

Kalina

**COMPANY
NOTE**

BUY

Upside: 28%
Target Price: \$47.2

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Stock data

Ticker	KLNA	M.Cap, \$ mn	353.5
Shares Ords	9,752,311	Free float, %	33%
Shares Prefs	-	Free float, \$ mn	116.6
Bid Ords, \$	35.5	Offer Ords, \$	37.0

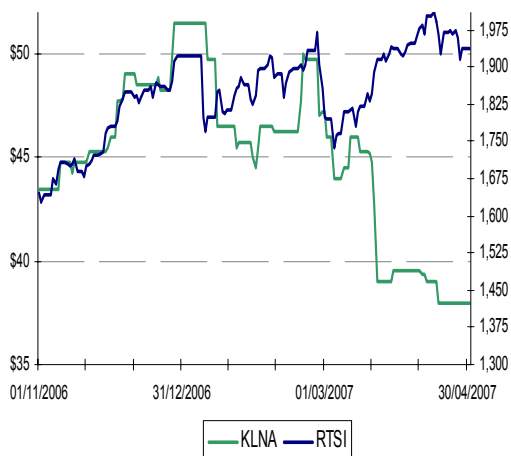
Market performance

		1 month	6 months
Absolute	Ords	-7.1%	-19.0%
Relative to RTSI	Ords	1.2%	-27.0%
Price range, \$			
High	Ords	39.00	51.50
Low	Ords	36.25	36.25

Financials, 2007E

Revenue, \$ mn	388.8	P/S	1.03
EBITDA, \$ mn	45.8	EV/EBITDA	8.66
Net income, \$ mn	18.9	P/E	18.7

Kalina's market performance



Source: RTS, Sovlink

**Still attractive –
good entry point**

- Kalina has recently reported full-year results for 2006 as well as for 1Q07. Understandably, the company's EBITDA and net income suffered as a result of additional expenses in 4Q06 related to restructuring costs, the integration of Dr Scheller, and the active marketing of Dr Scheller products.
- The market reacted very negatively to these figures, with Kalina's share price dropping to a six-month low. We have studied Kalina's financial results and incorporated the new information in our adjusted valuation model.
- In our updated DCF model, we have lowered our depreciation estimates and also reduced our gross profit and EBITDA forecasts due to the intense competition prevalent in the Russian cosmetics market, and increasing marketing and sales costs. Nevertheless, the market is still growing and full of opportunities, so there is room for the company to improve its financial results.
- In addition to our DCF model, we have also provided comparative valuations with peers from developed and emerging markets. Based on our analysis, we believe that Kalina is undervalued. Kalina's P/S, EV/EBITDA and P/E multiples are at a discount of approximately 18-57% relative to companies in developed markets and 24-76% in relation to companies in emerging markets. On average, Kalina's shares are trading at a discount of 42.8%.
- Combining our DCF and comparative valuation results, we value Kalina's shares at \$47.2, with potential upside of 28%. Despite the protracted consolidation process regarding Dr Scheller and the drop in the company's net income, we believe that this is a good opportunity to enter the Russian consumer sector. Accordingly, although we lower our price target from \$51.95 to \$47.2, we raise our recommendation from **HOLD** to **BUY**.

Financial results

Kalina's revenues for 2006 exceeded our expectations; however, its EBITDA and net income figures did not meet our forecasts due to additional expenses in 4Q06 related to restructuring costs, the integration of Dr Scheller, and the active marketing of Dr Scheller products. In the table below, we have given our forecasts as well as the actual results for 2006.

According to the management, the company will increase its advertising expenditures in the near future. The intense competition in the Russian cosmetics sector has forced companies to fight for customers. Nevertheless, the market is still growing and there are opportunities to develop a customer base that would lead to constant demand for the company's products.

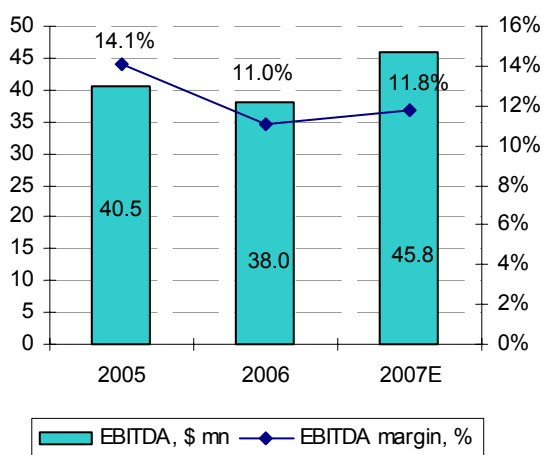
Comparison of forecast and actual results, \$ mn

	2005	2006	% chg., y-o-y	2006E	Diff., %
Sales	288.0	344.1	19.5%	339.6	1.3%
EBITDA	40.5	38.0	-6.2%	47.2	-24.3%
Net income	22.9	15.4	-32.9%	25.0	-62.8%
EBITDA margin, %	14.1%	11.0%	-3.1%	13.9%	-2.9%
Net margin, %	8.4%	4.5%	-3.9%	7.5%	-3.0%

