

# Mostotrest

**COMPANY  
NOTE**

**BUY**

**Target price: US\$581**

**Upside: 66%**

**Moving in the right direction**

**Analyst:**

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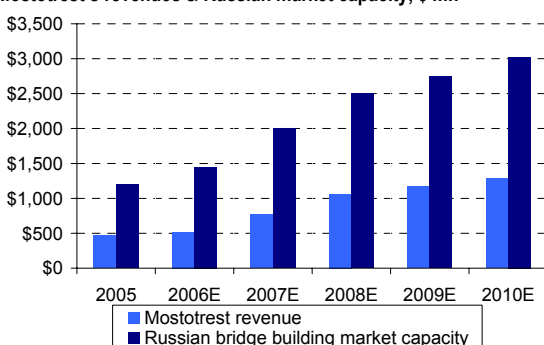
**STOCK DATA**

Ticker	mstt	MCap US\$ mn	435
Shares Ords	1,241,200	Free Float, %	25%+
Shares Pref	-	Free Float US\$ mn	109+
Bid Ords, US\$	342	Offer Ords, US\$	359

**Shareholders**

SeverstalTrans	50%+
Other	50%

**Mostotrest's revenues & Russian market capacity, \$ mn**

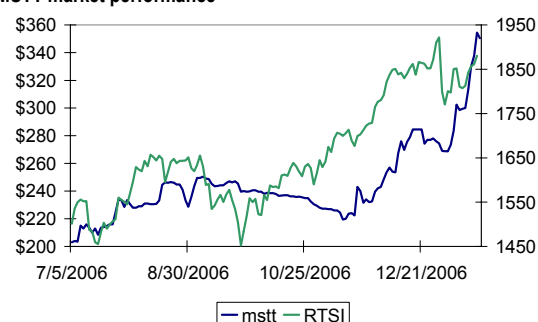


**Financials, \$ mn**

	2005	2006E	2007E
Sales	470.4	515.9	769.2
Gross profit	63.7	68.5	138.5
EBITDA	45.8	43.4	119.2
Net income	13.5	6.0	52.1
EBITDA margin, %	9.7%	8.4%	15.5%
Net margin, %	2.9%	1.2%	6.8%

	2006E	2007E	2008E
P/S	0.9	0.6	0.4
EV/EBITDA	9.9	3.6	2.5
P/E	82.6	8.6	5.5

**MSTT market performance**



- We continue to regard Mostotrest as the best investment idea in the Russian bridge-building industry. Besides the fact that Mostotrest is the largest company on the market—having a 40% market share—its new management team, led by General Director Vladimir Vlasov, has undertaken noticeable steps towards increasing the company's transparency and market capitalization.

- The high oil prices seen in the last two years allowed the Russian government to accumulate considerable Stabilization and Investment Funds (\$85 bn and \$2.6 bn at end-2006, respectively). From the position of the Russian government, the most rational use of Investment Fund money is building infrastructure, as these investments have the least impact on inflation.

- We underline that the order books and—thus—revenues of Russian bridge-builders do not depend on oil prices: *the main sources of financing infrastructure construction for 2007–08 have already been formed in the period of high oil prices.* Taking this into consideration, infrastructure builders seem to be a good investment instrument, an alternative to commodity-oriented shares. Moreover, in the next few years, bridge builders will show rapid growth in orders and revenues, as we expect a boom in the Russian bridge-building industry in 2007–08.

- The capacity of the Russian bridge-building market is \$1.45 bn at the present time. We expect that it will increase to \$2 bn by year-end and to \$2.5 bn in 2008. This rapid growth will be paid for by Investment Fund financing.

- New tendencies in the bridge-building industry appeared in 2006. Due to the rapid development of the bridge-building market and sustainable growth of orders on the one hand and limited capacities of Russian builders on the other, from 2007 there will be a capacity deficit on the Russian bridge-building market. In these conditions, Russian bridge-builders will tend not to compete for orders, but instead create alliances and joint-ventures. Mostotrest is already using this strategy, having entered into a joint-venture with Sistema-Hals and an alliance with Mostootryad-19 in 2006. This will allow the company to strengthen its position on the Moscow market and to gain ground in Saint-Petersburg.

