815	743	658	634
Inventory	2,040	2,708	2,148	2,414	2,358	2,240
Other Current assets	1,142	1,410	1,454	1,325	1,173	1,131
Fixed assets	6,346	6,389	6,586	6,826	6,909	6,942
Other non-current assets	0	0	0	0	0	0
Total Assets	**11,134**	**13,515**	**14,289**	**15,649**	**16,738**	**17,802**
Accounts payable	604	668	636	595	582	552
Short-term debt	979	1,883	1,031	966	943	896
Other current liabilities	2,047	3,088	2,204	2,098	2,062	1,986
Long-term debt	804	804	804	804	804	804
Other LT liabilities	1,505	1,505	1,505	1,505	1,505	1,505
Shareholders' equity	**11,134**	**13,515**	**14,289**	**15,649**	**16,738**	**17,802**
Total Liabilities & Equity	**25,292**	**27,452**	**28,964**	**29,833**	**31,767**	**31,768**
Total Debt	1,783	2,687	1,835	1,770	1,747	1,700
Net Debt	927	1,337	850	745	537	489
Credit						
Net debt to equity %	8.3	9.9	6.0	4.8	3.2	2.7
Total debt to total capital %	16.0	19.9	12.8	11.3	10.4	9.5
Times interest earned	29	23	25	22	26	26
Cash coverage of fixed charges	25	22	25	27	28	28
Profitability (%)						
EBITDA margin	37	43	48	47	43	44
Operating margin	53	58	61	60	56	56
Net margin	16	21	25	24	21	22
Growth (%)						
Revenues	68	23	3	-9	-11	-4
Operating profit	79	11	-5	-6	-2	-5
EBITDA	62	42	14	-10	-19	-2
Net income	40	63	24	-12	-30	1
Return%						
ROE	7	10	12	9	7	6
ROCE	15	18	20	14	10	10
per ton $						
Revenues	5567	7333	7275	6369	5538	5176
Operating cost	2625	3098	2839	2553	2449	2255
Operating profit	2942	4235	4436	3817	3089	2922
EBITDA	2073	3140	3460	3005	2383	2262
Net income	879	1533	1825	1551	1167	1148
Operating CF	1383	2196	2434	2196	1860	1820
Capex	500	629	826	899	779	705
Free CF	595	1480	1167	1071	1264	1095

E = Metropol research estimates

Source: Company data, Metropol research

Norilsk Nickel: Share Price Performance, 2001–4



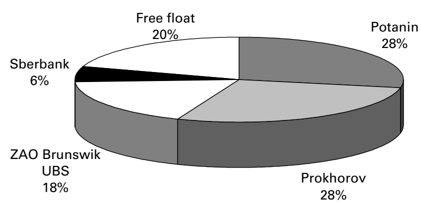
Source: Bloomberg

Norilsk Nickel: Company and Per-share Information

Market Cap ($mn)	11,765	**52-week High ($)**	81
Avg Daily Volume ($ mn)	15	**52-week Low ($)**	30
Shares Outstanding (mn)	214	**Annual Div. ($)**	1.5
Free Float (%)	26	**Div. Yield (%)**	2.7
Free Float ($ mn)	3054	**Pay-out (%)**	25
ADR Ratio:	1:1	**ADR Free Float (%)**	18

Source: Bloomberg, Metropol research

Norilsk Nickel: Shareholder Structure



Source: Company data

Norilsk Nickel: Valuation Summary, 2003E–2008E

	2003	2004E	2005E	2006E	2007E	2008E
Valuation ratios						
P/E	17	11	9	10	13	12
P/S	3	2	2	2	3	3
P/Book	1	1	1	1	1	1
EV/EBITDA	7	5	5	5	5	7
EV/Sales	3	2	2	2	2	2
EV/Production	15	16	16	15	12	13
Key drivers						
Production growtl	11	-6	4	4	2	3
Export Growth	57	46	3	-9	-11	-10
Revenue growth	68	23	3	-9	-11	-11
Operating margin	53	58	61	60	56	56
Net margin	16	21	25	24	21	22
EPS growth	40	63	24	-12	-23	5
EBITDA growth	62	42	14	-10	-19	-2

Source: Metropol research

Norilsk Nickel: Management and Headquarters

Address	22 Voznesensky Pereulok, Moscow, 125009, Russia
Tel/Fax	Tel: +7 (095) 785 1090, Fax +7 (095) 797 8613
CEO	Mikhail D. Prokhorov
E-mail	polikarpovss@rao.nornik.ru
Web	www.nornickel.com
Auditors	Deloitte & Touche

Source: Company data, Metropol research

Severstal

BUY

Price: $203
Target price: $260

We initiate coverage of Severstal with a BUY recommendation and a 12-month target price of $260, or 28% potential upside from the current price. We consider Severstal the best pick in the Russian steel industry for liquidity, growth prospects and corporate governance. The company has made good progress in sourcing its own raw iron ore and coke, and now buys only 20% and 35% of its iron and coke needs, respectively. Severstal had a strong 32% EBITDA margin in 2003 and good growth prospects, with 15% compound annual EBITDA growth in 2002–6, on our estimates. We believe the company should be revalued, approaching the emerging markets ferrous metals industry average 2004 EV/EBITDA of some 7.0. The company has recently acquired 100% of bankrupt US steel producer Rouge Industries, gaining access to American auto producers.

INVESTMENT DRIVERS

- **We project strong financial results in 2004.** We see 2004 EBITDA margin at 42%, 2004 EV/EBITDA of 2.1 and strong 3-year 2003–6 EBITDA CAGR at 15%.

- **Good dividend payout.** Severstal announced generous 2003 full-year dividends of $14.13 per common share, for a 9.4% dividend yield. We expect the company to pay full-year 2004 dividends of $11/share, for a DY of 5.6% and a payout ratio of 25% of IAS net profit. Severstal also pays quarterly interim dividends.

- **GDR should boost liquidity.** We expect the company to extend its GDR program from 11% to 20% of shares in issue by the end of this year.

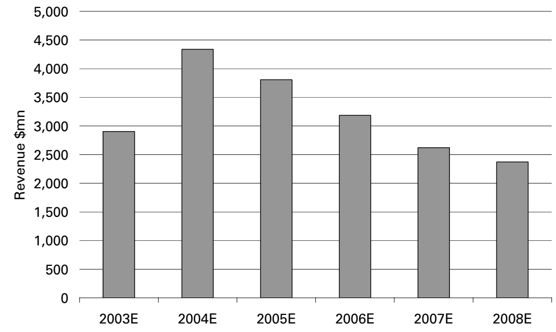
- **US acquisition boosts access to American market.** Severstal's acquisition of US steel producer Rouge Industries should help to increase access to the American market.

INVESTMENT RISKS

- **Controlling shareholder risk.** Severstal is still controlled by a single shareholder, Alexey Mordashov, who holds a 17% stake.

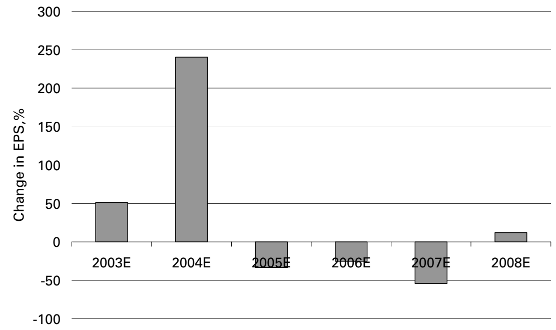
- **Non-core assets burden the bottom line.** Severstal Auto and several other non-core subsidiaries are a drag on the company's finances, in our view.

Severstal: Revenue Projections, 2003–2008E



Source: Bloomberg

Severstal: EPS Projections, 2003–2008E



Source: Bloomberg

Severstal: DCF Summary, 2003–2010E (US$ mn)

PROJECTED CASH FLOWS	**2003**	**2004E**	**2005E**	**2006E**	**2007E**	**2008E**	**2009E**	**2010E**	**CAGR**
Revenue	$3,201.8	$4,839.3	$4,171.6	$3,151.4	$2,593.9	$2,345.9	$2,580.7	$2,522.9	5.2%
Annual Growth	41.0%	51.1%	-13.8%	-24.5%	-17.7%	-9.6%	10.0%	-2.2%	
EBITDA	1,012.0	2,033.8	1,470.4	874.3	534.5	269.6	480.8	400.9	9.2%
Annual Growth	194.3%	101.0%	-27.7%	-40.5%	-38.9%	-49.6%	78.3%	-16.6%	
Margin	31.6%	42.0%	35.2%	27.7%	20.6%	11.5%	18.6%	15.9%	
Unleveraged Net Income	647.8	1,462.8	981.7	474.7	177.8	(39.4)	133.8	68.3	-8.8%
Annual Growth	129.7%	125.8%	-32.9%	-51.6%	-62.5%	-122.1%	-439.7%	-49.0%	
Margin	20.2%	30.2%	23.5%	15.1%	6.9%	-1.7%	5.2%	2.7%	
Plus: Depreciation & Amortization	-	249.9	273.2	295.4	317.6	317.6	317.6	317.6	
Less: Capital Expenditures	(180.0)	(220.0)	(200.0)	(200.0)	(200.0)	(202.0)	(200.0)	(200.0)	
Change in Working Capital	(325.9)	(354.4)	188.3	280.4	153.9	71.1	(80.5)	17.3	
Free Cash Flow	134.8	1,131.1	1,236.1	843.4	442.3	140.2	163.7	196.1	19.0%

PRESENT VALUE OF EQUITY	
PV of FCF 2002-2006	$2,782.2
PV of Terminal Value	3,834.1
Enterprise Value	6,616.3
- ST & LT Debt & Taxes Owed	(1,099.0)
- Preferred Equity	-
+ Cash	229.9
Equity Value	5,747.1
Common Shares	22,074
Value Per Share	**$260**

DCF ASSUMPTIONS	
WACC	10.7%
Terminal Growth Rate	3.5%
EBITDA % Plan Realized	100%
Tax Rate	18.0%

WACC	
Risk-free rate (10y Rus Eu	6.20%
Corporate spread	2%
ERP	6%
Beta	0.88
Cost of Equity	11.5%
Cost of Debt	8.2%
Cost of preferred	9.8%
D/E	19.1%
D/A	16.1%
P/A	0.0%
WACC	**10.72%**

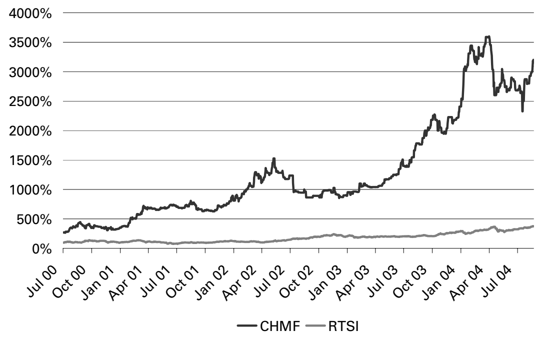
E = Metropol research estimates
Source: Company data, Metropol research

Severstal: Production and Financial Data, 2003–2008E

	2003	2004E	2005E	2006E	2007E	2008E
Production (000 ton)						
HR Sheet	4,164	4,455	4,634	4,309	4,094	4,217
CR Sheet	2,680	2,814	2,898	2,782	2,727	2,781
HR Sections	1,638	1,720	1,771	1,701	1,667	1,683
Cold Formed profikes and sheets	318	334	344	327	317	320
Total rolled steel	8,800	9,323	9,648	9,119	8,804	9,001
Total Crude Steel	**10,500**	**11,124**	**11,511**	**10,881**	**10,505**	**10,740**
YoY growth	4%	6%	3%	-5%	-3%	2%
Product exports, % of prod. Output	47%	40%	42%	45%	45%	45%
Income Statement						
Revenues	3,202	4,839	4,172	3,151	2,594	2,346
Operating costs	(1,914)	(2,178)	(2,173)	(1,852)	(1,706)	(1,754)
Operating profit	1,288	2,661	1,999	1,300	888	592
Pretax profit	760	1,747	1,236	685	357	109
Net income	**591**	**1,355**	**957**	**527**	**272**	**78**
EBITDA	1,012	2,034	1,470	874	535	270
Cash Flow Statement						
Operating cash flow	**591**	**1,355**	**957**	**527**	**272**	**78**
Capex investment	(180)	(220)	(200)	(200)	(200)	(202)
Cash used for investing	**(244)**	**(312)**	**(163)**	**(143)**	**(169)**	**(188)**
Net change in cash	21	939	1,255	960	574	279
Free cash flow	**135**	**1,131**	**1,236**	**843**	**442**	**140**
Balance Sheet						
Cash & Investments	464	620	420	375	425	426
Receiables(net)	355	398	343	259	213	193
Inventory	361	411	410	349	322	331
Other Current assets	650	968	834	630	519	469
Fixed assets	1,926	1,896	1,823	1,727	1,610	1,494
Other non-current assets	179	271	234	176	145	131
Total Assets	**3,933**	**5,345**	**6,300**	**6,759**	**6,999**	**7,088**
Accounts payable	262	298	298	254	234	240
Short-term debt	144	163	163	139	128	132
Other current liabilities	85	85	85	85	85	86
Long-term debt	970	970	970	970	970	970
Other LT liabilities	36	36	36	36	36	36
Shareholders' equity	**2,079**	**3,434**	**4,391**	**4,918**	**5,189**	**5,266**
Total Liabilities & Equity	**25,292**	**27,452**	**28,964**	**29,833**	**31,767**	**31,768**
Total Debt	1,114	1,133	1,133	1,109	1,098	1,102
Net Debt	650	513	713	734	673	676
Credit						
Net debt to equity %	31	15	16	15	13	13
Total debt to total capital %	54	33	26	23	21	21
Times interest earned	59	251	-17	-4	-1	0
Cash coverage of fixed charges	1	1	1	1	0	-1
Profitability						
EBITDA margin %	32	42	35	28	21	11
Operating margin	40	55	48	41	34	25
Net margin	18	28	23	17	10	3
Growth						
Revenues	41	51	-14	-24	-18	-10
Operating profit	27	14	0	-15	-8	3
EBITDA	194	101	-28	-41	-39	-50
Net income	213	129	-29	-45	-48	-71
Return						
ROE, %	28	39	22	11	5	1
ROCE, %	22	36	20	9	3	-1
per tonne						
Revenues	304.9	435.0	362.4	289.6	246.9	218.4
Operating cost	182.3	195.8	188.8	170.2	162.4	163.3
Operating profit	122.7	239.2	173.6	119.4	84.6	55.1
EBITDA	96.4	182.8	127.7	80.4	50.9	25.1
Net income	**56.3**	**121.8**	**83.1**	**48.4**	**25.8**	**7.3**
Operating CF	56.3	121.8	83.1	48.4	25.8	7.3
Capex	17.1	19.8	17.4	18.4	19.0	18.8
Free CF	**12.8**	**101.7**	**107.4**	**77.5**	**42.1**	**13.1**

Source: Company data, Metropol research estimates

Severstal: Share Price Performance, 2000–2004



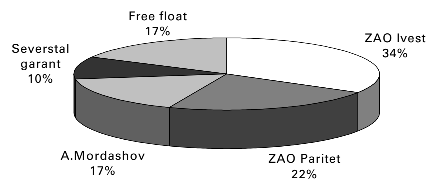
Source: Bloomberg

Severstal: Company and Per-share Information

Market Cap ($ mn)	3,311	**52-week High ($)**	200
Avg. Daily Volume ($ mn)	0.5	**52-week Low ($)**	76
Shares Outstanding (mn)	22	**Annual Div. ($)**	7.5
Free float (%)	17	**Div. Yield (%)**	4.5
Free Float ($ mn)	563	**Payout (%)**	45
ADR Ratio	1:1	**ADR Free-float (%)**	8

