SOVLINK
YOUR FIRST CALL – FOR THE SECOND TIER

July 30, 2007

Severstal-Auto

Flash Note

BUY

Upside: 50.3%
Target Price: $52.6

Expanding its horizons

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Stock data

Ticker	svav	M.Cap, $ mn	1,200
Shares Ords	34,270,159	Free Float, %	35
Shares Pref	-	Free Float, $ mn	420
Bid Ords, $	33.00	Offer Ords, $	36.00

Performance

	1 month	6 month
Absolute	5.7%	22.6%
Relative to RTS	0.5%	14.6%

Key financials

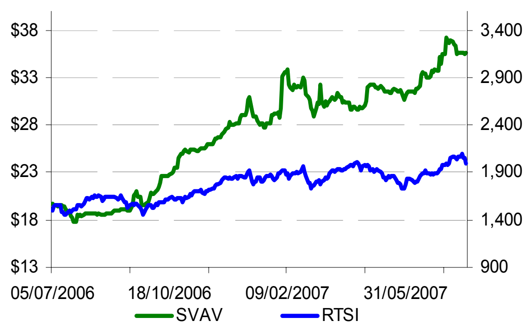
	2005	2006	2007E
Sales, $ mn	938	1,231	1,741
EBITDA, $ mn	129	162	253
Net profit, $ mn	54	67	114
EBITDA margin, %	13.8%	13.2%	14.5%
Net margin, %	5.8%	5.4%	6.5%

Comparative multiples, 2007E

	P/S	EV/ EBITDA	P/E
Developed market peers	0.64	5.6	13.1
Emerging market peers	1.81	8.0	14.8
Severstal-Auto	0.69	7.56	10.6

Source: Company data, Sovlink estimates

SVAV – Relative performance



Source: RTS

• In a recent meeting with analysts, CEO Vadim Shvetsov confirmed that the company would continue with its development strategy of expanding its partnerships (in order to increase production) and its dealer network from 25 dealers in 2006 to 70 in 2008. Management plans to increase sales volumes through its dealer networks, supported by Europlan, a leasing company.

• Severstal-Auto announced the establishment of a company in which it holds a stake of 66%, Isuzu – 29%, and SOJITS (a Japanese trading house) – 5%. The majority of Isuzu trucks in Russia will be produced at this plant.

• Severstal-Auto's SUVs are already well-known in the Russian market. However, taking into consideration the steady growth of the light commercial vehicle (LCV) and heavy duty truck (HDT) markets in Russia and the simultaneous contraction of the second-hand LCV-HDT market, the company has decided to establish a truck-manufacturing plant. The plant is scheduled to be operational in 1Q08 with an annual production capacity of 25,000 trucks and will produce most LCV and HDT models. The company will initially produce the N-series models, followed by the first F-series trucks at the end of 2008, and the C/E-series in early 2009.

• The company conservatively estimates to produce 16,000 units of the N-series models, 3,500 units of the F-series and 2,500 units of the C/E-series by 2012.

• Severstal-Auto will follow the example of Japanese manufacturers in terms of controlling and reducing its prime costs. Thus, sharing the painting unit used for the Fiat Ducato with the LCV-HDT production unit, is one of the ways in which it plans to lower its costs.

• At its new facility, the company plans to switch from the simpler screw driver SKD (Semi Knocked Down) technology to the CKD (Completely Knocked Down) full-value industrial production technology.

• The company will make an initial investment of 350 mn roubles in the project, which will be used for the acquisition of welding and assembling equipment. The low initial cost of the project is partly due to the availability of a (suitable) existing building with an area of 225,000 square metres.

• In order to further reduce costs, the company plans to locally produce some of the basic materials to be used in its LCV-HDT models – in particular the frames, cabins and moulding. Within 3 years, the company expects to produce 30% of these sub-units for use in the vehicles produced at this plant – and plans to increase this to 50% in 6 years' time.

• The company will also establish facilities for the production of diesel engines for Isuzu trucks in Elabuga. Furthermore, the company announced that if the price of petrol were to exceed the price of diesel by 46%, the plant would be expanded to supply diesel engines to third-party producers.

• Severstal-Auto recently raised 3 bn roubles by issuing a bond on which it pays interest of 7.7% per annum. The funds raised will be used to finance the project and to reduce the company's overall debt.