- We underline that the deterioration of the company's financials in 2006 was temporary, as it was caused mainly by company-wide restructuring. Mostotrest is in the process of internal modifications that concern a wide range of processes—from materials sourcing to bank accounts.

- We have modified our DCF model, taking into consideration the announced plans of the company for 2007 and lowering our discount rate, as the company is becoming more transparent. Our new one-year target price for Mostotrest is \$581 per share, which gives us a **BUY** rating.

## **Mostotrest's recent changes**

• We remind readers that Mostotrest has been managed by a new team installed by core shareholder SeverstalTrans since 3Q06. As a result, we believe that Mostotrest has now entered a new era in its development. The new team, led by General Director Vladimir Vlasov, has launched a series of reforms concerning different business directions.

The most important reforms are:

**1. The system of subsidiaries' budgeting**—Each of Mostotrest's 17 subsidiaries will have its own income and expenditures budget;

**2. Raw materials supply system**—Mostotrest's provisioning system will be centralized for the whole company. At the end of 2006, 60%–70% of the company's supplies were already centralized. Further, the reforms imply a liquidation of the company's trading house. Implementing the process of supply centralization is an especially important part of Mostotrest's optimization program, taking into consideration the expected deficit on the cement and metal construction markets;

**3. Launching a cost normalization system**—The company will create a database of expense norms, which will include official norms for labor costs, supply norms, etc. Every subsidiary should follow the norm-setting coefficients for labor costs and raw materials expenses. As a result, the company expects to save up to 15% on expenses.

**4. Optimization of bank accounts**—The company's regional branches will eliminate superfluous bank accounts.

**5. Introduction of a project management system**—Mostotrest intends to introduce the principle of "project management" for the administration of some of its construction projects. This approach allows the company to manage its projects more effectively. These principles are currently being implemented at the company's Murom suspension bridge project.

• We stress that Mostotrest's new management team is ready to have an open dialogue with investors and make noticeable steps towards increasing the company's transparency and market capitalization. One of these steps was a meeting with investors in December, 2006, where investors saw up close Mostotrest's largest construction project—the bridge over the Moscow River at Serebriany Bor.

• Mostotrest's key advantage over other bridge builders is that it possesses technology that allows the company to have the shortest time periods of bridge building. Mostotrest can ensure the highest quality of building in the shortest amount of time. This means that Mostotrest is now the most likely candidate to receive new orders.

• The new approach of the two main regulators of the Russian bridge-building industry—The Ministry of Transportation and the Federal Road Agency—assumes a reduction of required construction durations and a liquidation of "long-term construction." The longer the period of construction, the more expensive a bridge becomes, due to maintenance costs.

• Long durations of construction are also not favorable for bridge builders, because it creates economic inefficiency. The fact is that budget financing is being corrected by a deflator value each year, but the increase of building materials' prices always surpasses the deflator value, which leads to lower margins.

## **Mostotrest's current projects**

Mostotrest is currently working on five large projects:

1. The construction of a section of the ring road in St. Petersburg;
2. The construction of a bridge in Irkutsk across the Angara River;
3. A bridge over the Oka river;
4. The construction of 15 km of the Don autobahn, including a bridge over the Don river;
5. A bridge over the Moscow River, which will be the part of Krasnopresnensky Prospekt.

- Mostotrest utilizes some construction technologies that are unique in Russia. For example, the Angara River bridge—with a length of more than 2 km—has almost no pre-cast concrete. All bridge spans (the length of each is 105 m) are being constructed by special methods never used in Russia before, despite the wide usage of these methods throughout the world.
- Another of Mostotrest's keys project is a suspension bridge across the Moscow River, currently under construction. Suspension bridges are the most complicated kind of bridges and the most expensive. Their key advantage is that they minimally disturb the river-bed and surrounding nature.

### **Future projects**

- Mostotrest's future orders may include participation in the construction of infrastructure for the Moscow-City business complex. The Moscow-City project assumes the need for three bridges, and we believe Mostotrest will build all of them.
- Mostotrest has strong chances of building road and bridge infrastructure in Sochi, regardless of whether Sochi wins its Winter Olympics bid.
- According to the company, Mostotrest will take part in the construction of the subway system in Nizhny Novgorod.