Source: Bloomberg, company data

Severstal: Shareholder Structure



Source: Company

Severstal: Valuation Summary, 2003E–2008E

	2003	2004E	2005E	2006E	2007E	2008E
Valuation ratios						
P/E	7.6	3.3	4.7	8.5	16.5	neg
P/S	1.0	0.7	0.7	1.4	1.7	1.9
P/Book	1.1	0.8	0.7	0.7	0.6	0.6
EV/EBITDA	5.1	2.1	3.2	6.0	9.6	19.1
EV/Sales	1.6	1.0	1.2	1.7	2.0	2.2
EV/Production	488.7	449.0	451.2	479.3	490.6	480.1
Key drivers %						
Production growth	3.5	5.9	3.5	-5.5	-3.5	2.2
Export Growth	36.3	38.3	-4.9	-16.3	-17.7	-9.6
Revenue growth	41.0	51.1	-13.8	-24.5	-17.7	-9.6
Operating margin	40.2	55.0	47.9	41.2	34.2	25.2
Net margin	18.5	28.0	22.9	16.7	10.5	3.3
EPS growth	212.7	129.4	-29.4	-44.9	-48.5	12.0
EBITDA	194.3	101.0	-27.7	-40.5	-38.9	11.0

Source: Metropol research

Severstal: Management and Headquarters

Address	Mira street 30, Cherepovets, Vologda Region, 162600, Russia.
Tel/Fax	Tel: +7-8202-531261 Fax: +7-8202-533010
CEO	Alexey A. Mordashov
E-mail	infodep@stal.ru
Web	www.severstal.ru
Auditors	KPMG

Source: Company data

NLMK

BUY

Price: $1.11
Target price:$1.27

NLMK Steel is our favorite second-tier ferrous metals producer. We initiate on the company with a BUY recommendation and a 12-month price target of $1.27, for some 14% potential upside to the current price. NLMK is the most profitable and least expensive stock in the sector, with a projected 2004 EV/EBITDA of 2.2 and 2004 PE of 4.7 on our estimates. One drawback to holding the stock is that the company plans no new share offerings in the medium term, so its low liquidity is likely to continue.

INVESTMENT DRIVERS

- **NLMK is the cheapest and most profitable** of Russia's steel producers, with a projected 2004 EBITDA margin of 48%, on our estimates.

- **The company produces high-value products,** including cold-rolled and galvanized steel sheet and profiles, of which 30% by total revenue is sold to EU and US markets.

- **Flexible production and distribution policy** NLMK's flexible production process allows the company to increase sales of higher-priced products such as slab and pig iron during periods of consumption growth.

- **Good raw materials supply should help to control costs.** The company controls a sufficient supply of raw materials, which should allow it to control costs.

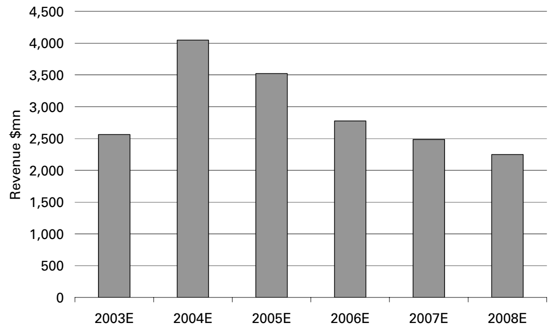
- **High-quality management team.**

- **Acquisition plans should boost value.** NLMK plans several acquisitions to create horizontal integration, which we believe should boost shareholder value.

INVESTMENT RISKS

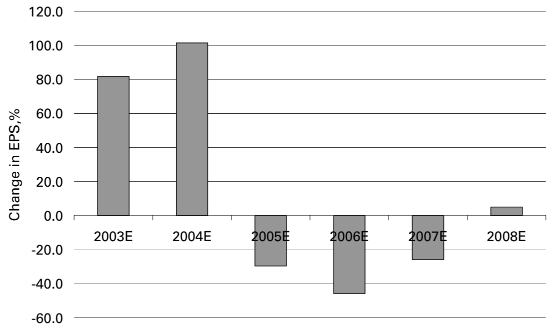
- **Low liquidity hinders share price.** NLMK management plans no shares offerings in the near future, so we expect its share liquidity to remain low. We see the shares' low liquidity as a factor likely to keep its stock price low. However, there is huge potential for a re-rating, should management begin to improve liquidity, information flow and corporate governance.

NLMK: Revenue Projection, 2003–2008E



Source: Metropol research

NLMK: EPS Projection, 2003–2008E



Source: Metropol research

NLMK: DCF Summary, 2003–2010E ($ mn)

PROJECTED CASH FLOWS	2003	2004E	2005E	2006E	2007E	2008E	2009E	2010E	CAGR
Revenue	$2,562.1	$4,072.2	$3,684.1	$2,775.3	$2,482.9	$2,248.2	$2,432.6	$2,627.6	13.4%
Annual Growth	49.7%	58.9%	-9.5%	-24.7%	-10.5%	-9.5%	8.2%	8.0%	
EBITDA	1,017.4	1,943.3	1,603.4	935.3	799.9	521.3	929.3	1,038.8	5.5%
Annual Growth	65.9%	91.0%	-17.5%	-41.7%	-14.5%	-34.8%	78.3%	11.8%	
Margin	39.7%	47.7%	43.5%	33.7%	32.2%	23.2%	38.2%	39.5%	
Unleveraged Net Income	613.8	1,270.9	994.5	477.9	354.0	150.6	448.5	528.4	0.8%
Annual Growth	80.1%	107.1%	-21.8%	-51.9%	-25.9%	-57.4%	197.7%	17.8%	
Margin	24.0%	31.2%	27.0%	17.2%	14.3%	6.7%	18.4%	20.1%	
Plus: Depreciation & Amortization	176.7	202.2	241.1	280.7	315.0	315.0	315.0	315.0	
Less: Capital Expenditures	(138.0)	(220.0)	(324.0)	(230.0)	(250.0)	(250.0)	(250.0)	(250.0)	
Change in Working Capital	(151.3)	(286.8)	71.7	170.7	56.5	36.0	(58.4)	(46.8)	
Free Cash Flow	502.4	967.6	984.5	700.5	476.7	252.8	456.2	547.8	12.0%

PRESENT VALUE OF EQUITY	
PV of FCF 2002-2006	$2,671.0
PV of Terminal Value	4,495.7
Enterprise Value	7,166.7
- ST & LT Debt & Taxes Owed	(19.2)
- Preferred Equity	-
+ Cash	433.7
Equity Value	7,581.2
Common Shares	5,987,240
Value Per Share	**$1.27**

DCF ASSUMPTIONS	
WACC	11.5%
Terminal Growth Rate	5.0%
EBITDA % Plan Realized	100%
Tax Rate	27.0%

WACC	
Risk-free rate (10y Rus E	6.24%
Corporate spread	5%
ERP	6%
Beta	0.87
Cost of Equity	11.5%
Cost of Debt	11.2%
Cost of preferred	11.4%
D/E	0.3%
D/A	0.3%
P/A	0.0%
WACC	**11.47%**

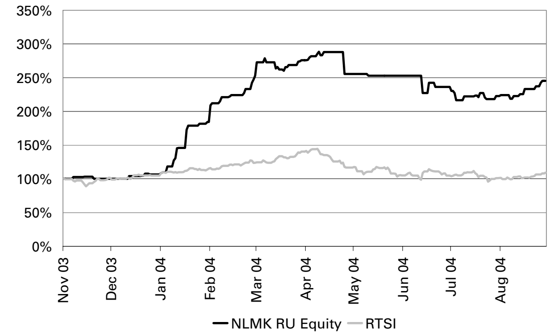
Source: Metropol research estimates

NLMK: Production and Financial Data, 2003–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Production (000 ton)						
HR Sheet	2,335	2,500	2,598	2,494	2,445	2,518
CR Sheet	2,176	2,285	2,353	2,283	2,237	2,304
Slabs	3,404	3,574	3,682	3,608	3,536	3,642
Coated Steel	0	0	0	0	0	0
Total	**7,915**	**8,359**	**8,633**	**8,385**	**8,217**	**8,464**
Total Crude Steel	**9,350**	**9,875**	**10,198**	**9,905**	**9,707**	**9,998**
YoY growth, %	5%	6%	3%	-3%	-2%	3%
Product exports, % of prod. output	60%	63%	64%	65%	65%	66%
Income Statement						
Revenues	2,562	4,072	3,684	2,775	2,483	2,248
Operating costs	(1,356)	(1,822)	(1,810)	(1,631)	(1,491)	(1,547)
Operating profit	1,206	2,251	1,875	1,144	992	701
Pretax profit	841	1,741	1,362	655	485	20[illegible]
Net income	**615**	**1,307**	**1,009**	**479**	**355**	**152**
EBITDA	1,017	1,943	1,603	935	800	52[illegible]
Cash Flow Statement						
Operating cash flow	**615**	**1,307**	**1,009**	**479**	**355**	**152**
Capex investment	(138)	(220)	(324)	(230)	(250)	(250
Cash used for investing	**(153)**	**(243)**	**(318)**	**(216)**	**(246)**	**(246**
Net change in cash	488	980	1,004	714	481	256
Free cash flow	**502**	**968**	**984**	**700**	**477**	**253**
Balance Sheet						
Cash & Investments	921	850	785	670	700	701
Receiables(net)	456	725	656	494	442	407
Inventory	271	364	362	326	298	309
Other Current assets	15	24	22	17	15	13
Fixed assets	1,129	1,147	1,230	1,179	1,114	1,049
Other non-current assets	38	61	55	42	37	34
Total Assets	**2,903**	**4,294**	**5,301**	**5,748**	**6,078**	**6,240**
Accounts payable	241	324	322	290	266	275
Short-term debt	4	5	5	5	4	5
Other current liabilities	17	17	17	17	17	17
Long-term debt	3	3	3	3	3	3
Other LT liabilities	2	2	2	2	2	2
Shareholders' equity	**2,606**	**3,913**	**4,923**	**5,402**	**5,757**	**5,909**
Total Liabilities & Equity	**25,292**	**27,452**	**28,964**	**29,833**	**31,767**	**31,768**
Total Debt	7	8	8	8	7	8
Net Debt	(914)	(842)	(777)	(662)	(693)	(693)
Credit						
Net debt to equity %	35	22	16	12	12	12
Total debt to total capital %	0	0	0	0	0	0
Times interest earned	0	0	0	0	0	0
Cash coverage of fixed charges	25	22	25	27	28	28
Profitability						
EBITDA margin %	40	48	44	34	32	23
Operating margin	47	55	51	41	40	31
Net margin	24	32	27	17	14	7
Growth						
Revenues	50	59	-10	-25	-11	-9
Operating profit	43	34	-1	-10	-9	4
EBITDA	66	91	-17	-42	-14	-35
Net income	82	113	-23	-53	-35	-134
Return						
ROE, %	24	33	21	9	6	3
ROCE, %	33	45	28	12	8	4
per ton						
Revenues	274.0	412.4	361.2	280.2	255.8	224.9
Operating cost	145.0	184.5	177.4	164.7	153.6	154.7
Operating profit	129.0	227.9	183.8	115.5	102.2	70.1
EBITDA	108.8	196.8	157.2	94.4	82.4	52.1
Net income	**65.8**	**132.4**	**99.0**	**48.4**	**36.6**	**15.2**
Operating CF	65.8	132.4	99.0	48.4	36.6	15.2
Capex	14.8	22.3	31.8	23.2	25.8	25.0
Free CF	**53.7**	**98.0**	**96.5**	**70.7**	**49.1**	**25.3**

Source: Company data

NLMK: Share Price Performance, 2000–4

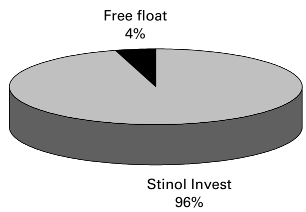


Source: Bloomberg

NLMK: Company and Per-share Information

Market Cap ($ mn)	4,490	**52-wk High ($)**	0.3
Avg. Daily Volume ($mn)	0.1	**52-wk Low ($)**	1.0
Shares Outstanding (mn)	5,987	**Annual Div. ($)**	0.02
Free Float (%)	4	**Div. Yield (%)**	2.8
Free Float ($ mn)	198	**Payout (%)**	18

NLMK: Shareholder Structure



Source: Company

NLMK: Valuation Summary, 2003–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Valuation ratios						
P/E	10.8	5.1	6.6	13.9	18.7	43.8
P/S	2.6	1.6	1.8	2.4	2.7	3.0
P/Book	2.3	1.5	1.3	1.2	1.1	1.1
EV/EBITDA	5.6	2.4	3.6	6.4	7.4	11.4
EV/Sales	2.2	1.4	1.6	2.2	2.4	2.6
EV/Production	613	588	576	604	613	595
Key drivers						
Production growth	5.3	5.6	3.3	-2.9	-2.0	3.0
Revenue growth	49.7	58.9	-9.5	-24.7	-10.5	-9.5
Operating margin	47.1	55.3	50.9	41.2	39.9	31.2
Net margin	24.0	32.1	27.4	17.3	14.3	6.8
EPS growth	81.7	112.5	-22.8	-52.5	-25.9	5.0
EBITDA	65.9	91.0	-17.5	-41.7	-14.5	-34.8

Source: Metropol research

NLMK: Management and Headquarters

Address	2 Metalurgiv Str., Lipetsk, 398040
Tel/Fax	Tel: +70742-444006, Fax: 70742-432541
CEO	Vladimir Lisin
E-mail	info@nlmk.ru
Web	www.nlmk.ru
Auditors	Ernst & Young

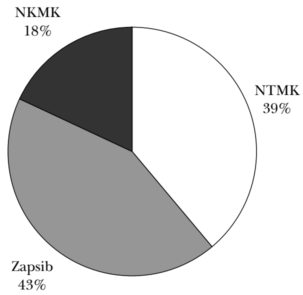
Source: Company data

EvrazHolding: Output by Subsidiary, 2003

Subsidiary	Product	Production '000 t 2003
NTMK	Long	5500.0
Zapsib	Long/Flat	5900.0
KMK	Long	3000.0
Vysokogorsky GOK	Iron ore	2.1
Nakhodkinsky shiping	n/a	n/a

Source: Bloomberg

EvrazHolding: Subsidiaries' Share in Total Production, 2003



Source: Company data

EvrazHolding

EvrazHolding is the biggest vertically-integrated metallurgical holding in Russia, producing a total of 12.3 thousand tons of rolled steel and metal semi-finished products for the construction and machine-building sectors, with annual sales of over $2.5 billion. The holding consists of three enterprises: Nizhny Tagil metallurgical plant (NTMK), Western Siberian Metallurgical Plant (Zapsib) and Novokuznetsk Metallurgical Plant. EvrazHolding controls a 75–95% stake in each of the three enterprises. Although the holding has no tradable stock, we include it here to help investors better understand ownership of the sector.

Through NTMK, EvrazHolding has a domestic monopoly in rail production. China and neighboring Asian countries are its core export markets, buying some 40% of the company's exports. The holding makes about 55% of total revenues from exports.

