

ARMADA

**Company
NOTE**

BUY

**Upside: +30 %
Target Price: \$27.2**

Analyst: Alefirenko Michael
alefirenko@sovlink.ru

Stock data

Ticker	ARMD	M.Cap, \$ mn	252
Shares Ords	12,000,000	Free Float, %	49%
Shares Prefs	-	Free Float, \$ mn	123.5
Bid Ords, \$	20.25	Offer Ords, \$	21

Market performance

		1 month	6 months
Absolute	Ords	0.24%	32.08%
Relative to RTSI	Ords	11.57%	32.79%
Price range, \$			
High	Ords	21.6	21.6
Low	Ords	21	15.2

Financials, 2008F

Revenue, \$ mn	167.4	P/S	1.51
EBITDA, \$ mn	30.1	EV/EBITDA	8.2
Net Income, \$ mn	19	P/E	12.78

Armada market performance



Source: RTS

On course for growth

- Armada was formed as a result of RBC (RBCI) spinning off its IT assets. The company has been operating on the Russian market since 2000 under the RBC-soft brand. The company's primary business concerns software development, IT-services and hardware production. The company benefits from a large customer base and derives 45% of its revenues from state owned entities. The company's prospects have been boosted by recent government announcements regarding the development of the high-tech industry in Russia – as the state plans to automate the customs services, the legal system, the state statistics system and the state auto insurance system, and create a National Electronic Library.

- The possibility of a recession in the US is worrying investors and has resulted in investors selling IT companies in expectation of lower IT spending. However, as long as the Russian IT market has no exposure to the global IT services market we do not see any significant risk, which could exert downward pressure on the Russian IT market. Furthermore, the Russian government's spending plans, which account for about 45% of the Russian IT market, will further protect the sector from the effects of the turbulence prevalent on global markets.

- The company has spent the funds received via its IPO on the acquisition of companies operating in the rapidly growing IT services market. The successful acquisition of Helios in 2006 has encouraged management to search for new acquisition targets in the higher margin growth sectors. Armada's CEO, Alexey Kuzovkin, feels that "the Russian market is very fragmented", and participating in its consolidation offers them the opportunity of becoming "a leading provider of IT services in Russia". Furthermore, Armada acquires companies with average P/E multiples of 5.5, which is quite cheap for this rapidly growing market sector.

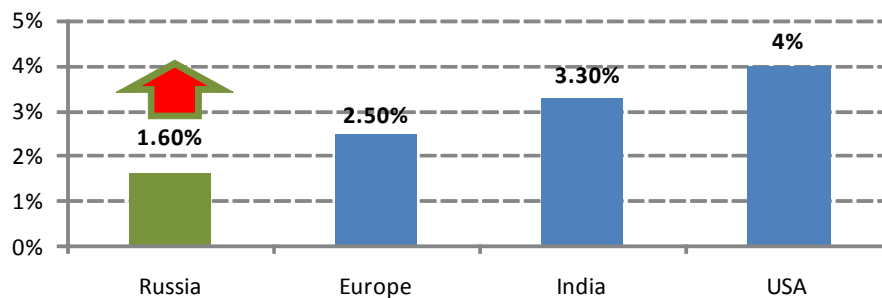
- Armada's management is seeking to increase the company's share in the most profitable market segments: namely, the software development and IT-services sectors. The company's long-term target is to win a 3-5% share of the overall IT market in 3-5 years. At the same time, the hardware business sector is not expected to grow at a fast rate in the near future.

- Based on our DCF analysis, we estimate the fair value of the company at \$28 per ordinary share, which gives potential upside of 33% from current prices. At the same time, a multiples-based valuation with its foreign peers implies a price of \$26.4 per share. Taking the average of our DCF and multiples-base analysis, we obtain a target price of \$27.2 per share, implying 30% upside from current price levels. Thus, we initiate coverage on Armada by issuing a **BUY** recommendation on its ordinary shares with a target price of **\$27.2** per share.

