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Mostotrest: a highway to Russian infrastructure construction market

BUY
Target price: US\$ 8.6
Upside: 48%
Stock data

Ticker	MSTT	M.Cap, \$ mn	1 629
Shares Ords	282 215 500	EV, \$ mn	1 457
Shares Pref	-	Free Float	28.5%
Price, Ords, \$	5.8	Free Float, \$ mn	464

Market performance

		1 month	6 months
Absolute	Ords	-2.5%	-27.8%
Relative to RTSI	Ords	-6.8%	-2.9%
Price range, \$			
High	Ords	6.36	8.11
Low	Ords	5.36	4.65

Financials, RUB mn

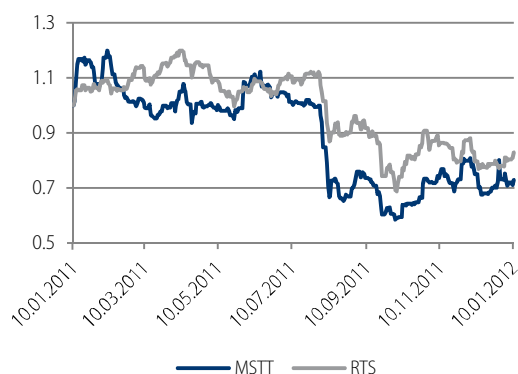
	2010	2011E	2012E
Revenue	74 879	88 321	108 685
Gross income	11 060	11 459	15 196
EBITDA	9 011	8 649	11 151
Operating income	5 497	5 110	8 259
Net income	1 043	3 214	5 428

Margins

	2010	2011E	2012E
Gross margin	14.8%	13.0%	14.0%
EBITDA margin	12.0%	9.8%	10.3%
Operating margin	7.3%	5.8%	7.6%
Net margin	1.4%	3.6%	5.0%

Ratios

	2010	2011E	2012E
EV/S	0.61	0.52	0.42
EV/EBITDA	5.1	5.3	4.1
P/E	49.2	16.0	9.5

Relative performance


Source: Bloomberg

MSTT
Initiation of coverage

We begin our coverage of Mostotrest – a leader in the Russian infrastructure construction market, which looks as one of the most attractive markets in Russia now due to expected large government spending. A number of infrastructure objects must be built for Sochi 2014 Winter Olympic Games and 2018 FIFA World Cup. Mostotrest, in our opinion, is one of a few opportunities to participate in this promising market and the only liquid company in this sector.

We assign **BUY** rating to Mostotrest common shares with 12-month target price of **USD 8.6** per share.

Drivers:

- **Quick expected growth of construction market due to lack of existing infrastructure.** According to PMR research and consulting company, in 2011-2015 the total value of this market is to exceed RUB 5.0 trln and CAGR is to be more than 16%. The Federal Program, approved by the government, is even more ambitious and provides for RUB 10.2 trln for infrastructure construction market in 2011-2015. According to PMR, more than 70% of the total Program budget is expected to be spent on roads and bridges – Mostotrest specialization. Russia is 125th in the world on overall road quality list and has 7x and 11x less road density, compared to China and South Africa respectively.

- **Mostotrest is the market leader, capable of implementing complicated and unique projects.** The company has the largest market share in the Russian infrastructure construction market (8%) and bridges construction segment (25%). Large market share, good expertise and broad experience allow Mostotrest to get orders with high margins. In bridges segment gross margin could reach 25-30%. In the current backlog the share of roads and bridges is more than 80%.

- **Company's strategy is aimed at further expansion.** Mostotrest itself is going to implement more projects, however, we do not rule out the possibility that the company could decide to enter prospective regions by acquiring smaller local companies. Among potential acquisitions we expect that Mostotrest could increase its share in Mostostroy-11 to a controlling stake in coming years.

- **Mostotrest is currently trading with a discount to foreign peers** on EV/EBITDA 2012 multiple. The current discount is more than 25% to developed market peers and is about 40% to emerging market peers. Taking into account the prospects of the Russian infrastructure construction market, we see this discount as unjustified and expect it to start shrinking in near future.

Risks:

- **Potential state budget sequester could negatively affect company's order book.** If oil price significantly goes down, the budget deficit will increase. In this case some projects could be either frozen or postponed. However, Russia has some obligations to build a number of infrastructure objects for Sochi 2014 Winter Olympic Games and 2018 FIFA World Cup, and consequently, their construction will be finished anyway.

- **Possible increase in share of subcontractors.** Currently the share of subcontractors is 20%, but it is growing. As the margin of general constructor business is only 5%, the share of subcontractor work significantly affects company's margins. However, in our estimates we are conservative and apply 40% share of subcontractors to all new company projects.

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Russian infrastructure sector: huge investments are expected

Russia heavily needs new road infrastructure

In our opinion, in terms of territory Russia is comparable to the USA, Canada, Brazil and China, whose territories are only 1.7x-2.0x smaller than the Russian one. Road density per square kilometer in Russia, according to World Bank data, is 2.5x less compared to Canada, 3.6x less than in Brazil, 7.0x less than in China and 11.5x less compared to the USA. The difference compared to Japan and European developed countries, which have significantly smaller territory, looks even more dramatic. In terms of population headcount, Japan (127.5 mn people) among developed countries and Brazil (195 mn people) among emerging countries look as the most comparable with Russia (142 mn people). However, road density per capita in Russia is 26% less than in Japan and 23% less compared to Brazil. We also note that road length per capita in Russia is 2.2x less than in South Africa and almost 6.0 times less compared to Canada. India and China have only 1.9x-2.4x less roads per capita, than Russia does, despite the population in these countries is 8.3x-9.4x higher. Russia needs to build 770,000 km of new roads to reach Brazil - its closest emerging countries peer both in terms of population and territory. Taking into account this information, huge investments are expected in new roads construction in coming years.

Figure 1. Road density in different countries, km per 1 000 sq.km.

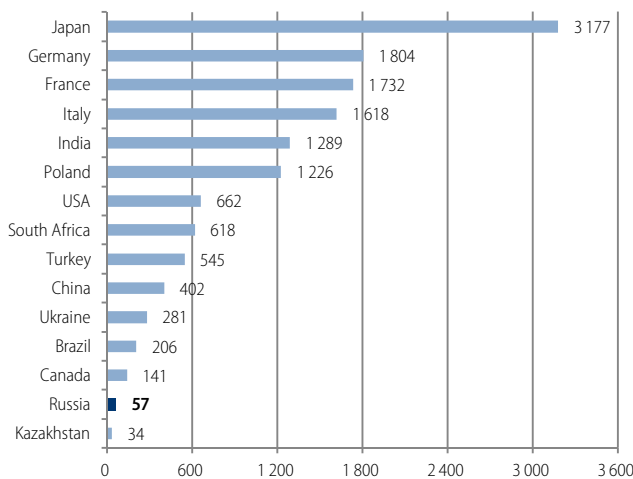
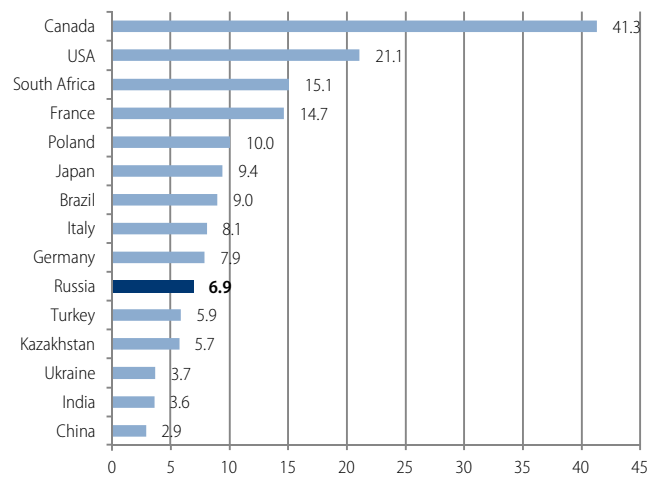


Figure 2. Road density in different countries, km per '000 people



Source: World Bank, World Factbook, SOVLINK

A lack of road infrastructure results in 5-10% GDP loss yearly and hinders economic growth

According to the Russian Deputy Prime Minister Sergey Ivanov, Russia loses approximately 5% of its GDP per annum due to underdevelopment of road network and poor quality of existing roads. Road experts are forecasting that till the end of 2015 yearly losses due to poor road infrastructure could reach 10% of GDP per annum, if yearly spending for road infrastructure does not reach 4.5-5% GDP. However, they also point to the necessity to increase the effectiveness of using the budget for road construction. The share of transportation costs in total price of goods in Russia is twice higher (15-20%), compared to Europe and the USA (7-10%).

Railroad density is behind the majority of developed and emerging countries, but the situation is better, compared to road infrastructure...

According to World Bank data, railroad density per square kilometer in Russia is 3.6x less than in South Africa, 3.9x less compared to India and 4.6x less than in the USA. The gap between Russia and China is only about 40% in favor of China. Canada has only 17% more railroads per square kilometer, compared to Russia. However, railroad density per capita looks significantly better. In Russia the railroad length per capita is 15% more than in France, 46% more than in Germany and 3.9x more compared to Brazil. However, this figure is 18% less compared to the USA and 31% less than in Kazakhstan.

...however, Russian railcar operators have started to face some troubles due to railroad infrastructure overloading

Despite the fact that the situation with railroads in Russia is considerably better than with roads, railcar operators have started to face problems, which are admitted by Russian Railways management. Russian Railways cannot satisfy all the demand for railcars transportation due to infrastructure overloading. Consequently, the Russian government and Russian Railways are going to invest in railroad infrastructure in the coming years.

Figure 3. Railroad density in different countries, km per 1 000 sq.km.