• The information gathered at the meeting, confirmed the assumptions built into our DCF model. However, due to changes in the assumptions used in calculating the WACC used in our DCF model and after updating our peer valuation, we raise our one-year target price from $51 to $52.6 – offering potential upside of 50.3% from the current price of $35. Accordingly, we reiterate our **BUY** recommendation on Severstal-Auto's ordinary shares.

Valuation

We used a combination of our DCF model and comparative valuation to calculate the fair price of Severstal-Auto. Our DCF model indicates a fair price of $49.7 per ordinary share, whereas our updated comparative valuation implies a fair price of $56.9. Combining these values, we obtained a weighted aggregate target price of $52.6 per ordinary share.

DCF model

We made the following changes to our DCF model:

1. We have used the current yield of 6.12% offered by the Russian 30-year government Eurobond as the relevant risk free rate. We have applied a Beta coefficient of 0.80 – which corresponds to the unleveraged global sector average Beta adjusted to the debt level of Severstal-Auto. We have also added a liquidity risk premium of 1.50%. Finally, in view of the company's recent bond issue, we adjusted the structure of the company's capital.

2. As a result we apply a slightly lower WACC rate of 13.05% (as opposed to the 13.21% applied previously) to the company's cash flows.

Risk free rate	6.12%
Russian equity standard premium	14.00%
Beta	0.80
Liquidity premium	1.50%
Required return on equity	13.96%
Cost of debt	9.00%
Cost of debt adjusted for tax	6.84%
Share of liabilities in Book Value	12.80%
Share of equity in Book Value	87.20%
WACC	13.05%

Source: Company data, Sovlink estimates

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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

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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
Other income/(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			-86	43	96	127	156	181	160	147	142	105

Source: Company data, Sovlink estimates

WACC	13.05%
Terminal growth rate	3%
NPV of forecast years	1,072.4
NPV of terminal value	1,080.5
Fair EV, $ mn	2,152.9
Net Debt, $ mn	291.0
Minority interest, $ mn	157.0
Fair M.Cap, $ mn	1,704.9
Fair price, ordinary share $	**49.7**

Source: Company data, Sovlink estimates

Comparative valuation

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

Developed market peer comparison, 2007E

Company	Ticker	Country	P/S	EV/EBITDA	P/E
Tenneco	TEN US	USA	0.29	5.7	14.9
Cummins	CMI US	USA	0.97	6.8	15.9
Press Kogyo	7246 JP	Japan	0.29	4.8	10.2
Riken	6462JP	Japan	0.76	4.9	12.1
Brembo	BRE IM	Italy	0.87	5.9	12.4
Average			**0.64**	**5.6**	**13.1**

Source: Company data, Bloomberg

Emerging market peers, 2007E

Company	Ticker	Country	P/S	EV/EBITDA	P/E
Cummins India	KKC IN	India	3.56	9.5	19.3
Motor Industries	MICO IN	India	3.62	11.2	18.3
Kia Motors	000270 KS	South Korea	0.25	10.2	19.5
Brilliance China	1114 HK	Hong Kong	0.69	5.7	17.2
Ashok Leyland	AL IN	India	3.04	6.0	9.3
Tata Motors	TTMT IN	India	0.86	8.3	11.3
Ford Otomotiv Sanayi	FROTO TI	Turkey	0.68	5.1	8.6
Average			**1.81**	**8.0**	**14.8**

Source: Company data, Bloomberg

Fair price – re comparative valuation

	P/S	EV/EBITDA	P/E	Weight
Developed market peers	0.64	5.6	13.1	30%
Emerging market peers	1.81	8.0	14.8	70%
Weighted Average	1.46	7.3	14.3	
Severstal-Auto	0.69	8.0	10.6	
Upside, %	111%	-9%	34%	
Weights	50%	25%	25%	
Weighted upside			62.5%	
Fair price, $			**56.9**	

Source: Company data, Bloomberg, Sovlink estimates

Final valuation

	Fair price, $	Weights
DCF valuation	49.7	60%
Comparative valuation	56.9	40%
Final target price, $	**52.6**	

Source: Company data, Bloomberg, Sovlink estimates

Based on our modified DCF model and updated comparative valuation, we have raised our one-year target price from $51 per ordinary share to $52.6, which implies upside of 50.3% from the current price of 35. Accordingly, we reiterate our **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

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