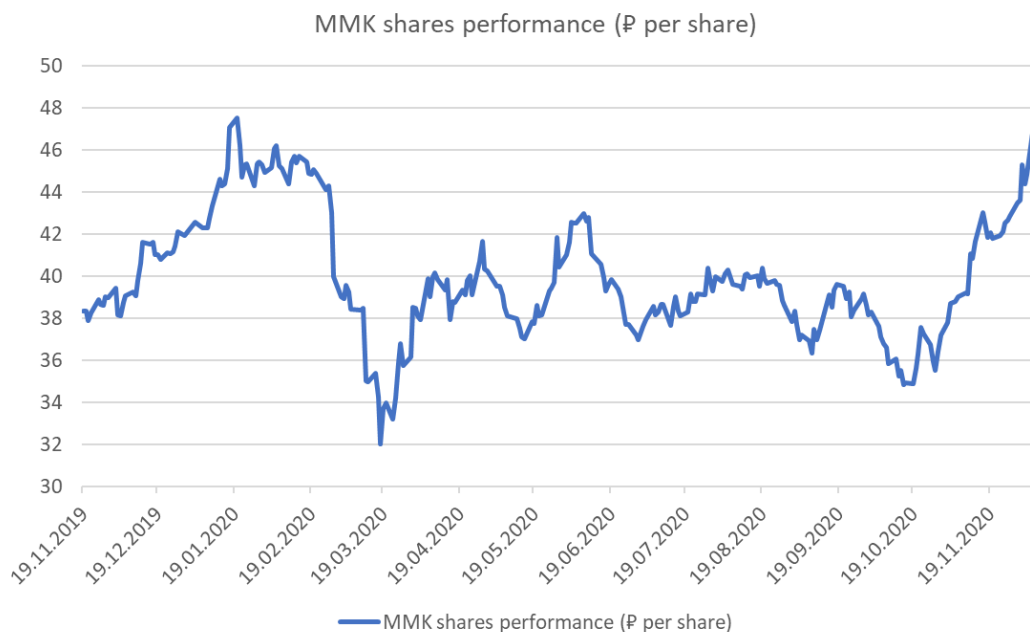


MMK: EBITDA \$1 bln growth, free-float not priced in?

MMK: EBITDA GROWTH BY \$1 BLN NOT PRICED IN? FREE-FLOAT MAY PICK UP

The idea to buy MMK, which we presented on November 30, is working and, despite growing by 11%, is still relevant. The chat that the company's leadership team had with investors on December 8, supports the news flow and may trigger the revision of financial forecasts for MMK. The key growth drivers:

- (i) favourable market environment for steel producers;
- (ii) iron ore prices peak seems to have been passed;
- (iii) implementation of projects will drive up EBITDA by 60% (by 2025 from 2019);
- (iv) top management's intention to get back to MSCI and actions aimed at reaching this goal.



Sources: Bloomberg, ITI Capital

On December 8, the company held an “MMK Online. Fireside chat with the leadership team” event. Chairman of the Board of Directors Victor Rashnikov and CEO Pavel Shilyaev discussed market trends, as well as the latest corporate developments and the group's strategic view for 2025. We assume the event provided a positive backdrop, as expected.

DEMAND FOR STEEL IN RUSSIA REMAINS STRONG

MMK'S 100% CAPACITY UTILISATION RATE IN 4Q20 SUPPORTS POSITIVE VIEW ON STEEL DEMAND

Viktor Rashnikov, MMK's main beneficiary and BoD Chairman, said that 4Q20 MMK's capacity utilization rate is 100% (90% in September) and the company expects to maintain it through 1Q21.

MMK expects Russian steel consumption to grow by 5.9% yoy in 2021, sees a 2.2% average annual growth rate in 2019-2025 and 3% in 2020-2025.

The domestic market environment is characterised as positive by MMK competitor as well. Severstal improved its baseline forecast this week, expects steel demand in Russia to fall by 5.7% in 2020, up from the previous estimate of 6.4%-7%.

Global steel demand may decrease by 2.4% in 2020 instead of the 6.4% decline expected earlier, the World Steel Association said in its October forecast. The main drivers of growth are high demand in China, low inventories due to expectations of a strict lockdown, which was eventually abandoned almost everywhere, and low bank deposit rates (also relevant for Russia).

Global steel prices are growing strongly, which should have a positive effect on steelmakers' financial results in 4Q20 and 1Q21. Export prices for hot-rolled steel rose from \$500 per tonne in November to \$620 per tonne by early December. Domestic steel prices tend to lag 1.5 months behind export prices.

STRONG 4Q20-1Q20, PRICE PREMIUM RESTORATION IN DOMESTIC MARKET EXPECTED

We assume that following the strong 3Q20 we may expect strong financial results in 4Q20 and a steel price premium restoration in the domestic market as compared to international markets in 1Q20-2Q20. Domestic steel prices tend to lag 1.5 months behind export prices, which have been growing strongly in the 4Q20.

MMK expects premium to restore in the domestic market. Viktor Rashnikov attributed its drop to a seasonal slowdown in construction. The lack of a domestic premium (which usually amounts to \$40-50 per tonne) is attributed to a recent weakening of the Russian currency, therefore prices in roubles lag behind export prices. The price premium for steel in the domestic market is determined by the following factors: (1) delivery period in the domestic market is on average one or two weeks-long, delivery period for export supplies is way longer; (2) Logistics costs for exports supplies stand at \$70-80 per tonne; (3) consolidated Russian market, high entry barrier; (4) domestic consumers prefer rouble prices to exclude currency risks.