The IT market in Russia

IT company prices have fallen as a result of the volatility prevalent on global financial markets. The possibility of a recession in the US is worrying investors and has resulted in investors selling IT companies in expectation of lower IT spending. However, as long as the Russian IT market has no exposure to the global IT services market we do not see any significant risk, which could exert downward pressure on the Russian IT market. Furthermore, the Russian government's spending plans, which account for about 45% of the Russian IT market, will further protect the sector from the effects of the turbulence prevalent on global markets.

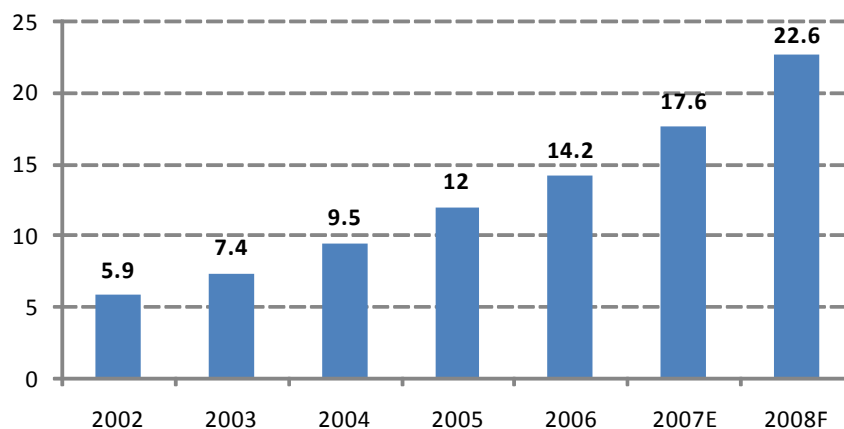
IT spendings, % of GDP



Source: IDC

We consider Armada has one of the brightest prospects amongst Russian companies. The company has a straight forward strategy and was amongst the first Russian companies to realise that the IT market in Russia is ready for mergers and acquisitions – and that in order to be a market leader, a company has to be known in the market, be listed on the stock exchange (in order to acquire companies via an exchange of company stock) and be experienced in merger transactions.

Russian IT market volume, \$ bn



Source: IDC, Russian IT and Communications Ministry (December 2007)

Company outlook

Armada started operating in 1993 as one of RBC's technical departments. In 1995, it gained its first commercial clients, who contracted the company for web development work. In 2000, RBC Soft was formed – RBC's management decided to separate the company's programming department for external from internal purposes. Thus, currently RBC has its own software development department, for all its internal tasks. Since 2000, RBC Soft has been delivering its own internet solutions. According to management, RBC Soft quickly won a leading position in the web development market. Since 2005, this

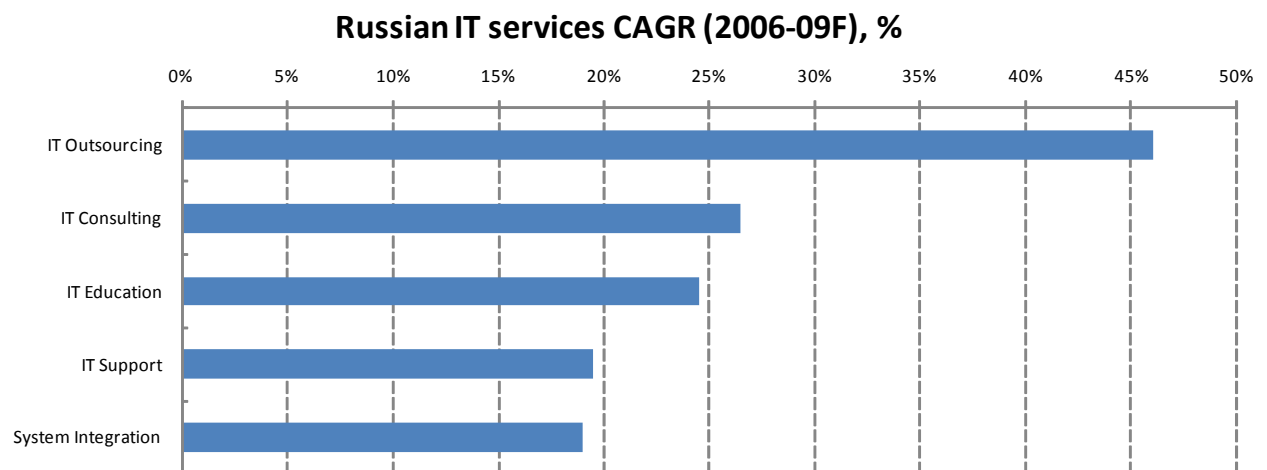
relatively young company has implemented large projects both for the government (10% of its projects portfolio) and for the business community (90% of its portfolio).