Management has announced some details of the company's M&A strategy. EvrazHolding plans to concentrate on acquiring iron ore and coal mining assets (GOKs), as well as on adding to its portfolio of transport and general infrastructure assets in Western Siberia, in order to reduce costs and ensure stability of production. The holding recently acquired Russia's fourth-largest iron ore mining plant, Kachkanarsky GOK, and holds a controlling stake in Nakhodkinsky Shipping Company. The holding has announced plans for its long-term development program, including more than $300 million worth of acquisitions over the next five years.

EvrazHolding has made it clear that it is not interested in the equity markets in the near future. The company is not considering an international IPO program, nor does it see any need for efforts to boost the market cap of its subsidiaries. Instead, the company sees real benefits for minority shareholders in actively building value through capex and efficiency gains. EvrazHolding shares are not publicly traded; instead, the company is represented on the stock market by its two major subsidiaries, NTMK and Zapsib, which trade on RTS.

EvrazHolding published consolidated 2003 IAS results in July.

NTMK HOLD

Price: $0.87
Target price: $0.95

NTMK: rapidly-growing steel producer, but upside limited. We are initiating coverage of NTMK with a speculative HOLD rating and a fair value of $0.95/share. Nizhny Tagil Metallurgical Plant (NTMK) is one of the three subsidiaries of EvrazHolding, and the largest maker of long products in Russia. EvrazHolding owns 74% of the company through three offshore holding companies (Please see 'NTMK Shareholder Structure' in this section). NTMK has a free float of 14%. The company currently trades on a 2003 EV/EBITDA of 5.2 and a 2003 PE of 15.4.

INVESTMENT DRIVERS

- **Growing demand to boost sales.** NTMK should benefit from rapidly-growing demand for long products in Russia and abroad.

- **Improved technology should boost margins.** The company has completed several technological and equipment upgrades, and hopes to improve operating margins in 2003–4 to 33–28% from 23% in 2003.

- **Monopoly supplier of rails to Russia's railroads.** NTMK holds a monopoly over production of rails for Russia's railroads.

- **Control of raw materials means good cost-control.** NTMK controls 100% of the high-quality coal resources, and some 75% of the iron ore, that it requires for production, enabling the company to control operating costs.

INVESTENT RISKS

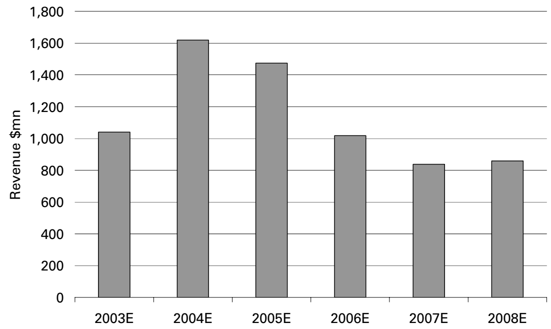
- **High capex requirements.** More capex is needed to replace obsolete equipment and technology.

- **High price sensitivity.** High dependence on domestic market prices and Chinese demand.

- **Transfer-pricing and collateral risks.** NTMK sells steel products to EvrazHolding at below-market prices, reducing profitability (please see Exhibit 35) and draining value from minority shareholders. Also, some of the holding's general credit liabilities are secured by NTMK assets.

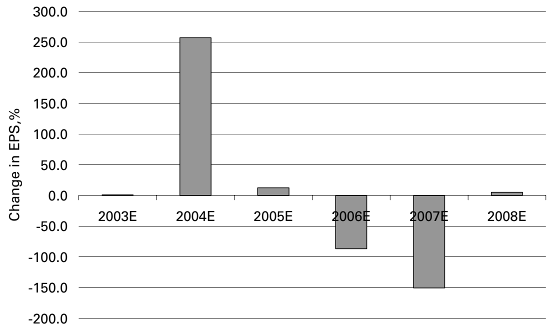
- **Poor corporate governance.** Most of the shares are controlled by company management, particularly by EvrazHolding CEO Alexander Abramov.

NTMK: Revenue Projection, 2003–2008E



Source: Metropol research

NTMK: EPS Projection, 2003–2008E



Source: Metropol research

NTMK: DCF Summary, 2003–2010E (US$ mn)

PROJECTED CASH FLOWS	**2003E**	**2004E**	**2005E**	**2006E**	**2007E**	**2008E**	**2009E**	**2010E**	**CAGR**
Revenue	$1,040.1	$1,618.4	$1,473.8	$1,018.1	$838.2	$858.6	$925.2	$995.3	5.9%
Annual Growth	28.3%	55.6%	-8.9%	-30.9%	-17.7%	2.4%	7.8%	7.6%	
EBITDA	234.8	528.8	588.9	261.2	148.8	235.6	265.2	297.3	4.6%
Annual Growth	97.7%	125.2%	11.4%	-55.6%	-43.0%	58.3%	12.6%	12.1%	
Margin	22.6%	32.7%	40.0%	25.7%	17.8%	27.4%	28.7%	29.9%	
Unleveraged Net Income	89.9	283.2	316.0	82.9	(3.0)	56.3	76.5	98.3	-164.6%
Annual Growth	240.8%	215.1%	11.6%	-73.8%	-103.6%	-1999.2%	35.8%	28.5%	
Margin	8.6%	17.5%	21.4%	8.1%	-0.4%	6.6%	8.3%	9.9%	
Plus: Depreciation & Amortization	103.6	115.4	127.6	140.2	153.1	153.3	153.5	153.8	
Less: Capital Expenditures	(70.0)	(72.1)	(74.3)	(76.5)	(78.8)	(81.1)	(83.6)	(86.1)	
Change in Working Capital	9.8	(14.4)	(14.9)	24.3	7.0	(11.2)	(0.9)	(1.0)	
Social Expenses	-	-	-	-	-	-	-	-	
Free Cash Flow	133.3	312.1	354.4	170.8	78.4	117.3	145.6	165.0	3.8%

PRESENT VALUE OF EQUITY	
PV of FCF 2002-2006	$798.3
PV of Terminal Value	557.8
Enterprise Value	1,356.1
- ST & LT Debt & Taxes Owed	(129.9)
- Preferred Equity	-
+ Cash	13.9
Equity Value	1,240.1
Common Shares	1,310,003
Value Per Share	**$0.95**

DCF ASSUMPTIONS	
WACC	10.6%
Terminal Growth Rate	2.0%
EBITDA % Plan Realized	100%
Tax Rate	31.5%

WACC	
Risk-free rate (10y Rus	6.20%
Corporate spread	4%
ERP	6%
Beta	0.80
Cost of Equity	11.0%
Cost of Debt	10.2%
Cost of preferred	10.6%
D/E	10.5%
D/A	9.5%
P/A	0.0%
WACC	**10.65%**

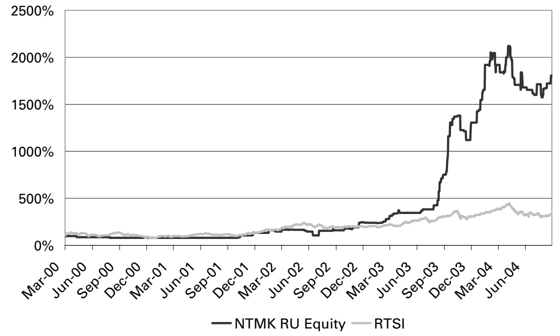
Source: Metropol research

NTMK: Production and Financial Data, 2003–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Production (000 ton)						
Slabs	917	899	926	879	862	896
Bloom	1,151	1,128	1,162	1,127	1,104	1,137
HR Sections	1,232	1,207	1,244	1,206	1,182	1,218
Rail	599	611	630	648	668	688
Pipes	805	822	846	872	898	925
Total	**4,705**	**4,667**	**4,807**	**4,732**	**4,714**	**4,864**
Total Crude Steel	**5,467**	**5,423**	**5,586**	**5,499**	**5,478**	**5,652**
YoY growth, %	10%	-1%	3%	-2%	0%	3%
Product exports, % of prod. output	42%	43%	42%	45%	45%	145%
Income Statement						
Revenues	1,040	1,618	1,527	1,018	838	859
Operating costs	(770)	(1,006)	(815)	(721)	(666)	(599)
Operating profit	270	613	712	297	172	260
Pretax profit	108	388	486	96	-29	57
Net income	**74**	**264**	**330**	**65**	**-20**	**39**
EBITDA	235	529	638	261	149	236
Cash Flow Statement						
Operating cash flow	**74**	**264**	**330**	**65**	**-20**	**39**
Capex investment	(70)	(72)	(74)	(76)	(79)	(81)
Cash used for investing	**(76)**	**(85)**	**(72)**	**(65)**	**(75)**	**(82)**
Debt issue/(repayment)	0	0	0	0	0	0
Net change in cash	111	280	366	169	65	99
Free cash flow	**133**	**312**	**384**	**175**	**78**	**117**
Balance Sheet						
Cash & Investments	125	406	772	941	1,006	1,106
Receiables(net)	85	133	126	84	69	71
Inventory	57	75	60	53	49	44
Other Current assets	0	0	0	0	0	0
Fixed assets	553	510	456	393	318	246
Other non-current assets	23	36	34	22	18	19
Total Assets	**844**	**1,158**	**1,448**	**1,493**	**1,461**	**1,486**
Accounts payable	131	171	138	123	113	102
Short-term debt	35	45	37	32	30	27
Other current liabilities	0	0	0	0	0	1
Long-term debt	104	104	104	104	104	104
Other LT liabilities	0	0	0	0	0	0
Shareholders' equity	**471**	**735**	**1,066**	**1,131**	**1,111**	**1,149**
Total Liabilities & Equity	**25,292**	**27,452**	**28,964**	**29,833**	**31,767**	**31,768**
Total Debt	138	149	140	136	134	130
Net Debt	13	(257)	(632)	(805)	(873)	(975)
Credit						
Net debt to equity %	3	-35	-59	-71	-79	-85
Total debt to total capital %	29	20	13	12	12	11
Times interest earned	5	16	19	4	-1	2
Cash coverage of fixed charges	3	11	13	3	-1	2
Profitability						
EBITDA margin %	23	33	42	26	18	27
Operating margin	26	38	47	29	21	30
Net margin	9	17	23	8	0	7
Growth						
Revenues	28	56	-6	-33	-18	2
Operating profit	27	31	-19	-12	-8	-10
EBITDA	98	125	21	-59	-43	58
Net income	3527	257	25	-2	12	151
Return						
ROE, %	16	36	31	6	-2	3
ROCE, %	18	42	39	9	0	6
per ton						
Revenues	190.3	298.4	273.4	185.1	153.0	151.9
Operating cost	140.9	185.5	145.9	131.2	121.6	105.9
Operating profit	49.4	113.0	127.5	54.0	31.4	46.0
EBITDA	42.9	97.5	114.3	47.5	27.2	41.7
Net income	**13.5**	**48.7**	**59.1**	**11.9**	**-3.6**	**6.9**
Operating CF	13.5	48.7	59.1	11.9	-3.6	6.9
Capex	12.8	13.3	13.3	13.9	14.4	14.4
Free CF	**24.4**	**57.6**	**68.7**	**31.9**	**14.3**	**20.8**

Source: Company data, Metropol research estimates

NTMK: Share Price Performance, 2000–4



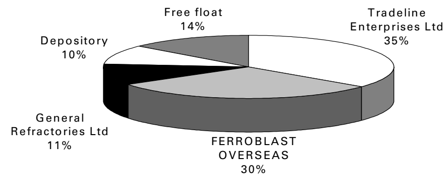
Source: Bloomberg

NTMK: Company and Per-share Information

Market Cap ($ mn)	825	**52-week High ($)**	0.2
Avg Daily Volume ($ mn)	0.1	**52-week Low ($)**	0.8
Shares Outstanding (mn)	1,310	**Annual Div. ($)**	n/a
Free Float (%)	14	**Div. Yield (%)**	n/a
Free Float ($ mn):	113	**Payout (%)**	n/a

Source: Bloomberg, company data

NTMK: Shareholder Structure



Source: Company

NTMK: Valuation Summary, 2003E–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Valuation ratios						
P/E	15.4	4.3	3.4	29.0	-57.1	25.2
P/S	1.1	0.7	0.7	1.1	1.4	0.8
P/Book	1.4	1.0	0.8	0.8	0.8	0.9
EV/EBITDA	5.2	2.3	1.9	1.3	1.8	0.7
EV/Sales	1.1	0.5	0.3	0.3	0.3	0.2
EV/Production	210.8	162.8	90.9	60.9	48.7	29.1
Key drivers %						
Production growt	9.9	-0.8	3.0	-1.5	-0.4	3.2
Revenue growth	28.3	55.6	-5.6	-33.3	-17.7	2.4
Operating margir	25.9	37.9	46.6	29.1	20.5	30.3
Net margin	8.6	17.5	22.9	8.1	-0.4	6.6
EPS growth	1.1	256.9	25.1	-88.1	-150.7	5.2
EBITDA growth	97.7	125.2	20.7	-59.1	-43.0	58.3

Source: Metropol research

NTMK: Management and Headquarters

Address	Nizny Tagil, Sverdlovsk Region 622025
Tel/Fax	Tel: +7-3435-292194 Fax: +7-3435-292694
CEO	Sergey Nosov
E-mail	webmaster@ntmk.ru
Web	www.ntmk.ru
Auditors	Ernst & Young

Source: Company

Zapsib

BUY

Price: $108
Target price: $140

We are initiating coverage of Zapsib with a speculative BUY rating and a fair value of $140/share. Zapadno-Sibirsky Metallurgical Plant (Zapsib) is EvrazHolding's largest subsidiary by output, with 43% of total production. EvrazHolding controls 93% of the company, which has a very low 0.5% free float. Currently, Zapsib trades on a 2003 EV/EBITDA of 5.9. The company has a strong 2002–6 EBITDA CAGR of 131% and a low 2004 EV/EBITDA of 1.9 on our projections.

INVESTMENT DRIVERS

- **Dynamic demand growth.** Zapsib should benefit from dynamic growth in demand for long products in Russia and worldwide, in our view.

- **Technological upgrades to boost output quality.** The company has recently modernized its assets and technologies, and plans additional capex of $460 million in 2004–7.

- **Located close to biggest export market.** Zapsib is located in Western Siberia, close to its biggest export market, China, which helps it to reduce transport costs. Zapsib exports over half its output to China.

- **Plans to extend product mix.** Zapsib has announced plans to start producing rolled sheet products in 2006–8, thus extending its production mix with higher value-added hot and cold rolled sheet steel.

- **Cheap valuation and strong growth perspectives** Zapsib represents a good buying opportunity in the Russian steel industry. We consider investment in Zapsib to be a good way to gain cheap access to EvrazHolding. Zapsib has an attractive valuation and strong growth prospects, on our estimates.

INVESTMENT RISKS

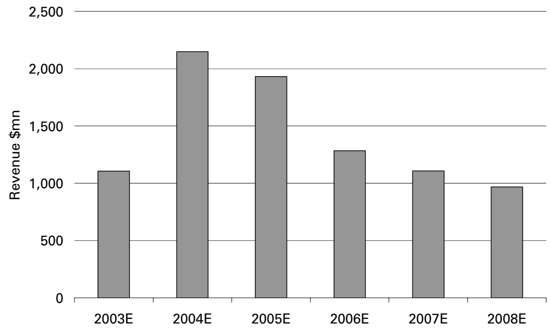
- **Low quality raw materials supplies.** Zapsib controls only 50% of the iron ore supplies it needs through Vysokogorsky GOK, a mine that produces unusually poor iron content.