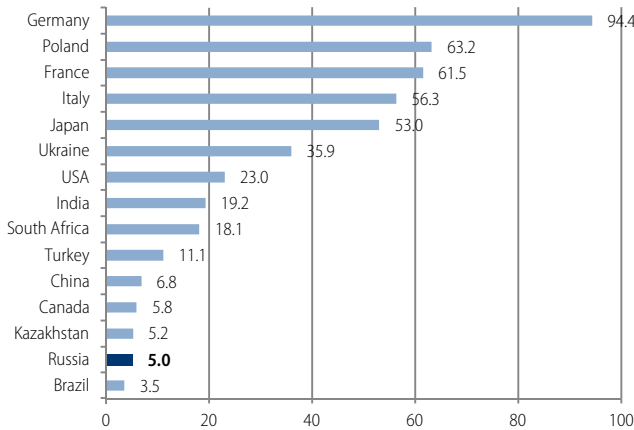
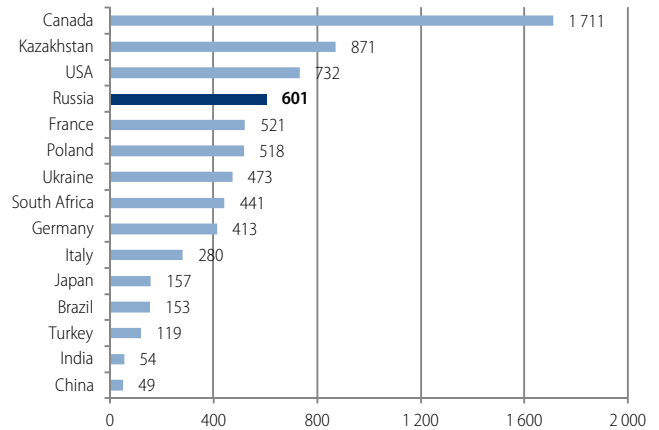


Figure 4. Railroad density in different countries, km per mn people



Source: World Bank, World Factbook, SOVLINK

The quality of Russian infrastructure is poor

Russia takes 94th place in overall infrastructure quality global rank and only 125th place in road quality rank. In these ranks Russia is far below developed countries and lower, compared to BRIC. For comparison, we highlight that South Africa is far above Russia in these ranks: on 43rd place in the road quality rank and on 56th place in overall infrastructure quality rank. According to road experts, due to low quality, the average speed on Russian roads is 280-300 km per day while in Europe it is more that 3x higher and exceeds 1 000 km per day. The average fuel consumption of vehicles in Russia is 35-40% more, than in European countries. Consequently, poor infrastructure quality results in direct losses in Russian GDP. In our opinion, in case of infrastructure quality improvement it could have a sizable effect on GDP, which means that making investments in infrastructure is beneficial for the government.

Figure 5. Overall infrastructure quality rank

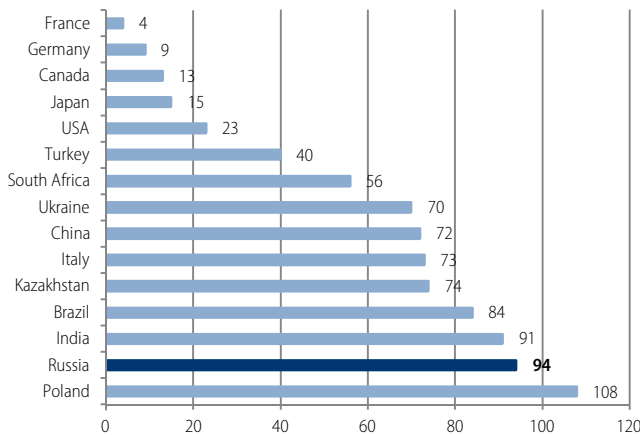
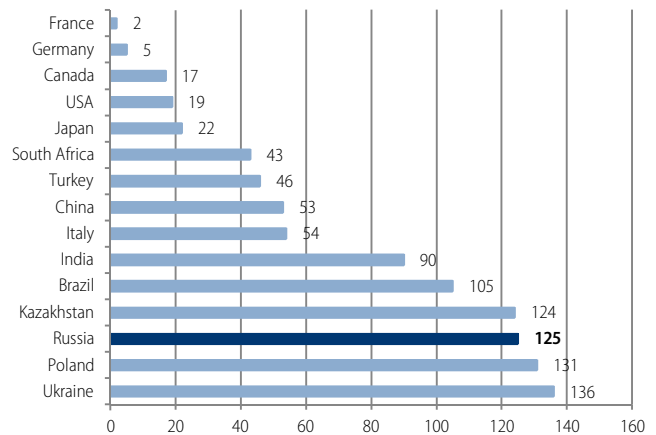


Figure 6. Roads quality rank



Source: The Global Competitiveness Report 2010-2011 (World Economic Forum)

Russian infrastructure construction market grew at 13.3% CAGR in 2005-2010...

According to PMR estimates, the Russian infrastructure construction market in 2005-2010 almost doubled from RUB 317 bn in 2005 to RUB 592 bn in 2010 (excluding VAT). The total infrastructure

construction market value in 2005-2010 was RUB 2.9 trln. Lack of infrastructure and its poor quality, which are described earlier, forced the government to make large investments, which forced the market to grow quickly. We also note that in 2005-2008 the growing prices for oil and gas resulted in surplus of the Russian budget, consequently, the Russian government could afford large infrastructure spending. Consequently, in 2007 infrastructure construction market grew by 26% y-o-y and in 2008 it increased by another 27% y-o-y. In 2009-2010 the government tried to balance between huge need in infrastructure investments and budget deficit. As a result, infrastructure construction market grew by only 4.9% in 2009 and declined by 0.3% in 2010.

Figure 7. Russian infrastructure construction market in 2005-2010 (VAT excluded), RUB bn

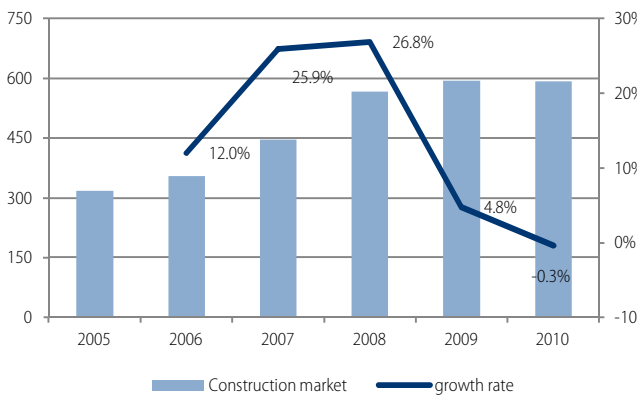
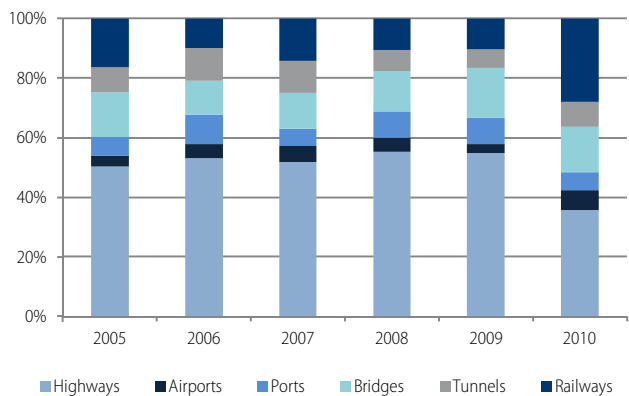


Figure 8. Segment shares of Russian infrastructure construction market in 2005-2010



Source: PMR, Mostotrest, SOVLINK

...due to Federal Program realization, which was approved in 2005 and targeted RUB 7.5 trln spending on infrastructure in 2005-2010 (VAT included)

Taking into account the corrections to 2010 figures due to a new program approval (May 2008), Federal Program of infrastructure modernization supposed RUB 7.5 trln spending on building transport infrastructure in 2005-2010 and RUB 4.2 trln were reserved for roads (VAT included). These figures include both the federal budget spending and regional budgets spending and private investments. Consequently, these figures reflect the market potential. In its initial version, the Federal program provided for RUB 8.25 trln investments in infrastructure in 2005-2010 and implied a CAGR of 27.2%. The road subprogram provided for RUB 5.1 trln investments with a CAGR of 30.8% in 2005-2010.

However, the average implementation rate was only 49% for the entire Federal Program and only 46% for roads subprogram

We link rather low implementation rate to initially too ambitious plans both in absolute and relative terms. In 2005 all the figures of the Federal Program were approved, and even this year the implementation rate was only 70%. In 2006 and 2007 it declined to 60% and 53% respectively, which means that the program supposed too high growth rates. We link the further decline of implementation rate in 2009 and 2010 to 41% and 33% respectively to the global economic crisis. As for the road modernization subprogram, the implementation rate followed almost the same dynamics.

Roads and bridges were the priorities

According to our estimates, 56% of total Federal Program budget was expected to be spent on road building. We link the accent on roads to huge underinvestment of this sector in the previous years due to difficulty to attract private investments into this sector. According to PMR data, in 2005-2010 the share of road building was 53.3% of the entire infrastructure construction market. Another 15.0% of the market is bridges construction (both highway and railway bridges). The rest (31.7% of the market) is spread among tunnels, airports, ports and railways. We note that the market share of each segment fluctuates from year to year, but the volatility is not significant.

Figure 9. Russian Federal program of infrastructure modernization in 2005-2010 (VAT included), RUB bn

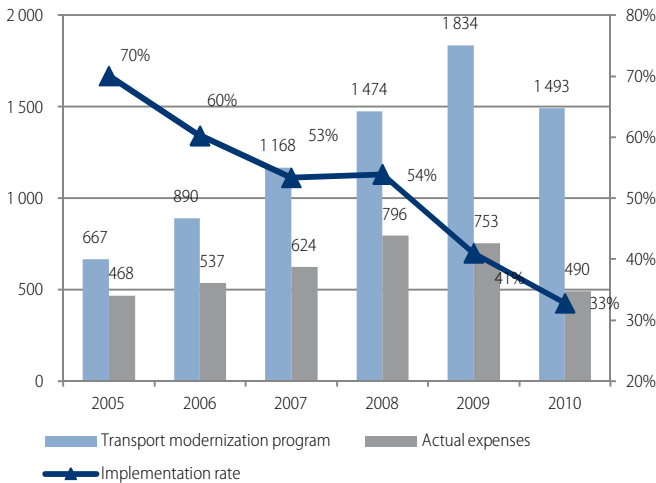
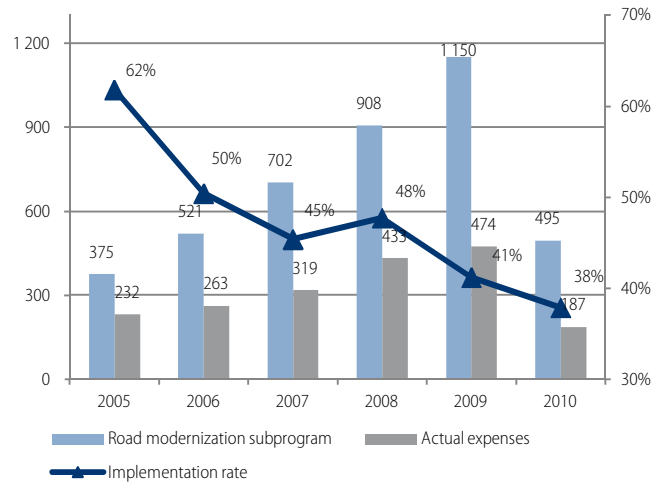


Figure 10. Russian Federal subprogram of road network modernization in 2005-2010 (VAT included), RUB bn



Source: Russian Ministry of Transport and Russian Ministry of Economic Development

In 2011-2015 the market is expected to accelerate and increase at 16.2% CAGR, compared to 13.3% CAGR in 2006-2010...