The company's first large government project was implemented for the Russian customs office. The project concerned the registration system for imported vehicles. Currently, Armada continues to upgrade its existing solution and provides educational services for the customs authorities. This demonstrates that the company values long-term relationships. It is interested not only in hardware delivery and the development of software solutions, but also in updating its programs and thereby generating new demand.

Armada has a diversified project portfolio, with the majority of its projects costing under \$10 mn each. In this way, the company is not exposed to the risk of being dependent on one large project. The company has developed its contacts amongst mid-level state bureaucrats and is not worried about sudden changes at the minister level. Furthermore, its diversified project portfolio means that it is extremely unlikely that all its contracts could be terminated simultaneously.

With respect to large and complex projects, RBC Soft felt the lack of a hardware base, as clients needed complex solutions – software development, hardware delivery, educational services and after-sale services. In 2006, Armada bought Helios, a hardware company. With this acquisition, Armada was able to work on more complex projects without using subcontractors. During 2006, Armada experienced both the benefits and complications of integrating a software company with a hardware company (based on different business models). Now, both companies use one business centre and have reduced their costs on maintenance staff, office area (the same negotiations rooms) etc.

The company values organic growth but is also interested in acquiring businesses with a bright future. Armada carried out an IPO in July 2007, in order to raise capital for acquisitions and become a publicly traded company. The company is counting on growth in the IT software segment and in the IT services segment, as they offer the most attractive growth potential.



Source: IDC

Armada is trying to expand its market share in the fast growing IT services market. In June 2007, it acquired PM Expert (a project management consultant with 2007F sales of \$5 mn). Since its IPO in July 2007, Armada has also acquired SouzInform (a leading Russian IT outsourcer with 2007F sales of \$20 mn) and ETC (a leading e-procurement systems developer with 2007F sales of \$2 mn).

We have provided below a short summary about companies currently belonging to Armada.

RBC Soft offers various consulting services, system integration, corporate solutions, internet solutions, media accompaniment, multimedia presentations and analysis.

Helios IT-Solutions is a multi-purpose infrastructure solutions integrator for corporate and government entities. Helios offers very different services in comparison to RBC Soft – it has a different business model, outlook, etc. However, Armada has succeeded in merging these two businesses and has benefitted from the synergies gained from its increased capabilities in terms of providing complex solutions. At the same time, the use of combined sales, marketing, HR and maintenance groups help to cut costs.

PM Expert is a project management consultancy headquartered in the centre of Moscow, with a nationwide presence. The company is one of the country leaders in, and promoters of, project management. The company's main line of business includes: consulting, outsourcing, and training services.

Armada's management considers this company is too young (at the moment) to be merged into Armada's structure. Armada's strategy is to give PM Expert enough freedom to allow it to grow at a double-digit pace for the next two-three years. Alexey Kuzovkin, Armada's CEO, is quite confident that after several years of working with Armada, PM Expert will recognise the necessity of moving into Armada's premises in order to communicate with other divisions and will benefit from Armada's facilities.

SoyuzInform is one of the leading Russian IT outsourcing companies. It provides complex services for the maintenance of computer equipment and software support.

ETC is a pure software developer for different trading systems – both for business and government purposes. The company was purchased in October 2007 and has been integrated smoothly into the company, as Armada stopped its own development programs regarding trading systems and concentrated its energies on the newly acquired business.