NORMALISATION OF THE RAW MATERIAL TREND

Unlike Severstal and NLMK, that rely on their own iron ore raw materials, MMK purchases most of the raw materials required for steel production. Lower prices for

this raw material, due to higher demand from China and greater supplies from Brazil, may have a favourable impact on MMK's margin.

Prices of iron ore have been rising since 2Q20 and recently topped seven-year highs, or \$145 per tonne. There are two main factors driving iron ore prices this year: (i) a surge in demand for iron ore in China (the world's leading steel producer) due to implementation of the large-scale infrastructure projects; (ii) supply disruptions in Brazil, one of the countries most affected by Covid-19.

INTRODUCTION OF EXPORT DUTIES WILL REINFORCE THE TREND

In addition, the Pipe Industry Development Fund (PIDF) has asked the Ministry of Economy that the Customs and Tariffs Subcommittee meeting consider a proposal to raise the export duty on ferrous scrap from 5% to 15% year, but not less than €45 per tonne, effective from 1 January 2021. The news could be positive for MMK as one of the largest consumers of scrap metal in Russia.

EBITDA \$1 BLN GROWTH THROUGH 2025 NOT PRICED IN?

MMK could boost EBITDA by an additional \$1 bln to \$3 bln (up from \$1.8 bln in 2019) by implementing its strategy for 2019-2025. CEO Pavel Shilyaev said that production chain strategic initiatives could boost EBITDA by an additional \$600 mln through 2025, while expanding the product line would add \$350 mln and improved customer relations would add \$60 mln.

In particular, the launch of new coke battery with a 2.5 mtpa capacity planned for 2022-2023 will boost EBITDA by \$55 mln, the launch of a new blast furnace with a 400 ktpa annual capacity in 2025 will boost EBITDA by \$120 mln. The launch of a new tin and galvanized and cold-rolled steel production complex (planned for 2022-2026) with a 400 ktpa premium products capacity will increase EBITDA by \$110 mln, while an upgrade of converter plant (a 1 mtpa steel capacity) in 2023-2025 will add \$70 mln to EBITDA.

We believe that commissioning of new projects and their impact on EBITDA are far from being fully priced in. For instance, MMK's EBITDA for 2024 is estimated at \$2.5 bln, according to Bloomberg consensus. We do not rule out the revision of analysts' models following comments from the company's management.

CAPEX GROWTH

PRODUCTION CAPACITY EXPANSION WILL PUSH UP CAPEX COSTS

MMK did not provide details on its capex guidance, however, given that the company's investments peaked in 2008-2010, it is reasonable to expect a pick-up in investments.

Utilization of the blast furnace complex reached 100% in the third quarter. Therefore, it seems reasonable that MMK's plans to increase steel output by 1 mln tonnes and

iron output by 400,000 mln tonnes by 2025.

CAPEX GROWTH WILL HAVE A LIMITED IMPACT ON ANNUAL DIVIDENDS

MMK owner reiterated its commitment to the dividend policy. The company's dividend policy provides for a built-in mechanism to offset the negative impact of FCF decline on dividends by exceeding \$700 mln capex threshold. Against this backdrop, higher capex will not materially affect the dividend payout for the year.

While 4Q20 will be strong in terms of sales, we expect FCF which is the base for dividend payout to come under pressure due to investment in floating capital amid sold-out stocks in 3Q20 and increased export supplies that requires longer diversion of financial resources.

The company has approved a dividends for 3Q20 of ₺2.39 per share (a 5% dividend yield). The record date to receive dividends is December 14, 2021.

MSCI FACTOR NOT FORGOTTEN

The company said that it expects to return to MSCI in 2021 after exclusion on November 30, 2020. Activities aimed at increasing investor demand for the stock may help reach this goal. The free-float volume is also important to get back to the MSCI.

FREE-FLOAT MAY PICK UP

Viktor Rashnikov has indicated that he may consider increasing the company's free-float at a certain level of capitalization. When it comes to a readmission to the MSCI the free-float volume makes a difference. Vladimir Lisin sold a 2.1% stake in NLMK last week in order to increase the company's appeal to public investors by boosting liquidity and the shares' weight in the MSCI. The FTSE announced December 8 that it will increase NLMK's weight in its indices.

We believe the risk of additional shares availability is more than justified given a possible readmission to the index and expansion of the investor base.

M&AS ARE NOT RULED OUT, BUT NOT ON THE AGENDA FOR NOW

TURKISH ASSETS

MMK is prepared to consider selling its Turkish asset, MMK Metalurji, if a market price is offered, majority shareholder Viktor Rashnikov said at the company's Investor Day.

Higher demand in Turkey could lift the Turkish asset's EBITDA to \$75 mln, Rashnikov said.

We assume, MMK Metalurji remains an important strategic asset for MMK.

IRON ORE PRODUCERS

Management does not rule out strengthening the company's vertical integration but sees the acquisition of iron ore producers as an insufficiently attractive investment project, given the current high prices of raw materials.

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