According to PMR estimates, the infrastructure construction market is expected to double in 5 years from RUB 592 bn in 2010 to RUB 1.25 trln in 2015 (VAT excluded). The total value of this market in 2011-2015 will reach RUB 5.22 trln, excluding VAT. The government has taken a decision to continue investing in infrastructure. The highest growth rates are expected in 2011 (22.4% y-o-y), in 2012 (23.1% y-o-y) and in 2013 (17.5% y-o-y). A number of large infrastructure projects have already been started and there is high probability that these projects will be finished, because the government has reserved the money for them in the budget.

...due to 2014 Winter Olympic games and 2018 FIFA World Cup preparation...

We note that in 2011-2012 Russia is preparing for APEC summit in Vladivostok and, thereby, required infrastructure objects are being built. A large part of projects in 2011-2013 are related to the 2014 Winter Olympic Games in Sochi, which must be finished till this strict deadline. Thereby, in our opinion, there is a very high probability that the expected high growth rates of Russian infrastructure construction market will be realized in the coming several years. After Olympic Games in Sochi Russia should start preparing for 2018 FIFA World Cup, so large infrastructure investments will continue to be made, in our view.

Figure 11. Russian infrastructure construction market in 2010-2015 (VAT excluded), RUB bn

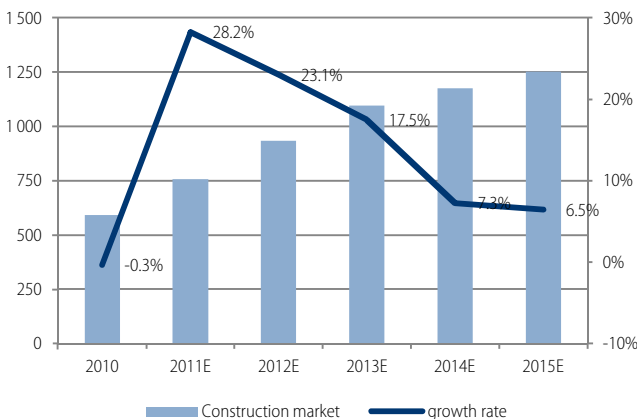
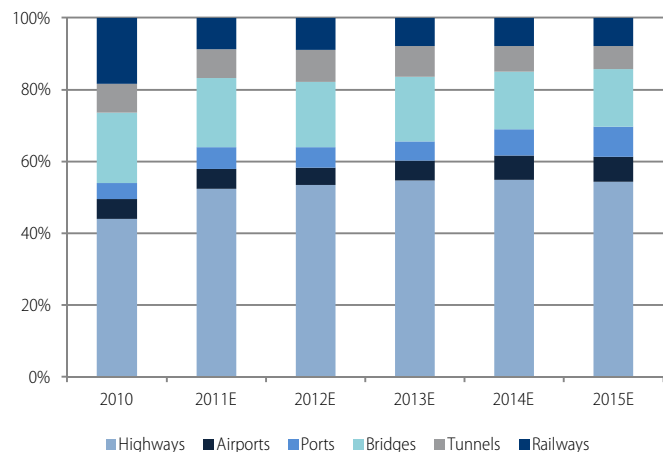


Figure 12. Segment shares of Russian infrastructure construction market in 2010-2015



Source: PMR, Mostotrest, SOVLINK

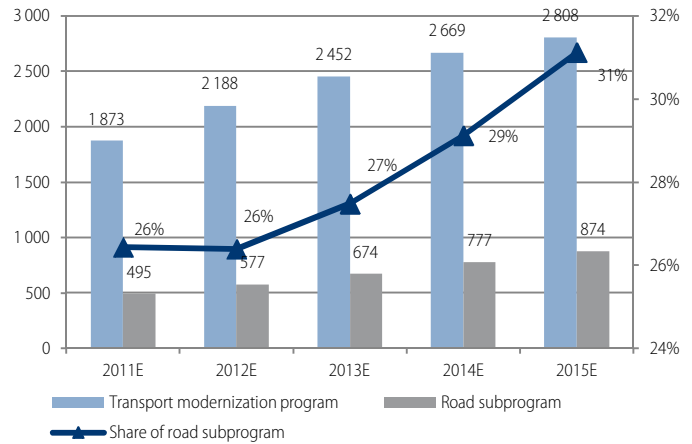
...with roads and bridges to remain the priority

Russian authorities are going to pay more attention to road construction: the share of road subprogram in transport modernization program is expected to grow from 26% in 2011 to 31% in 2015

Transport modernization program implies RUB 12.0 trln spending on infrastructure, including RUB 3.4 trln on roads (VAT included).

The share of road segment in infrastructure construction market will slightly increase from 52% in 2005-2010 to 54% in 2011-2015, and the share of bridges segment is expected to grow more considerably from 15% to 17% respectively. The total market value of road segment is expected to reach RUB 2.82 trln and bridges segment is expected to exceed RUB 0.9 trln in 2011-2015.

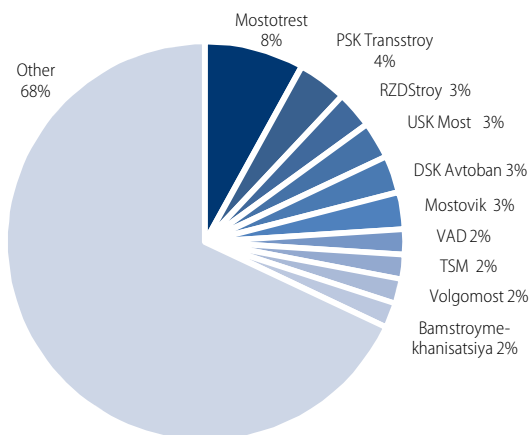
Figure 13. Russian Federal program of infrastructure modernization and road subprogram in 2011-2015 (VAT included), RUB bn



Source: Russian Ministry of Transport and Russian Ministry of Economic Development

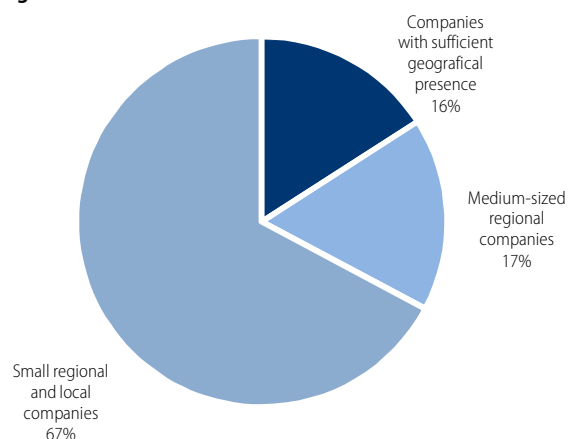
In 2008 the Russian government approved a new Federal Program of infrastructure modernization, which implies RUB 12.0 trln spending in 2011-2015 (VAT included). This figure is almost twice as optimistic, compared to PMR estimate. However, taking into account the historical implementation rate of 49% in 2005-2010, these forecasts are rather close. Using the implementation rate of 49% and excluding VAT, the Federal Program implies RUB 4.98 trln spending on infrastructure in 2011-2015, according to our estimates (vs. RUB 5.22 trln in PMR estimates). Comparing PMR estimates with Federal Program forecast on a yearly basis, the expected implementation rate in 2011-2015 fluctuates between 48% and 53%, which is in line with the historical implementation rate. However, we point out that the share of road subprogram in the Federal Program is only 26-31%, which is considerably less than 50-55% estimate made by PMR. This difference arises due to methodology. PMR estimates include maintenance and repair spending, while Federal Program does not. In our opinion, PMR figures better reflect the potential market and thereby, we prefer to use them further.

Figure 14. Largest companies' shares on the Russian infrastructure construction market



Source: PMR, Mostotrest

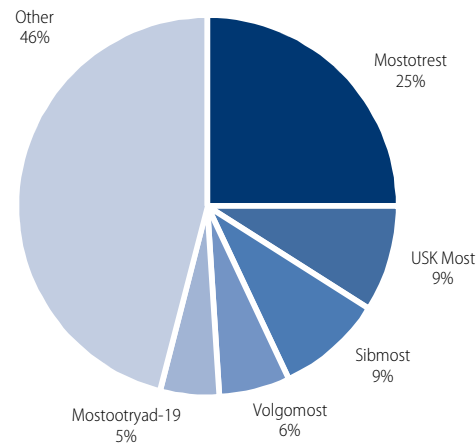
Figure 15. Russian infrastructure construction market by company segments



Mostotrest is the largest company in both the Russian construction market and bridges construction segment with a market share of 8% and 25% respectively...

According to PMR data, more than 150,000 companies work on the Russian construction market. Mostotrest is the largest company on this market with a share of 8%. Taking into account the number of companies in the industry, we could characterize Mostotrest market share as large. We also note, that the majority of companies on the market (67%) are small regional and local firms, most of them cannot make large sophisticated projects. Medium-sized regional companies (17% of the market) have resources and competences to implement large regional projects, but their engineering capabilities are limited. Companies with significant geographical presence can do projects of any complexity and account for 16% of the market. Thus, Mostotrest has 50% share of the segment in which companies can do sophisticated engineering projects. Ceteris paribus, this means that a half of projects which require sophisticated engineering, will be made by Mostotrest. This idea is confirmed by 25% market share of Mostotrest in bridge construction segment. Bridges construction requires a large and experienced team of engineers, which could be hired only by large players.

Figure 16. Largest companies' shares on the Russian bridges construction market



Mostotrest has one quarter of the bridges construction market in Russia due to experienced team of engineers. The company can build bridges of any complexity.

Source: PMR, Mostotrest

...and the only possible liquid play in the sector on the Russian stock market

Mostotrest held an IPO in November 2010. Its shares are currently trading on Russian stock exchanges: MICEX (list B) and RTS (Classica section). Mostotrest is one of 50 Russian stocks, which are included in RTS Index. The share of Mostotrest in RTS is 0.28%. Large free float at 30% makes Mostotrest accessible for a large number of investors.

