SOVLINK
YOUR FIRST CALL – FOR THE SECOND TIER

September 25, 2007

Severstal-Auto

Flash Note

BUY

Upside: 16%
Target Price: 56.3$

Analyst: Igor Kraevsky
kraevsky@sovlink.ru

Stock data

Ticker	svav	M.Cap, $ mn	1,662
Shares Ords	34,270,159	Free float	35%
Shares Prefs	-	Free float, $ mn	582
Bid Ords, $	46.90	Offer Ords, $	48.75

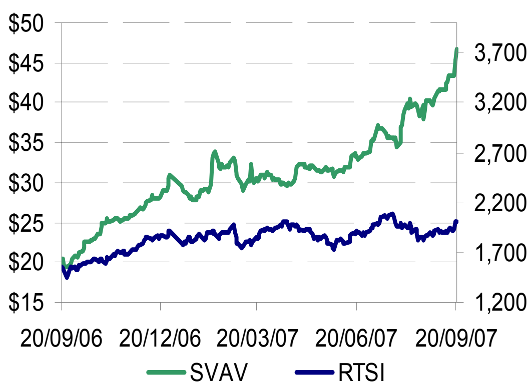
Market performance

		1 month	6 months
Absolute	Ords	20.5%	54.4%
Relative to RTSI	Ords	10.3%	46.3%
Price range, $			
High	Ords	39.0	29.7
Low	Ords	47.0	47.0

Financials, 2007E

Revenue, $ mn	1,741	P/S	0.95
EBITDA, $ mn	253	EV/EBITDA	8.02
Net income, $ mn	114	P/E	14.63
EBITDA margin, %	14.5%		
Net income, %	6.5%		

Severstal-Auto – Relative performance



Source: RTS, Sovlink

Strong 1H07 IFRS Results

• In a recent meeting with analysts, CEO Vadim Shvetsov and CFO Nikolay Sobolev announced the company's 1H07 IFRS results.

• Revenue increased by 67% y-o-y to $896 mn, with EBITDA rising to $111 mn vs $72 mn last year. However, the company's EBITDA margin dropped from 13.4% to 12.4% due to costs related to the launch of new models. We consider that the company's profitability margins will recover in 12 months' time. Based on 1H07 results, the company's net income almost doubled, growing by 96%.

• For the first time, the company's revenues from vehicle sales ($62 mn) exceeded revenues earned from the sale of engines ($49 mn). Higher Ssang Yong sales and the introduction of Fiat models were the main drivers behind the revenue growth.

• Severstal-Auto's 1H07 results support our annual estimates for the company. Although the decline in the EBITDA margin was unexpected, we are confident that the new models will add to the company's profitability in the near future.

• During the meeting, management confirmed that it had signed a letter of intent regarding the creation of a joint venture between Severstal-Auto and the Fiat Group. According to this agreement, the new company (joint venture) will become the official distributor for all Fiat models sold in Russia. The next step regarding the development of the Fiat brand in the Russian market entails the production of the new Fiat Linea model. At first, the plant will use SKD production and will then start producing components locally.

• Management also announced the company's long-term development strategy, which is to concentrate on producing components and providing maintenance services to clients. These sectors are more profitable and offer huge growth potential. We agree with management and consider that their long-term strategy will improve the company's financial results.

• This note gives a short description of the key points of the meeting. Later, we will prepare a more detailed research note, including a deeper analysis of changes that took place at the company in 1H07.

• Last month, the company's share price increased by 21% as a result of the company buying its own shares for its bonus programme. Therefore, we advise investors not to buy the company's shares in the short-term. However, we consider that the company is still undervalued on a fundamental basis, which is why we reiterate our **BUY** recommendation for Severstal-Auto's ordinary shares. Based on our modified DCF model and updated comparative valuation, we have raised our one-year target price from $52.6 per ordinary share to $56.3, which implies potential upside of 16% from the current price of $48.5.