### **Mostotrest's joint projects**

- **Joint-venture with Sistema-Hals**—The joint-venture between Mostotrest and Sistema-Hals seems very lucrative for both companies. Sistema-Hals has considerable resources in the integration and planning of infrastructure projects. As such, the Mostotrest/Sistema-Hals joint-venture could have synergies, as Sistema-Hals owns OOO Organizator, the general contractor for all large infrastructure construction in Moscow. Organizator is currently allocating contracts for the building of Krasnopresnensky Prospekt, where Mostotrest is one of the builders.
- **An alliance with Mostootryad-19 (St. Petersburg)**—In the near future, we expect a deficit of bridge-building capacities, especially in the two most important regions—Moscow and St. Petersburg. These markets are currently divided by two key players on the Russian bridge-building market—Mostotrest (which operates mostly on the Moscow market) and Mostootryad-19 (which operates mostly on the St. Petersburg market). We believe that each company is likely to continue receiving orders in its respective region because of the existence of steady contacts with municipal authorities. As such, the alliance between Mostotrest and Mostootryad-19 in a set of projects provides sustainable benefits for both companies. Mostootryad-19 will be a subcontractor on Moscow projects, while Mostotrest remains the general contractor. Likewise, on the St. Petersburg market, Mostotrest will be a subcontractor and Mostootryad-19 will be the general contractor. Mostotrest's new management team is of the opinion that the largest bridge builders should join efforts in getting orders and accomplish them jointly, but not to compete for orders by using dumping practices.

## The Russian bridge-building market

- The Russian bridge-building market has seen rapid growth rates in recent years. We expect that bridge-building market capacity will reach \$2 bn in 2007, doubling from \$1 bn in 2004. At the same time, we expect the Russian bridge-building industry to experience a boom in 2007–08.
- Russia accumulated a sustainable amount of money in gold and currency reserves as well as in the Stabilization Fund in the recent period of high oil prices. Moreover, the amount of the Investment Fund will be increased by 25% in 2007 to \$3.4 bn due to the advanced repayment of Russia's Paris Club debts last year. Infrastructure construction is considered to have a non-accelerating effect on inflation, which is why the government will likely put large amounts of funds into infrastructure. Officially approved financing of bridge-building from the federal budget for 2007 was raised by 75% to Rb 21 bn (\$792 mn). We believe that in 2008, federal budget financing will reach over Rb 30 bn (\$1.13 bn).

### Russian bridge building market capacity

	2005	2006E	2007E	2008E	2009E	2010E
Russian bridge building market capacity, \$mn	1,200	1,450	2,000	2,500	2,750	3,025
annual growth rate, %	20%	21%	38%	25%	10%	10%

Source: Sovlink estimates

- We expect the bridge-building market in Russia to hit \$2 bn in 2007. Given that we forecast Mostotrest to post revenues of \$770 mn for 2007, the company should get about 40% of this.

### Key players on the Russian bridge-building market, \$ mn

Company	Ticker	Sales 2006E	Sales 2005	Assets 2006E	BV 2006E	EBITDA 2006E	NI 2006E	Core shareholder(s)
Mostotrest	mstt	564	471	408	160	44.2	5.4	SeverstalTrans
Mostotrayd-19	msot	204	228	122	60	4.6	1.3	Management
Dalmostostroy	dmoa	160	152	71	56	16.0	5.6	Transmashholding and Mikhail Abizov
Dormost	drmo	120	134	60	24	6.7	0.9	Mosinzhstroj
Volgomost*	-	-	133	107	47	16.3	2.1	SOK
Mostostroy 11	msts	-	129	118	16	-	-	Management
Mostostroy 6	-	-	105	-	-	-	-	Management
Sibmost	sibm	149	93	73	17	13.6	8.9	Sistema-Hals, Albert Koshkin

\* Financials shown for Volgomost are full-year 2005 results. The company did not publish any financial results for 2006.

Source: Company data, Sovlink estimates

- Because of the rapid growth rates of the Russian bridge-building industry and high margins, Russian bridge builders have become quite attractive acquisition targets for huge industrial structures. In 2006, a number of huge holdings bought stakes in bridge-building companies.