Mostotrest: attractive investment case in the Russian construction market

Company structure

Mostotrest has a long history of more than 80 years

The company was founded in 1930 and its main goal was to build extra-large bridges. According to the company data, it was the only bridge construction company in the USSR until 1941. In 1992 Mostotrest was privatized. In 2007 Marc O'Polo Investments Ltd became the majority shareholder of Mostotrest with a share of 50.3%.

Mostotrest acquired ETS and TSM in mid-2010 for RUB 3.48 bn in cash and RUB 1.4 bn in form of dividends to former shareholders...

In 2010 before an IPO Mostotrest pursued extensive-growth strategy and acquired 51% in ETS, 50.1% in TSM and 25.002% in Mostostroy-11. The deal was structured in the following way: Mostotrest paid RUB 1.264 bn in cash for 50.1% of TSM in May 2010, plus RUB 0.2 bn was paid by TSM in the form of dividends before the transaction. In June 2010 Mostotrest acquired 51.0% of ETS and paid RUB 2.22 bn in cash plus RUB 1.2 bn was paid by ETS in the form of dividends before the deal took place.

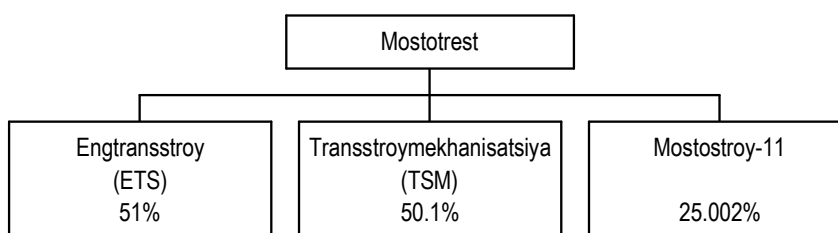
... and made an IPO in November 2010

After the new holding structure was formed, company made its IPO, which finished in the beginning of November 2010. The IPO price was USD 6.25 per share. At this IPO Mostotrest attracted USD 212 mn, which were used to finance investment program and decrease debt.

Mostotrest is a market leader

Mostotrest is the largest company on Russian infrastructure construction market with 8% share. On the bridge construction market the company has 25%. Nowadays Mostotrest is a diversified holding, which acts as both general constructor and subcontractor, what positively affects its margins. The company works in all of the market segments and is capable of repairing and building bridges, roads, railroads, airport and port infrastructure and implement other types of construction works. Mostotrest has a broad network of branches in the European part of Russia: 14 branches are situated in Moscow, Moscow region, Yaroslavl, Razan, Tula, Nizhny Novgorod, Cheboksary, Rostov-on-Don, Krasnoyarsk and Irkutsk. Mostotrest Group backlog as of June 30, 2011 is RUB 248 bn (USD 8.8 bn).

Figure 17. Mostotrest Group structure



Source: Mostotrest, SOVLINK

The Group key assets are:

- **Mostotrest**

Group corporate structure is rather simple. Besides 14 branches of Mostotrest, there are two main subsidiaries (ETS and TSM) and one affiliate (Mostostroy-11). In 1H2011 Mostotrest invested RUB 2 mn in 51% in United Toll Systems (UTS). This is Moscow-based company, which provides road toll management systems and their operations. As for now, the size of UTS business is insignificant compared to Mostotrest Group. However, the company is going to acquire new competence, because the paid highways have only started developing in Russia and in 5-10 years this business segment could multiply.

Mostotrest is the parent company of the holding and the key construction asset of the Group. Mostotrest builds the most complicated bridges (both highway and railway), complex traffic interchanges and overpasses, roads and railroad infrastructure facilities. The key current projects of the company are Section of Moscow Forth

- **Engtransstroy (ETS)**
- **Transstroymekhanisatsiya (TSM)**
- **Mostostroy-11**

Ring Road between Enthusiasts and Izmailovo Avenues, Kurortny Avenue Relief Road in Sochi and Moscow – Saint Petersburg Toll Highway M-11 (15-58 km, 258-334 km).

ETS does project management works, participates in tenders and actually works as a general contractor by transferring all the works from its contracts to subcontractors. The main subcontractor of ETS is TSM. If the works could be made within the group, they are transferred to one of the companies of the holding. The key current projects of ETS are Naryn – Lugokan new railway construction and “Belarus” Highway M-1 upgrade.

TSM generally builds roads, bridges and railroad infrastructure objects, which are less complicated than what Mostotrest does. Also TSM constructs airfields, airports, port infrastructure and hydro engineering facilities. TSM works as both subcontractor and general contractor. The key projects of TSM are upgrade of Voronezh Bypass on M-4 “Don” highway, M-9 Baltiya reconstruction project in Moscow region, Naryn – Lugokan new railway construction, “Vnukovo” and “Sheremetyevo” Airports upgrade and development.

Mostostroy-11 focuses on bridges construction, like Mostotrest does, but the regional branch network is completely different. The company has branches, which are situated in Siberia region: Tyumen, Surgut, Tobolsk, Nizhny Vartovsk, Novyi Urengoi and Nefteugansk. Mostotrest does not rule out that the stake in Mostostroy-11 will be increased in future, which should help the company to enter new regions.

Shareholder structure

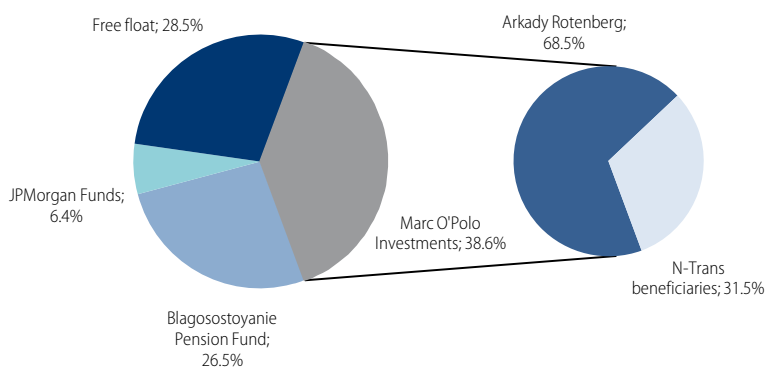
Marc O’Polo Investments and Transfingroup are holders of controlling stake in Mostotrest

Marc O’Polo Investments owns 38.6% of Mostotrest shares, its beneficiaries are Arkady Rotenberg (68.5%) and N-Trans beneficiaries (Konstantin Nikolaev, Nikita Mishin and Andrey Filatov). N-Trans is a diversified transportation group, which provides railroad transportation services, stevedoring services, container carriage. Pension fund of Russian Railways - Blagosostoyanie holds 26.5% stake in Mostotrest.

Mostotrest free float is 28.5%

In our opinion, large free float increases liquidity of company’s shares, which is positively perceived by investors. Investors, who want to buy a significant stake in Mostotrest should not face any difficulties.

Figure 18. Mostotrest shareholder structure



Source: Mostotrest, SOVLINK

1H2011 financials

Despite revenue increased by 16.2% y-o-y in 1H2011...

...gross income declined by 7.6% to RUB 5.7 bn due to sharp rise in subcontractors costs

In the end of September 2011 Mostotrest published 1H2011 IFRS results. We make all the comparisons with 1H2010 results on a pro-forms basis to ensure comparability of results.

Mostotrest core business of building roads and bridges looked very well in 1H2011. The revenue from this segment increased by healthy 31% y-o-y from RUB 18.2 bn in 1H2010 to RUB 23.8 bn in 1H2011. However, revenue from other sectors showed negative dynamics. Rail infrastructure construction sector revenue fell by 71% y-o-y from RUB 7.0 bn in 1H2010 to 2.1 bn in 1H2011, because Mostotrest completed a large project (Adler – Alpika-Service Combined Road construction), but no new large projects were won in 1H2011. Revenue from the airport infrastructure construction segment also declined by 15% from RUB 3.7 bn in 1H2010 to RUB 3.1 bn in 1H2011 due to the completion of core phases of Vladivostok Airport upgrade project and Sochi Airport construction project. Revenue from other projects grew from RUB 2.6 bn in 1H2010 to 7.5 bn in 1H2011.

Cost of sales grew faster (+21.9% y-o-y), compared to revenue (+16.2% y-o-y), which resulted in decline in gross income by 7.6%. Gross margin also decreased by 4.0 pp y-o-y from 19.6% in 1H2010 to 15.6% in 1H2011. The main driver behind cost growth is increase in services of subcontractors costs by 29% y-o-y from RUB 11.3 bn in 1H2010 to RUB 14.6 bn in 1H2011. Company explains this growth with active phase of building Kurortny Avenue project, where the share of subcontractors is relatively large (70% of total project value) due to the construction of 6 tunnels. Consequently, the share of subcontractors costs in total costs of goods sold increased from 44.8% in 1H2010 to 47.4% in 1H2011. Personnel costs also grew significantly – by 48% y-o-y from RUB 3.1 bn in 1H2010 to RUB 4.6 bn in 1H2011 – due to increase in payroll tax rate from 26% to 34%. Mostotrest also had started hiring personnel to support construction volumes growth, specifically for Moscow – Saint Petersburg Toll Highway project.

Table 1. Key Mostotrest financial indicators on IFRS basis in 1H2011, RUB mn

	1H2011	1H2010*	Change
Revenue	36 433	31 361	16.2%
Cost of goods sold	-30 762	-25 226	21.9%
Gross income	5 671	6 135	-7.6%
<i>Gross margin</i>	<i>15.6%</i>	<i>19.6%</i>	<i>-4.0 pp</i>
Other income (expenses)	-535	-107	400%
Administrative expenses	-2 819	-2 260	24.7%
Operating income	2 317	3 768	-38.5%
<i>Operating margin</i>	<i>6.4%</i>	<i>12.0%</i>	<i>-5.6 pp</i>
EBITDA**	4 328	5 515	-21.5%
<i>EBITDA margin</i>	<i>11.9%</i>	<i>17.6%</i>	<i>-5.7 pp</i>
Net finance costs**	-184	-2 189	-91.6%
Net income	1 605	864	85.8%
<i>Net margin</i>	<i>4.4%</i>	<i>2.8%</i>	<i>+ 1.6 pp</i>
Net debt	-5 407	10 720	-
Net debt/EBITDA	-0.62	0.97	-
Backlog	247 772	201 395	23.0%

* - pro-forma

** - SOVLINK estimates

Source: Mostotrest, SOVLINK

In general, we see Mostotrest 1H2011 financials as neutral. On the one hand, the company's business is growing, which resulted in both revenue and backlog increase. On the other hand, margins are under pressure from increasing share of works done by subcontractors and administrative costs.

