SOVLINK
YOUR FIRST CALL – FOR THE SECOND TIER

July 06, 2007

Severstal-Auto

Company Note

BUY

UPSIDE: 46%
Target Price: US$51

Analyst: Nikolay Saperov
saperovn@sovlink.ru

STOCK DATA

Ticker	SVAV	M.Cap, $ mn	1,216
Shares Ords	34,270,159	Free Float, %	35
Shares Pref	-	Free Float, $ mn	426
Bid Ords, $	35	Offer Ords, $	36

PERFORMANCE

	1 month	6 month
Absolute	7.3%	9.1%
Relative to RTS	-1.9%	10.3%

KEY FINANCIALS

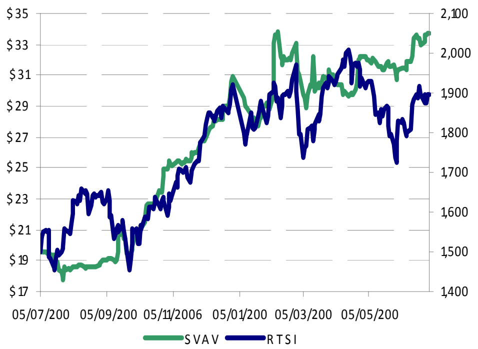
	2005	2006	2007E
Sales, $ mn	938	1,231	1,741
EBITDA, $ mn	129	162	253
Net profit, $ mn	54	67	114
EBITDA margin, %	13.8%	13.2%	14.5%
Net margin, %	5.8%	5.4%	6.5%

COMPARATIVE MULTIPLES, 2007E

	P/S	EV/EBITDA	P/E
Developed market peers	0.56	5.6	13.1
Emerging market peers	1.22	10.3	17.6
Severstal-Auto	0.65	7.6	9.9

Source: Company data, Sovlink estimates

SVAV – Relative performance, %



Source: RTS

Winning Strategy

• In our opinion, Severstal-Auto is currently the only Russian car producer that can benefit from retail market development and the growth of real disposable income in Russia. Clearly, developing a strategy of local vehicle assembly is most lucrative when consumer demand for automobiles is sensitive to price/quality levels.
• The company has an excellent management team, led by CEO Vadim Schvetsov – one of the proponents of developing car assembling facilities in Russia. In January 2007, Schvetsov became the controlling shareholder (58%) of the company.
• Currently Severstal-Auto's strategy involves balancing the development of car assembling facilities and maintaining market share in the cheaper segment of the Russian car market. In addition to the assembly of Korean Ssang Yong off-road vehicles, Severstal-Auto will also start assembling light-duty Fiat Ducato trucks. In 2006, the company completely reconstructed its ZMA plant production capacities in Tatarstan, in order to produce Fiat cars. Results from 2006 show that cheaper vehicles remain in high demand by Russian governmental enterprises. The company is planning to launch new assembly facilities for Isuzu LCVs, new Ssang Yong SUVs, and Fiat cars as to retain its market share in the UAZ SUV and low-budget car sectors.
• Representatives of Severstal-Auto have declared plans for the development of their own dealer network, which will sell about 30% of the cars sold, including imported Fiat models. The dealer network will help the company understand the market better, gain a deeper understanding of changes in demand, and also raise profitability at the holding level. Furthermore, the company management continues to use the lean production approach of the Japanese regarding the organisation of industrial and marketing processes, which is targeted to maximise expense reduction. Severstal-Auto remains the most profitable domestic car manufacturer.

• In spite of the fact that Severstal-Auto is the most expensive domestic car manufacturing company, and it's multiplies are higher than those of other companies in developing markets, we believe that it still has the potential for further growth. The company deserves a premium for following the optimum development strategy and having the best corporate management in the local automotive sector. We believe that that in future the company may be valued at multiples that are closer to multiples of auto manufacturers in developed markets. Foreign cars assembled in Russia are a bargain for local consumers given the price/quality relationship. Today Severstal-Auto offers a unique opportunity to invest in the expected boom in the domestically assembled car market in Russia.

• Based on our DCF model and comparative valuation, we obtained a one-year target price of $51 per ordinary share, which implies upside of 46%. Accordingly, we issue a **BUY** recommendation on Severstal-Auto.

Business description

The Severstal-Auto Holding consists of three divisions: UAZ (based in Ulianovsk), ZMZ (based in Nizhniy Novgorod), and ZMA (based in Naberezhnye Chelni, Tatarstan). Severstal-Auto is currently implementing a strategy of assembling foreign brands in Russia. In this way, the company is trying to retain its market share in the Russian cheap vehicles segment.

UAZ is one of the biggest producers of SUVs (the UAZ Hunter and the UAZ Patriot) and LCVs in Russia. (As of July 2006, UAZ started assembling ISUZU LCVs.)

ZMZ is the largest Russian producer of 4-8 cylinder engines used in SUVs, LCVs, and buses. The GAZ group purchases approximately 90% of the engines produced by ZMZ.

In 2005, Severstal-Auto acquired the ZMA plant, situated in Tatarstan. This plant was considered optimal for implementing Severstal-Auto's assembly facilities for Ssang Yong and Fiat. The production capacities of this plant, designed for the production of the Oka (a small Russian car), were reconstructed to assemble the Ssang Yong Rexton and the Fiat Albea.