- **High price sensitivity** both on the domestic market and for export, primarily to China.

- **Transfer-pricing and collateral risks.** Zapsib sells its steel products to EvrazHolding at below-market prices, reducing profitability (Exhibit 35), thus value from minority shareholders. Some of the holding's general credit liabilities are secured against Zapsib's assets.

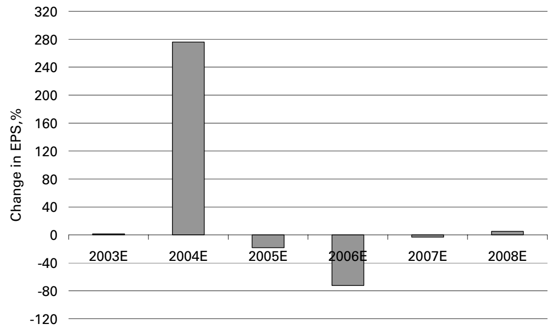
- **Poor corporate governance.** Most of the shares are controlled by company management, particularly by EvrazHolding CEO Alexander Abramov, through three offshore companies, Lakemill Trading and Invest (51%), Logicmind Investments (28%) and Ferrotrade and Co. Ltd (14%).

Zapsib: Revenue Projections, 2003–2008E



Source: Metropol research estimates

Zapsib: EPS Projections, 2003–2008E



Source: Metropol research estimates

Zapsib: DCF Summary, 2003–2010E ($ mn)

PROJECTED CASH FLOWS	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E	CAGR
Revenue	$1,106.0	$2,147.2	$1,930.7	$1,284.3	$1,107.4	$968.2	$1,041.0	$1,117.4	10.1%
Annual Growth	55.3%	94.1%	-10.1%	-33.5%	-13.8%	-12.6%	7.5%	7.3%	
EBITDA	264.2	807.3	694.3	294.6	303.4	181.2	223.3	254.8	40.1%
Annual Growth	369.4%	205.5%	-14.0%	-57.6%	3.0%	-40.3%	23.2%	14.1%	
Margin	23.9%	37.6%	36.0%	22.9%	27.4%	18.7%	21.5%	22.8%	
Unleveraged Net Income	145.2	545.8	447.2	130.6	123.0	30.0	61.6	85.0	163.1%
Annual Growth	14772.3%	275.9%	-18.1%	-70.8%	-5.9%	-75.6%	105.0%	38.1%	
Margin	13.1%	25.4%	23.2%	10.2%	11.1%	3.1%	5.9%	7.6%	
Plus: Depreciation & Amortization	72.7	87.3	104.3	122.3	141.1	141.6	142.1	142.6	
Less: Capital Expenditures	(75.0)	(100.0)	(105.0)	(110.3)	(115.8)	(121.6)	(127.6)	(134.0)	
Change in Working Capital	20.8	(9.4)	(8.4)	9.9	(10.9)	13.6	4.4	2.2	
Free Cash Flow	163.7	523.7	438.1	152.6	137.4	63.6	80.4	95.8	10.1%

PRESENT VALUE OF EQUITY	
PV of FCF 2002-2006	$1,073.0
PV of Terminal Value	913.3
Enterprise Value	1,986.3
- ST & LT Debt & Taxes Owed	(111.5)
- Preferred Equity	-
+ Cash	0.6
Equity Value	1,875.4
Common Shares	13,388
Value Per Share	**$140**

DCF ASSUMPTIONS	
WACC	11.1%
Terminal Growth Rate	2.0%
EBITDA % Plan Realized	100%
Tax Rate	24.2%

WACC	
Risk-free rate (10y Ru	6.43%
Corporate spread	5%
ERP	6%
Beta	0.80
Cost of Equity	11.2%
Cost of Debt	11.4%
Cost of preferred	11.3%
D/E	5.9%
D/A	5.6%
P/A	0.0%
WACC	**11.08%**

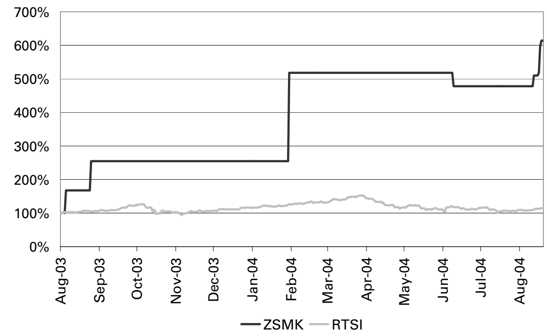
Source: Metropol research estimates

Zapsib: Production and Financial Data, 2003–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Production (000 ton)						
Slabs	507	492	763	500	703	689
Bloom	1,611	1,370	1,506	1,431	1,388	1,360
HR Sections	3,074	2,920	2,979	2,830	2,745	2,690
Total	**5,192**	**4,782**	**5,248**	**4,761**	**4,836**	**4,739**
Total Crude Steel	**5,945**	**5,766**	**5,536**	**5,370**	**5,262**	**5,367**
YoY growth, %	4%	-3%	-4%	-3%	-2%	2%
Product exports, % of prod. output	42%	43%	42%	45%	45%	45%
Income Statement						
Revenues	1,106	2,019	1,974	1,315	1,138	990
Operating costs	(804)	(1,177)	(1,056)	(834)	(719)	(717)
Operating profit	302	842	918	481	419	273
Pretax profit	188	630	650	211	202	71
Net income	**142**	**472**	**488**	**158**	**151**	**54**
EBITDA	264	723	760	344	349	219
Cash Flow Statement						
Operating cash flow	**142**	**472**	**488**	**158**	**151**	**54**
Capex investment	(75)	(100)	(105)	(110)	(116)	(122)
Cash used for investing	**(84)**	**(118)**	**(104)**	**(97)**	**(112)**	**(119)**
Net change in cash	199	390	463	196	170	91
Free cash flow	**164**	**465**	**472**	**193**	**173**	**93**
Balance Sheet						
Cash & Investments	200	590	1,053	1,248	1,419	1,510
Receiables(net)	112	205	200	133	115	100
Inventory	95	142	127	100	87	86
Other Current assets	0	0	0	0	0	0
Fixed assets	401	414	414	402	377	357
Other non-current assets	22	40	39	26	23	20
Total Assets	**830**	**1,390**	**1,834**	**1,911**	**2,020**	**2,073**
Accounts payable	181	264	237	187	162	161
Short-term debt	113	165	148	117	101	100
Other current liabilities	5	5	5	5	5	5
Long-term debt	29	29	29	29	29	29
Other LT liabilities	2	2	2	2	2	2
Shareholders' equity	**320**	**792**	**1,280**	**1,438**	**1,589**	**1,643**
Total Liabilities & Equity	**25,292**	**27,452**	**28,964**	**29,833**	**31,767**	**31,768**
Total Debt	142	194	177	146	130	130
Net Debt	(58)	(396)	(875)	(1,102)	(1,288)	(1,380)
Credit						
Net debt to equity %	-18	-50	-68	-77	-81	-84
Total debt to total capital %	44	25	14	10	8	8
Times interest earned	19	57	59	19	18	6
Cash coverage of fixed charges	14	43	44	14	14	5
Profitability						
EBITDA margin %	24	36	39	26	31	22
Operating margin	27	42	46	37	37	28
Net margin	13	23	25	12	13	5
Growth						
Revenues	55	83	-2	-33	-13	-13
Operating profit	42	46	-10	-21	-14	0
EBITDA	369	174	5	-55	2	-37
Net income	-1478	231	3	-68	-4	-183
Return						
ROE, %	44	60	38	11	10	3
ROCE, %	35	60	43	13	12	4
per ton						
Revenues	186.1	350.1	356.6	244.9	216.2	184.4
Operating cost	135.3	204.2	190.8	155.3	136.6	133.5
Operating profit	50.7	146.0	165.8	89.6	79.6	50.8
EBITDA	44.4	125.3	137.4	64.0	66.3	40.8
Net income	**24.0**	**81.9**	**88.1**	**29.4**	**28.8**	**10.0**
Operating CF	24.0	81.9	88.1	29.4	28.8	10.0
Capex	12.6	17.3	19.0	20.5	22.0	22.6
Free CF	**27.5**	**80.7**	**85.2**	**35.9**	**32.8**	**17.4**

Source: Company data, Metropol research estimates

Zapsib: Share Price Performance, 2003–4



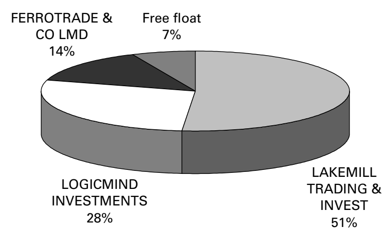
Source: Bloomberg

Zapsib: Company and Per-share Information

Market Cap ($ mn)	870	**52-week High ($)**	10
Avg. Daily Volume ($ mn)	0.1	**52-week Low ($)**	70
Shares Outstanding (mn)	13.4	**Annual Div. ($)**	n/a
Free Float (%)	7	**Div. Yield (%)**	n/a
Free Float ($ mn)	57	**Payout (%)**	n/a

Source: Bloomberg, company data

Zapsib: Shareholder Structure



Source: Company

Zapsib: Valuation Summary, 2003E—2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Valuation ratios						
P/E	neg	2.7	3.3	9.2	9.5	44.1
P/S	1.3	0.7	0.8	0.9	1.0	1.1
P/Book	1.2	0.7	0.5	0.5	0.5	0.7
EV/EBITDA	5.9	1.9	2.2	0.1	-0.4	-1.0
EV/Sales	1.0	0.3	0.1	0.0	-0.1	-0.2
EV/Production	177.2	112.4	37.7	4.8	-23.3	-34.0
Key drivers						
Production growth	4.0	-0.5	-4.0	-3.0	-2.0	2.0
Revenue growth	55.3	94.1	-10.1	-33.5	-13.8	-12.6
Operating margin	27.3	43.8	43.9	33.4	33.4	24.1
Net margin	12.9	24.9	22.7	9.4	10.6	2.6
EPS growth	1.3	275.8	-18.2	-72.4	-3.2	5.0
EBITDA growth	25.0	205.5	-14.0	-57.6	3.0	-40.3

Source: Metropol research

Zapsib: Management and Headquarters

Address	Novokuznetsk, Kemerovo Regn, 654043
Tel/Fax	Tel: +7-3843-593015 Fax: +7-3843-594343
CEO	Andrey Mokrinsky
E-mail	zsmk@zsmk.ru
Web	www.zsmk.ru
Auditors	Ernst & Young

Source: Company data

MECHEL STEEL GROUP

Exhibit 58

Mechel Steel Group: Product Profile

Asset	Product	2003 Prod '000 t
Mechel	Rolled steel products, specialty steel	2700
COST (Romania)	Rolled steel products	450
Beloretsky steel	Steel hardware	700
Vyartsyl Steel	Steel hardware	55
Lutvinian	Steel hardware	10
S.C.Industria Sarmai (Romania)	Steel hardware	n/a
Mechel Zeljezara (Croatia)	Steel pipes	8
Yuzhny Kuzbass	Coal	13 000
Korshunovsky GOK	Iron ore	1500
Yuzharalnickel	Nickel	15

Source: Company data

Mechel Steel Group is a leader in stainless and specialty rolled steel production. Mechel (MECH, $137), which trades on the RTS, is the holding's core asset, and accounts for 50% of the holding company's total group sales. MECH is 70%-owned by Mechel Steel Group.

The Group also has interests in coal, iron ore and hardware products. In addition to seven subsidiaries within the Russian Federation, the Group includes metallurgical assets in Eastern Europe. Mechel Steel Group management has said it plans to consolidate MECH shares into the Group in the next 1–2 years. The Group expects to receive some $200–$350 million from a US IPO of the shares of the holding, which could raise the total market cap to above $1 billion, on our estimates. The Group has said it plans to use the IPO proceeds either to purchase the state's 23% stake in Magnitogorsk Metallurgical plant, Russia's third-largest steel producer, in which Mechel already holds a 16% stake, or for further modernization.

Mechel

BUY

Price: $180
Target price: $235

Mechel, or Chelyabinsky Metallurgichesky Kombinat (Chelyabinsk Metallurgical Plant), is the core asset of Mechel Steel Group. Mechel (MECH) is the group's principal tradable security, and accounts for some 50% of the holding company's total group sales. Mechel trades on the RTS (MECH, $180). Mechel Group holds some 70% of MECH. Mechel Steel Group has said it plans an IPO in the US during 2004. We expect MECH's local RTS price to increase in connection with the IPO, which is scheduled for November or December this year.

We believe Mechel Steel Works represents a good buying opportunity in the Russian steel industry. We consider the company to be a good way to gain access to Mechel Steel group. MECH has an attractive valuation, with a 2003 EV/EBITDA of 4, a PE of 6.1, and strong growth prospects, in our view. We initiate coverage with a BUY recommendation on MECH, with a 12-month price target of $235, or some 31% upside potential to the current market price.

INVESTMENT DRIVERS

- **Leading stainless producer; products meet EU standards.** MECH is Russia's leading producer of stainless and specialty steel products, with output that meets EU standards.

- **Monopoly position for production of specialty steel** in Russia after the acquisition of the second-largest specialty steel producer Izhstal.

- **More chances to access foreign markets.** Following cancellation of a US-Russian anti-dumping agreement, which expired in July, Mechel and other small Russian steel producers have more chance to access the US steel market, in our view. MECH sales to the US could rise by some $150–$200 million annually.

- **Good access to raw materials.** Mechel controls 100% of the iron and coke resources it requires.

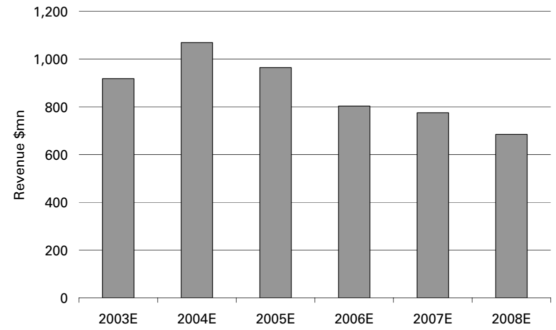
- **Modernization should boost output quality.** The company has recently modernized its assets and technologies, and plans to invest an additional $460 million in modernization in 2004–7.

- **ADR plans should boost share price.** Mechel Steel Group has announced plans for an US ADR Level 3 program in Nov-Dec 2004.

INVESTMENT RISKS

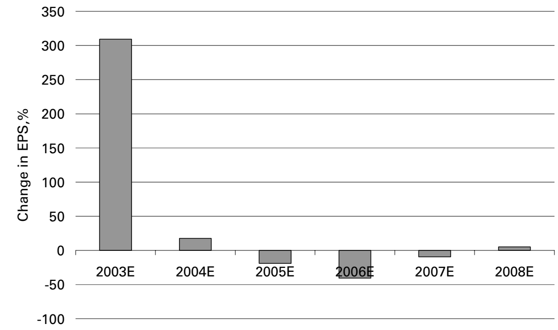
- **Domestic stainless steel prices remain low** as demand is weak. Mechel is less profitable than Severstal and NLMK, with a 2003 EBITDA margin of 15%, compared with 32% and 40%, respectively, for Severstal and NLMK.