Administrative costs grew significantly due to project managers hiring

Administrative expenses increased by 24.7% y-o-y from RUB 2.3 bn in 1H2010 to RUB 2.8 bn in 1H2011. The reasons for growth in administrative expenses are the same, as for personnel costs growth: new hiring in order to support new projects and increase in payroll tax rate from 26% to 34%.

EBITDA dropped by 21.5% y-o-y in 1H2011 and EBITDA margin declined by 5.7 pp y-o-y to 11.9%

Increase in total costs resulted in significant decline in EBITDA by 21.5% y-o-y from RUB 5.5 bn in 1H2010 to RUB 4.3 bn in 1H2011. Operating income dropped more significantly - by 38.5% y-o-y to RUB 2.3 bn and operating margin fell by 5.6 pp y-o-y to 6.4% in 1H2011.

Net debt was negative at RUB 5.4 bn

After the acquisition of TSM and ETS in May and June 1H2010, Mostotrest Group net debt reached RUB 10.7 bn. However, in one year it declined to negative figure of – RUB 5.4 bn due to significant decrease in net working capital. We also note that in 1H2010 before the acquisition of ETS and TSM these companies had paid dividends of RUB 1.4 bn, which are included in the pro-forma. Consequently, this high base resulted in sharp decline in net finance costs by 92% y-o-y in 1H2011. However, we note, that decrease in net debt also added to net financial costs decline.

Backlog increased by 5% in 1H2011 to RUB 247.8 bn

Among key projects, which Mostotrest gained in 1H2011 we note:

- reconstruction of M-9 Baltiya highway in Moscow region (total contract value is RUB 18.5 bn)
- upgrade of Voronezh Bypass on M-4 “Don” highway (total contract value is RUB 16.3 bn);
- Vnukovo Airport upgrade (total contract value is RUB 6.3 bn).

Company strategy

Organic development

Basically, Mostotrest is going to pursue the strategy of organic growth. Today's position of the company looks rather strong: the group is a national construction company with the largest market share (8% on infrastructure construction market and 25% in bridges construction segment). Large market share will help the company to benefit on overall construction market growth in Russia. The Russian market is expected to increase at 15.1% CAGR in 2011-2015 to RUB 1.25 trln in 2015. Mostotrest has strong positions in Moscow, which is going to increase investments in road infrastructure significantly. Taking into account high density of buildings in Moscow, a lot of bridges and complex bypasses are expected to be built, what provides the company with higher margins, compared to road building. Another goal for Mostotrest is to enter new regions, where company's positions are weak now, but we expect it will take some time. In addition, Mostotrest is going to enter in associated segments. The company has just entered road toll management market by creating a JV with an Austrian company, which has good expertise in this particular market segment.

Extensive growth

However, organic growth is not enough to enter new segments or new regions quickly. If Mostotrest finds lucrative opportunities, it could acquire some regional companies. However, the company highlights, that the economic efficiency of potential acquisitions comes first. Among potential acquisitions we point out that Mostotrest could increase its share in Mostostroy-11 to a controlling stake in coming years, which will help the holding to strengthen its positions in Siberia region. We also do not rule out that the company will buy some players in associated market segments in order to quickly enter them. However, today Mostotrest Group is presented in all of the market segments of infrastructure construction market and is capable of building roads, bridges, railroads, ports and airports. In our view, among associated businesses we list concrete, asphalt, bitumen production and providing different types of road and other infrastructure servicing.

Mostotrest revenue and backlog

Roads and bridges construction contracts represent more than 80% of Mostotrest backlog

Mostotrest's specialization is construction of roads and bridges, consequently, the share of this sector in backlog is 80.8%. In 2H2011 Mostotrest has won several large projects, including Businovskaya Traffic Interchange construction project in Moscow (RUB 14.4, excluding VAT) and 17-50 km segment of M-9 "Baltiya" highway upgrade (RUB 15.7, excluding VAT). Thus, we expect that the share of revenue from roads and bridges segment will increase in coming years from only 65.2% in 1H2011. The rest 19.2% of backlog are spread between railways, ports, airports and other projects. Mostotrest is developing its business in these segments, but we do not expect their shares to change dramatically in the coming years.

Figure 19. Mostotrest 1H2011 revenue breakdown

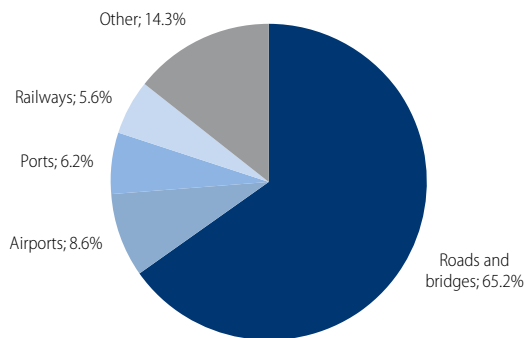
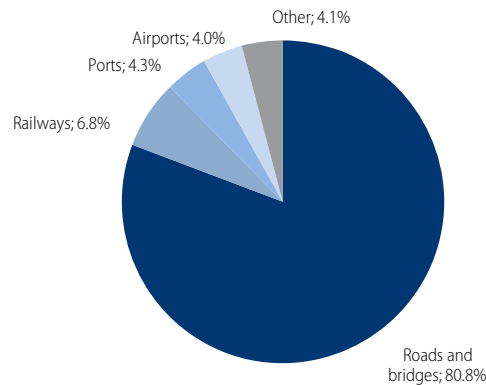


Figure 20. Mostotrest backlog breakdown as of June 30, 2011



Source: Mostotrest, SOVLINK

We assume Mostotrest revenue to grow in line with the market in 2012-2015 at 13.4% CAGR, which is a conservative assumption, in our view

As Mostotrest is the largest company on the Russian construction market and has projects in different regions of the country, we expect that company's revenue will increase in line with the infrastructure construction market CAGR of 13.4% in 2012-2015, taking into account company's current backlog and overall construction market expectations. However, considering Mostotrest's current strategy, aimed at expansion, the growth in line with the market in 2012-2015 looks as conservative assumption. In 2011 we forecasted company's revenue using only its current mix of projects. According to our estimates, in 2011 Mostotrest's revenue will increase by 18.0%, which is slightly below the expected market growth of 22.4%. The main reason for this is significant exposure of Mostotrest to projects in Moscow while a number of new projects were frozen in 1H2011 due to the change of mayor and delay in approval of Moscow – Saint-Petersburg Toll Highway project by Russian authorities.

Figure 21. Mostotrest Group revenue in 2009-2015, RUB bn

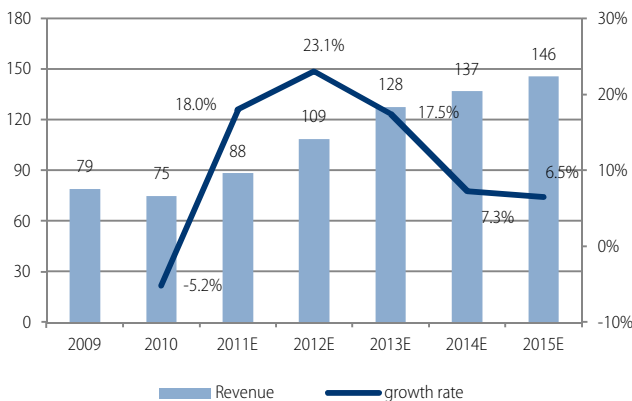
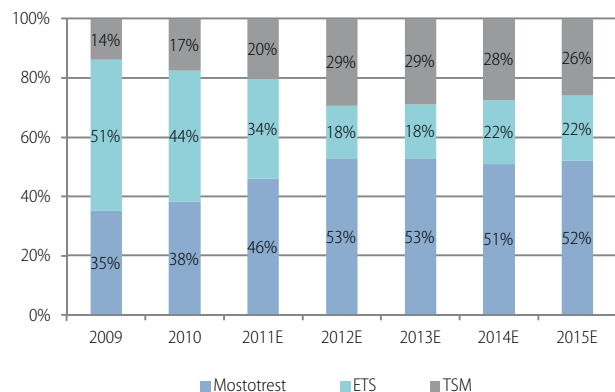


Figure 22. Mostotrest Group revenue breakdown in 2009-2015



Source: Mostotrest, SOVLINK

We anticipate Mostotrest standalone to increase its share in Group revenue to 52%...

Using current backlog structure of the group, we expect Mostotrest standalone to increase its revenue share from 38% in 2010 to 46% in 2011 and 53% in 2012. The main reason for this increase is that Mostotrest this year has won a number of large road construction projects. Road projects are also the reason for increase in TSM revenue share from 17% in 2010 to 20% in 2011 and 29% in 2012. Taking into account the increase of road subprogram in transport modernization program from 26% in 2011 to 31% in 2015, we expect Mostotrest and TSM shares to stay high and fluctuate in a narrow range of 51-53% and 26-29% respectively.

...however, the share of subcontractors is expected to grow from 20% to 40%

In our opinion the quick growth of the company will be accompanied by further increase of subcontractors' share. The experience of Kurortny Avenue Relief Road construction, where the share of subcontractors is 70%, shows that complicated projects are implemented in partnerships with other companies. As the share of roads in revenue is expected to increase, there is high probability that subcontractors' share in projects could also grow, in our opinion.

Company margins

Normal gross margin for general contractor only is 5%

If the company works as general contractor, i.e. 100% of works is done by a subcontractor outside the group, gross margin of Mostotrest group in this case is only 5-6%. In our forecasts we used a conservative estimate of 5%. ETS is a pure general contractor, however, most of the projects are made by other companies of Mostotrest Group.

Normal gross margin on bridges and other complex infrastructure objects construction works is 25%

Normally, complicated works like bridges and interchanges are done by Mostotrest, as this company of the group has good experience and expertise in this sector. As this market segment is far less competitive, compared to entire infrastructure construction market, the margins are rather strong here. According to company data, gross margin reaches 25% in bridges and other complex infrastructure objects construction segment. Normally, Mostotrest does about 80% of works in such projects and 20% are done by subcontractors. According to our estimates, this means that if Mostotrest did all the jobs within these projects using its own forces, the gross margin on them would reach 30%.

Normal gross margin is 10% if Mostotrest Group works on common infrastructure objects and represents both general contractor and subcontractor

If the object is not complicated, competition increases significantly. For comparison, Mostotrest has 8% of total infrastructure and 10 largest companies have only 32% of this market. In the bridges segment Mostotrest has 25% of the market and 5 largest companies have 54% of the market. Among common projects we name road construction (without any bridges and tunnels), landing fields, airports, ports. As a consequence, gross margin for common infrastructure projects is only 10%.