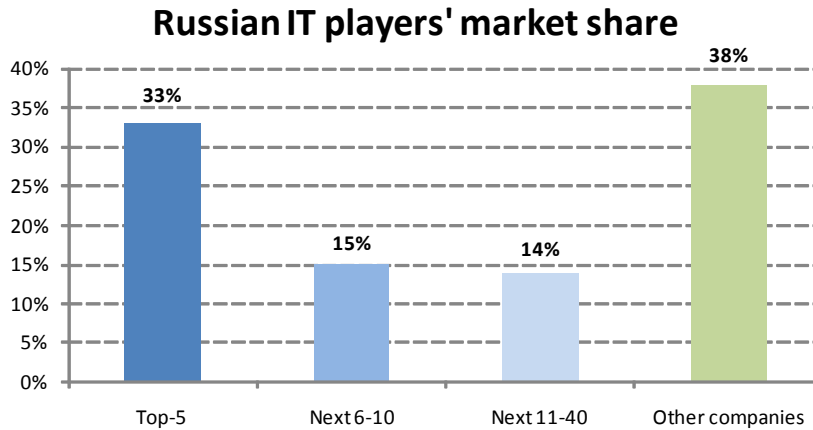
Key Armada projects:

- National Electronic Library (the largest storage of material in electronic form in Russia – a joint project with the Lenin Library)
- Large government program for developing the Linux based operating systems, which will be used by all Russian government institutions so that they can function with Russian software that will be provided free of charge. The first stage of this program was implemented via a pilot project for Russian schools. The next stage of this large project is expected to be implemented in the public health sector. The government plans to save money that would have been spent in buying foreign software licenses and at the same time provide security for Russian military and other ministries. One of the company's future acquisition ideas is to acquire a Linux development team. Medvedev suggested the idea of providing free software to the Russian government and we expect it to be successfully implemented in the near future, especially as Medvedev is the most-likely candidate for president in 2008. Armada is going to provide support for this software.
- Currently, Armada is also working on a project for implementing an analogue of the American Carfax system for the Russian Auto Insurance Companies' Society. The idea of the project is to enable the Society to find out all relevant information about a particular car after it enters the Russian customs territory. In January 2008, Armada plans to start operating the first stage of this program.
- The Transneft project in Western Siberia and the Pacific Ocean. Armada has prepared software, which allows companies to design pipelines, which conform to the different construction regulations in force in different regions along the pipeline. (The pipeline runs through many regions and every region has its own project rules.)

Currently, 45% of Armada's revenues are based on government orders, 23% from financial institutions, 14% from the manufacturing and energy industries and 18% from others.

Acquisition strategy

According to Alexey Kuzovin, Armada's CEO, the company is at the start of "a consolidation process in the Russian IT market. There are about 5,000 IT players currently in the Russian IT market. Many of them are small companies. We aim to become the leading company in our market sector via consolidation. We consider ourselves to be a provider of complex services and software."