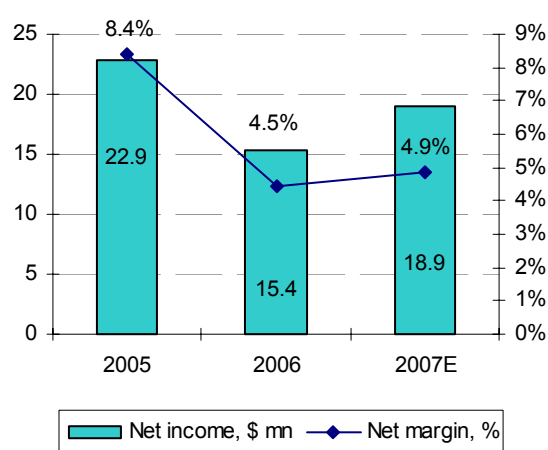
Source: Company data, Sovlink estimates

Higher advertising expenses related to marketing the Dr Scheller brand in the Russian market led to lower margins for Kalina in 2006, with EBITDA and net income dropping by 6% and 33% y-o-y respectively. We believe that these declines are temporary, and in 2007, we expect the company's revenues to increase to \$388.8 mn and its EBITDA margin to 11.8%. We also expect a higher net margin in 2007 due to the completion of Dr Scheller's restructurisation and a return to normal advertising costs.

EBITDA dynamics



Net income dynamics



Source: Company data, Sovlink estimates

Valuation

We have updated our fair value (based on a combination of comparative and DCF methods) for Kalina's shares. Our DCF-model uses forecasts based on consolidated IFRS results, which include Dr Scheller.

The company's EBITDA figures suffered as a result of additional expenses in 4Q06 related to restructuring costs, the integration of Dr Scheller, and the active marketing of Dr Scheller products.

We view Kalina's 2006 revenue figures positively. We have adjusted our DCF model by using Kalina's actual 2006 revenues, which were 1.1% higher than our estimates.

Kalina financials, \$ mn

	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Revenues	344.1	388.8	427.6	466.0	503.8	543.5	584.8	629.3	676.4	727.0
Cost of sales	189.2	211.9	233.0	254.0	277.1	298.9	321.7	346.1	372.0	399.9
Gross profit	154.9	176.9	194.5	212.0	226.7	244.6	263.2	283.2	304.4	327.2
Selling, general and administrative expenses	128.2	143.8	153.9	166.8	178.9	191.6	204.7	225.3	239.8	250.1
Operating profit	26.7	33.0	40.6	45.2	47.9	53.0	58.5	57.9	64.5	77.1
Amortisation & depreciation	11.3	12.7	14.0	15.2	16.5	17.8	19.1	20.6	22.1	23.8
EBITDA	38.0	45.8	54.6	60.4	64.3	70.8	77.6	78.5	86.6	100.8
Other expenses	-1.5	-1.6	-1.3	-1.4	-1.5	-1.5	-1.5	-1.6	-1.7	-1.8
Interest	-5.2	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0
EBT	20.1	26.5	34.3	38.8	41.4	46.5	52.0	51.3	57.8	70.2
Taxes	5.7	7.5	9.8	11.1	11.8	13.3	14.8	14.6	16.5	20.0
Net income	15.4	18.9	24.6	27.7	29.6	33.3	37.2	36.7	41.4	50.2
EBIT	25.2	31.5	39.3	43.8	46.4	51.5	57.0	56.3	62.8	75.2
EBITDA margin	11.0%	11.8%	12.8%	13.0%	12.8%	13.0%	13.3%	12.5%	12.8%	13.9%
Net margin	4.5%	4.9%	5.7%	6.0%	5.9%	6.1%	6.4%	5.8%	6.1%	6.9%

Source: Company data, Sovlink estimates

In our updated model, we lowered depreciation costs and also reduced our gross profit and EBITDA forecasts due to the intense competition prevalent in the Russian cosmetics market and the increasing marketing and sales costs. Nevertheless, the market is still growing and full of opportunities.

Kalina DCF model, \$ mn

	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Revenues	344.1	388.8	427.6	466.0	503.8	543.5	584.8	629.3	676.4	727.0
Gross profit	154.9	176.9	194.5	212.0	226.7	244.6	263.2	283.2	304.4	327.2
EBITDA	38.0	45.8	54.6	60.4	64.3	70.8	77.6	78.5	86.6	100.8
Net profit	15.4	18.9	24.6	27.7	29.6	33.3	37.2	36.7	41.4	50.2
EBITDA margin, %	11.0%	11.8%	12.8%	13.0%	12.8%	13.0%	13.3%	12.5%	12.8%	13.9%
Net profit margin, %	4.5%	4.9%	5.7%	6.0%	5.9%	6.1%	6.4%	5.8%	6.1%	6.9%
Net income	15.4	18.9	24.6	27.7	29.6	33.3	37.2	36.7	41.4	50.2
Amortisation & Depreciation	11.3	12.7	14.0	15.2	16.5	17.8	19.1	20.6	22.1	23.8
Capex	7.5	7.5	7.8	8.0	8.1	8.2	8.5	8.8	9.0	9.5
FCFF	-	24.2	30.7	35.0	38.0	42.8	47.8	48.5	54.5	64.5
FCFF discounted	-	21.4	24.1	24.2	23.3	23.3	22.9	20.6	20.5	21.5