Mostotrest gross margin on current projects is 25% and 20% is expected on new projects...

For all current projects of the company we used the above-mentioned margins (25% for bridges and other complicated objects, 10% for common infrastructure objects and 5% for projects, in which the group is the general contractor only), except for two Mostotrest projects:

- Kurortny Avenue Relief Road in Sochi, where the share of subcontractors works is 75% due to 6 tunnels construction. Consequently, gross margin for this project is 12.5% (70%·5% + 30%·30%).
- Section of the Moscow Fourth Ring Road between Enthusiasts and Izmailovo Avenues, where the share of subcontractors, according to the company data, is 40% vs. 20% average for other projects.

As mentioned before, currently Mostotrest gives to subcontractors approximately 20% of its projects on average. Consequently, the gross

...ETS has 5% gross margin as a general contractor and TSM earns 10% gross margin on its projects

margin on these projects is 25%. However, for the new project we expect the share of subcontractors to increase to 40%, consequently, on new projects Mostotrest gross margin will go down to 20%.

ETS is a pure general contractor, consequently, its projects have 5% gross margin. We expect that this margin will remain for the new projects. We highlight, that 5% margin is a rather conservative assumption and there is some room for increasing it. TSM builds not complicated objects and usually acts as subcontractor, consequently, its gross margin on current projects is 10%. The market, on which TSM operates, is competitive now, consequently, we do not expect the margin to change in coming years. So, we put in our model 10% gross margin for all new TSM projects.

Administrative expenses are expected to grow in line with inflation

As was mentioned earlier, in 1H2011 company hired new personnel in order to service sophisticated projects. Company managements asserts that this was one-off hiring, which will not repeat in future. Now Mostotrest has enough personnel to service all its potential orders. Besides, in the beginning of 2011 a social tax was significantly increased from 26% to 34%. This resulted in one-off 25% y-o-y upsurge in administrative expenses in 1H2011. Consequently, we do not expect a significant rise in company's administrative expenses in 2012-2015. According to our estimates, administrative expenses will grow in line with inflation, which is expected to be 7.8% in 2012 and gradually decline to 5.6% in 2015.

Figure 23. Mostotrest Group EBITDA in 2009-2015, RUB bn

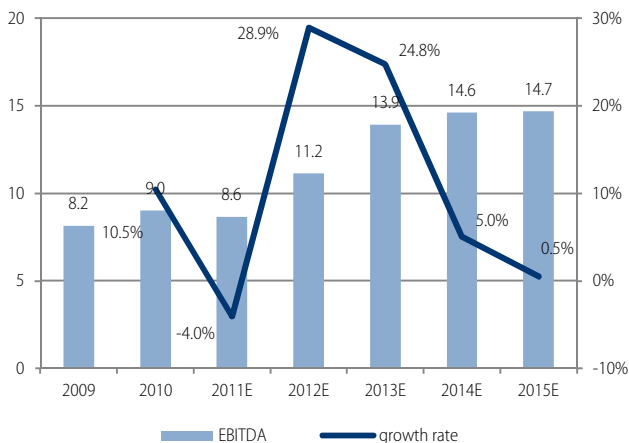
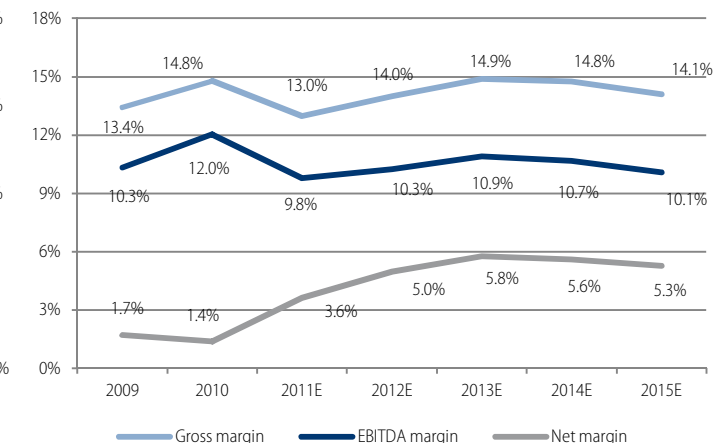


Figure 24. Mostotrest Group key margins in 2009-2015



Source: Mostotrest, SOVLINK

We expect Mostotrest EBITDA to grow at 10.3% CAGR in 2011-2015...

We expect the most rapid growth of EBITDA by 29% in 2012 due to revenue growth of 23% because of new orders inflow in 2011 and due to increase in gross margin, because these orders have better margins, than the average one of Mostotrest in 2011. This year Mostotrest margin is diluted by large share of Kurortny Avenue project in Sochi, where the margins are significantly lower due to large share of subcontractors. Moderate pace of administrative expenses growth will also add to EBITDA margin. The EBITDA margin is expected to reach its peak in 2013 at 10.9% and after that it will go down, as new Mostotrest projects have only 20% gross margin vs. 25% currently.

... and our EBITDA margin at 10.1% in 2015 is in line with the company's management expectations

Company management considers that 2009 results could represent normal margins of Mostotrest holding. In 2009 EBITDA margin was 10%, thus our forecasts are in line with management expectations. However, in 2009 the share of subcontractors was about 20% vs 40% in our current estimate for long-term period. This means that there is a good upside potential for Mostotrest margins and valuation. However, as for now, we prefer to look conservatively on this issue, because projects become more complicated, which leads to an increase in the share of subcontractors.

Dividend policy

Mostotrest dividend policy provides for 30% payout ratio of IFRS net income

At the end of September 2010 Mostotrest Board of Directors approved a new dividend policy. According to this document, the company is going to pay not less than 30% of its IFRS net income. However, the net income figure should be corrected for a number of non-cash items. Among these potential corrections we highlight the following:

- negative goodwill;
- share of profit of equity accounted investees;
- revaluation of financial assets and liabilities;
- non-cash income (loss) due to M&A activity;
- deferred taxes.

According to company's dividend policy, the maximum dividends are also limited by net income amount according to RAS, which actually reflects only Mostotrest standalone financial results.

Following the best corporate governance practices, Mostotrest dividend policy stipulates that dividend payments are made to all shareholders simultaneously. The deadline for dividend payment is approved by the general meeting of shareholders.

Table 2. Mostotrest dividends in 2010-2015, RUB mn

	2010	2011E	2012E	2013E	2014E	2015E
Net income, attributable to shareholders of Mostotrest	1 043	3 216	5 427	7 384	7 694	7 681
<i>Payout ratio</i>	81%*	60%	70%	80%	90%	90%
Total dividends	845	1 930	3 799	5 907	6 924	6 913
Dividends per share, RUB	3.0	6.8	13.5	20.9	24.5	24.5

* - on pro-forma basis

Source: Mostotrest, SOVLINK

As Mostotrest is a company with significant positive free cash flow, we expect it to increase payout ratio till 2015

Company's current net debt is negative and its free cash flows are positive starting from 2012, according to our estimates. These two factors form a good basis for increase in dividend payments in the coming years. According to our estimates, the payout ratio of Mostotrest could increase from 60% in 2011 to 90% in 2015, if the company does not make any acquisitions. However, following its strategy, Mostotrest could acquire some regional companies, thus, it will need sources of funding for potential deals.

Mostotrest valuation

For Mostotrest valuation we used DCF model based on free cash flows to firm. The forecast period is 5 years till 2015.

Table 3. Key Russian macroeconomic indicators

	2010	2011E	2012E	2013E	2014E	2015E
Average \$ rate, RUR	30.31	29.35	32.15	32.20	30.90	30.00
Closing \$ rate, RUR	30.48	32.20	32.80	31.60	30.20	29.80
CPI Russia	8.8%	6.1%	7.8%	7.2%	6.2%	5.6%
PPI Russia	16.7%	16.0%	9.5%	8.7%	7.4%	6.8%
Average Brent, \$/bbl	80	110	90	95	102	110
Real GDP growth rate	4.0%	4.2%	3.5%	4.0%	4.2%	4.3%

Source: SOVLINK

We expect improvement in macroeconomic conditions till 2015, however, anticipate some deterioration in 2012

Due to expected moderate recession in Europe in 2012 we expect the decrease in oil price from USD 110 in 2011 to USD 90 in 2012 and the slowdown of Russian economy to 3.5% from 4.3% in 2011. However, next year the government is going to spend 23.1% more on infrastructure construction than this year. The Russian government does not intend to decrease spending on infrastructure projects despite possible temporary decrease in budget income due to correction in oil prices. After 2012 we expect acceleration of the Russian economy, which should support spending on infrastructure.

Revenue is expected to increase with 14.3% CAGR in 2011-2015 and EBITDA is anticipated to rise at 10.3% CAGR

For detailed revenue forecast, please, refer to the section "Mostotrest revenue and backlog". Section "Company's margins" provides with detailed methodology of EBITDA estimates. We link slower growth rates of EBITDA compared to revenue to expected decrease in company margins due to increasing share of subcontractors. However, if Mostotrest succeeds in maintaining average share of subcontractors at current 20% level (vs. our conservative forecast at 40%), its EBITDA CAGR in 2011-2015 will increase to 14.9%. Consequently, this creates a potential upside driver for Mostotrest shares.

Table 4. Mostotrest free cash flow to firm, RUB mn

	2010	2011E	2012E	2013E	2014E	2015E
EBIT	5 497	5 110	8 259	11 491	12 109	12 102
Tax on EBIT	-1 469	-1 329	-2 106	-2 873	-3 027	-3 026
Tax rate	26.7%	26.0%	25.5%	25.0%	25.0%	25.0%
D&A	3 514	3 539	2 892	2 420	2 499	2 577
Capex	-3 198	-3 000	-2 722	-2 882	-2 958	-3 054
Investments in WC	5 444	-6 780	-3 604	-3 556	-481	-161
FCFF	9 788	-2 459	2 719	4 600	8 142	8 438

Source: SOVLINK

We expect Mostotrest capex at RUB 2.7-3.1 bn per year in 2011-2015

For 2011 we used capex estimate, provided by the company. For 2012-2014 Mostotrest expects to spend RUB 2.0-2.5 bn per year. However, due to inflation we expect these figures to be by approximately 15% higher, which makes our estimates more conservative. We note that Mostotrest made large investments in 2010-2011, which helped the company to decrease the average age of its equipment. Taking into account rather conservative revenue growth, we expect that new capex will be about 10%, the rest 90% is maintenance capex.

Net working capital is negative in 2009-2015, however, the absolute number is decreasing, so the company will have to invest in net working capital

Net working capital of Mostotrest is negative in 2009-2015 due to business specific. Normally, construction companies receive large advances. This item together with accounts payable usually significantly exceeds advances paid to subcontractors, inventories, accounts receivable and amounts due from customers.