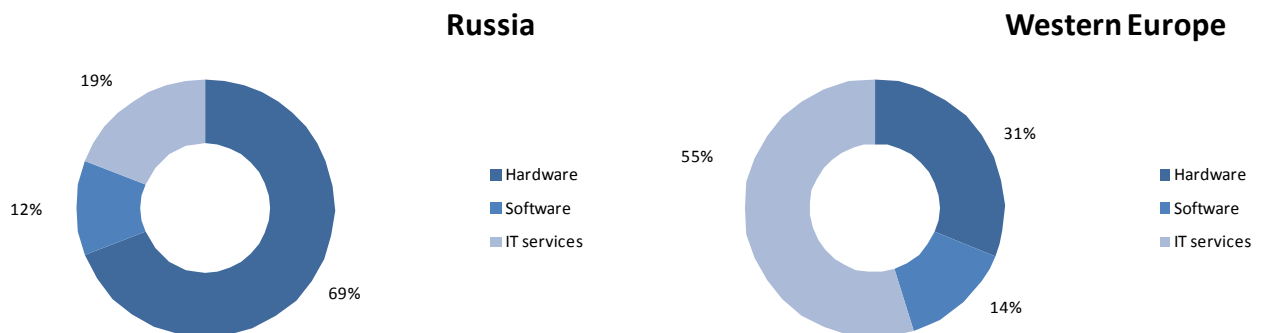


Source: CNews

Acquiring an IT company means the acquisition of a team of experts. Armada's acquisition strategy is based on understanding its current shareholders' interests. A lot of attention is paid to motivating management after the completion of the acquisition – by making the previous owners think about their future prospects and motivate their teams. Acquisitions are paid for in cash and have performance-related options which can be swapped for shares in Armada. The better the company's results, the greater the number of Armada shares that will be retained by the previous owner in exchange for his company's stake. Acquisition deals are different in terms of the length of time needed to complete them and the final price depends on the future performance of the acquired company as part of Armada. For example, Helios's acquisition included a share swap option. Kuzovkin added that they try "to maintain motivation – we never buy a business from an owner who is going to withdraw from the company after the deal. It is important to keep the motivation and independence of the purchased companies".

A special department has been formed in Armada to resolve problems arising as a result of integration. There is also an M&A department which searches for acquisition targets and initiates negotiations. At the moment, Armada has 15 companies on its acquisition short list. Currently, the company is in negotiations with potential targets and we expect new acquisition announcements in 1H08. We also note that Armada is trying to buy companies with P/E ratios ranging from 4-8x, whereas the company itself trades on a P/E of 22.4x.

IT market structure 2006



Source: IDC, CNews, Company data

We expect the Russian IT services and software develop sectors to grow at a rapid pace over the next few years. (In Western Europe, IT services amount to 55% of the whole IT market, software development accounts for 14% of the market and hardware 31%). Thus, Armada will benefit from consolidating a fast growing and high margin business at an acceptable price (not higher than 8x net income, with an average acquisition P/E multiple of 5.5x).

Each company that plans to expand via an active M&A strategy will have to go through the process that Armada has already experienced. Armada expects to incorporate future mergers more efficiently into its corporate structure due to the experience it has already gained. We believe that having such a strong merger & acquisition track record offers Armada the best prospects in the Russian IT sector.

Valuation

We expect Armada to outperform its rapidly growing market sector in the near future. Our expectation is based mainly on management targets and market growth forecasts. Our revenue forecast includes potential increases in company revenue based on upcoming acquisitions and on gaining a higher share in certain market segments, such as IT services.

Revenue forecast

	2006	2007E	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F
Total	81.2	110.2	167.4	202.5	240.1	285.5	331.2	380.5	437.5	503.4
Soft	36.6	50.1	67.7	84.6	99.8	117.8	139.0	159.8	183.8	211.4
IT-services	3.7	15.4	51.2	65.0	82.5	104.8	123.6	145.9	172.2	203.1
Hardware	40.9	44.6	48.6	53.0	57.7	62.9	68.6	74.8	81.5	88.8

Source: Company data, Sovlink estimates

In our DCF model we consider the company's debt load will increase in 2008. The debt could be raised in the form of a CLN and the amount of the company's debt is expected to range from 4x-5x its EBITDA. We also assume a WACC rate of 14.97% and a terminal growth rate of 3%. According to management, the company's net debt by the end of 2007 is expected to be negative, implying that at the end of 2007, the company had a strong cash position.

DCF summary

	2006	2007E	2008F	2009F	2010F	2011F	2012F	2013F	2014F	2015F
Revenue	81.2	110.2	167.4	202.5	240.1	285.5	331.2	380.5	437.5	503.4
Operating expences	70.0	92.6	137.3	165.2	195.0	230.9	267.2	306.3	351.4	403.6
EBITDA	11.2	17.6	30.1	37.3	45.1	54.6	64.0	74.2	86.0	99.8
Depreciation		2.8	4.2	5.5	6.2	7.1	7.9	8.8	9.6	10.6
EBIT		14.8	25.9	31.9	38.9	47.5	56.1	65.4	76.4	89.2
Tax rate		24%	24%	24%	24%	24%	24%	24%	24%	24%
EBIT*(1-Tax)		11.3	19.7	24.2	29.5	36.1	42.6	49.7	58.1	67.8
Depreciation		2.8	4.2	5.5	6.2	7.1	7.9	8.8	9.6	10.6
Capex		4.4	5.0	5.9	6.7	7.7	8.6	9.5	10.5	11.6
NWC		2.0	3.4	2.1	2.3	2.7	2.7	3.0	3.4	4.0
FCFF		7.6	15.4	21.7	26.8	32.8	39.2	46.0	53.8	62.9
FCFF discounted		7.6	13.44	16.42	17.63	18.76	19.51	19.92	20.25	20.59