Mechel: Revenue Projections, 2003–2008E



Source: Metropol research estimates

Mechel: EPS Projections, 2003–2008E



Source: Metropol research estimates

Mechel: DCF Summary, 2003–2010E (US$ mn)

PROJECTED CASH FLOWS	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E	CAGR
Revenue	$918.3	$1,171.7	$992.6	$803.0	$775.0	$684.7	$819.7	$835.7	8.8%
Annual Growth	65.4%	27.6%	-15.3%	-19.1%	-3.5%	-11.6%	19.7%	1.9%	
EBITDA	140.4	284.6	193.5	128.7	131.1	109.5	253.0	260.4	10.1%
Annual Growth	73.2%	102.7%	-32.0%	-33.5%	1.8%	-16.5%	131.0%	2.9%	
Margin	15.3%	24.3%	19.5%	16.0%	16.9%	16.0%	30.9%	31.2%	
Unleveraged Net Income	86.3	196.0	116.9	58.7	53.8	36.5	151.4	157.2	6.1%
Annual Growth	115.4%	127.1%	-40.3%	-49.8%	-8.4%	-32.1%	314.3%	3.9%	
Margin	9.4%	16.7%	11.8%	7.3%	6.9%	5.3%	18.5%	18.8%	
Plus: Depreciation & Amo	32.5	39.6	47.3	55.4	63.9	63.9	63.9	63.9	
Less: Capital Expenditures	(40.0)	(45.0)	(47.3)	(49.6)	(52.1)	(54.7)	(57.4)	(60.3)	
Change in Working Capita	67.5	(6.9)	0.4	(11.9)	(6.4)	(9.6)	(30.1)	(0.4)	
Free Cash Flow	146.3	183.7	117.3	52.5	59.2	36.1	127.6	160.3	5.6%

PRESENT VALUE OF EQUITY	
PV of FCF 2002-2006	$431.2
PV of Terminal Value	372.5
Enterprise Value	803.7
- ST & LT Debt & Taxes (	(61.3)
- Preferred Equity	-
+ Cash	2.2
Equity Value	744.6
Common Shares	3,162
Value Per Share	**$235**

DCF ASSUMPTIONS	
WACC	11.6%
Terminal Growth Rate	2.2%
EBITDA % Plan Realized	100%
Tax Rate	20.0%

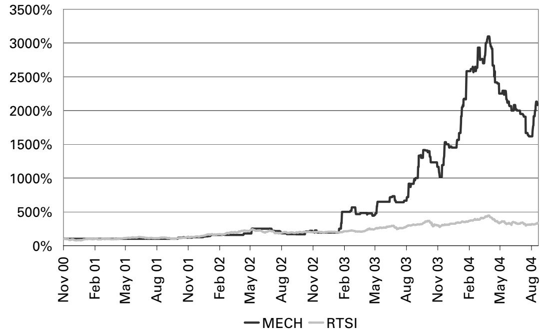
WACC	
Risk-free rate (10y Ru:	6.30%
Corporate spread	7%
ERP	6%
Beta	0.89
Cost of Equity	11.7%
Cost of Debt	13.3%
Cost of preferred	12.5%
D/E	8.2%
D/A	7.6%
P/A	0.0%
WACC	**11.59%**

Mechel: Production and Financial Data, 2003–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Production (000 ton)						
Middle	525	546	568	539	523	534
Long Sctions	520	536	552	535	524	535
HR Sections	520	536	552	535	524	535
Light Sections	1,133	1,156	1,179	1,132	1,109	1,131
Rolled products	**2,698**	**2,773**	**2,850**	**2,741**	**2,681**	**2,735**
Total Crude Steel	**4,000**	**4,111**	**4,225**	**4,064**	**3,975**	**4,054**
YoY growth, %	4%	3%	3%	-4%	-2%	2%
Product exports, % of prod. output	32%	30%	35%	40%	40%	140%
Income Statement						
Revenues	918	1,172	993	803	775	685
Operating costs	(768)	(873)	(787)	(664)	(634)	(566)
Operating profit	150	299	206	139	141	119
Pretax profit	104	237	138	65	59	38
Net income	**83**	**171**	**99**	**47**	**43**	**27**
EBITDA	140	285	193	129	131	110
Cash Flow Statement						
Operating cash flow	**83**	**171**	**99**	**47**	**43**	**27**
Capex investment	(40)	(45)	(47)	(50)	(52)	(55)
Cash used for investing	**(71)**	**(68)**	**(31)**	**(33)**	**(50)**	**(47)**
Net change in cash	112	136	116	58	51	35
Free cash flow	**146**	**184**	**117**	**53**	**59**	**36**
Balance Sheet						
Cash & Investments	114	250	366	423	474	509
Receiables(net)	126	161	136	110	106	94
Inventory	175	198	179	151	144	129
Other Current assets	46	59	50	40	39	34
Fixed assets	183	188	188	182	170	161
Other non-current assets	83	105	89	72	70	62
Total Assets	**726**	**961**	**1,007**	**979**	**1,003**	**988**
Accounts payable	379	430	388	328	313	279
Short-term debt	92	105	94	80	76	68
Other current liabilities	0	0	0	0	0	0
Long-term debt	3	3	3	3	3	3
Other LT liabilities	0	0	0	0	0	0
Shareholders' equity	**251**	**422**	**521**	**568**	**611**	**638**
Total Liabilities & Equity	**25,292**	**27,452**	**28,964**	**29,833**	**31,767**	**31,768**
Total Debt	96	108	98	83	80	71
Net Debt	(18)	(141)	(268)	(340)	(394)	(438)
Credit						
Net debt to equity	-7	-34	-51	-60	-65	-69
Total debt to total capital	38	26	19	15	13	11
Times interest earned	26	30	17	8	7	5
Cash coverage of fixed charges	21	21	12	6	5	3
Profitability						
EBITDA margin %	15	24	19	16	17	16
Operating margin	16	25	21	17	18	17
Net margin	9	15	10	6	6	4
Growth						
Revenues	65	28	-15	-19	-3	-12
Operating profit	64	14	-10	-16	-5	-11
EBITDA	73	103	-32	-33	2	-16
Net income	309	105	-42	-53	-10	-57
Return						
ROE, %	33	40	19	8	7	4
ROCE, %	31	46	24	11	10	6
per tonne						
Revenues	229.6	285.0	234.9	197.6	195.0	168.9
Operating cost	192.0	212.3	186.3	163.4	159.6	139.5
Operating profit	37.6	72.7	48.6	34.1	35.4	29.4
EBITDA	35.1	69.2	45.8	31.7	33.0	27.0
Net income	**20.8**	**41.5**	**23.5**	**11.6**	**10.7**	**6.7**
Operating CF	20.8	41.5	23.5	11.6	10.7	6.7
Capex	10.0	10.9	11.2	12.2	13.1	13.5
Free CF	**36.6**	**44.7**	**27.8**	**12.9**	**14.9**	**8.9**

Source: Company data, Metropol research

Mechel: Share Price Performance, 2000–4



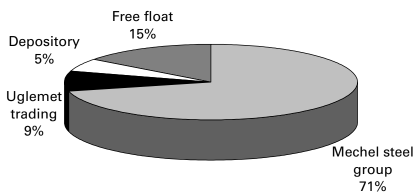
Source: Bloomberg

Mechel: Company and Per-share Information

Market Cap ($ mn)	379	**52-week High ($)**	186
Avg. Daily Volume ($ mn)	0.1	**52-week Low ($)**	38
Shares Outstanding (mn)	3	**Annual Div. ($)**	n/a
Free Float (%)	15	**Div. Yield (%)**	n/a
Free Float ($ mn)	56	**Payout (%)**	n/a

Source: Company data

Mechel: Shareholder Structure



Source: Company data

Mechel: Valuation Summary, 2003E–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Valuation ratios						
P/E	6.1	3.0	5.1	10.7	11.9	18.7
P/S	0.6	0.4	0.5	0.6	0.7	0.7
P/Book	0.7	0.5	0.5	0.5	0.5	0.5
EV/EBITDA	4.1	2.0	2.9	1.3	0.8	0.6
EV/Sales	0.5	0.3	0.2	0.2	0.1	0.1
EV/Production	121.9	88.7	56.4	40.7	28.0	16.9
Key drivers						
Production growth	3.8	2.8	2.8	-3.8	-2.2	2.0
Revenue growth	65.4	27.6	-15.3	-19.1	-3.5	-11.6
Operating margin	16.4	25.5	20.7	17.3	18.2	17.4
Net margin	9.0	14.6	10.0	5.9	5.5	4.0
EPS growth	309.2	105.3	-41.7	-52.7	-9.4	5.0
EBITDA growth	73.2	102.7	-32.0	-33.5	1.8	-16.5

Source: Metropol research

Mechel: Management and Headquarters

Address	14, 2nd Poveletskaya St., Chelyabinsk
Tel/Fax	Tel: +7-3512-240995, Fax: 7-3512-241683
CEO	Aleksey Ivanushkin
E-mail	info@mechel.ru
Web	www.mechel.ru
Auditors	n/a

Source: Company data

MMK

HOLD

Price: $0.50
Target price: $0.50

We are initiating coverage of MMK with a HOLD rating and a fair value of $0.45/share. MMK is Russia's largest flat rolled steel producer, with output of 9.4 million tons in 2003. Its shares are not traded on the RTS. However, it is currently trading on the RTS Board, a listing for illiquid companies, in a range of around $0.45–$0.50/share. This level is in line with our fair value estimate for the share of $0.47. We initiate with a HOLD recommendation on MMK.

INVESTMENT DRIVERS

- **IAS results.** MMK has published IAS results audited by KPMG since 1998.

- **Stable B bond rating.** S&P rates MMK Eurobonds B, with a stable outlook. The company also has an extended ruble bond program.

- **Low 8.4% D/E ratio** compared with the international average of 50%.

- **Modernization program nearly complete.** The company has nearly finished a huge modernization program aiming to replace its obsolete OHF equipment and technology to increase production efficiency. The company has spent more than $500 million on capex in 2002–4.

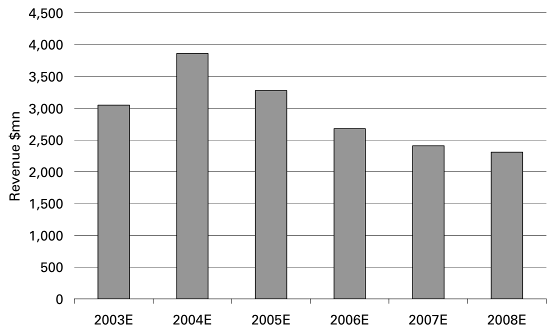
INVESTMENT RISKS

- **MMK historically underperforms industry peers** Severstal and NLMK on operating and financial results. We expect this trend to continue in 2004, despite the company's strong 2003 results. We project a 2004 EBITDA margin of 34%, compared with 42% for Severstal and 48% for NLMK.

- **Poor raw materials resources means pricing risk.** MMK is poorly supplied with iron ore and coal resources. As a result, the company faces raw materials pricing risks, and has trouble controlling its operating expenses.

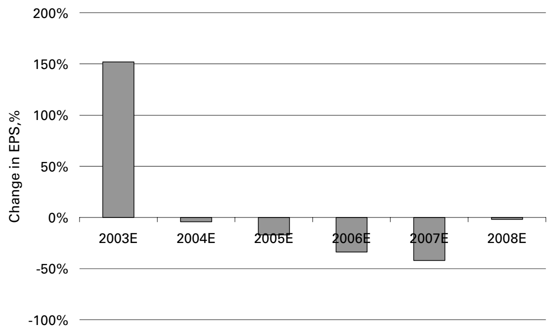
- **Uncertainty over privatization of 16% state stake.** Lack of clarity related to privatization of the state's 16% stake in MMK makes it difficult for management to improve corporate governance.

MMK: Revenue Projections, 2003–2008E



Source: Metropol research

MMK: EPS Projection, 2003–2008E



Source: Metropol research

MMK: DCF Summary, 2003–2010E ($ mn)

PROJECTED CASH FLOWS	2003	2004E	2005E	2006E	2007E	2008E	2009E	2010E	CAGR
Revenue	$3,047.0	$4,368.5	$3,739.7	$2,710.7	$2,408.5	$2,306.6	$2,468.8	$2,591.7	6.8%
Annual Growth	47.6%	43.4%	-14.4%	-27.5%	-11.1%	-4.2%	7.0%	5.0%	
EBITDA	1,061.6	1,481.8	1,341.8	784.9	611.5	571.6	756.5	822.3	5.6%
Annual Growth	128.3%	39.6%	-9.5%	-41.5%	-22.1%	-6.5%	32.4%	8.7%	
Margin	34.8%	33.9%	35.9%	29.0%	25.4%	24.8%	30.6%	31.7%	
Unleveraged Net Income	620.7	962.8	828.0	350.2	183.2	150.7	301.5	355.1	-1.7%
Annual Growth	210.9%	55.1%	-14.0%	-57.7%	-47.7%	-17.7%	100.0%	17.8%	
Margin	20.4%	22.0%	22.1%	12.9%	7.6%	6.5%	12.2%	13.7%	
Plus: Depreciation & Amortization	300.0	300.4	325.9	355.2	386.6	386.6	386.6	386.6	
Less: Capital Expenditures	(185.0)	(186.9)	(220.0)	(250.0)	(252.5)	(255.0)	(257.6)	(260.2)	
Change in Working Capital	(64.3)	(52.9)	18.0	78.9	24.2	5.8	(27.2)	(16.1)	
Free Cash Flow	681.4	1,033.5	961.8	544.4	351.5	298.1	413.3	475.5	13.7%

PRESENT VALUE OF EQUITY	
PV of FCF 2002-2006	$2,709.5
PV of Terminal Value	2,768.2
Enterprise Value	5,477.7
- ST & LT Debt & Taxes Owed	(405.0)
- Preferred Equity	-
+ Cash	233.0
Equity Value	5,305.7
Common Shares	10,630,222
Value Per Share	**$0.50**

DCF ASSUMPTIONS	
WACC	11.2%
Terminal Growth Rate	3.5%
EBITDA % Plan Realized	100%
Tax Rate	18.5%

WACC	
Risk-free rate (10y Rus I	6.24%
Corporate spread	2%
ERP	6%
Beta	0.89
Cost of Equity	11.6%
Cost of Debt	8.2%
Cost of preferred	9.9%
D/E	7.6%
D/A	7.1%
Tax rate	19%
WACC	**11.22%**

