



# Elektrogaz

**Company  
Note****BUY****Target Price: \$1,144****Upside: 82%****Analyst:****Nikolay Saperov**

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**STOCK DATA**

Ticker	elgz	MCap (US\$ mn)	44.5
Shares Ords	57,814	Free Float, %	49
Shares Pref	19,272	Free Float (\$ mn)	20
Bid Ords, \$	500	Offer Ords, \$	975
Bid prefs, \$	210	Offer prefs	250

**PERFORMANCE**

	2005	2006E	2007E
Sales, \$ mn	64.1	90.3	112.0
EBITDA, \$ mn	4.35	5.28	5.37
Net profit, \$ mn	1.30	2.44	4.84
EBITDA margin, %	6.8%	5.9%	8.7%
Net margin, %	2.0%	2.7%	4.3%

**COMPARATIVE MULTIPLES, 2006E**

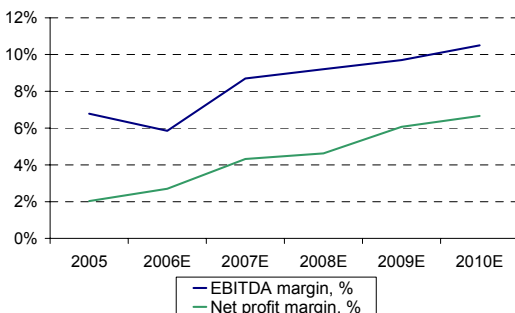
	P/S	EV/ EBITDA	P/E
Russian peers	0.65	9.5	26.2
Global peers	1.13	10.8	35.3
Elektrogaz	0.49	8.6	18.3

Note: Given the large bid-ask spread in Elektrogaz shares, we base our valuations for the company on a price of \$630 per share, the price of the last OTC trade.

**ELEKTROGAZ VALUATION**

Comparative valuation	995
DCF valuation	1,294
<b>Average</b>	<b>1,144</b>

Source: Sovlink estimates

**ELEKTROGAZ' EBITDA AND NET MARGIN, %****9MO6 RSA results surprise on the upside**

- Elektrogaz' 9MO6 results exceeded our expectations. As such, we have modified our DCF model, taking these improvements into consideration and changing our forecasts for the company's financials.

- In our previous research ("Elektrogaz: Under Gazprom's protection" of November 28, 2006), we highlighted that the main investment idea for Elektrogaz was expected explosive revenue growth in 2007–08 due to the increase in Gazprom's orders for electricity networks and the assembly of power supply equipment.

- The company's strong 9MO6 RSA results—which we feel are a good indicator for its full-year results—surpassed our expectations and caused us to revise our forecasts for 2006 and beyond.

**Elektrogaz 2006 forecast changes, \$ mn**

	2005	2006E (old)	2006E (new)
Sales	64.1	75.7	90.3
EBITDA	4.3	5.4	5.3
Net profit	1.3	1.8	2.4
EBITDA margin, %	6.8%	7.1%	5.9%
Net margin, %	2.0%	2.4%	2.7%

Source: Company data, Sovlink estimates

- These results lend support to our thesis that Gazprom will make huge investments in the construction of infrastructure for gas fields, including the creation of electrical capacities. The main proof of it remains the fact that Gazprom's largest potential gas fields have no transport or electrical infrastructure.

- Due to unexpectedly high 9MO6 RSA results, we increase our revenue growth forecast to 24% year-on-year in 2007 and 22% in 2008. The slight decrease in the 9MO6 EBITDA margin is a result of increased COGS, but, at the same time, Elektrogaz' 9MO6 results indicate a slight increase in net margin. In our DCF model, we proceed from the assumption that Elektrogaz will increase its posted net margin to 6.7% in 2010.

- We have modified our DCF model and refreshed our comparative valuation. As a result, we come to a fair value of \$1,144 per ordinary share, implying 82% upside from the last OTC trade. We rate the company a **BUY**.