Source: Sovlink estimates

		WACC composition	Cost of equity		
WACC	14.97%	Tax rate	24%	Risk free	4.5%
Terminal growth rate	3%	Cost of equity	16.9%	Levered Beta	1.27
NPV of forecast years, \$ mn	154.1	Cost of debt (impl.)	9.5%	Market premium	7%
NPV of Terminal Value, \$ mn	177.2	Debt	20%	Country risk premium	2%
Fair EV, \$ mn	331.3	Equity	80%	Small cap premium	1%
Net Debt, \$ mn	-5.0	WACC	14.97%	Company specific risk	1%
Fair M.Cap, \$ mn	336.3			Cost of equity	16.9%
Target price, \$	28.0				

Source: Sovlink estimates

Our DCF model implies a fair price \$28 for Armada's shares. We do not see this as an aggressive target, since management plans to win a market share of 3%-5% of the whole IT market in Russia over the next 3-5 years and our revenue and profitability estimates are lower than management's forecasts.

Comparative valuation

Ticker	Exchange Code	Name	MCap	EV	P/S		P/E		EV/EBITDA			
					2007E	2008F	2007E	2008F	2007E	2008F		
Emerging markets												
ACP	PW	ASSECO POLAND SA	1,379.1	1,367.4	2.9	2.4	24.9	21.2	16.4	11.9		
PKM	PW	PROKOM SOFTWARE SA	649.8	1,081.1	0.7	0.6	14.9	12.9	8.2	6.9		
CMR	PW	COMARCH SA	413.5	438.1	1.7	1.4	22.0	17.1	22.7	18.6		
299	HK	SINOCOM SOFTWARE GROUP LTD	190.2	149.5	2.9	2.1	14.3	10.7	12.3	9.4		
002063	CH	GUANGDONG YGSOFT INC -A	314.7	284.8	15.8	12.6	36.5	29.2	-	-		
002195	CH	SHANGHAI HYRON SOFTWARE -A	251.1	244.0	11.5	8.5	69.0	49.8	-	-		
VKI	IN	VAKRANGEE SOFTWARE LIMITED	91.9	91.0	1.7	0.9	7.9	4.7	2.4	1.3		
III	IN	3I INFOTECH LIMITED	427.7	560.9	1.4	1.1	12.6	9.2	7.3	5.2		
GLOT	IN	GLODYNE TECHNOSERVE LTD	92.7	92.5	1.4	0.9	11.2	7.9	-	-		
ALDS	IN	ALLIED DIGITAL SERVICES LTD	323.4	324.5	4.4	2.1	29.0	21.4	-	-		
<i>Average:</i>							4.4	3.3	24.2	18.4	11.6	8.9
Developed markets												
ILO	FP	ILOG SA	188.6	126.9	1.0	0.9	17.4	11.8	10.8	7.3		
CODA	LN	CODA PLC	280.9	256.6	2.4	2.3	17.2	15.7	10.4	9.4		
SFT	LN	SINOSOFT TECHNOLOGY PLC	34.3	17.4	2.7	2.2	12.9	9.0	5.0	3.5		
MXM	LN	MAXIMA HOLDINGS PLC	117.0	130.3	1.2	1.1	8.8	7.6	6.9	6.3		
PTEC	LN	PLAYTECH LTD	1,383.6	1,268.9	13.6	10.3	20.8	15.4	13.1	9.4		
EXACT	NA	EXACT HOLDING NV	940.1	796.5	2.6	2.3	15.7	14.1	7.7	6.8		
SUO	NO	SUPEROFFICE ASA	110.1	91.9	1.9	1.7	9.8	9.7	-	-		
3800	JP	BSP INC	39.4	10.2	0.9	0.9	11.4	7.7	-	-		
3846	JP	HI CORP	67.2	50.0	2.8	2.6	23.8	18.8	-	-		
HIQ	SS	HIQ INTERNATIONAL AB	245.7	246.1	1.7	1.4	11.9	10.9	9.9	8.9		
BPHX	US	BLUEPHOENIX SOLUTIONS LTD	405.9	409.3	4.6	3.8	27.1	17.6	23.1	10.5		
DST	US	DST SYSTEMS INC	4,229.4	4,636.2	2.5	2.2	16.9	15.0	11.2	10.4		
RMKR	US	RAINMAKER SYSTEMS INC.	127.6	92.9	1.7	1.4	23.6	15.9	21.2	10.6		
LPSN	US	LIVEPERSON INC	188.4	158.2	3.6	2.4	18.9	15.7	23.4	13.5		
CSVI	US	COMPUTER SERVICES INC	254.7	263.8	2.0	-	16.3	-	-	-		
IGTE	US	IGATE CORP	456.4	382.5	1.5	1.4	27.5	19.2	14.2	9.5		
MANH	US	MANHATTAN ASSOCIATES INC	621.3	549.7	1.8	1.7	18.4	16.1	11.0	9.6		
SYNT	US	SYNTEL INC	1,120.2	1,025.6	3.3	2.7	18.3	15.9	21.4	17.6		
CTSH	US	COGNIZANT TECH SOLUTIONS-A	7,592.9	6,804.0	3.6	2.6	22.3	17.5	24.6	18.2		
FDS	US	FACTSET RESEARCH SYSTEMS INC	2,631.1	2,455.9	4.6	4.0	22.1	18.9	13.1	11.2		
IHS	US	IHS INC-CLASS A	3,829.4	3,677.5	4.7	4.2	31.8	26.1	15.9	13.3		
DWS	AU	DWS ADVANCED BUSINESS SOLUTI	291.9	279.5	3.5	2.9	14.1	11.5	9.1	7.4		
CPU	AU	COMPUTERSHARE LIMITED	3,862.6	4,227.6	2.4	2.3	14.0	12.9	13.2	12.4		
CSV	AU	CSG LTD	223.7	230.6	1.9	1.5	14.0	10.8	7.3	5.7		
SYS	LN	SYSTEM C HEALTHCARE PLC	51.6	28.2	1.5	1.4	12.8	10.0	7.6	6.1		
NUR	CN	NURUN INC	158.1	133.0	1.9	1.8	62.5	36.1	15.8	10.6		
<i>Average:</i>							2.9	2.5	19.6	15.2	13.5	9.9