At the end of 2006, Severstal-Auto started assembling the Fiat Albea sedan at its ZMA plant. This was the first joint project between Severstal-Auto and Fiat. We emphasise that the Fiat Albea looks very attractive in terms of price/quality comparisons and is well placed to compete strongly in the lower locally assembled vehicles segment against the Ford Focus and the Hyundai Accent. The company expects to sell over 20,000 units of the Albea in 2007.

Isuzu is the third international car producer to enter into a strategic vehicle assembly partnership with Severstal-Auto. The company started assembling the ISUZU LCV N-series in the middle of 2006 at UAZ' facilities. In 2007, Severstal-Auto plans to expand the number of Isuzu dealership centres from 9 to 30 and to create a national dealer network, which will cover all large cities and regional centres in Russia. The company plans to sell about 2,000 Isuzu trucks in 2007 and to increase sales to 10,000 by 2010.

In addition to assembling the Fiat, Isuzu and Ssang Yong models outlined above, Severstal-Auto also possesses exclusive dealership rights to these vehicles in Russia. The company announced plans to launch and develop its own dealership network, which will allow it to improve its EBITDA margin by 2 p.p.

Strategy

The company's strategy for the next three years aims to increase its market share in the assembly of foreign brands' sector and retain its market share in the cheap Russian vehicle sector. We expect the automobile market in Russia to grow by 77% by 2010, and the number of domestically assembled vehicles to increase by more than 4 times. Severstal-Auto intends to further develop its existing assembly plants with Ssang Yong, Fiat and Isuzu. Between 2007-08 the company will launch the following new models:

1. Ssang Yong Actyon (2007)
2. Fiat Doblo (2007)
3. Fiat Ducato (2007)
4. Isuzu SKD (2007)
5. Fiat Linea (2008)

According to Severstal-Auto's announcements, the company intends to retain its market share in the Russian SUV and LCV sectors. As its low-budget models – namely, the UAZ Hunter and the UAZ LCV remain in high demand by traditional corporate consumers such as the regional medical and police authorities – Severstal-Auto will continue producing these models for the next several years. Nevertheless, we predict a gradual decline in the production of these models as Russian consumers become more interested in quality rather than the cheap price of these models. For example, the traditional purchasers of the Hunter are now transferring to the more expensive UAZ Patriot. We note that the UAZ Hunter is the least profitable of Severstal-Auto's various production models.

In summary, the company's development plans are based on expanding its assembly plants, modernising its traditional UAZ models and engines, and developing its own distribution network.

Market

The Russian auto market grew by 25% in 2006 (in dollar terms), primarily due to the passenger car and SUV sectors, which rose by 25.5% and 36% respectively. We believe that the Russian auto market will continue to grow at a CAGR of 21%. The domestically assembled foreign brand sector will remain the fastest growing sector of the Russian auto market due to its optimal price-to-quality characteristics. We expect that this segment will grow at a CAGR of 60% up to 2010. The main growth driver for this sector will be the further growth of real disposable household income and the consequent shift in consumer interest towards higher quality products rather than the cheapest price. We believe this change in attitude has led to the shift in demand towards higher-quality foreign-brand vehicles.

We believe that, based on the following factors, the Russian auto market still has the potential to grow further:

1. The growth of disposable income of Russian citizens, which will enable them to shift demand to better-quality foreign brands.
2. The number of cars per 1,000 inhabitants in Russia remains lower than in developed economies and some emerging markets. Further economic growth and the development of retail banking will also play a role in the growth of the Russian auto market.

The growth in value terms in the Russian auto market sector between 2005-06 was based mainly on increased sales of foreign models, both new and assembled. Amongst the domestically-assembled brands, the Ford and the South Korean Hyundai, Ssang Yong models were the most popular. Although sales of new foreign models was the fastest growing sector of the Russian market in 2004-2006, we expect that between 2006-10, the Russian market will increase primarily due to locally produced foreign models.

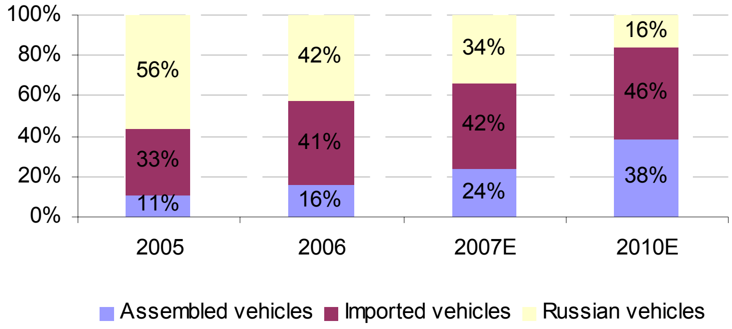
In 2005, the Russian government decreased import duties for auto components used for car assembly from 12.5% to 3%. Since then, the domestically-assembled car sector in Russia has developed rapidly. Severstal-Auto took advantage of the reduced duties by launching the assembly of the Korean Ssang Yong model in Russia.

We notice that increasing competition from cheap Chinese cars produced in China is a dangerous threat to the Russian auto market. In 2006, sales of Chinese cars in Russia accounted for only slightly above 1% of the total Russian auto market, but we believe that gradually Chinese imports and cars assembled in China might threaten existing Russian auto producers and their assembly projects.

