



SOVLINK

YOUR FIRST CALL – FOR THE SECOND TIER

May 2, 2006

Mostotrest

COMPANY
NOTE

STRONG BUY

Target price: US\$ 558

Upside: 142%

Analyst:

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STOCK DATA

| | | | |
|-------------------------|------------|--------------------|------------|
| Ticker | mstt | MCap US\$ mn | 285 |
| Shares Ords | 1,241,200 | Free Float, % | 20-25 |
| Shares Pref | - | Free Float US\$ mn | 57-71 |
| Ords: Price US\$ | 230 | TARGET US\$ | 558 |

MULTIPLES 2005E

| | |
|-----------|------|
| P/S | 0.7 |
| P/E | 10.6 |
| EV/EBITDA | 5.2 |
| P/BV | 0.8 |
| EV/S | 0.8 |

Financials

| US\$ mn | 2004 | 2005E | 2006E |
|--------------|------|-------|-------|
| Sales | 344 | 406 | 475 |
| Gross profit | 47 | 77 | 90 |
| EBITDA | 38 | 63 | 76 |
| Net profit | 9 | 27 | 33 |

Shareholders

| | |
|----------------|------|
| Severstaltrans | 50+% |
| Others | 50-% |

From expectations to success

• Given large industrial structures' increasing attention towards the construction industry and the emergence of construction companies in trading systems, we expect a substantial increase in investor interest in construction company shares. We note Mostotrest's undervaluation on key multiples in comparison with its Russian and foreign peers and on the results of our DCF model. We assign a **STRONG BUY** recommendation to Mostotrest shares, with a target price of US\$558 per share.

• The consolidation of Mostotrest into Severstal Group, which we believe is to be completed in the near term, would give the bridge-builder soild access to sources of profiled iron, one of key materials used in bridge building.

• The company possesses a diversified order book in the Moscow region, which is one of the key factors affecting the long-term growth of the company's revenue and operational results. In 2005 the company increased revenues by more than 18% due to its participation in the construction of a cable-stayed bridge across the Moskva River near Serebryany Bor, an overpass on Krasnopresnensky Prospekt, and the reconstruction of Kievskoe Shosse. We expect an increase in orders in the future due to the company's alliance with Severstal.

• The company's weighted upside compared with its Russian peers is 146%, while its upside to foreign bridge-builders is 175%. A comparison with Russian peers suggests the considerable undervaluation of the company on a P/E multiple (236% upside). We assume that the business of the company is not quite transparent, and thus its net profit and profitability could be much higher. A comparison with foreign peers suggests undervaluation on a P/S multiple.

• The upside potential for Mostotrest shares based on our DCF valuation is 123%. In our model we use a conservative annual growth assumption of 10% for the forecast period and 3% for the terminal period. Our DCF model takes into account the possibility of profitability increasing due to the alliance with Severstal.

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- We consider the company's diversified portfolio in the Moscow region to be an important factor in long-term revenue growth. This distinguishes the company from other producers in the industry. Mostotrest's main projects in 2005 were the construction of a cable-stayed bridge over the Moskva River, building the Krasnopersnensky Prospekt overpass, and the reconstruction of Kievskoe Shosse. Moreover, Mostotrest has a broad portfolio of regional projects: i.e. the construction of a bridge in Irkutsk across the Angara River, the construction of a section of the ring road in Saint Petersburg, etc.
- The Moscow bridge engineering industry has greater prospects than in the regions. The bridge engineering industry is characterized by a shift in activity to the Moscow and St. Petersburg markets. For example, Sistem-Hals' (Sistema's real-estate subsidiary) purchase of a blocking stake in Siberian company Sibmost opened access to the Moscow market for the bridge builder.
- Currently, the bridge-building industry is characterized by independent companies consolidating into huge industrial structures. For example, Sistema purchased a blocking stake in Sibmost, and Severstal bought a controlling stake in Mostotrest.
- The national program of transport system modernization implies significant investment in this area and also contributes to sector's investment attraction. Experts believe the bridge engineering industry is one of the most interesting industries for a highly remunerative investment.
- The difference between bridge industries' contributions to GNP in Russia and in developed countries illustrates the sector's potential: the average value in developed countries is about 3-5%, while in Russia it is only 1.1%. As a result, Russian road-building and bridge-building industries have upside potential of 100-300%.
- A merger with Severstal, one of the leaders in the Russian steel industry, would allow Mostotrest to reduce its raw materials costs, which come to 40% of output prime cost. We note that Igor Levitin – who worked at Severstal Group in the past -- now holds the position of Transport Minister, which may lead to increased government orders.
- In the near term Mostotrest could take a part in the construction of the Fourth Transport Ring in Moscow, building the Moscow - St. Petersburg toll road, and the reconstruction of Leningradsky Prospekt in Moscow.