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 $52.5 per ordinary share, whereas our updated comparative valuation implies a fair price of $61.9. Combining these values, we obtained a weighted aggregate target price of $56.3 per ordinary share.

DCF model, $ mn

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Vehicles	474	703	1,160	1,636	2,257	2,844	3,413	3,498	3,585	3,657	3,730	3,805
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**	**2,250**	**2,966**	**3,660**	**4,301**	**4,398**	**4,500**	**4,569**	**4,660**	**4,753**
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	576	823	1,046	1,216	1,236	1,259	1,247	1,254	1,263
Gross profit margin, %	23%	24%	25%	26%	28%	29%	28%	28%	28%	27%	27%	27%
Distribution costs	32	48	78	113	178	220	258	264	270	274	280	285
General and administrative expenses	80	98	131	180	267	366	409	418	428	434	443	452
Other operating expenses	5	16	10	10	10	10	10	10	10	10	10	10
Operating income	101	128	214	274	368	450	539	544	551	529	522	516
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**	**320**	**425**	**516**	**608**	**617**	**628**	**612**	**609**	**607**
EBITDA margin	13.8%	13.2%	14.5%	14.2%	14.3%	14.1%	14.1%	14.0%	14.0%	13.4%	13.1%	12.8%
Interest payment	12	12	22	27	30	33	35	35	35	35	35	35
EBT	90	119	187	242	333	412	499	504	511	489	482	476
Income tax expense	22	28	49	63	87	107	130	131	133	127	125	124
Minority interest	14	24	25	41	53	62	65	55	54	49	43	33
Net income (for equity holders)	54	67	114	138	193	243	304	318	325	313	313	319
NI margin, %	5.8%	5.4%	6.5%	6.1%	6.5%	6.6%	7.1%	7.2%	7.2%	6.8%	6.7%	6.7%

Source: Company data, Sovlink estimates

DCF summary, $ mn

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
Revenues	938	1,231	1,741	2,250	2,966	3,660	4,301	4,398	4,500	4,569	4,660	4,753
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	576	823	1,046	1,216	1,236	1,259	1,247	1,254	1,263
Commercial and administrative expenses	80	98	131	180	267	366	409	418	428	434	443	452
Other income/(expenses)	37	64	10	10	10	10	10	10	10	10	10	10
EBITDA	129	162	253	320	425	516	608	617	628	612	609	607
Amortisation & depreciation	27	31	34	41	52	61	64	68	72	78	82	86
EBIT	102	131	219	279	373	455	544	549	556	534	527	521
Interest payments	12	12	22	27	30	33	35	35	35	35	35	35
Net profit	54	67	114	138	193	243	304	318	325	313	313	319
EBITDA margin, %	13.8%	13.2%	14.5%	14.2%	14.3%	14.1%	14.1%	14.0%	14.0%	13.4%	13.1%	12.8%
Net profit margin, %	5.8%	5.4%	6.5%	6.1%	6.5%	6.6%	7.1%	7.2%	7.2%	6.8%	6.7%	6.7%

	2005	2006	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
NI	54	67	114	138	193	243	304	318	325	313	313	319
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	25	46	39	32	-35	-24	-42	-76	3
FCFF			-97	59	146	218	301	391	391	406	444	375
FCFF discounted			-86	46	101	133	163	187	166	152	147	110

Source: Company data, Sovlink estimates

WACC	13.05%
Terminal growth rate	3%
NPV of forecast years	1,120.0
NPV of terminal value	1,126.3
Fair EV, $ mn	2,246.3
Net Debt, $ mn	291.0
Minority interest, $ mn	157.0
Fair M.Cap, $ mn	1,798.3
Fair price, ordinary share $	**52.5**

Source: Company data, Sovlink estimates

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

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	0.27	6.2	17.5
Cummins	CMI US	USA	1.07	6.6	16.8
Press Kogyo	7246 JP	Japan	0.29	5.1	10.6
Riken	6462JP	Japan	0.66	5.1	11.4
Brembo	BRE IM	Italy	0.81	6.3	12.8
Average			**0.62**	**5.9**	**13.8**