We predict that the driving force of the Russian auto market will be the locally produced foreign brands, which we expect to increase by 316% by 2010. Our forecast is conditional on the continuing growth of disposable income in Russia and the continuation of rising demand for quality foreign brands. On the other hand, we expect that the Russian auto market will face increasing competition from cheap Chinese imports (including cars assembled in China). Under such conditions we expect the market share of Russian brands to decrease from the current 56% (in unit terms) to 35% by 2010.

Passenger cars

Passenger car market sectors

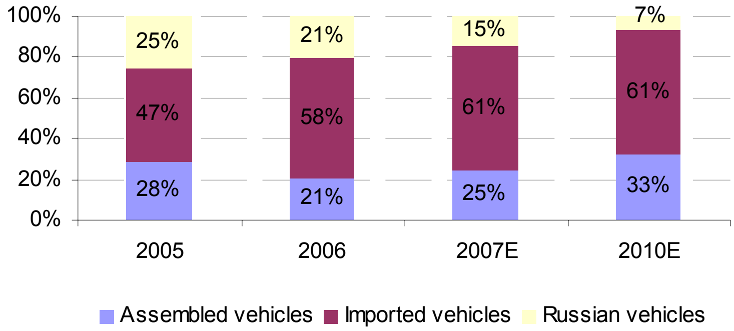


Source: AEB, Company data

Over the past three years the domestically assembled car sector has been the fastest growing sector in the Russian auto market. For the past two years, Severstal-Auto has followed the strategy of locally assembling some of its foreign models.

SUV vehicles

SUV vehicle market sectors

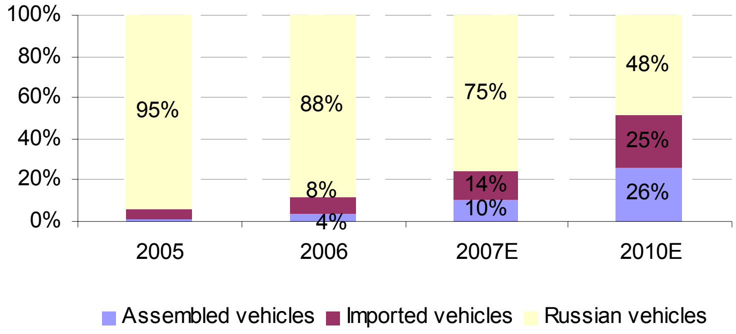


Source: AEB, Company data

The Russian SUV market grew by 36% in 2006: we expect this segment to increase by another 34% in 2007. We expect that the domestically-assembled vehicles sector in the SUV market will increase by over 1.5 times by 2010. Severstal-Auto will be able to considerably increase its stake in this market due to its partnership with the Korean Ssang Yong.

LCV market

LCV vehicle market sectors

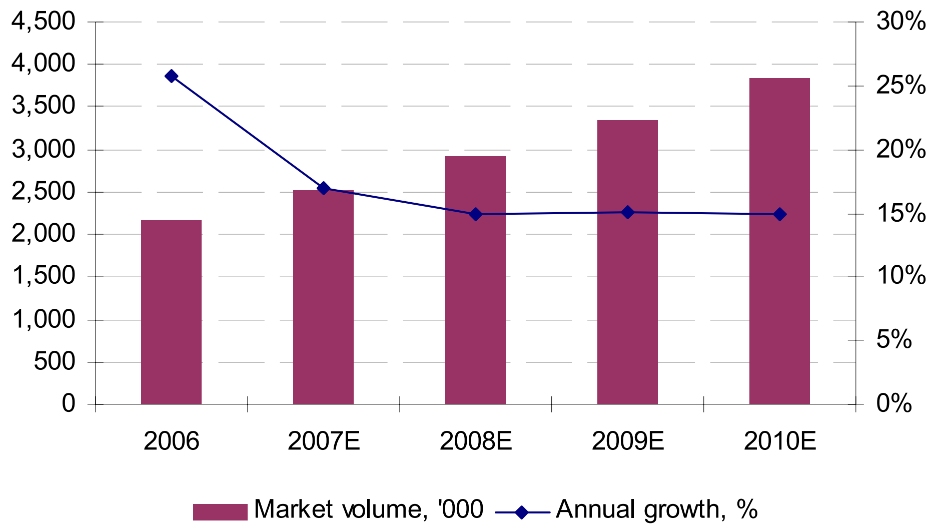


Source: AEB, Company data

Severstal-Auto's stake in the Russian LCV market was 15% in 2006. We expect the company will be able to increase its share of this segment due to its new assembly models – namely Fiat and Isuzu LCVs.