Source: Metropol research

MMK: Production and Financial Data, 2003–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Production (000 ton)						
HR Sheet	5,880	5,821	5,763	5,417	5,146	5,301
CR Sheet	1,575	1,559	1,528	1,467	1,423	1,451
HR Sections	1,664	1,647	1,614	1,550	1,503	1,533
Cold Formed profikes and sheets	336	333	326	313	304	310
Total	**9,455**	**9,360**	**9,231**	**8,747**	**8,376**	**8,595**
Total Crude Steel	**11,250**	**11,138**	**10,984**	**10,408**	**9,966**	**10,227**
YoY growth, %	5%	-1%	-1%	-5%	-4%	3%
Product exports, % of prod. output	52%	49%	48%	47%	50%	150%
Income Statement						
Revenues	3,047	4,368	3,740	2,711	2,409	2,307
Operating costs	(1,583)	(2,297)	(1,913)	(1,587)	(1,497)	(1,453)
Operating profit	1,464	2,072	1,826	1,123	911	854
Pretax profit	744	1,164	998	412	207	167
Net income	**616**	**941**	**808**	**340**	**176**	**144**
EBITDA	1,062	1,482	1,342	785	611	572
Cash Flow Statement						
Operating cash flow	**616**	**941**	**808**	**340**	**176**	**144**
Capex investment	(185)	(187)	(220)	(250)	(253)	(255)
Cash used for investing	**(189)**	**(191)**	**(218)**	**(247)**	**(252)**	**(255)**
Net change in cash	663	998	934	527	335	281
Free cash flow	**681**	**1,033**	**962**	**544**	**352**	**298**
Balance Sheet						
Cash & Investments	896	850	785	670	700	701
Receiables(net)	392	563	482	349	310	297
Inventory	283	410	342	283	267	259
Other Current assets	0	0	0	0	0	0
Fixed assets	2,033	1,919	1,813	1,708	1,574	1,442
Other non-current assets	9	13	11	8	7	7
Total Assets	**3,611**	**4,796**	**5,473**	**5,701**	**5,846**	**5,974**
Accounts payable	369	535	446	370	349	338
Short-term debt	174	253	210	175	165	160
Other current liabilities	0	0	0	0	0	1
Long-term debt	218	218	218	218	218	218
Other LT liabilities	32	32	32	32	32	32
Shareholders' equity	**2,446**	**3,387**	**4,195**	**4,535**	**4,711**	**4,854**
Total Liabilities & Equity	**25,292**	**27,452**	**28,964**	**29,833**	**31,767**	**31,768**
Total Debt	392	471	428	393	383	378
Net Debt	(504)	(379)	(357)	(277)	(317)	(323)
Credit						
Net debt to equity	0	0	0	0	0	0
Total debt to total capital	0	0	0	0	0	0
Times interest earned	43	66	57	24	13	10
Cash coverage of fixed charges	25	22	25	27	28	29
Profitability						
EBITDA margin %	35	34	36	29	25	25
Operating margin	48	47	49	41	38	37
Net margin	20	22	22	13	7	6
Growth						
Revenues	48	43	-14	-28	-11	-4
Operating profit	22	45	-17	-17	-6	35
EBITDA	128	40	-9	-41	-22	-7
Net income	436	53	-14	-58	-93	-22
Return						
ROE, %	25	28	19	7	4	3
ROCE, %	23	28	20	8	4	3
per tonne						
Revenues	270.8	392.2	340.5	260.5	241.7	225.5
Operating cost	140.7	206.2	174.2	152.5	150.2	142.1
Operating profit	130.1	186.0	166.3	108.0	91.4	83.5
EBITDA	94.4	133.0	122.2	75.4	61.4	55.9
Net income	**54.8**	**84.5**	**73.6**	**32.6**	**17.6**	**14.1**
Operating CF	54.8	84.5	73.6	32.6	17.6	14.1
Capex	16.4	16.8	20.0	24.0	25.3	24.9
Free CF	**60.6**	**92.8**	**87.6**	**52.3**	**35.3**	**29.2**

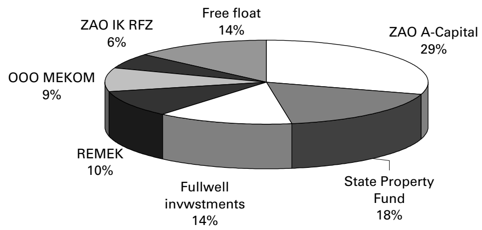
Source: Company data, Metropol research estimates

MMK: Company and Per-share Information

Market Cap ($ mn)	4,784	**52-week High ($)**	0.5
Avg Daily Volume ($ mn)	0.1	**52-week Low ($)**	0.4
Shares Outstanding (mn)	10,630	**Annual Div. ($)**	n/a
Free Float (%)	8	**Div. Yield (%)**	n/a
Free Float ($ mn)	369	**Payout (%)**	n/a

Source: Bloomberg, company data

MMK: Shareholder Structure



Source: Company data

MMK: Valuation Summary, 2003E–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Valuation ratios						
P/E	8.6	5.6	6.6	15.7	30.3	37.0
P/S	1.7	1.2	1.4	2.0	2.2	2.3
P/Book	1.5	1.1	1.0	0.9	0.9	0.9
EV/EBITDA	4.5	2.6	3.8	6.4	8.2	8.7
EV/Sales	1.6	1.1	1.3	1.9	2.1	2.2
EV/Production	428	443	451	484	501	488
Key drivers						
Production growt	4.8	-1.0	-1.4	-5.2	-4.2	2.6
Revenue growth	47.6	43.4	-14.4	-27.5	-11.1	-4.2
Operating margin	48.0	47.4	48.8	41.4	37.8	37.0
Net margin	20.2	21.5	21.6	12.5	7.3	6.2
EPS growth	10.0	52.7	-14.1	-58.0	-48.3	5.0
EBITDA	55.0	39.6	-9.5	-41.5	-22.1	-6.5

Source: Metropol research

MMK: Management and Headquarters

Address	93, Kirova Str., Magnitogorsk, 455002
Tel/Fax	Tel: +7-3511-333004 Fax: 7-3511-337073
CEO	Viktor Rashnikov
E-mail	info@mmk.ru
Web	www.mmk.ru
Auditors	KPMG

Source: Company data

Exhibit 59

UGMK: Corporate Structure

Copper Production	2002 Prod 000 t
Uralelectromed	310
KaturInvest	235
Mid-Ural Copper	106
Karabashmed	46
Mednogor Copper	31

	2002 Prod 000 t
Copper Concentrate Production	
Serov Copper	612
Svyatogor	178
Iron and Copper Ore Production	
Kachkanarsky GOK	42
Urupsky GOK	22
Gaysky GOK	4
Uchalinsky GOK	5
Baguslovskoye	1
Sophynovskaya Med	1

Source: Company data

UGMK

BUY

Price: $60
Target price:$100

Uralelectromed is the largest subsidiary of UGM Holding (Uralskaya Metal and Mining Company), accounting for 56% of total group sales. The company produces 330 thousand tons of copper, exporting more than 67% of total production. UGMK is Russia's second-largest copper producer after Norilsk Nickel. UGMK Holding has interests in copper, iron ore mining, heavy machinery and construction. Total group sales in 2003 exceeded $1 billion. UGMK Holding has said it plans a London IPO in 2004–5.

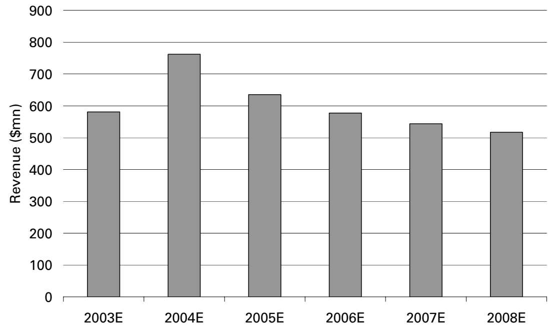
INVESTMENT DRIVERS

- **High copper prices in 2004–5** should boost Uralelectromed earnings, on our projections.
- **Uralelectromed is cheap by valuation,** trading at a 2003 EV/EBITDA of 3.9 and a PE of 5.6.
- **Consolidation into UGMK expected in 2004–5.** We believe minority shareholders could benefit from a favorable conversion ratio.
- **Good access to copper resources.** The company controls all the copper raw materials it needs.
- **Good management.**
- **ADR should boost liquidity and share price.** UGMK has announced plans for an ADR program in 2004–5.

INVESTMENT RISKS

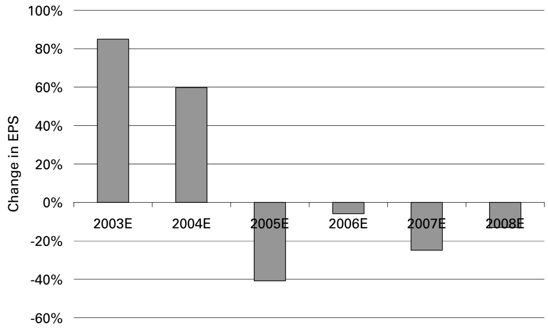
- **Consolidation risks.** Consolidation of Uralelectromed into UGMK may take time. Dilution during the conversion process is also a risk, as we believe the holding could propose an unfair conversion ratio.
- **Low grade copper resources.** UGMK controls access to the raw materials it requires. However, it uses heavily depleted, low-grade copper mines producing ore that contains only 0.8–1%/ton of copper. We believe these mines will only be sufficient for the next 10–15 years.
- **Low-efficiency production.** UGMK uses inefficient production technologies based on coke for smelting, with high costs of $1,200–$1,300/ton. (Norilsk Nickel, by comparison, uses gas smelting, with a production cost of only $800–$850/ton.)

Uralelectromed: Sales Projections, 2003–2008E



Source: Metropol

Uralelectromed: EPS Projections, 2003–2008E



Source: Metropol

Uralelectromed: DCF Summary, 2003–2010E (US$ mn)

PROJECTED CASH FLOWS	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Revenue	$580.9	$762.1	$635.1	$577.1	$543.6	$517.1	$511.4	$521.7
Annual Growth	66.0%	31.2%	-16.7%	-9.1%	-5.8%	-4.9%	-1.1%	2.0%
EBITDA	104.5	162.6	124.8	130.9	123.0	116.0	113.7	115.0
Annual Growth	395.0%	55.7%	-23.3%	4.9%	-6.0%	-5.7%	-2.0%	1.2%
Margin	18.0%	21.3%	19.6%	22.7%	22.6%	22.4%	22.2%	22.0%
Unleveraged Net Income	58.2	90.4	57.5	54.5	42.4	37.7	36.1	36.9
Annual Growth	681.4%	55.5%	-36.4%	-5.2%	-22.1%	-11.2%	-4.2%	2.2%
Margin	10.0%	11.9%	9.1%	9.4%	7.8%	7.3%	7.1%	7.1%
Plus: Depreciation & Amortization	17.7	27.7	38.9	49.5	59.6	59.8	59.9	60.0
Less: Capital Expenditures	(35.0)	(45.0)	(45.0)	(40.0)	(40.8)	(41.6)	(42.4)	(43.3)
Change in Working Capital	28.5	9.5	(7.0)	(11.3)	(2.9)	(2.4)	(0.5)	0.9
Free Cash Flow	69.3	82.6	44.5	52.7	58.4	53.4	53.0	54.5

PRESENT VALUE OF EQUITY	
PV of FCF 2002-2006	$226.4
PV of Terminal Value	362.7
Enterprise Value	589.1
- ST & LT Debt & Taxes Owed	(87.3)
- Preferred Equity	-
+ Cash	5.4
Equity Value	507.2
Common Shares	5,071
Value Per Share	**$100.0**

DCF ASSUMPTIONS	
WACC	11.9%
Terminal Growth Rate	2.5%
EBITDA % Plan Realized	100%
Tax Rate	33.0%

WACC	
Risk-free rate (10y Ru	6.43%
Corporate spread	2%
ERP	6%
Beta	1.10
Cost of Equity	13.0%
Cost of Debt	8.4%
Cost of preferred	10.7%
D/E	17.2%
D/A	14.7%
P/A	0.0%
Tax rate	33%
WACC	**11.93%**

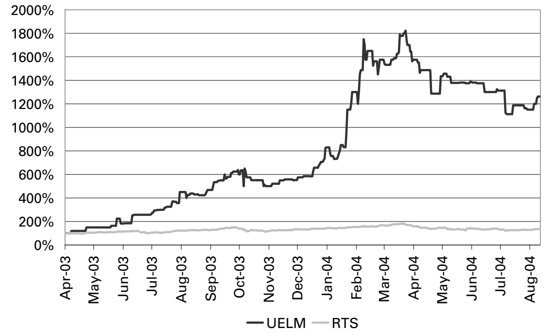
Source: Metropol research

Uralelectromed: Production and Financial Data, 2003–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Production (000 ton)						
Copper	300	324	334	324	314	308
YoY growth, %	0%	8%	3%	-3%	-3%	-2%
Product exports, % of prod.t output	60%	60%	65%	65%	65%	65%
Income Statement						
Revenues	553	754	628	571	538	511
Operating costs	(404)	(524)	(450)	(394)	(371)	(353)
Operating profit	82	133	84	80	62	55
Pretax profit	74	124	75	71	53	46
Net income	**49**	**83**	**49**	**46**	**34**	**30**
EBITDA	100	161	123	129	122	115
Cash Flow Statement						
Operating cash flow	**67**	**111**	**88**	**96**	**94**	**90**
Capex investment	(35)	(45)	(45)	(40)	(41)	(42)
Disposals/(acquisitions)	0	0	0	0	0	0
Cash used for investing	**(41)**	**(53)**	**(40)**	**(38)**	**(39)**	**(41)**
Net change in cash	52	70	41	47	52	47
Free cash flow	**63**	**84**	**44**	**52**	**57**	**53**
Balance Sheet						
Cash & Investments	10	39	80	127	179	225
Receiables(net)	80	109	91	83	78	74
Inventory	38	50	43	37	35	34
Other Current assets	6	8	6	6	5	5
Fixed assets	71	88	94	84	66	47
Other non-current assets	22	30	25	23	22	20
Total Assets	**227**	**324**	**340**	**360**	**385**	**406**
Accounts payable	61	79	68	59	56	53
Short-term debt	121	157	135	118	111	106
Long-term debt	0	0	0	0	0	0
Shareholders' equity	**92**	**175**	**224**	**270**	**304**	**334**
Total Liabilities & Equity	**222**	**324**	**340**	**360**	**385**	**406**
Total Debt	121	157	135	118	111	106
Net Debt	111	118	55	(9)	(67)	(120)
Credit						
Net debt to equity %	121	68	24	-3	-22	-36
Total debt to total capital %	132	90	60	44	37	32
Times interest earned	29	23	25	22	26	26
Cash coverage of fixed charges	25	22	25	27	28	28
Profitability						
EBITDA margin	18	21	20	23	23	22
Operating margin	15	18	13	14	12	11
Net margin	9	11	8	8	6	6
Growth						
Revenues	58	36	-17	-9	-6	-5
Operating profit	637	63	-37	-5	-22	-11
EBITDA	371	62	-23	5	-6	-6
Net income	90819	68	-41	-6	-25	-13
Return						
ROE, %	54	48	22	17	11	9
ROCE %	12	15	13	11	15	17
per tonne						
Revenues	1844	2326	1882	1763	1712	1662
Operating cost	(1347)	(1618)	(1349)	(1216)	(1181)	(1147)
Operating profit	273	411	253	247	197	179
EBITDA	332	496	370	400	387	373
Net income	**165**	**257**	**147**	**142**	**110**	**97**
Operating CF	224	342	264	295	300	291
Capex	117	139	135	124	130	135
Free CF	**210**	**258**	**131**	**160**	**183**	**171**

Source: Company data, Metropol research

Uralelectromed: Share Price Performance, 2003–4



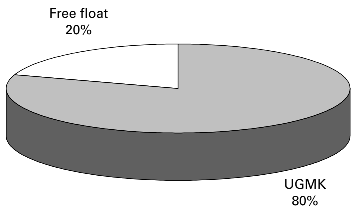
Source: Bloomberg

Uralelectromed: Company and Per-share Information

Market Cap ($ mn)	279	**52-week High ($)**	65
Avg. Daily Volume ($ mn)	0.1	**52-week Low ($)**	12
Shares Outstanding (mn)	5	**Annual Div. ($)**	n/a
Free Float (%)	20	**Div. Yield (%)**	n/a
Free Float ($ mn)	56	**Payout (%)**	n/a

Source: Company data

Uralelectromed: Shareholder Structure



Source: Company data

Uralelectromed: Valuation Summary

	2003E	2004E	2005E	2006E	2007E	2008E
Valuation ratios						
P/E	neg	6.2	3.7	7.3	9.7	11.2
P/S	0.6	0.4	0.8	0.6	0.6	0.7
P/Book	1.5	1.0	1.0	0.9	0.9	0.8
EV/EBITDA	4.2	2.6	3.4	2.5	2.2	1.9
EV/Sales	0.8	0.6	0.6	0.6	0.5	0.4
EV/Production	1116	1033	1003	1034	1066	1088
EV/Researves	0.9	0.9	0.8	0.8	0.8	0.8
Key drivers %						
Production growth	0.0	8.0	3.0	-3.0	-3.0	-2.0
Revenue growth	58.1	36.2	-16.7	-9.1	-5.8	-4.9
Operating margin	14.8	17.7	13.4	14.0	11.5	10.7
Net margin	8.9	11.0	7.8	8.1	6.4	5.8
EPS growth	10.0	68.2	-41.0	-6.0	-25.3	-13.3
EBITDA	25.0	61.6	-23.3	4.9	-6.0	-5.7

Source: Metropol research

UGMK: Management and Headquarters

Address	1 Lenin St., Sverdlovsk Region, 624080
Tel/Fax	Tel: +7-34368-46122 Fax: 7-34368-42626
CEO	Alexander Kozitsin
E-mail	postmaster@elem.ru
Web	www.elem.ru
Auditors	n/a

Source: Company data

VSMPO

BUY

Price: $89
Target price: $150

We initiate coverage of VSMPO with a BUY recommendation and a 12-month target price of $150/share, implying 69% upside to the current market price. The company has good growth potential, with 2002–5 EBITDA CAGR of 37%, on our projections, in a period of recovery in the global aerospace industry. VSMPO produces titanium products that comply with international standards.