Source: Company data, Bloomberg

Emerging market peers, 2007E

Company	Ticker	Country	P/S	EV/EBITDA	P/E
Cummins India	KKC IN	India	4.62	10.6	27.2
Motor Industries	MICO IN	India	3.97	11.9	24.7
Kia Motors	000270 KS	South Korea	0.22	13.2	28.3
Brilliance China	1114 HK	Hong Kong	0.52	5.1	16.6
Ashok Leyland	AL IN	India	0.83	5.7	13.1
Tata Motors	TTMT IN	India	1.03	12.4	13.9
Ford Otomotiv Sanayi	FROTO TI	Turkey	0.78	4.9	9.8
Average			**1.71**	**9.1**	**19.1**

Source: Company data, Bloomberg

Fair price – re comparative valuation

	P/S	EV/EBITDA	P/E	Weight
Developed market peers	0.62	5.9	13.8	30%
Emerging market peers	1.71	9.1	19.1	70%
Weighted Average	1.38	8.1	17.5	
Severstal-Auto	0.95	8.0	14.6	
Upside, %	45%	1%	20%	
Weights	50%	25%	25%	
Weighted upside			27.7%	
Fair price, $			**61.9**	

Source: Company data, Bloomberg, Sovlink estimates

Final valuation

	Fair price, $	Weights
DCF valuation	52.5	60%
Comparative valuation	61.9	40%
Target price, $	**56.3**	

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 $52.6 per ordinary share to $56.3, which implies upside of 16% from the current price of $48.5. Accordingly, we reiterate our **BUY** recommendation on Severstal-Auto's ordinary shares.

STOCK RATING POLICY

STRONG BUY:	Upside over 25%; confidence level – high / upside over 100%; confidence level - low
BUY:	Upside between 15 and 25%; confidence level – high / upside between 25% and 100%; confidence level – low
HOLD:	Upside of less than 15%; confidence level – high / upside of less than 25%; confidence level – low
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

The Information is exclusively of an informational/analytical nature, and should not be interpreted as a recommendation to take any particular investment action. The Information should not be relied upon as a justification for the execution of any transactions, and should not be referred to as such. Sovlink LLC takes no responsibility for any actions taken on the basis of the Information. The enclosed Report does not contain an offer or an invitation to make an offer to buy or sell any securities or any options, futures or other derivatives related to such securities.

This Report does not have regard to any specific investment objectives, financial situation and the particular needs of any specific person who may receive this Information. Investors should seek financial advice regarding the appropriateness of investing in any securities mentioned and should understand that statements regarding future prospects may not be realized. Investors should note that income from such securities, if any, may fluctuate and that each security's price or value may rise or fall. Accordingly, investors may earn less than originally invested. Past performance is not necessarily a guide for future performance. Foreign currency exchange rates may adversely affect the value, price or income of any security mentioned in the Report. Please bear in mind that investment activity in emerging markets is very risky, and investors should conduct their own due-diligence prior to making an investment decision.

The individual(s) responsible for the preparation of this Report (the Author(s)), or Sovlink LLC may hold short- and long-term positions in any of the securities mentioned in the Report, and may take part in investment activities with companies mentioned in the Report.

In preparing this Report, the Author(s) assumed that the issuers mentioned in the Report disclose information in the amount and under the procedure stipulated by the securities legislation of the Russian Federation for issuers who publicly place securities.

This Report and the Information is based exclusively on publicly-available information, which is deemed to be reliable, however Sovlink LLC makes no representation that this Information is accurate or comprehensive, and it should not be relied upon as such. Sovlink LLC makes no representation that this Report has been released to all readers simultaneously, nor that Sovlink LLC will update this material on a regular basis, or that it will correct inaccuracies contained in this Report.