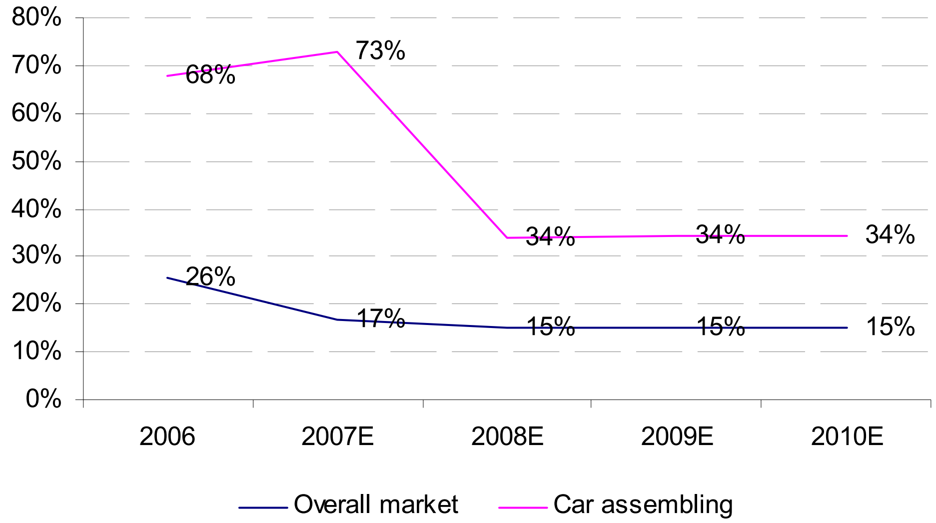
The Russian overall car market grew by 25% in 2006 (including imported and assembled cars) and is one of the fastest-growing car markets in the world. We estimate that in 2006, the Russian car market produced 3,848,000 units more than the previous year – an increase of 77%. We believe that in 2006, the vehicle assembling sector was the fastest growing sector in the Russian auto market, whose annual output more than quadrupled.

The Russian car market



Source: PriceWaterHouseCoopers

The Russian car market and car assembly sector growth, %



Source: PriceWaterHouseCoopers

Models

UAZ Hunter

This is the most basic model amongst Severstal-Auto's SUVs. It combines a military appearance with modern refinement. Its relatively low retail price of approximately $9,000 is its main strength. Consequently, Russian budget-financed organisations – namely the army and the regional police authorities – are its principal purchasers. However, Hunters also have the lowest margin amongst Severstal-Auto models.

UAZ Patriot

The Patriot is a more modern-looking, more expensive, and more profitable SUV for Severstal-Auto. The company plans to transfer its traditional purchasers of UAZ Hunters to the Patriot and to increase its output to 17,000 units by 2010.

Ssang Yong

Following a licensing agreement between Korean Ssang Yong and Severstal-Auto, which was signed at the end of 2004, the company started assembling the first Ssang Yong SUV – the Rexton – at the end of 2005 at its newly-acquired ZMA plant.

Severstal-Auto has not only the rights to assemble SUVs, but also exclusive distribution rights for all Ssang Yong SUVs in Russia. In 2006, Severstal-Auto sold only 4,000 Sssang Yong units, but it plans to increase sales to over 8,000 in 2007. We believe that in order to increase Ssang Yong sales, the company needs to raise the profile of the Ssang Yong brand.

Rexton

Rexton was Severstal-Auto's first assembly project. In 2006, the company produced 3,000 Rextons, and plans to increase output to 6,000 units in 2007. The implementation of this project opened new perspectives for the auto assembly sector in Russia.

Kyron

The Kyron was the second SUV after the Rexton to be assembled at the ZMA plant in accordance with the agreement signed with Ssang Yong. The company started selling the Kyron in April 2006, and began locally assembling it in October 2006. Initial sales showed that the model is very popular amongst Russian consumers with 800 Kyrons being sold in 2006 – Severstal-Auto plans to sell about 4,000 units in 2007.

Actyon

Severstal-Auto is the exclusive distributor of the Ssang Yong Actyon SUV in Russia, but has still not started assembling these models. The company started selling this model only at the end of 2006. About 300 Actyons were sold in the first quarter of 2007 with the company planning to sell over 1,300 units in 2007. The company also plans to begin assembling Actyon models, which would become Severstal-Auto's third assembly project with Ssang Yong.

Fiat

An agreement with Fiat was signed in December 2005. Production of the Fiat Albea, a passenger car, started in 2006. In addition to the assembly agreement, Severstal-Auto also has a distribution agreement with Fiat. In 2006, a total of 700 imported and assembled Albeas were sold. In 2007, the company plans to increase its Fiat sales to 7,700 units.

The largest joint project between Severstal-Auto and Fiat – the Fiat Ducato – will start at the end of 2007 at its ZMA plant. The company has invested $130 mn in this project (in comparison to capex expenditures of $50 mn for the Ssang Yong Rexton project). The company expects to produce 75,000 units annually, with the majority of them to be sold outside Russia.

Isuzu

In 2006, Severstal-Auto and Isuzu (a Japanese company) signed an agreement for the assembly of Isuzu light trucks. Production of the NQR truck will start this year at the UAZ plant. The company expects to sell a combined total of 2,150 units of Isuzu trucks in 2007 and plans to increase its annual production of each Isuzu model to 3,000 units by 2010. Currently, Severstal-Auto is discussing the possibility of developing joint assembly projects with Isuzu.

Engine business

In 2006, Severstal-Auto's engines unit continued as the company's most profitable business. The company's engine business EBITDA margin (22%) in 2006 exceeded more than 2 times the company's vehicle unit EBITDA margin (9%). In 2006, sales from the engines unit accounted for 34% of the company's total sales, yet at the same time the engine business earned 58% of total EBITDA.