However, each year in the forecast period we observe an increase in net working capital. The main reason is the following: in 2010

Mostotrest received a large advance for Kurortny Avenue Relief Road at 30% of total project value. This project is to be finished in 2014, consequently, this advance will be gradually written off till this time, as the project is implemented. Consequently, Mostotrest will have to invest in working capital. For comparison, normally in the beginning of each year the company receives an advance of up to 30% of the project part, expected to be made in this particular year.

Table 5. Mostotrest WACC estimation

	2010	2011E	2012E	2013E	2014E	2015E
Debt value, RUB mn	6 675	780	2 759	5 504	7 161	8 207
Equity value, RUB mn	17 405	19 569	23 066	26 653	28 442	29 201
Debt share	27.7%	3.8%	10.7%	17.1%	20.1%	21.9%
Equity share	72.3%	96.2%	89.3%	82.9%	79.9%	78.1%
Before tax rate of return on debt	9.0%	7.5%	7.5%	7.5%	7.5%	7.5%
Effective tax rate	27%	26%	26%	25%	25%	25%
Cost of equity	15.2%	15.2%	15.2%	15.2%	15.2%	15.2%
WACC	12.8%	14.8%	14.1%	13.5%	13.2%	13.1%

Source: SOVLINK

WACC fluctuates in 13.1%-14.8% range in 2011-2015

Due to rather significant expected change in total debt load (from 4% of total capital in 2011 to 22% in 2015) we used yearly changing WACC technique. We expect Mostotrest to increase its total debt in order to use more optimal capital structure, which results in lower weighted average cost of capital.

Cost of equity is 15.2% in 2011-2015

To calculate cost of equity we use beta at 1.2 for each year. In our opinion, this beta reflects higher risks of investment in construction sector on the one hand. However, we should note that Mostotrest implements good corporate governance standards, which is the factor for lower beta, compared to other companies of the sector, on the other hand.

As Russian risk-free rate we used the yield on Russian Eurobonds which mature in 2028. The principal on these bonds is repaid at maturity. The current yield is approximately 5.8%. Expected premium for the Russian market we estimate at 7.8%.

Cost of debt equals to 7.5% in the forecast period

Cost of debt is 7.5% in 2011-2015, which corresponds to the current interest rate of Mostotrest on loans. We do not expect any further decrease in interest rate for the company, despite the expectations of inflation moderation, as 7.5% interest rate is low. We also do not rule out that interest rate for the real sector could go up in the coming years, as World Central Banks start tightening monetary policy.

For valuation of minority interest of ETS and TSM we used future multiples methodology

As the balance value of minority interest in TSM and ETS does not reflect their potential market value and Mostotrest has only 50.1% and 51% stake in these companies respectively, we made a separate valuation for them. The balance value of minority interest at the end of 1H2011 was only RUB 577 mn, while in the middle of 2010 Mostotrest paid RUB 3.48 bn in cash for 50.1% of TSM and 51.0% of ETS together plus RUB 1.4 bn were paid out in the form of dividends before the deal took place.

As TSM and ETS are controlled by Mostotrest and their financials are consolidated in the financial statements of the Group, there is not enough information for a justified enough DCF model. However, a number of the most crucial financial indicators, including backlog, income statement, gross margins on current projects and debt, are disclosed, which allows us to construct estimates for TSM and ETS income statements. Consequently, we decided to use the future multiples method.

Table 6. ETS and TSM future multiples model details, RUB mn

	ETS	TSM
Target EV/EBITDA 2014 for MSTT	4.8	4.8
Discount to MSTT	35%	35%
Target multiple for company	3.1	3.1
EBITDA 2014	504	3 956
Current enterprise value	1 572	12 337
Current net debt	1 467	3 998
Current equity value	105	8 339
Mostotrest share	51.0%	50.1%
Minority share	49.0%	49.9%
Minority interest current value	51.5	4 161
Minority interest value in 12 months	58.8	4 751

Source: SOVLINK

According to our estimates, the value of minority stakes in ETS and TSM is RUB 4.81 bn

As the company's value is determined by future cash flows, we decided to use future multiples for 2014. We believe that EBITDA is the best financial indicator, which reflects company's ability to generate cash flows. According to our estimates of Mostotrest fair value, the target EV/EBITDA 2014 is 4.8. As ETS and TSM are closed companies, which are parts of a large holding, in addition, we applied a discount to Mostotrest multiple at 35%. After deducting the current net debt from the fair value of each company, we made a compounding to get company's value in 12 months. The value of minority stakes in ETS and TSM is RUB 4.81 bn, according to our estimates.

Table 7. Mostotrest DCF model details, RUB mn

FCFF 2015	8 438
Terminal growth rate	3.0%
Terminal discount rate	13.1%
Terminal value	86 325
Discounted terminal value	59 386
Discounted FCFF in the forecast period	16 190
Total fair value of Mostotrest	75 576
- Net debt	-8 653
- Fair value of minority interest	4 810
Mostotrest shares fair value	79 419
Number of shares, mn	282.2
Fair value per share, RUB	281.4
Fair value per share, USD	8.6

Source: SOVLINK

We assign **BUY** rating to Mostotrest shares with a 12-month target price of USD 8.6 per share.

Peer group analysis

We compare Mostotrest current market valuation with both developed and emerging market peers.

Table 8. Mostotrest peer group analysis

Company	Ticker	Country	MC, \$ mn	EV, \$ mn	P/E		EV/EBITDA		EV/S	
					2011	2012	2011	2012	2011	2012
Mostotrest	MSTT-MZ		1 629	1 457	16.0	9.5	5.3	4.1	0.52	0.42
<i>Discount/premium to developed market peers</i>					50%	-6%	-16%	-27%	24%	4%
<i>Discount/premium to emerging market peers</i>					57%	-6%	-29%	-40%	-12%	-14%
Developed market peers										
STRABAG SE	STR-VI	Austria	3 261	3 594	12.9	13.0	3.8	3.7	0.20	0.20
AECON GROUP INC.	ARE-T	Canada	624	1 103	17.0	10.6	8.1	6.1	0.38	0.36
BOUYGUES S.A.	EN-FR	France	9 307	16 471	7.2	6.7	3.8	3.8	0.40	0.40
Eiffage S.A.	FGR-FR	France	2 371	20 731	7.7	7.7	7.8	7.8	1.12	1.16
VINCI S.A.	DG-FR	France	25 444	44 834	10.1	10.1	6.3	6.4	0.95	0.96
Bilfinger Berger SE	GBF-XE	Germany	4 029	3 842	13.9	13.3	5.9	5.6	0.37	0.37
Astaldi Societa per Azioni	AST-MI	Italy	636	1 531	6.6	6.0	4.6	4.1	0.50	0.46
Impregilo S.p.A.	IPG-MI	Italy	1 217	2 018	12.4	11.5	6.3	5.4	0.72	0.66
MAEDA ROAD CONSTRUCTION CO., LTD.	1883-TO	Japan	1 065	574	11.8	10.3	2.2	2.1	0.22	0.21
ACS Actividades de Construccion y Servicios	ACS-MC	Spain	9 090	25 290	8.4	7.6	9.1	6.6	0.73	0.55
NCC Aktiebolag	NCC'B-SK	Sweden	1 406	2 709	9.4	6.2	8.4	6.8	0.37	0.35
Peab AB	PEAB'B-SK	Sweden	1 321	2 596	10.7	7.9	8.3	7.5	0.42	0.41
Skanska AB	SKA'B-SK	Sweden	6 823	7 390	13.7	14.3	8.4	8.7	0.42	0.42
GALLIFORD TRY PLC	GFRD-LN	UK	597	536	8.4	7.2	5.0	4.3	0.24	0.24
GRANITE CONSTRUCTION INCORPORATED	GVA-N	USA	1 005	924	21.0	18.3	6.4	5.6	0.47	0.43
Median					10.7	10.1	6.3	5.6	0.42	0.41
Emerging market peers										
China Gezhouba Group Company Limited	600068-SH	China	4 357	7 547	13.8	11.2	9.5	7.4	1.02	0.83
SHANGHAI TUNNEL ENGINEERING CO.,LTD.	600820-SH	China	929	1 303	8.3	8.5	4.8	6.4	0.48	0.42
PT. PEMBANGUNAN PERUMAHAN (PERSERO) TBK	PTPP-JK	Indonesia	256	419	9.7	7.5	7.3	5.4	0.61	0.45
DAELIM INDUSTRIAL CO.,LTD	000210-SE	South Korea	2 910	3 906	6.8	6.5	7.5	7.0	0.57	0.48
GS Engineering & Construction Corp	006360-SE	South Korea	4 269	4 520	10.7	10.2	7.5	7.4	0.59	0.50
Hyundai Engineering & Construction Co.,Ltd.	000720-SE	South Korea	6 737	6 951	12.1	10.6	9.3	7.7	0.68	0.58
BUDIMEX SPOLKA AKCYJNA	BDX-WA	Poland	579	295	8.1	9.9	3.2	3.9	0.20	0.19
POLIMEX-MOSTOSTAL SPOLKA AKCYJNA	PXM-WA	Poland	262	569	12.6	10.5	7.8	6.8	0.42	0.40
RAUBEX GROUP LIMITED	RBX-JO	South Africa	310	308	7.9	7.7	3.6	3.5	0.60	0.58
Sino-Thai Engineering And Construction Public Company Limited	STEC-TH	Thailand	478	345	19.7	17.8	9.3	7.4	0.74	0.59
Median					10.2	10.1	7.5	6.9	0.59	0.49

Source: ThomsonReuters, SOVLINK

Mostotrest is trading with significant discount to foreign peers on EV/EBITDA multiples...

The discount of Mostotrest on EV/EBITDA 2012 multiple exceeds 25% to developed market peers and about 40% to emerging market peers. Taking into account the prospects of the Russian infrastructure construction market, we see this discount as unjustified and expect it to start shrinking in near future. Realization of large government projects provides Mostotrest with a sustainable project pipeline and decreases the risk of its business. We point to negative net debt of Mostotrest, which also decreases company's risks and should lead to a decline in discount of Mostotrest to foreign peers.

...however, there is no discount to peers on P/E 2012 multiple

The discount of Mostotrest to both developed and emerging market peers is only 6% on P/E 2012. In our view, this small discount is explained by accounting of subsidiaries' non-controlling interest before pre-tax profit. The premium of more than 50% on P/E 2011 multiple is explained by accounting specifics (large one-off amortization of intangible assets). Thereby, EV/EBITDA multiple looks as the most representative ratio for Mostotrest.