### Last deals in the industry

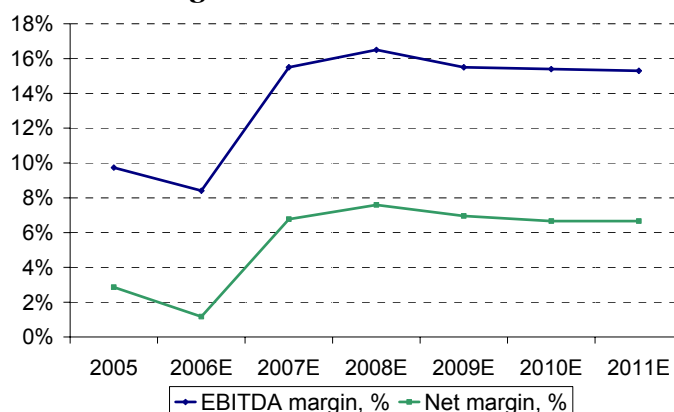
Target	Acquirer	Stake
Mostotrest	SeverstalTrans	c50%
Sibmost	Sistema-Hals	25%
Volgomost	SOK	75%
Dalmostostroy	Transmashholding and Mikhail Abizov	>50%

Source: Company data

## Mostorest's financials

• We expect to see a deterioration in Mostotrest's financials in 2006 in comparison to 2005, due to company-wide restructuring. The company is in the process of internal modifications that concern a wide range of processes—from materials sourcing to bank accounts. This was the reason for drops in the quality of cashflows and a fall in the company's EBITDA and net margins during 2006.

### Mostotrest EBITDA and net margins



Source: Company data, Sovlink estimates

- We believe that Mostotrest will become more transparent this year, and will post higher EBITDA and net profit. We believe that in 2007 Mostotrest will post EBITDA of \$119 mn and net profit of \$52 mn, showing margins of 15.5% and 6.8% respectively.
- According to new management forecasts, net income will be \$5 mn for 2006. Management expects full-year revenues of 14 bn rubles (\$524 mn), which is in line with our forecast of \$516 mn.
- Mostotrest's management expects turnover to rise to 20 bn rubles (\$749 mn) in 2007, suggesting 43% growth over 2006. The company is aiming for pre-tax profit of about 2 bn rubles (\$74.9 mn) for the year. This is roughly in line with our forecasts of \$769 mn in revenues, \$70 mn in EBT and \$52 mn in net profit.

## Valuation

• We value Mostotrest on two methods: DCF and comparative valuation.

### DCF model

• We believe that Mostotrest's EBITDA margin will be 15.5% in 2007 and that the company's net margin will reach 6.8%. Building our DCF model we proceed from the assumption of explosive growth in revenues and profits in 2007–08 year and conservative 10% revenue growth after. We lowered our discount rate to 15% from 18%, taking into consideration the company's improving corporate relations and transparency.

#### Mostotrest DCF summary, \$ mn

	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Revenues	515.9	769.2	1,061.5	1,167.7	1,284.5	1,412.9	1,554.2	1,709.6	1,880.6	2,068.6	2,275.5
COGS	447.5	630.8	859.8	957.5	1,053.3	1,158.6	1,274.4	1,401.9	1,542.1	1,696.3	1,865.9
Gross profit	68.5	138.5	201.7	210.2	231.2	254.3	279.8	307.7	338.5	372.4	409.6
Commercial and administrative expenses	45.2	53.8	74.3	81.7	89.9	98.9	108.8	119.7	131.6	144.8	159.3
Balance of other incomes and expenses	5.4	8.1	11.1	11.7	19.3	21.2	31.1	34.2	47.0	51.7	56.9
EBITDA	43.4	119.2	175.2	181.0	197.8	216.2	234.7	256.4	282.1	310.3	341.3
Amortization & depreciation	20.1	34.6	47.8	52.5	56.5	60.8	63.7	68.4	75.2	82.7	91.0
EBIT	23.2	84.6	127.4	128.4	141.3	155.4	171.0	188.1	206.9	227.6	250.3
interest payments	7.8	6.2	7.4	7.0	6.4	7.1	7.8	8.5	9.4	10.3	11.4
Net profit	6.0	52.1	80.5	81.2	85.5	94.1	97.8	107.5	111.3	122.5	134.7
EBITDA margin, %	8.4%	15.5%	16.5%	15.5%	15.4%	15.3%	15.1%	15.0%	15.0%	15.0%	15.0%
Net margin, %	1.2%	6.8%	7.6%	7.0%	6.7%	6.7%	6.3%	6.3%	5.9%	5.9%	5.9%
Net profit	6.0	52.1	80.5	81.2	85.5	94.1	97.8	107.5	111.3	122.5	134.7
Amortization & depreciation	20.1	34.6	47.8	52.5	56.5	60.8	63.7	68.4	75.2	82.7	91.0
Capex	2.2	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.2
investments in NWC	25.9	86.4	107.4	44.0	22.8	48.5	37.8	40.0	42.3	65.4	71.9
FCFF		-2.0	18.6	87.4	116.9	104.0	121.4	133.6	141.9	137.5	151.6
FCFF discounted		-1.8	14.1	57.5	66.8	51.7	52.5	50.2	46.4	39.1	37.5