We note that Severstal-Auto's engine business is very dependent on its main consumer – the GAZ group, which accounted for 87% of the company's engine sales. GAZ is trying to diversify its engine purchases and to lower its dependence on Severstal-Auto. Pricing conflicts and increasing competition from Severstal-Auto to GAZ' main business – the LCV segment – may force GAZ to either create in-house engine production or to buy an independent engine producer. Under these circumstances – and given that Severstal-Auto intends to create a joint venture with Fiat for engine production – we think that the sale of the ZMZ plant to the GAZ group looks very possible.

Own dealership network

The basic strategy of the company is to capture at least 20% of the SUV and 25% of the LCV markets in Russia and, and at the same time, retain market share in its traditional UAZ models. Besides this, Severstal-Auto intends to create and develop its own dealer network. At the beginning of 2006, the company's dealer network consisted of more than 200 dealers. The company plans to sell up to 30% of the total vehicles sold by it through its own dealer network. We have noticed that since Vadim Schvetsov acquired a controlling stake in Severstal-Auto, the company's strategy has become increasingly focused. Plans regarding the development of an own dealer network is proof that the company's management has a long-term view of its auto business in Russia. The own dealer network will allow the company to increase efficiency in the growing Russian market as it will reduce its working capital needs and will improve its EBITDA margin by up to 2 p.p.

As a result of this project, 16 dealer centres will be built by 2009. Starting from 2009, the company plans to sell 65,000 vehicles annually through the company's own dealer network. The company estimates its investments in the project to amount to $139 mn.

Plans regarding the creation of the company's own dealer network are an indication of the confidence of the company's management led by CEO Vadim Schvetsov in the long-term development of Severstal-Auto's business. Furthermore, the company's own dealership will allow it to obtain a stronger position in auto retail and to set retail standards for other dealers.

The company is targeting an EBITDA margin of 7-8% for its dealer business, which is substantially lower than the EBITDA margin for the overall Severstal-Auto group. However, the creation of its own dealer network and sales of up to 30% of the company's total vehicles through it will allow the company to improve its overall EBITDA margin by up to 1-2 p.p.

Financials

Severstal-Auto 2006 IFRS results showed 31% growth in revenues. We emphasise that the company will continue to show impressive dynamics for its financial figures at least over the next three years. Expected revenue growth for 2007 is expected to be 32%. We underline that the clear improvement in the company's 2006 financials is a consequence of its focusing on assembling foreign brands, launching new successful products, and cost optimisation.

Company`s financial forecast for 2007

	2005	2006	2007E
Revenue, $ mn	938	1,231	1,741
EBITDA, $ mn	129	162	253
NI, $ mn	54	67	114
EBITDA margin	13.8%	13.2%	14.5%
NI margin	5.8%	5.4%	6.5%

Source: Company data, Sovlink estimates

Most of the increase in revenues and profits was generated by the company's vehicles segment: revenues from vehicle sales increased by 43% whilst revenues from engine sales increased by only 14%. However, the engine segment remained the most profitable segment of the company: in 2006, the engine sales EBITDA margin exceeded the vehicle sales EBITDA margin by more than two times.

The EBITDA margin for the company's engine business increased by 1 p.p., whilst the EBITDA margin for the vehicle sector remained the same, despite the fact that EBITDA grew by 36%. The acquisition of the ZMA plant and the high level of investment in its reorganisation lowered the EBITDA of the vehicle segment.

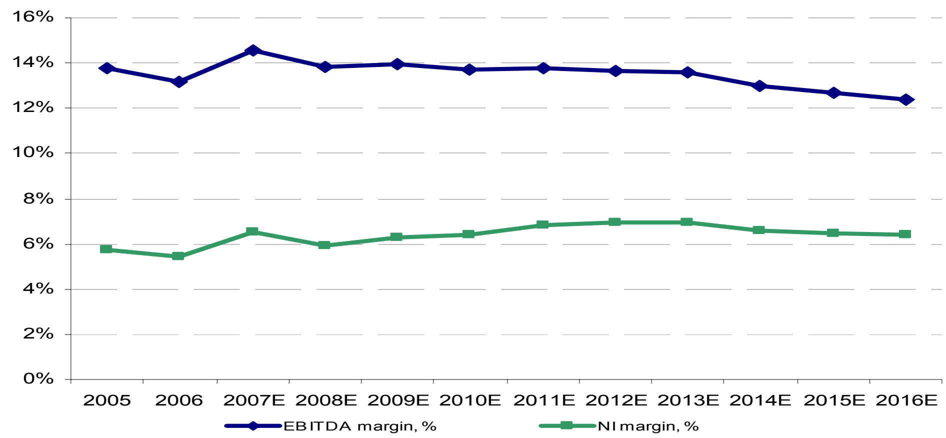
Vehicle and engine sector financials 2005-2006, $ mn

	Vehicles			Engines		
	2005	2006	% chg.	2005	2006	% chg.
Sales	558	797	43%	380	434	14%
Gross profit	97	154	59%	119	136	14%
Gross margin	17%	19%	2 %	31%	31%	-
EBITDA	50	68	36%	78	94	21%
EBITDA margin	9%	9%	-	21%	22%	1%

Source: Company data, Sovlink estimates

We believe that the company will remain the most profitable Russian car producer, with an EBITDA margin above 12% and NI margin above 6% in the long term.