INVESTMENT DRIVERS

- **Unique technology.** VSMPO uses unique equipment and technology enabling it to meet a variety of customer needs.

- **VSMPO and AVISMA merger to close in November 2004.** VSMPO has announced conversion ratios for its merger with its major titanium sponge supplier, Avisma. The merger will increase the investment attractiveness of VSMPO's shares for portfolio investors as the VSMPO-Avisma structure becomes clearer, and will reduce the risks for minority shareholders, in our view.

- **VSMPO commands a strong resource base.** Acquisition of Avisma, Russia's largest titanium sponge producer, means a reliable supply of the titanium sponge the company needs for the foreseeable future. More than 15% of the titanium sponge produced by Avisma is exported, adding an additional $50–$70 million to VSMPO-Avisma's consolidated sales.

- **ADR to boost liquidity.** The company plans to issue a Level I ADR this year on 10–15% of its total equity capital, which should boost the company's currently low free float of only 5–8%.

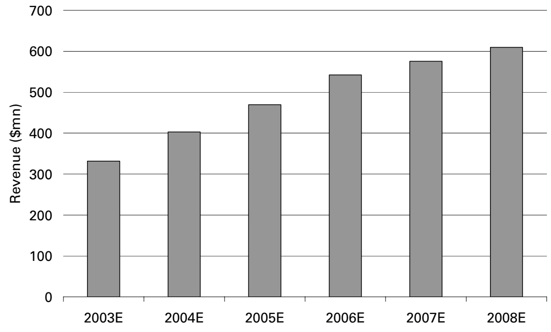
- **Improving corporate governance** and good management.

INVESTMENT RISKS

- **Slower-than-expected recovery in global airline and auto industries** would mean potentially slower growth in revenues for the company in the medium term, on our estimates.

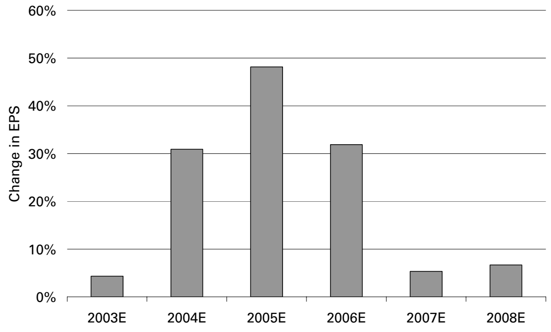
- **US import tariff hike on Russian titanium** could result in small shortage in working capital. We estimate that 15% titanium tariff hike could cause a working capital shortfall as reclamation of the 15% tariff takes time. VSMPO's exports up to $275 million worth of titanium products to the US.

VSMPO: Revenue Projections, 2003–2008E



Source: Metropol research

VSMPO: EPS Projections, 2003–2008E



Source: Metropol research

VSMPO: DCF Summary, 2003–2010E ($ mn)

PROJECTED CASH FLOWS	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E	CAGR
Revenue	$347.8	$542.9	$658.2	$759.0	$739.7	$694.9	$780.9	$826.9	21.5%
Annual Growth	24.3%	56.1%	21.2%	15.3%	-2.5%	-6.1%	12.4%	5.9%	
EBITDA	122.7	201.7	251.0	283.1	268.2	250.9	281.1	296.8	22.2%
Annual Growth	24.9%	64.4%	24.4%	12.8%	-5.3%	-6.4%	12.0%	5.6%	
Margin	35.3%	37.2%	38.1%	37.3%	36.3%	36.1%	36.0%	35.9%	
Unleveraged Net Income	93.3	154.3	191.4	214.6	200.2	186.4	210.6	223.1	22.6%
Annual Growth	29.2%	65.4%	24.0%	12.2%	-6.7%	-6.9%	13.0%	5.9%	
Margin	26.8%	28.4%	29.1%	28.3%	27.1%	26.8%	27.0%	27.0%	
Plus: Depreciation	6.1	8.9	11.8	14.8	17.9	17.9	17.9	17.9	
Less: Capital Expenditures	(25.0)	(25.8)	(26.5)	(27.3)	(28.1)	(29.0)	(29.0)	(29.0)	
Change in Working Capital	(53.7)	(53.6)	(30.6)	(27.2)	3.7	12.6	(20.9)	(12.8)	
Free Cash Flow	20.7	83.8	146.0	174.9	193.7	188.0	178.6	199.3	33.9%

PRESENT VALUE OF EQUITY	
PV of FCF 2002-2006	$406.3
PV of Terminal Value	1,444.5
Enterprise Value	1,850.8
- ST & LT Debt & Taxes Owed	(81.5)
- Preferred Equity	-
+ Cash	23.0
Equity Value	1,792.3
Common Shares	11,957
Value Per Share	**$150**

DCF ASSUMPTIONS	
WACC	12.3%
Terminal Growth Rate	4.5%
EBITDA % Plan Realized	100%
Tax Rate	20.0%

WACC	
Risk-free rate (10y Rus Eu	6.30%
Corporate spread	2%
ERP	6%
Beta	1.04
Cost of Equity	12.6%
Cost of Debt	8.3%
Cost of preferred	10.4%
D/E	4.5%
D/A	4.4%
P/A	0.0%
WACC	**12.31%**

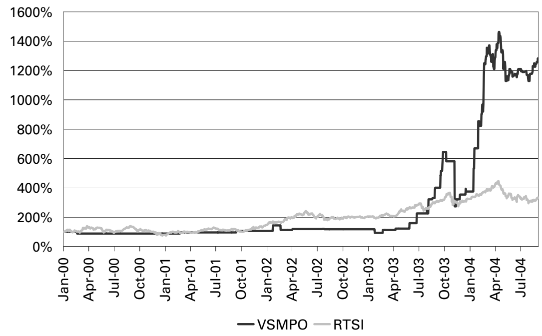
Source: Metropol

VSMPO: Production and Financial Data, 2003–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Production (000 ton)						
Titan and alloys	15	21	23	23	24	2
Aluminum alloy	10	11	10	10	10	1
Total	**25**	**32**	**33**	**34**	**34**	**3**
YoY growth	4%	28%	3%	3%	1%	1%
Product exports, % of product output	82%	85%	85%	88%	88%	88%
Income Statement						
Revenues	348	543	658	759	740	69
Operating costs	(201)	(299)	(353)	(402)	(399)	(375
Operating profit	117	193	239	268	250	23
Pretax profit	100	173	219	248	230	21
Net income	**80**	**135**	**171**	**186**	**173**	**16**
EBITDA	123	202	251	283	268	25
Cash Flow Statement						
Operating cash flow	**86**	**144**	**183**	**201**	**191**	**178**
Capex investment	(25)	(26)	(27)	(27)	(28)	(29)
Disposals/(acquisitions)	0	0	0	0	0	0
Cash used for investing	**(43)**	**(37)**	**(36)**	**(26)**	**(25)**	**(37)**
Net change in cash	1	47	115	137	168	165
Free cash flow	**21**	**84**	**146**	**175**	**194**	**188**
Balance Sheet						
Cash & Investments	50	71	186	323	491	656
Receiables(net)	57	89	108	125	122	114
Inventory	143	214	252	287	285	268
Other Current assets	0	0	0	0	0	0
Fixed assets	61	78	93	105	115	127
Other non-current assets	31	49	59	68	67	63
Total Assets	**343**	**500**	**698**	**908**	**1,080**	**1,228**
Accounts payable	49	74	87	99	98	92
Short-term debt	50	75	88	100	100	94
Other current liabilities	0	0	0	0	0	0
Long-term debt	0	0	0	0	0	0
Other LT liabilities	0	0	0	0	0	0
Shareholders' equity	**217**	**352**	**523**	**709**	**882**	**1,041**
Total Liabilities & Equity	**343**	**500**	**698**	**908**	**1,080**	**1,228**
Total Debt	50	75	88	100	100	94
Net Debt	0	4	(98)	(223)	(391)	(563)
Credit						
Net debt to equity %	0	1	-19	-31	-44	-54
Total debt to total capital %	23	21	17	14	11	9
Times interest earned	48	23	25	22	26	26
Cash coverage of fixed charges	25	22	25	27	28	28
Profitability						
EBITDA margin	35	37	38	37	36	36
Operating margin	34	36	36	35	34	34
Net margin	23	25	26	25	23	23
Growth						
Revenues	24	56	21	15	-3	-6
Operating profit	29	65	24	12	-7	-7
EBITDA	25	64	24	13	-5	-6
Net income	87	68	27	9	-7	-7
Return						
ROE, %	20	15	22	25	25	27
ROCE %	29	23	21	28	26	25
per tonne						
Revenues	13911	16991	20059	22445	21559	20090
Operating cost	8021	9366	10755	11875	11629	10836
Operating profit	4665	6035	7290	7934	7295	6738
EBITDA	4908	6314	7649	8371	7816	7254
Net income	**3210**	**4219**	**5210**	**5507**	**5034**	**4619**
Operating CF	3453	4498	5570	5944	5555	5136
Capex	1000	806	808	808	820	838
Free CF	**828**	**2624**	**4449**	**5173**	**5645**	**5434**

Source: Company data, Metropol research

VSMPO: Share Price Performance, 2000–4



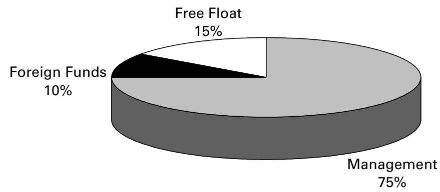
Source: Bloomberg

VSMPO: Company and Per-share Information

Market Cap ($ mn)	776	**52-week High ($)**	92
Avg. Daily Volume ($ mn)	0.2	**52-week Low ($)**	15
Shares Outstanding (mn)	11	**Annual Div. ($)**	n/a
Free Float (%)	15	**Div. Yield (%)**	n/a
Free Float ($ mn)	116	**Payout (%)**	n/a

Source: Company data

VSMPO: Shareholder Structure



Source: Company

VSMPO: Valuation Summary, 2003E–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Valuation ratios						
P/E	24.3	11.1	7.7	6.0	5.0	5.4
P/Book	2.3	1.7	1.2	0.9	0.8	0.7
EV/EBITDA	7.4	5.1	3.8	2.2	1.7	1.2
EV/Sales	2.2	1.6	1.2	0.8	0.6	0.4
EV/Production	31431	26917	23097	18698	13507	8436
Key drivers						
Production growth	16.7	14.6	2.7	3.1	1.5	0.8
Revenue growth	42.0	37.4	21.2	15.3	-2.6	-6.1
Operating margin	33.7	35.5	36.4	35.4	33.8	33.5
Net margin	23.7	24.9	26.0	24.6	23.4	23.0
EPS growth	119.8	44.3	26.8	8.9	-7.3	-7.5
EBITDA growth	42.6	44.7	24.4	12.8	-5.3	-6.5

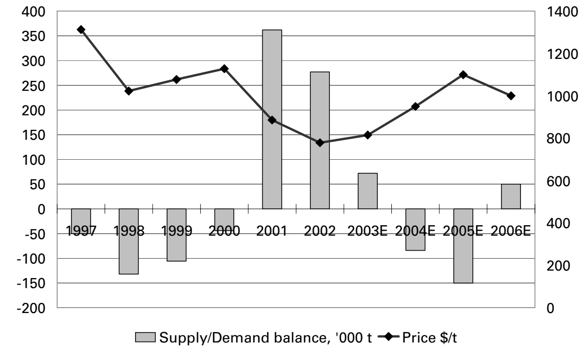
Source: Metropol research

VSMPO: Management and Headquarters

Address	1 Verkhnyaya Salda, Sverdlovsk Region 624600
Tel/Fax	Tel: +7-34375-21786 Fax: +7-34345-24736
CEO	Victor Breshet
E-mail	jachmenev@vsmpo.ru
Web	www.vsmpo.ru
Auditors	n/a

Source: Company data

Exhibit 58
World Zinc Market: Supply-Demand Balance, 1997–2006E



Source: IISI

Chelyabinsk Zinc

BUY

Price: $40
Target price: $210

We initiate coverage of Chelyabinsk Zinc with a BUY recommendation and a price target of $210, implying 600% upside potential from the current market price. This unusually high potential upside represents both the risks and rewards of owning the stock. While we project the share price rising to this level in the next 12 months if all goes well for the company, we also see a fairly high chance that our target will not be met. The stock is quite illiquid, and so would not be appropriate for all investors.

Chelyabinsk Zinc Plant is Russia's largest zinc producer, accounting for 60% of total Russian production and 2% of world production. The company produced 155,000 tons of zinc in 2002. Chelyabinsk Zinc is dependent on ore supplied by mining deposits in the Urals controlled by UGMK. The company has strong cash flows and a healthy balance sheet, in our view. Both Norilsk Nickel and UGMK have expressed interest in acquiring a controlling stake in Chelyabinsk Zinc. We believe the company is very inexpensive at current valuations, trading on a 2003 EV/EBITDA of 0.8 and a historical PE of 1.4, compared with global industry averages of 19.8 and 44, respectively. We base our unusually high price target on the following factors.

INVESTMENT DRIVERS

- Very low free float of 1-2% of total share capital and a wide bid-ask spread of some $34 per share (the stock currently trades at $26/$60 on the RTS.

- **High projected world zinc prices** through 2005, based on IISI estimates.

- **High quality zinc output.** ChelZinc produces Special High Grade zinc that is 99.995% pure, complying with global quality standards.

- **Technical modernization program nearly complete.** The company has almost replaced its obsolete equipment and technology, investing some $300,000 in capex in 2002–4 to help reduce smelting costs.

- **Potential acquisition target.** We believe the company could become an acquisition target, which we believe should benefit minority shareholders of Chelyabinsk Zinc.