- The key indicator of Mostotrest's investment appeal remains the significant undervaluation of the company, confirmed both by a comparison with its main Russian and foreign peers and by a DCF valuation. According to these estimates, upside is nearly 150% from current market prices. Combining all three estimates we value one common share at US\$558.

Peer comparison, 2005E

| | Ticker | Mcap, US\$ mn | Net Debt, US\$ mn | EV, US\$ mn | Sales, US\$ mn | EBITDA, US\$ mn | Net Income, US\$ mn |
|-----------------|--------|------------------|----------------------|-------------|-------------------|--------------------|------------------------|
| Dalmoststroi | dmoa | 160.6 | 7.4 | 168.0 | 140.2 | 15.4 | 7.5 |
| Mostootryad №19 | msot | 42.4 | n/a | 42.4 | 180.0 | 6.9 | 1.0 |
| Dormost | drmo | 141.3 | 6.0 | 147.3 | 110.0 | 13.0 | 7.6 |
| DSK-1 | dskt | 2,016 | n/a | 2,016.0 | 850.0 | 63.7 | 33.7 |
| Mostotrest | mstt | 285 | 37.4 | 322.4 | 406.0 | 62.6 | 27.0 |

Source: Sovlink Securities

- We compare Mostotrest with its Russian peers Dalmoststroi, Mostootryad №19, Dormost, and DSK – 1, as well as with its most similar foreign peers.

Russian peer valuation comparison

| | Ticker | P/S | P/E | P/BV | EV/S | EV/EBITDA |
|-----------------|--------|-------------|--------------|------------------------|-------------|---------------|
| Dalmoststroi | dmoa | 1.15 | 21.36 | 1.93 | 1.20 | 10.91 |
| Mostootryad №19 | msot | 0.24 | 42.43 | 0.37 | 0.24 | 6.18 |
| Dormost | drmo | 1.28 | 18.49 | 2.96 | 1.34 | 11.33 |
| DSK-1 | dskt | 2.37 | 59.82 | 3.38 | 2.37 | 31.65 |
| Average | | 1.26 | 35.53 | 2.16 | 1.29 | 15.02 |
| Mostotrest | mstt | 0.70 | 10.57 | 0.81 | 0.80 | 5.16 |
| Upside,% | | 79.1% | 236.0% | 166.1% | 61.7% | 191.2% |
| Weights | | 30% | 20% | 30% | 10% | 10% |
| | | | | weighted upside | | 146.1% |

Source: Sovlink Securities

- A comparison with Russian bridge engineering companies shows that the average undervaluation of Mostotrest is 146%.

**Foreign peer valuation comparison**

| | Country | P/S | P/BV | P/E |
|--------------------------|---------|------------------------|--------|---------------|
| AMBER | USA | 2.17 | 2.79 | 14.50 |
| Avatar Holdings Inc. | USA | 0.98 | 1.61 | 9.80 |
| NVR Inc. | USA | 0.85 | 6.70 | 9.00 |
| Lafarge SA | USA | 1.07 | 1.75 | 15.60 |
| Sterling Construction | USA | 1.33 | 4.67 | 23.80 |
| Haltec Corporation | Japan | 0.56 | 0.53 | 63.50 |
| Kidoh construction | Japan | 1.17 | 2.07 | 25.92 |
| Japan Bridge Corporation | Japan | 0.32 | 1.60 | 36.79 |
| Zhejiang Expressway Co | China | 6.63 | 2.06 | 18.02 |
| Xiandai Investment Co | China | 3.90 | 1.53 | 36.82 |
| Chongqing Road & Bridge | China | 5.19 | 1.09 | 14.69 |
| Mostostal Plock S.A. | Poland | 0.44 | 1.07 | 42.00 |
| Average | | 2.05 | 2.29 | 25.87 |
| Mostotrest | Russia | 0.70 | 0.81 | 10.57 |
| Upside, % | | 191.7% | 182.3% | 144.7% |
| Weights | | 50% | 20% | 30% |
| | | weighted upside | | 175.7% |

Source: Bloomberg, Sovlink Securities

- A comparison with foreign bridge engineering companies shows Mostotrest's significant undervaluation: relative to its foreign peers, upside reaches 176%.