Severstal-Auto's forecast margins



Source: Company data, Sovlink estimates

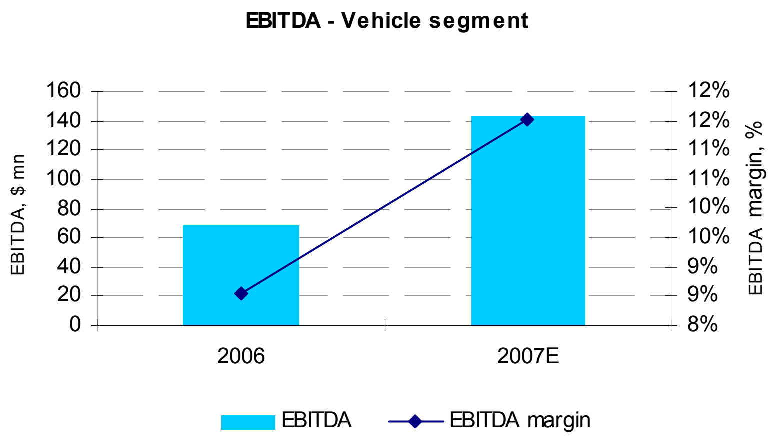
The company controls costs tightly, using Japanese economical production principles. The company's cost optimizsation programme and the development of its own dealership will allow the company to remain the most profitable Russian car producer. We note that in 2007, the company's COGS grew by 31% – at the same rate as its revenue growth. Severstal-Auto managed to keep its COGS growth rate in line with its revenue growth despite higher rouble-based materials prices and an increased steel price. Moreover, the company showed an increase of only 26% in its overheads, which is a good indication of the successful implementation of its cost saving programme – especially given the high costs regarding the restructuring of its ZMA plant.

Vehicle and engine segment financials 2006-2007E

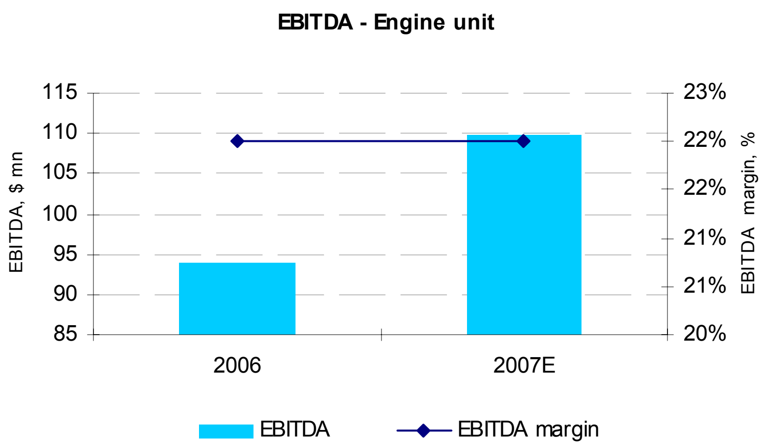
	Vehicles			Engines		
	2006	2007E	% chg.	2006	2007E	% chg.
Sales	797	1,242	56%	434	499	15%
Gross profit	154	278	81%	136	155	14%
Gross margin	19%	22%	3%	31%	31%	-
EBITDA	68	143	111%	94	110	17%
EBITDA margin	9%	12%	3%	22%	22%	-

Source: Company data, Sovlink estimates

We predict that Severstal-Auto's margins will increase dramatically in 2007: the company's EBITDA margin will increase to 14.5% from 13.2% in 2006, and its NI margin will increase to 6.5% from 5.4%. This positive shift will be provided mainly by its vehicle business. We expect its vehicle segment EBITDA margin to increase to 12% from 9% and the EBITDA margin for its engine unit to remain at the same level of 22%. Our expectations of a higher margin for the company's vehicle segment are based on the launch of new assembly models in 2007 – namely the Ssang Yong Actyon, Isuzu SKD, Fiat Doblo, and Fiat Ducato. These models will result in higher margins than those obtained from traditional UAZ products.



Source: Company data, Sovlink estimates



Source: Company data, Sovlink estimates

Valuation

We used our DCF model and comparative valuation to calculate the fair price of Severstal-Auto. Our DCF model indicated a fair price of $52 per ordinary share, whereas the comparative valuation implied a fair price of $49. Combining these values, we obtained a weighted aggregate fair value price of $51 per ordinary share.

DCF model

In our DCF model we used the following assumptions:

1. We believe that until 2011 the company's revenues will grow rapidly. We expect revenues of approximate $1,741 mn in 2007, 41% higher than in 2006. Most of the company's revenues will be provided by the vehicle segment, primarily from the sales of new locally assembled vehicles. We expect that the company will maintain its high revenue growth rates until 2011, but they will steadily gradually slow down to 17.5% by 2011. We assume that after that period, as all existing large projects will have been implemented, the company's revenue growth rate will decrease to a CAGR of 2%.