Appendix 1. Balance sheet, RUB mn

	2009P	2010P	1H2011	2011E	2012E	2013E	2014E	2015E
ASSETS								
Non-current assets								
Goodwill	2 009	2 404	2 404	2 404	2 404	2 404	2 404	2 404
Intangible assets	1 228	1 846	1 067	534	0	0	0	0
Property, plant and equipment	12 864	13 099	13 863	13 872	14 236	14 698	15 157	15 634
Trade and other receivables	58	51	179	68	84	98	105	112
Investments in equity account. investees	0	1 525	1 395	1 514	1 529	1 560	1 607	1 671
Other investments	196	316	295	353	435	511	548	583
Other non-current assets	2 279	0	358	512	623	724	778	835
Total non-current assets	18 634	19 241	19 561	19 257	19 310	19 995	20 599	21 239
Current assets								
Inventories	2 989	3 938	5 327	4 804	5 843	6 791	7 297	7 828
Income tax receivable	1 065	15	88	97	120	140	151	160
Trade and other receivables	3 499	6 144	7 806	7 360	9 057	10 638	11 413	12 150
Amounts due from customers on construction contracts	3 216	7 084	9 901	8 029	9 880	11 605	12 451	13 255
Prepayments	7 251	13 739	17 876	15 372	15 581	15 522	15 567	15 656
Other investments	206	869	934	1 148	1 413	1 659	1 780	1 895
Cash and cash equivalents	12 792	19 950	8 719	9 715	11 412	13 403	15 751	16 768
Total current assets	31 018	51 739	50 651	46 526	53 306	59 759	64 410	67 712
TOTAL ASSETS	49 652	70 980	70 212	65 783	72 617	79 753	85 009	88 952
EQUITY AND LIABILITIES								
Equity								
Share capital	131	131	136	136	136	136	136	136
Additional paid in capital	0	0	6 180	6 180	6 180	6 180	6 180	6 180
Reserve for available-for-sale fin.assets	110	141	134	134	134	134	134	134
Prepaid shares reserve	0	6 185	0	0	0	0	0	0
Reserve for acquisition of own shares	0	-68	-607	-607	-607	-607	-607	-607
Retained earnings	6 842	9 940	10 701	12 311	14 932	17 251	17 778	17 319
Total equity attributable to equity holders of the Company	7 083	16 329	16 544	18 154	20 775	23 094	23 621	23 162
Non-controlling interest	1 418	1 076	577	1 414	2 291	3 559	4 821	6 039
Total equity	8 501	17 405	17 121	19 569	23 066	26 653	28 442	29 201
Long-term liabilities								
Loans and borrowings	4 375	491	756	314	512	787	787	787
Long-term trade and other payables	218	0	150	192	253	320	343	417
Deferred income	0	85	45	0	0	0	0	0
Deferred tax liabilities	828	358	262	470	485	516	563	627
Total long-term liabilities	5 421	934	1 213	976	1 250	1 622	1 692	1 831
Short-term liabilities								
Loans and borrowings	6 079	6 184	2 556	466	2 247	4 718	6 374	7 421
Trade and other payables	15 052	16 394	13 924	17 875	21 742	25 268	26 534	27 833
Amounts due to customers on construction contracts	13 425	29 701	35 267	26 720	24 114	21 275	21 740	22 432
Provisions	311	43	89	89	89	89	89	89
Deferred income	0	31	4	0	0	0	0	0
Current tax liabilities	863	288	37	88	109	128	137	146
Total short-term liabilities	35 730	52 641	51 878	45 238	48 300	51 478	54 874	57 920
TOTAL EQUITY AND LIABILITIES	49 652	70 980	70 212	65 783	72 617	79 753	85 009	88 952

Source: SOVLINK

Appendix 2. Income statement, RUB mn

	2009P	2010P	1H2011	2011E	2012E	2013E	2014E	2015E
Revenue	78 971	74 879	36 433	88 321	108 685	127 652	136 961	145 805
Cost of sales	-68 360	-63 819	-30 762	-76 862	-93 489	-108 654	-116 750	-125 246
Gross profit	10 611	11 060	5 671	11 459	15 196	18 998	20 212	20 558
<i>Gross margin</i>	13.4%	14.8%	15.6%	13.0%	14.0%	14.9%	14.8%	14.1%
Other income	421	615	161	442	543	638	685	729
Administrative expenses	-5 389	-5 084	-2 819	-5 638	-6 078	-6 515	-6 919	-7 307
Other expenses	-879	-1 094	-696	-1 153	-1 402	-1 630	-1 868	-1 879
Operating income	4 764	5 497	2 317	5 110	8 259	11 491	12 109	12 102
<i>Operating margin</i>	6.0%	7.3%	6.4%	5.8%	7.6%	9.0%	8.8%	8.3%
Depreciation and amortization	-3 392	-3 514	-2 011	-3 539	-2 892	-2 420	-2 499	-2 577
EBITDA	8 156	9 011	4 328	8 649	11 151	13 911	14 608	14 679
<i>EBITDA margin</i>	10.3%	12.0%	11.9%	9.8%	10.3%	10.9%	10.7%	10.1%
Finance income	358	166	261	528	280	331	389	452
Finance costs	-2 865	-1 585	-382	-834	-94	-317	-605	-752
Dividends and non-controlling interest	0	-1 940	56	-340	-876	-1 266	-1 259	-1 216
Share of profit of equity accounted investees	0	-7	-119	0	15	31	47	64
Profit before income tax	2 257	2 131	2 133	4 463	7 585	10 270	10 680	10 650
Income tax expense	-897	-1 088	-528	-1 249	-2 158	-2 884	-2 985	-2 967
<i>Effective tax rate</i>	39.7%	51.1%	24.8%	28.0%	28.4%	28.1%	27.9%	27.9%
Net income	1 360	1 043	1 605	3 214	5 428	7 386	7 696	7 683
<i>Net margin</i>	1.7%	1.4%	4.4%	3.6%	5.0%	5.8%	5.6%	5.3%
Profit attributable to:								
owners of the parent	0	0	1 606	3 216	5 427	7 384	7 694	7 681
non-controlling interests	0	0	-1	-2	1	2	2	2

Appendix 3. Cash flow statement, RUB mn

	2010P	1H2011	2011E	2012E	2013E	2014E	2015E
Cash flow from operating activities							
Profit for the period	1 043	1 605	3 214	5 428	7 386	7 696	7 683
<i>Adjustments for:</i>							
Depreciation and amortization	3 514	2 011	3 539	2 892	2 420	2 499	2 577
Share of loss/(profit) of equity accounting investees	7	119	0	-15	-31	-47	-64
Change in non-controlling interest	1 940	-56	340	876	1 266	1 259	1 216
Loss/(gain) on disposal of PPE	0	59	0	0	0	0	0
Net finance costs	1 419	115	306	-187	-14	216	300
Allowance for doubtful loans given	0	110	0	0	0	0	0
Income tax expense	1 088	528	1 249	2 158	2 884	2 985	2 967
Cash flow from operating activities before changes in working capital and provisions	9 011	4 491	8 649	11 151	13 911	14 608	14 679
(Increase)/decrease in inventories	-949	-1 230	-866	-1 039	-948	-506	-531
(Increase)/decrease in trade and other receivables	-2 638	-1 750	-1 233	-1 713	-1 595	-783	-744
(Increase)/decrease in amounts due from customers on construction contracts	-3 868	-2 817	-945	-1 851	-1 724	-846	-804
(Increase)/decrease in prepayments	-6 488	-4 495	-1 633	-209	59	-45	-89
(Increase)/decrease in other assets	2 562	0	-595	-133	-122	-64	-66
Increase/(decrease) in other liabilities	18	46	-70	0	0	0	0
Increase/(decrease) in trade and other payables	1 124	-3 685	1 673	3 927	3 594	1 289	1 373
Increase/(decrease) in amounts due to customers on construction contracts	16 276	5 566	-2 981	-2 606	-2 839	465	692
Cash flow from operations before income taxes and interest paid	15 048	-3 874	1 999	7 527	10 336	14 118	14 509
Income tax paid	-2 133	-964	-1 337	-2 122	-2 834	-2 929	-2 893
Net cash used in operating activities	12 915	-4 838	663	5 405	7 502	11 189	11 615
Cash flows from investing activities							
Interest received	166	177	528	280	331	389	452
Acquisition of PPE	-1 047	-1 369	-3 000	-2 722	-2 882	-2 958	-3 054
Withdrawal/(placement) of bank deposits	-989	-50	-316	-346	-322	-158	-150
Other	-1 967	-107	-195	0	0	0	0
Net cash used in investing activities	-3 837	-1 349	-2 983	-2 787	-2 873	-2 727	-2 752
Cash flows from financing activities							
Proceeds from placement of shares	6 185	0	0	0	0	0	0
Proceeds/(repayment) from/(of) loans and borrowings and finance lease liabilities	-3 779	-4 315	-5 895	1 979	2 745	1 657	1 047
Interest paid	-1 585	-319	-834	-94	-317	-605	-752
Dividends paid to equity holders of the Company	-801	-330	-845	-1 930	-3 799	-5 907	-6 924
Dividends paid to non-controlling interests	-1 940	-80	-340	-876	-1 266	-1 259	-1 216
Net cash used in/from financing activities	-1 920	-5 044	-7 915	-921	-2 637	-6 115	-7 846
Net increase/(decrease) in cash and cash equivalents	7 158	-11 231	-10 235	1 697	1 992	2 347	1 017

Appendix 4. Current and target ratios

	2009P	2010P	2011E	2012E	2013E	2014E	2015E
EV/Sales market	0.58	0.61	0.52	0.42	0.36	0.34	0.32
EV/Sales target	0.90	0.95	0.80	0.65	0.56	0.52	0.49
EV/EBITDA market	5.6	5.1	5.3	4.1	3.3	3.1	3.1
EV/EBITDA target	8.7	7.9	8.2	6.4	5.1	4.8	4.8
P/E market	37.8	49.2	16.0	9.5	7.0	6.7	6.7
P/E target	58.5	76.3	24.8	14.7	10.8	10.3	10.4

Stock recommendations

STRONG BUY:	Upside over 25%; confidence level – high / upside over 100%; confidence level – low
BUY:	Upside between 15 and 25%; confidence level – high / upside between 25% and 100%; confidence level – low
HOLD:	Upside of less than 15%; confidence level – high / upside of less than 25%; confidence level – low
SELL:	Target price at or below current price levels

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