INVESTMENT RISKS

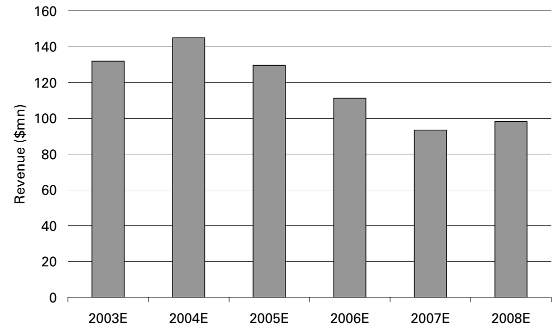
- **Acquisition risks.** A controlling stake in the company belongs to Chelyabinsk Pipe company (ChTPZ), which considers Chelyabinsk Zinc a non-core business. We see some risk that ChTPZ could sell the company off below market price, at a loss for minority investors.

- **Risk of legal investigations of tolling schemes.** The company receives 50% of revenues from tolling schemes. We believe it could face legal investigations into these activities in future.

- **No resource base.** Chelyabinsk Zinc has no mining base, importing over 60% of its concentrate from abroad. Zinc concentrate prices rose 14% in 2003 and 20% in 1H04.

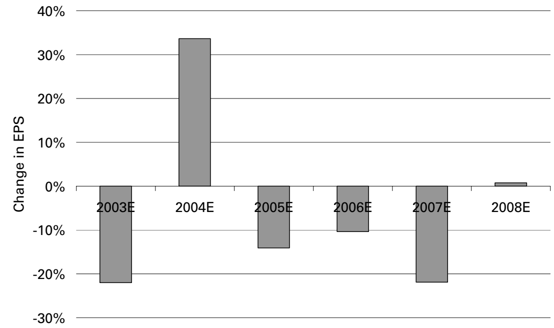
- **Tough competition with low-cost producers** in Kazakhstan and Uzbekistan. On the domestic market, ChelZinc faces stiff price competition from other CIS producers.

Chelyabinsk Zinc: Revenue Projections, 2003–2008E



Source: Metropol research

Chelyabinsk Zinc: EPS Projections, 2003–2008E



Source: Metropol research

Chelyabinsk Zinc DCF Summary, 2003–2010E (US$ mn)

PROJECTED CASH FLOWS	2003E	2004E	2005E	2006E	2007E	2008E	2009E	2010E
Revenue	$131.9	$145.0	$129.6	$111.2	$93.5	$98.1	$106.0	$124.9
Annual Growth	5.5%	9.9%	-10.6%	-14.2%	-16.0%	5.0%	8.0%	17.9%
EBITDA	25.3	32.8	29.2	27.0	22.7	22.8	23.7	27.3
Annual Growth	-15.5%	29.8%	-11.1%	-7.3%	-16.1%	0.6%	4.0%	15.1%
Margin	19.2%	22.6%	22.5%	24.3%	24.3%	23.3%	22.4%	21.9%
Unleveraged Net Income	18.4	24.5	21.1	18.9	14.8	14.9	15.7	18.7
Annual Growth	-21.2%	33.3%	-14.0%	-10.3%	-21.7%	0.8%	5.1%	19.5%
Margin	13.9%	16.9%	16.2%	17.0%	15.8%	15.2%	14.8%	15.0%
Plus: Depreciation & Amortization	3.7	4.0	4.4	4.8	5.3	5.3	5.3	5.3
Less: Capital Expenditures	(4.0)	(4.1)	(5.0)	(5.1)	(6.0)	(6.0)	(6.1)	(6.2)
Change in Working Capital	(1.4)	(2.5)	3.6	4.6	4.1	(1.1)	(1.8)	(4.4)
Free Cash Flow	16.6	21.9	24.0	23.2	18.2	13.1	13.0	13.4

PRESENT VALUE OF EQUITY	
PV of FCF 2002-2006	$72.5
PV of Terminal Value	76.6
Enterprise Value	149.0
- ST & LT Debt & Taxes Owed	(20.2)
- Preferred Equity	-
+ Cash	5.0
Equity Value	133.8
Common Shares	637
Value Per Share	**$210.2**

DCF ASSUMPTIONS	
WACC	13.1%
Terminal Growth Rate	0%
EBITDA % Plan Realiz	100%
Tax Rate	15.0%

WACC	
Risk-free rate (10y F	6.57%
Corporate spread	2%
ERP	6%
Beta	1.23
Cost of Equity	14.0%
Cost of Debt	8.6%
Cost of preferred	11.3%
D/E	15.1%
D/A	13.1%
P/A	0.0%
WACC	**13.09%**

Source: Metropol research

Chelyabinsk Zinc: Production and Financial Data, 2003–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Production (000 ton)						
Zinc	177	151	157	149	134	141
YoY growth, %	7%	-15%	4%	-5%	-10%	5%
Product exports, % of prod. output	30%	35%	40%	40%	40%	40%
Income Statement						
Revenues	132	145	130	111	93	98
Operating costs	(103)	(109)	(97)	(82)	(69)	(72)
Operating profit	29	36	32	30	25	26
Pretax profit	21	29	25	22	17	17
Net income	**18**	**24**	**21**	**19**	**15**	**15**
EBITDA	25	33	29	27	23	23
Cash Flow Statement						
Operating cash flow	**22**	**28**	**25**	**24**	**20**	**20**
Capex investment	(4)	(4)	(5)	(5)	(6)	(6)
Cash used for investing	**10**	**4**	**(3)**	**(4)**	**(3)**	**8**
Debt issue/(repayment)	0	0	0	0	0	0
Cash from financing activities	**0**	**0**	**0**	**0**	**0**	**0**
Net change in cash	11	15	32	32	27	11
Free cash flow	**17**	**22**	**24**	**23**	**18**	**13**
Balance Sheet						
Cash & Investments	16	31	62	95	121	132
Receiables(net)	13	15	13	11	9	10
Inventory	28	29	26	22	19	19
Other Current assets	5	6	5	4	4	4
Fixed assets	42	43	43	43	44	45
Other non-current assets	66	72	65	56	47	49
Total Assets	**171**	**196**	**215**	**231**	**244**	**259**
Accounts payable	11	12	11	9	8	8
Short-term debt	4	4	3	3	2	3
Other current liabilities	15	16	14	12	10	11
Long-term debt	0	0	0	0	0	0
Other LT liabilities	17	17	17	17	17	17
Shareholders' equity	**171**	**196**	**215**	**231**	**244**	**259**
Total Liabilities & Equity	**171**	**196**	**215**	**231**	**244**	**259**
Total Debt	4	4	3	3	2	3
Net Debt	(12)	(27)	(59)	(92)	(119)	(130)
Credit						
Net debt to equity	-7.0	-13.8	-27.4	-39.6	-48.8	-50.0
Total debt to total capital	2.1	1.9	1.6	1.2	1.0	1.0
Times interest earned	29	23	25	22	26	26
Cash coverage of fixed charges	25	22	25	27	28	28
Profitability						
EBITDA margin %	19	23	22	24	24	23
Operating margin	22	25	25	27	27	27
Net margin	14	17	16	17	16	15
Growth						
Revenues	5	10	-11	-14	-16	5
Operating profit	12	5	-10	-16	-16	5
EBITDA	-16	30	-11	-7	-16	1
Net income	-22	34	-14	-10	-28	1
Return						
ROE, %	11	12	10	8	6	6
ROCE, %	14	16	12	14	7	7
per tonne						
Revenues	744.0	961.7	826.9	746.9	697.2	697.2
Operating cost	582.6	720.0	620.7	547.6	511.4	511.4
Operating profit	161.4	241.7	206.2	199.3	185.8	185.8
EBITDA	142.5	217.7	186.0	181.6	169.3	162.2
Net income	**102.6**	**161.3**	**133.2**	**125.7**	**109.1**	**104.7**
Operating CF	123.3	187.9	161.3	158.0	148.5	142.2
Capex	22.6	27.1	31.9	34.2	44.8	42.6
Free CF	**93.6**	**145.4**	**153.3**	**155.7**	**136.0**	**93.1**

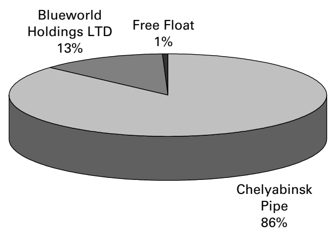
Source: Company data, Metropol research

Chelyabinsk Zinc: Company and Per-share Information

Market Cap ($ mn)	19	**52-week High ($)**	55
Avg. Daily Volume ($ mn)		**52-week Low ($)**	10
Shares Outstanding (mn)	0.6	**Annual Div. ($)**	n/a
Free Float (%)	1	**Div. Yield (%)**	n/a
Free Float ($ mn)	0.1	**Payout (%)**	n/a

Source: Company data

Chelyabinsk Zinc: Shareholder Structure



Source: Company

Chelyabinsk Zinc: Valuation Summary, 2003E–2008E

	2003E	2004E	2005E	2006E	2007E	2008E
Valuation ratios						
P/E	1.4	1.8	1.3	2.2	2.8	2.8
P/Book	0.3	0.3	0.3	0.4	0.4	0.4
EV/EBITDA	1.1	0.8	1.5	1.2	1.0	1.0
EV/Sales	1.2	0.4	-0.6	-1.9	-3.4	-3.9
EV/Production	0.2	0.1	-0.1	-0.5	-0.8	-0.9
	166.0	95.3	-111.9	-337.8	-579.8	-626.6
Key drivers						
Production growth						
Revenue growth	7.5	-15.0	4.0	-5.0	-10.0	5.0
Operating margin	5.5	9.9	-10.6	-14.2	-16.0	5.0
Net margin	21.7	25.1	24.9	26.7	26.7	26.7
EPS growth	13.8	16.8	16.1	16.8	15.7	15.0
EBITDA growth	-22.0	33.7	-14.1	-10.4	-21.9	0.8
EBITDA	-15.5	29.8	-11.1	-7.3	-16.1	0.6

Source: Metropol research

Chelyabinsk Zinc: Management and Headquarters

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CEO	Vsevolod Geykhman
E-mail	io@zinc.ru
Web	www.zinc.ru
Auditors	n/a

Source: Company data

APPENDIX 1: GLOSSARY

Crude steel
Steel in its natural state. Steel produced from iron ore, scrap metal and coke coal. Producing 1 ton of crude steel requires 1.8 tons of iron ore and 0.6 tons of coke, on average. Crude steel is used to manufacture all types of final products, or may be purchased direct from the producer for use in pig iron or slab production.

Rolled products
Final products made from crude steel. Rolled sheet is manufactured by rolling continuous cast slabs into coiled product in the required thickness. On average, 1.2 tons of crude steel are used to produce every ton of rolled product. Typically used in the manufacture of sheets or rolled long products.

Hot rolled steel
Hot rolled sheet is manufactured by rolling continuous cast slabs to coiled product in the required thickness. As a normal result of hot rolling, steel carries surface oxide (scale). Typically used in the manufacture of sheets and coils.

Cold rolled steel
Cold rolled sheet is manufactured from hot rolled coils by pickling to remove the surface oxide produced during the hot rolling stage, and reducing through a cold mill to the desired thickness. Cold reducing steel produces an extremely low ductility product. This is usually processed further to develop desired end use characteristics such as formability, surface texture, flatness, etc. Typically used in the manufacture of sheets and coils.

Stainless steel
Stainless steel is an alloy of iron containing at least 10% chromium. Stainless steel does not stain, but occasionally dulls or can show oily marks. Stainless is known for its hardness and is commonly used to make household utensils, tableware, sinks, counter tops, and small appliances. Part of the chromium in the alloy forms the hard oxide coating on the surface. If this is removed through corrosion or wear, stainless rusts like ordinary steel.

Flat steel products
Sheet rolled products such as hot and cold rolled sheet, typically used in the automotive and machine-building industries.

Long products
Long products include items such as billets, blooms, beams, channels, joists, columns, merchant bars, ropes, tubes, pipes and wire rods. Long products are most commonly produced from crude steel, and are used extensively throughout the world in the automotive, construction, ship-building and other heavy industries.

Capacity utilization
The percentage of an industry's production capacity that is actually used in production, over some period of time. Also called the operating rate. Measured in percent.

Steel price cycle
Normally 2–3 years long during world economic recovery and industrial production growth. The steel price cycle is characterized by price and the capacity utilization ratio. As steel prices begin growing, capacity utilization increases. At the beginning of a cycle, hot rolled sheet prices have tended to average some $210-$250/ton at 65–70% capacity utilization during the last four cycles. By the end of a cycle, prices commonly rise to some $350-$400/ton at 85–90% capacity utilization.

Apparent consumption
Calculated as crude steel production + imports − exports. Apparent consumption may exceed crude steel production due to inventory additions of rolled products.

GOK

Gorno-obogatitelny kombinat, or GOK, is the Russian name for iron ore or coking coal mining assets.

OHF

An open-hearth furnace (OHF) uses the heat of combustion of gaseous or liquid fuels to convert a charge of scrap and liquid blast-furnace iron to liquid steel. The high temperature required for melting is obtained by preheating the combustion air and, sometimes, the fuel gas.

BOF

Basic Oxygen Furnace technology turns iron into steel. This process reduces iron ores, fluxes and coke, as well as other reductants such as coal, oil, gas or processed waste plastics, in blast furnaces into hot metal, which is then converted into crude steel in downstream basic oxygen furnace (BOF) steel plants.

EAF

Electric arc furnace technology (EAF) melts scrap metal in the presence of electric energy and oxygen. The process does not require the three-step refinement needed to produce steel from ore. Production of steel from scrap can also be economical on a much smaller scale. Mills producing steel with EAF technology are often called mini-mills.

APPENDIX 2

	Severstal	NLMK	MMK	EvrazHolding	Mechel
1992		NLMK becomes an Open Joint-Stock company			
1994			Privatization of Steel Enterprises Begins		
	Through Severstal-Invest, Alexey Mordashov acquires a controlling stake in Severstal after privatization				
1995	A.Mordashov buys a further 15% stake in Severstal at a privatization auction, consolidating 95% of the company's shares				
1996				EvrazMetal (formerly EvrazHolding) acquires blocking stake in NTMK	
1997		Vladimir Lisin consolidates a 60% stake in NLMK, including an 11% stake acquired from offshore metals holding TWG Group.	Rashnikov becomes CEO of MMK, with control over 60% of its shares	EvrazHolding buys controlling stake in Zapsib from Alfa Bank	
1998		Renaissance Capital sells a controlling stake to Lisin, raising his stake to 63%	MMK publishes IAS results for the first time		Offshore company Skironas, controlled by Mechel CEO Zyuzin, (South Kuzbass) acquires 15% of Mechel
1999	Severstal begins publishing IAS accounts			EvrazHolding management acquires controlling stake in NTMK for RUR 8.5 bn assuming a company debt over 10 years	Glincore consolidates 35% stake in Mechel
2000		Interros acquires 34% of NLMK from TWG Group	MMK starts paying dividends	EvrazHolding and Alfa-Eko Group sign an agreement on restructuring Zapsib's $110 mn worth of debt; EvrazHolding gains a controlling stake in Zapsib	
2001		Interros sells its 34% stake to Lisin, who now controls 94% of the company	MMK adopts corporate governance charter		Glencore and South Kuzbass begin merger of their stakes in Mechel.

Source: Vedomosti, Kommersant, Metropol

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