Peer valuation summary

| | Upside | Weight | Average |
|---------------------------------|--------|--------|---------|
| Russian peer valuation | 146.1% | 50% | |
| Foreign peer valuation | 175.7% | 50% | |
| Average upside by multiples | | | 160.8% |
| Fair MCap by multiples, US\$ mn | | | 745 |

Source: Sovlink Securities

- In order to calculate the average estimate from the peer valuation comparisons, we use equal weights for Russian and foreign peer groups. Russian peers are Mostotrest's main competitors, which is why estimates relative to them seem to be the most suitable at first glance. However, we believe Mostotrest's consolidation into Severstal Group should increase the company's transparency, and that will make a comparison with foreign peers more suitable. Taking this into account, we give equal weights to valuations relative to Russian and foreign companies.

- Our weighted-average valuation demonstrates possible upside of 161%, and gives us a target market capitalization of US\$745 mn.

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DCF summary, US\$ mn

| | 2005E | 2006E | 2007E | 2008E | 2009E | 2010E | 2011E | 2012E | 2013E |
|------------------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| Revenues | 406.00 | 475.02 | 551.02 | 628.17 | 709.83 | 780.81 | 858.89 | 944.78 | 1039.26 |
| Gross profit | 77.00 | 90.09 | 104.50 | 119.14 | 134.62 | 148.08 | 162.89 | 179.18 | 197.10 |
| EBITDA | 62.60 | 76.00 | 88.16 | 106.79 | 127.77 | 148.35 | 171.78 | 188.96 | 207.85 |
| Net profit | 27.00 | 33.25 | 44.08 | 56.53 | 63.88 | 78.08 | 85.89 | 94.48 | 103.93 |
| EBITDA margin, % | 15% | 16% | 16% | 17% | 18% | 19% | 20% | 20% | 20% |
| Net margin, % | 7% | 7% | 8% | 9% | 9% | 10% | 10% | 10% | 10% |
| EBIT*(1-t) | 27.00 | 33.25 | 44.08 | 56.53 | 63.88 | 78.08 | 85.89 | 94.48 | 103.93 |
| Amortization | 20.30 | 23.75 | 27.55 | 31.41 | 35.49 | 39.04 | 42.94 | 47.24 | 51.96 |
| FCFF | | 57.00 | 71.63 | 87.94 | 99.38 | 117.12 | 128.83 | 141.72 | 155.89 |
| FCFF discounted | | 48.31 | 51.45 | 53.53 | 51.26 | 51.19 | 47.72 | 44.49 | 41.47 |

Source: Sovlink Securities

- In our DCF model we use a conservative assumption of 10% annual growth for the forecast period and 3% for the terminal period. We believe that Mostotrest's current financial figures are understated and do not correspond to actual amounts. In building our DCF model we took into account the possibility of a profitability increase due to Mostotrest's alliance with Severstal. We believe that the company's EBITDA margin will be 20% in 2013 and that the company's net margin will reach 10%.

Cashflow summary

| | |
|-------------------------------------|--------|
| WACC | 18% |
| Terminal growth rate | 3% |
| NPV of forecasted years | 389.41 |
| NPV of terminal value | 284.78 |
| Fair EV, US\$ mn | 674.19 |
| Net Debt, US\$ mn | 37.40 |
| Fair MCAP, US\$ mn | 636.79 |
| Number of ordinary shares, mn | 1.24 |
| Fair value per ordinary share, US\$ | 513.05 |

Source: Sovlink Securities

- The present value of the company's cashflows is US\$389 mn, and the terminal value is US\$285 mn. The company's fair value in this case is US\$674 mn. Taking into consideration the company's net debt of US\$37.4 mn, we believe that the company's fair capitalization is US\$637 mn.



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MCap Summary

| | |
|-------------------------------------|------|
| Fair MCAP on DCF, US\$ mn | 637 |
| Fair MCAP on Multiples, US\$ mn | 745 |
| Weight for DCF | 50% |
| Weight for Peers | 50% |
| Average weighted Fair MCap, mn US\$ | 691 |
| Number of ordinary shares, mn | 1.24 |
| Fair value per ordinary share, US\$ | 558 |

Source: Sovlink Securities

- We believe that the company's fair value is US\$691 mn, based on a weighted-average of our DCF model and peer valuation. As such, we believe the fair value of one share of Mostotrest is US\$558 per share. As the upside potential is 142% from current prices, we assign a **STRONG BUY** recommendation on the company's shares.



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STOCK RATING POLICY

| | |
|---------------------------|---|
| STRONG BUY: | Target price offers upside of over 100%; confidence level – high |
| STRONG BUY (SPEC): | Target price offers upside of over 100%; confidence level – low |
| BUY: | Target price offers upside of between 25% and 100%; confidence level – high |
| BUY (SPEC): | Target price offers upside of between 25% and 100%; confidence level – low |
| HOLD: | Target price offers upside of less than 25% |
| SELL: | Target price at or below current price levels |

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