Source: Sovlink estimates

WACC	15%
Terminal growth rate	3%
NPV of forecasted years	414.0
NPV of terminal value	321.6
Fair EV, \$ mn	735.7
Net debt, \$ mn	-11.5
<b>Fair M.Cap, \$ mn</b>	<b>747.2</b>
<b>Fair value, \$</b>	<b>602</b>

Source: Sovlink estimates

### Comparative valuation

• In order to calculate a fair value for Mostotrest based on a peer valuation comparison, we use only foreign peers. We consider that Russian bridge-building companies—except for Mostotrest—are rather non-transparent, with financial results that are understated and do not correspond to actual amounts. We believe that Mostotrest should trade at a premium to all companies in the domestic industry. We provide multiples for Russian bridge-builders for reference only and do not incorporate them into our valuation.

**Russian peer valuation, 2006E**

Company	Ticker	P/S	EV/A	EV/EBITDA	P/E
Mostootrayd-19	msot	0.71	0.85	22.6	115.2
Dalmostostroy	dmoa	0.67	1.44	6.4	19.1
Dormost	drmo	0.45	1.00	9.1	58.4
Mostostroy 11	msts	0.81	0.80	-	-
Sibmost	sibm	0.30	0.83	4.4	5.1
Average		0.66	1.02	12.7	64.2
Mostotrest	mstt	0.87	1.07	9.9	82.6

Source: Sovlink estimates

**Foreign peer valuation, 2006**

Company	Country	P/S	EV/EBITDA	P/E
Gold Bridge Engineer & Construction	Malaysia	0.98	neg.	neg.
Ho Hup Construction	Malaysia	1.49	13.0	67.0
Abengoa	Spain	1.07	6.0	32.8
Lian Beng Group	Singapore	1.66	18.3	168.0
Polimex Mostostal	Poland	4.69	10.3	202.9
AF Gruppen	Norway	2.44	6.6	116.3
Boskalis Westminster	Netherlands	1.42	9.1	26.2
Ludan Engineering	Israel	1.66	7.2	60.7
Intracom S.A.	Greece	1.03	17.1	37.7
Pfleiderer	Germany	1.23	13.5	35.3
Egypt Contracting Mokhtar	Egypt	1.83	-	45.7
Long Yuan Construction Group	China	3.70	7.2	158.4
Joao Fortes Engenharia	Brazil	3.86	18.1	69.5
Moury Construct	Belgium	0.40	3.8	11.2
Average		1.96	10.85	79.37
Mostotrest	Russia	0.87	9.86	82.59
Upside/downside, %		127%	10%	-4%
Weights		40%	30%	30%
			Weighted upside	53%

Source: Bloomberg, Sovlink estimates

• A comparison with foreign engineering companies suggests that Mostotrest has 53% upside. We notice that only P/S multiples suggest a serious undervaluation while EV/EBITDA and P/E suggest that Mostotrest is fairly valued. The reason for this is that Mostotrest posted low EBITDA and net profit in 2006 as a result of company-wide restructuring. We believe that as the company posts higher profit and becomes more transparent, it will look considerably more attractive on EV/EBITDA and P/E multiples.

**Final estimate**

	Fair value, \$	Weight
DCF model	602	70%
Comparative estimation	529	30%
Final target price	581	

Source: Sovlink estimates

• As a result of the weighted-average analysis of our DCF model and peer valuation, we believe Mostotrest's fair value is \$581, a slight increase from our previous target price of \$558. Due to recent stock performance, we tweak the company's rating from **STRONG BUY** to **BUY**, noting 66% upside.

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## STOCK RATING POLICY

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

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