Ticker	Exchange Code	Name	M.Cap	EV	P/S		P/E		EV/EBITDA	
					2007E	2008F	2007E	2008F	2007E	2008F
ARMD	RU	Armada	252	247	2.29	1.51	22.37	12.78	14.05	8.20
Discount to developed markets					-21.7%	64.5%	-12.3%	18.9%	-4.2%	21.0%
Discount to emerging markets					94.1%	116.0%	8.3%	44.1%	-17.8%	8.4%

Source: Bloomberg, Sovlink estimates

According to the table above, Armada appears to be overpriced to its peers from developed and emerging market countries in terms of 2007 EV/EBITDA multiples and in terms of 2007 P/E multiples for developed countries. Nevertheless, the company has quite attractive P/S multiples in relation to both emerging and developed market countries and in comparison to its 2007-08 P/E for emerging markets. By giving equal-weighting to all three multiples for 2007, we arrive at a fair price of \$26.4 per Armada share.

Conclusion

	Market	Multiples	DCF	Final Target price
Target price, \$	21	26.4	28	27.2
Upside, %	0%	26%	33%	30%

Source: Bloomberg, Sovlink estimates

Based on our DCF analysis, we estimate the fair value of the company at \$28 per ordinary share, which gives potential upside of 33% from current prices. At the same time, our multiples-based valuation with its foreign peers implies a fair price of \$26.4 per share. Taking the average of our DCF and multiples-based analysis, we obtain a target price of \$27.2 per share, implying 30% upside from current price levels. Thus, we initiate coverage on Armada by issuing a **BUY** recommendation on its ordinary shares with a target price of **\$27.2** per share.

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

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