## Comments on 9Mo6 RSA results

### Elektrogaz 9Mo6 RSA results, \$ mn

	3Q05	2005	3Q2006	% chg. y-o-y	2006E	% chg. y-o-y
Contractor and subcontractor works	40.56	58.60	51.48	26.9%	74.90	27.8%
Other	2.35	5.50	9.22	292.3%	15.40	180.0%
Revenues	42.92	64.10	60.71	41.4%	90.30	40.9%
COGS	25.12	39.42	42.58	69.5%	63.21	60.4%
Gross profit	17.80	24.68	18.12	1.8%	27.09	9.8%
Gross margin, %	41.5%	38.5%	29.8%	-11.7 ppt	30.0%	-8.5 ppt
Management expenses	13.37	18.40	11.82	-11.6%	18.06	-1.8%
Sales income	4.42	6.28	6.30	42.5%	9.03	43.8%
Cashflow of non-operating activities	2.34	2.70	3.50	49.6%	4.52	67.4%
EBITDA	2.59	4.35	3.54	36.7%	5.28	21.4%
EBITDA margin, %	6.0%	6.8%	5.8%	-0.2 ppt	5.9%	-0.9 ppt
Interest payments	0.19	0.15	0.31	63.2%	0.45	200.0%
Amortization & depreciation	0.51	0.77	0.53	3.9%	0.77	0.0%
EBT	1.89	3.43	2.84	50.3%	4.06	18.4%
Net profit	0.57	1.30	1.20	110.5%	2.44	87.7%
Net margin, %	1.3%	2.0%	2.0%	0.7 ppt	2.7%	0.7 ppt

Source: Company data, Sovlink estimates

Elektrogaz' 9Mo6 RSA results show a substantial improvement in the company's business. Firstly, the 41% year-on-year revenue growth shows that the company continues to increase its order book and contractor works for Gazprom. At the same time, while Elektrogaz demonstrated explosive revenue growth, its commercial and administrative expenses are falling, which suggests improving efficiency. One negative change was an increase in COGS and a lower gross margin, which led to a decrease in the company's 9Mo6 EBITDA margin. At the same time, Elektrogaz' 9Mo6 results indicate a slight increase in net margin, which could be evidence of improving transparency.

## Valuation changes

- We estimate the fair value of Elektrogaz shares via a DCF model as well as by comparing the company to its Russian and international peers.

## Comparison to Russian companies

- We added one company to the list of Elektrogaz' Russian peers—Zapsibelektrosetstroi. This company, similar to Sevzapelektrosetstroi, specializes in building electricity networks. Elektrogaz provides the same services for Gazprom, earning about 85% of its revenues from building electricity networks.

### Valuation comparison, 2006E

	P/S	EV/EBITDA	P/E	P/A
Sevzapelektrosetstroi	1.0	11.6	26.9	1.5
Lengazpetsstroi	0.4	7.0	10.3	0.8
Zapsibelektrosetstroi	0.5	10.0	41.2	1.1
<b>Average</b>	<b>0.7</b>	<b>9.3</b>	<b>18.6</b>	<b>1.1</b>

Source: Sovlink estimates



### International valuations

Company	Country	P/S	EV/EBITDA	P/E	P/A
Emcor Group Inc	US	0.39	8.99	30.3	1,02
Jacobs Engineering Group Inc	US	0.95	14.47	40.5	2,24
Englobal Corp	US	0.73	21.73	35.7	2,25
Sys	US	1.0	7.59	32.4	1,85
Abb Ltd Reg	Switzerland	2.13	9.18	65.0	2,15
Arcadis NV	Netherlands	0.8	7.98	23.9	1,29
Prinsiptek Corporation BHD	Malaysia	1.43	7.65	21.2	1,01
Lindea AG	Germany	1.08	6.33	20.4	0,86
SNC-Lavalin Group	Canada	1.67	13.22	48.7	1,51
<b>Average</b>		<b>1.13</b>	<b>10.79</b>	<b>35.3</b>	<b>1.57</b>

Source: Bloomberg, Factiva, Reuters

### Comparative price target derivation

	P/S	EV/EBITDA	P/E	P/A	Weights
Foreign peer multiples	1.13	10.8	35.3	1.57	70%
Russian peer multiples	0.65	9.5	26.2	1.11	30%
<b>Average</b>	<b>0.99</b>	<b>10.4</b>	<b>32.6</b>	<b>1.43</b>	
Elektrogaz	0.49	8.6	18.3	1.09	
Upside potential	100%	21%	79%	32%	
Weighted upside		58%			
Fair value		995			

Source: Sovlink estimates

### DCF valuation

- As Elektrogaz reported strong 9Mo6 RSA results that surpassed our expectations, we revised our assumptions for growth rates in 2007–08. We increase our revenue growth rates to 24% in 2007 and 22% in 2008.