Source: Company data, Sovlink estimates

WACC	13%
Terminal growth rate	3%
NPV of forecasted years, \$ mn	201.8
NPV of Terminal Value, \$ mn	228.6
Fair EV, \$ mn	430.4
Net Debt, \$ mn	43.2
Fair M.Cap, \$ mn	387.2
Number of shares outstanding	9,752,311
Fair value, per share, \$	39.7

Comparative valuation

Companies in the perfume and cosmetics sector in emerging markets are valued higher than their peers in developed markets. They enjoy an 82% P/S premium and a 70% EV/EBITDA premium – they are valued more expensively due to the higher growth rates of their consumer markets. Whereas Brazil, Russia, India, and China (BRIC) enjoy double-digit growth rates, growth rates in the US and Europe range between 3-4% annually. However, Kalina, which operates in a rapidly growing market, is valued cheaper than its peers in India and Brazil, and is even cheaper than some of its peers such as L’Oreal and Wella in developed markets. Therefore, we find the company to be quite undervalued, considering its forecast revenue growth rates.

Comparative price derivation

	Country	P/S			EV/EBITDA			P/E		
		2006	2007E	2008E	2006	2007E	2008E	2006	2007E	2008E
Robertet	France	1.4	1.3	1.2	9.2	9.1	8.6	17.4	18.2	17.2
L’OREAL	France	3.4	3.1	2.9	n.a.	14.6	13.4	n.a.	25.6	22.8
Ales Groupe	France	1.6	1.5	1.4	11.9	10.5	9.5	23.3	21.0	18.6
Ulric de Varen	France	2.5	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	18.6	15.8
Beiersdorf	Germany	2.6	2.4	2.3	16.3	14.8	13.2	29.3	27.9	23.9
Wella	Germany	3.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Inter Parfums	US	1.8	1.5	1.4	15.8	12.0	10.5	31.9	25.9	21.6
Avon Products	US	1.9	1.8	1.7	15.7	12.9	11.0	30.6	21.4	17.6
Colgate-Palmolive	US	2.8	2.6	2.5	13.1	12.0	10.9	23.1	20.2	17.9
Procter&Gamble	US	2.8	2.6	2.4	23.5	20.4	17.8	14.1	12.1	11.1
Developed markets		2.4	2.1	2.0	15.1	13.3	11.9	24.2	21.2	18.5
Dabur India Limited	India	4.6	3.5	3.0	n.a.	21.4	18.6	n.a.	26.3	21.8
Colgate-Palmolive India	India	4.6	4.0	3.6	22.8	20.5	17.4	31.5	26.5	22.1
Natura Cosmeticus	Brazil	3.9	n.a.	n.a.	n.a.	12.3	10.4	n.a.	20.1	16.9
Emerging markets		4.4	3.8	3.3	22.8	18.1	15.5	31.5	24.3	20.3
Kalina		1.0	0.9	0.8	10.4	8.7	7.3	23.0	18.7	14.4
Premium/discount to emerging markets		-76%	-76%	-75%	-54%	-52%	-53%	-27%	-23%	-29%
Premium/discount to developed markets		-58%	-57%	-58%	-31%	-35%	-39%	-5%	-12%	-22%
Average discount		-67%	-66%	-67%	-42%	-43%	-46%	-16%	-17%	-26%
Fair Mcap			1046.8			624.7		428.2		
Weights			20%			40%		40%		
Weighted M.Cap - based on 2007E figures, \$ mn				630.5						
Fair value, per share, \$				64.7						

Source: Bloomberg, Sovlink estimates

In our comparative valuation, we derived Kalina's fair market value by calculating Kalina's average discount to its peers in the developed and emerging markets – using 2007E P/S, EV/EBITDA, and P/E multiples given in the table above. Based on our fair value of \$64.7, Kalina's shares are currently trading at a discount of 42.8%.

Final price derivation

	Price, \$	Weight
Comparative valuation	64.7	30%
DCF	39.7	70%
Target price, \$		47.2

Source: Sovlink estimates

Combining our DCF and comparative valuation results, we value Kalina's shares at \$47.2, with potential upside of 28%. Despite the protracted consolidation process regarding Dr Scheller and the drop in the company's net income, we believe that this is a good opportunity to enter the Russian consumer sector. Accordingly, although we lower our price target from \$51.95 to \$47.2, we raise our recommendation from **HOLD** to **BUY**.

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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