	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Revenue growth, %	31.2%	41.5%	28.6%	31.8%	23.4%	17.5%	2.3%	2.3%	1.5%	2.0%	2.0%
EBITDA growth, %	25.6%	56.4%	22.2%	33.0%	21.3%	17.7%	1.4%	1.8%	-2.8%	-0.5%	-0.4%
NI growth, %	24.1%	69.6%	16.1%	40.5%	25.8%	25.2%	4.2%	2.2%	-3.9%	0.0%	1.6%

Source: Company data, Sovlink estimates

Revenue CAGR 2006-11, %	28.3%
Revenue CAGR 2011-16, %	2.0%

Source: company data, Sovlink estimates

2. We assume that competition in the Russian automobile industry will increase dramatically. This is especially true with respect to foreign models produced in Russia. On the one hand, locally assembled vehicles will face strong competition from imported vehicles – currently, imported vehicles make up almost 50% of the Russian car market; and on the other hand, an increasing number of international car manufacturers are starting to assemble vehicles in Russia: Hyundai, Ford, FAW. We expect the most intense competition in this sector. Under these conditions, it is inevitable that Severstal-Auto's margins will decrease, despite the creation and development of the company's own dealership network, which is expected to add at least 2 p.p. to its EBITDA margin. We predict a steady slowdown of Severstal-Auto's EBITDA margin from 14.5% in 2007 to 12.4% by 2016.

	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Gross profit margin, %	23.6%	24.9%	25.2%	27.4%	28.2%	27.9%	27.7%	27.6%	26.9%	26.5%	26.1%
EBITDA margin, %	13.2%	14.5%	13.8%	14.0%	13.7%	13.7%	13.6%	13.6%	13.0%	12.7%	12.4%
NI margin, %	5.4%	6.5%	5.9%	6.3%	6.4%	6.8%	7.0%	7.0%	6.6%	6.4%	6.4%

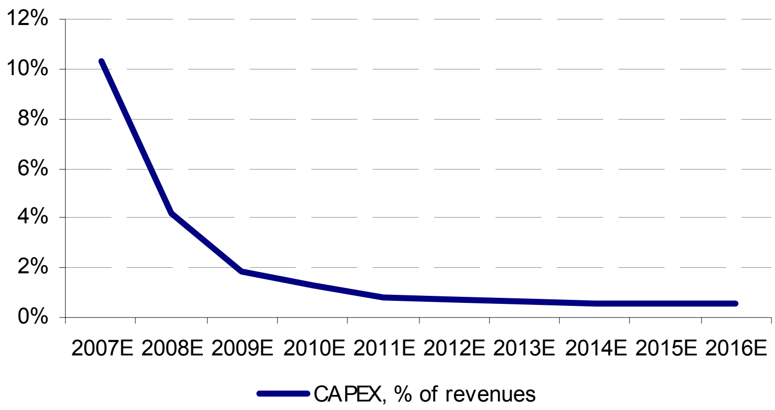
Source: Company data, Sovlink estimates

3. We assume that the company's capex in 2007 will equal $180 mn – the highest level predicted for the 2007-16 period. The high capital expenditure in 2007 is due to the company launching the implementation of several new projects. These projects include the construction of new production facilities in Tatarstan's Elabuga plant for assembling the Fiat Ducato, the creation of the company's own dealership, the joint venture with Fiat regarding engine production, and the modernization of UAZ' facilities for the assembly of Isuzu models. We expect that after 2010, once these projects are implemented, the company's capex will decrease to an average annual level of $30 mn.

	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Capex, $ mn	180	94	54	47	36	30	30	27	27	27
Capex, as % of revenues	10.3%	4.2%	1.8%	1.3%	0.8%	0.7%	0.7%	0.6%	0.6%	0.6%

Source: Company data, Sovlink estimates

Severstal-Auto's capex as % of revenues



Source: Company data, Sovlink estimates

4. We apply a discount rate of 13.21% to the company's cash flows.

Russian 30-year government Eurobond yield	5.60%
Russian equity standard premium	14.00%
Beta	1
Required return on equity	14.00%
Cost of debt	9.00%
Cost of debt adjusted for tax	6.84%
Share of liabilities in Book Value	11.00%
Share of equity in Book Value	89.00%
WACC	13.21%

Source: Company data, Sovlink estimates

DCF model, $ mn

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Vehicles	474	703	1,160	1,624	2,241	2,824	3,388	3,473	3,560	3,631	3,704	3,778
Engines	279	312	346	353	360	324	292	269	247	227	216	205
components	143	150	165	177	189	202	216	231	248	265	284	303
Dealer network	0	0	0	15	90	220	310	330	350	350	360	370
Other	42	66	70	70	70	70	70	70	70	70	70	70
Sales	**938**	**1,231**	**1,741**	**2,239**	**2,950**	**3,640**	**4,277**	**4,373**	**4,475**	**4,543**	**4,633**	**4,726**
Cost of sales	720	941	1,308	1,674	2,143	2,614	3,085	3,162	3,241	3,322	3,405	3,490
Gross profit	218	290	433	564	807	1,026	1,191	1,211	1,233	1,221	1,228	1,236
Gross profit margin, %	23%	24%	25%	25%	27%	28%	28%	28%	28%	27%	27%	26%
Distribution costs	32	48	78	112	177	218	257	262	268	273	278	284
General and administrative expenses	80	98	131	179	266	364	406	415	425	432	440	449
Other operating expenses	5	16	10	10	10	10	10	10	10	10	10	10
Operating income	101	128	214	263	355	433	519	523	530	507	500	493
Other income (expense)	1	3	5	5	5	5	5	5	5	5	5	5
Depreciation	27	31	34	41	52	61	64	68	72	78	82	86
EBITDA	**129**	**162**	**253**	**309**	**412**	**499**	**588**	**596**	**607**	**590**	**587**	**584**
EBITDA margin	13.8%	13.2%	14.5%	13.8%	14.0%	13.7%	13.7%	13.6%	13.6%	13.0%	12.7%	12.4%
Interest payment	12	12	22	27	30	33	35	35	35	35	35	35
EBT	90	119	187	231	320	395	479	483	490	467	460	453
Income tax expense	22	28	49	60	83	103	124	126	127	121	120	118
Minority interest	14	24	25	39	51	59	62	53	51	47	41	32
Net Income (for equity holders)	54	67	114	132	185	233	292	304	311	299	299	304
NI margin, %	5.8%	5.4%	6.5%	5.9%	6.3%	6.4%	6.8%	7.0%	7.0%	6.6%	6.4%	6.4%