### DCF model, \$ mn

	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Contractor's work	74.9	92.9	113.3	130.3	149.9	164.8	181.3	199.5	219.4	241.3	265.5
Other	15.4	19.1	23.3	27.7	33.0	37.6	42.9	48.9	55.7	63.5	72.4
<b>Revenues</b>	<b>90.3</b>	<b>112.0</b>	<b>136.6</b>	<b>158.0</b>	<b>182.8</b>	<b>202.4</b>	<b>224.2</b>	<b>248.3</b>	<b>275.1</b>	<b>304.9</b>	<b>337.9</b>
COGS	63.2	76.1	92.9	105.9	123.4	136.7	152.5	168.9	187.1	207.3	229.8
Gross profit	27.1	35.8	43.7	52.1	59.4	65.8	71.7	79.5	88.0	97.6	108.1
Gross margin, %	30%	32%	32%	33%	33%	33%	32%	32%	32%	32%	32%
Amortization	0.8	1.1	1.4	1.6	1.8	2.0	2.2	2.5	2.8	3.0	3.4
Management expenses	18.1	21.8	26.0	30.8	33.8	37.5	40.4	43.5	48.1	53.4	59.1
Cashflow of non-operating activities	4.5	5.4	6.6	7.6	8.2	9.1	10.1	11.2	12.4	13.7	15.2
<b>EBITDA</b>	<b>5.3</b>	<b>9.7</b>	<b>12.6</b>	<b>15.3</b>	<b>19.2</b>	<b>21.3</b>	<b>23.5</b>	<b>27.3</b>	<b>30.3</b>	<b>33.5</b>	<b>37.2</b>
EBITDA margin, %	5.9%	8.7%	9.2%	9.7%	10.5%	10.5%	10.5%	11.0%	11.0%	11.0%	11.0%
Interest payments	0.45	0.56	0.68	0.79	0.91	1.01	1.12	1.24	1.38	1.52	1.69
Amortization	0.8	1.1	1.4	1.6	1.8	2.0	2.2	2.5	2.8	3.0	3.4
EBT	4.1	8.1	10.5	13.0	16.5	18.2	20.2	23.6	26.1	29.0	32.1
Net profit	2.4	4.8	6.3	9.6	12.2	13.5	14.9	17.5	19.3	21.4	23.8
Net margin, %	2.7%	4.3%	4.6%	6.1%	6.7%	6.7%	6.7%	7.0%	7.0%	7.0%	7.0%

Source: Sovlink estimates



**DCF model, \$ mn (continued)**

	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Revenues	90.30	111.97	136.61	158.03	182.84	202.45	224.19	248.33	275.12	304.86	337.88
Gross profit	27.09	35.83	43.71	52.15	59.42	65.79	71.74	79.47	88.04	97.55	108.12
Non-COGS	4.52	5.37	6.56	7.59	8.23	9.11	10.09	11.17	12.38	13.72	15.20
EBITDA	5.28	9.74	12.57	15.33	19.20	21.26	23.54	27.32	30.26	33.53	37.17
Amortization & depreciation	0.77	1.12	1.37	1.58	1.83	2.02	2.24	2.48	2.75	3.05	3.38
EBIT	4.52	8.62	11.20	13.75	17.37	19.23	21.30	24.83	27.51	30.49	33.79
Interest payments	0.45	0.56	0.68	0.79	0.91	1.01	1.12	1.24	1.38	1.52	1.69
Net profit	2.44	4.84	6.31	9.59	12.18	13.48	14.93	17.46	19.34	21.43	23.75
EBITDA margin, %	5.9%	8.7%	9.2%	9.7%	10.5%	10.5%	10.5%	11.0%	11.0%	11.0%	11.0%
Net margin, %	2.7%	4.3%	4.6%	6.1%	6.7%	6.7%	6.7%	7.0%	7.0%	7.0%	7.0%
Net profit	2.44	4.84	6.31	9.59	12.18	13.48	14.93	17.46	19.34	21.43	23.75
Amortization & depreciation	0.77	1.12	1.37	1.58	1.83	2.02	2.24	2.48	2.75	3.05	3.38
Capex	2.24	2.31	2.31	2.31	2.31	2.31	2.31	2.31	2.31	2.31	2.22
NWC investments	-1.18	4.13	2.79	2.27	1.83	5.75	1.94	2.48	2.75	3.06	3.40
FCFF	2.14	-0.48	2.58	6.59	9.87	7.45	12.92	15.15	17.03	19.12	21.51
FCFF discounted		-0.42	1.95	4.33	5.64	3.71	5.59	5.70	5.57	5.43	5.32

Source: Sovlink estimates

WACC	15%
Terminal growth rate	4%
NPV of forecasted years	42.81
NPV of terminal value	50.3
Fair EV, \$ mn	93.1
Net Debt, \$ mn	0.8
Fair M.Cap, \$ mn	92.3
Fair value, ordinary, \$	1,294

Source: Sovlink estimates

**Price target derivation, \$**

Comparative valuation	995
DCF valuation	1,294
<b>Average</b>	<b>1,144</b>

Source: Sovlink estimates

Using the average of our fair value estimates, we arrive at a target price of \$1,144 per ordinary share of Elektrogaz, implying 82% upside from the last OTC trade. We rate the company a **BUY**.



**SOVLINK**

YOUR FIRST CALL – FOR THE SECOND TIER

January 31, 2007

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<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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