Source: Company data, Sovlink estimates

Tel.: +7 495 967 1300
Fax: +7 495 967 1311

DCF summary, $ mn

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Revenues	938	1,231	1,741	2,239	2,950	3,640	4,277	4,373	4,475	4,543	4,633	4,726
COGS	720	941	1,308	1,674	2,143	2,614	3,085	3,162	3,241	3,322	3,405	3,490
Gross profit	218	290	433	564	807	1,026	1,191	1,211	1,233	1,221	1,228	1,236
Commercial and administrative expenses	80	98	131	179	266	364	406	415	425	432	440	449
Balance of other incomes and expenses	37	64	10	10	10	10	10	10	10	10	10	10
EBITDA	129	162	253	309	412	499	588	596	607	590	587	584
Amortisation & depreciation	27	31	34	41	52	61	64	68	72	78	82	86
EBIT	102	131	219	268	360	438	524	528	535	512	505	498
Interest payments	12	12	22	27	30	33	35	35	35	35	35	35
Net profit	54	67	114	132	185	233	292	304	311	299	299	304
EBITDA margin, %	13.8%	13.2%	14.5%	13.8%	14.0%	13.7%	13.7%	13.6%	13.6%	13.0%	12.7%	12.4%
Net profit margin, %	5.8%	5.4%	6.5%	5.9%	6.3%	6.4%	6.8%	7.0%	7.0%	6.6%	6.4%	6.4%

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
NI	54	67	114	132	185	233	292	304	311	299	299	304
Amortisation & depreciation	27	34	34	41	52	61	64	68	72	78	82	86
Capex	47	73	180	94	54	47	36	30	30	27	27	27
Investments in NWC		59	64	24	45	39	31	-35	-24	-42	-76	3
FCFF			-97	55	138	208	289	378	377	392	429	359
FCFF discounted			-85	43	95	127	155	179	158	145	141	104

Source: Company data, Sovlink estimates

WACC	13%
Terminal growth rate	3%
NPV of forecast years	1,061.9
NPV of terminal value	1,048.0
Fair EV, $ mn	2,109.9
Net Debt, $ mn	1,74.0
Minority interest, $ mn	1,48.0
Fair M.Cap, $ mn	1,787.9
Target price, ordinary share $	52

Source: Company data, Sovlink estimates

Comparative valuation

We chose car producers from both developed and emerging markets for our comparative valuation of Severstal-Auto.

Developed market peers, 2007

Company	Country	P/S	EV/EBITDA	P/E
Tenneco	USA	0.25	6.1	19.0
Cummis	USA	0.78	6.8	13.8
Press Kogyo	Japan	0.29	4.1	8.0
Riken	Japan	0.60	4.3	9.2
Brembo	Italy	0.88	6.8	15.2
Average		0.56	5.6	13.1

Source: Company data, Bloomberg

Emerging market peers, 2007

Company	Country	P/S	EV/EBITDA	P/E
Cummins India	India	2.89	17.3	24.5
Motor Industries	India	2.66	13.1	23.9
Kia Motors	South Korea	0.21	8.7	16.0
Brilliance China	Hong Kong	0.48	10.4	24.2
Ashok Leyland	India	0.63	6.6	10.8
Tata Motors	India	1.01	9.9	14.2
Ford Otomotiv Sanayi	Turkey	0.66	5.9	9.6
Average		1.22	10.3	17.6

Source: Company data, Bloomberg

	P/S	EV/EBITDA	P/E	Weight
Developed market peers	0.56	5.6	13.1	30%
Emerging market peers	1.22	10.3	17.6	70%
Average	1.02	8.9	16.2	
Severstal-Auto	0.65	7.6	9.9	
Upside, %	57%	17%	63%	
Weights	50%	25%	25%	
Weighted upside			48.8%	
Fair price, $			49	

Source: company data, Bloomberg, Sovlink estimates

Final valuation

	Fair price, $	Weights
DCF valuation	52	60%
Comparative valuation	49	40%
Final target price	51	

Source: Company data, Bloomberg, Sovlink estimates

Based on our DCF model and comparative valuation, we obtained a one-year target price of $51 per ordinary share, which implies upside of 46%. Accordingly, we issue a **BUY** recommendation on Severstal-Auto.

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

SOVLINK LLC
Tel.: +7 495 967 1300
Fax: +7 495 967 1311

Kremlin Embankment 1, building 2,
Moscow 119019, Russia
www.sovlink.ru
research@sovlink.ru