



# JSC Mostostroyindustria

**Company  
Note****BUY****Upside: 57%****Target Price: \$667****Analyst: Pavel Zhavoronkov**

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**Stock data**

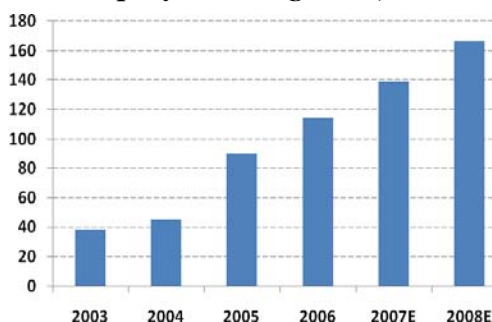
Ticker	MSIN	M.Cap, \$ mn	152.23
Shares Ords	358.192	Free float	19.4%
Shares Prefs	-	Free float, \$ mn	29.5
Last trade, \$	425	-	-

**Financials 2006**

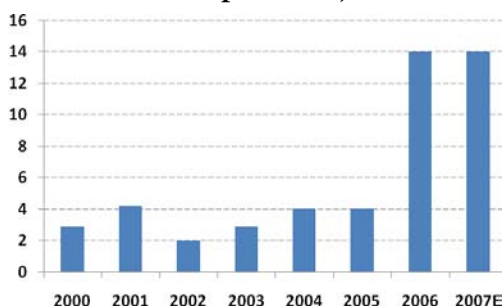
Revenue, \$ mn	113.96	P/S	1.34
EBITDA, \$ mn	5.70	EV/EBITDA	26.64
Net income, \$ mn	2.64	P/E	57.70

**Financials 2007E**

Revenue, \$ mn	138.79	P/S	1.10
EBITDA, \$ mn	7.68	EV/EBITDA	19.92
Net income, \$ mn	5.93	P/E	25.69

**Company revenue growth, \$ mn**

Source: Company data, SOVLINK estimates

**Dividends per share, RUR**

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Source: Company data, SOVLINK estimates

**Infrastructure investment**

• At the start of the infrastructure construction boom, investors are looking for companies whose growth will directly depend on the amount of investment in the industry. The company has participated in all major development projects that have taken place recently: the Moscow Ring Road, the Third Ring Road and a monorail in Moscow, Moscow-City, as well as bridges in Sochi. In addition, structural steel for bridges manufactured by JSC Mostostroyindustria is used in construction projects in Finland, Turkey and Israel.

• The aggregate revenues of companies in the Russian bridge construction industry are currently valued at \$1.5-1.7 bn. Taking into account the recently announced plans for infrastructure construction, we expect the sector's turnover to grow to \$2-2.5 bn by the end of 2008. In our opinion, an enterprise, which holds a leading position in manufacturing superstructures, bridge bearings and special equipment for the bridge construction industry is bound to have strong revenues.

• Being a manufacturer of structural steel, the company's performance depends on steel prices, which grew by 70% last year. The strong demand for metals implies that prices will remain high this year. We expect metal prices to grow by 15-20% in 2008, which would pressure the company's profitability.

• The company is well positioned in the processing chain and is a promising acquisition target. In particular, the company's clients – large construction corporations – are interested in acquiring it, as they would be able to significantly reduce the manufacturing costs of their products in future projects.

• In order to protect itself against a hostile takeover, JSC Mostostroyindustria could restructure its separate enterprises into a single company. This will also result in a higher valuation of the enterprise as a whole.

• In our opinion, the company's potential growth rate, based on the rapid economic growth forecast for the industry is not yet reflected in its shares. Based on these factors and our comparative analysis, we initiate coverage on the company by issuing a **BUY** recommendation, with a target price of \$667, giving potential upside of 57% from the current price.



## The Russian bridge construction sector

• Over the past few years, the Russian bridge construction sector has been growing at over 15% per annum. The market for the bridge construction sector is expected to reach \$2.5 bn in 2008. At the same time, we anticipate a sharp rise in the Russian bridge construction industry in 2008-09.

• The Russian Government has elaborated a strategic development programme for the transport system, which gives priority to the development of the transport infrastructure throughout Russia – including road construction in Moscow, construction of the Don highway to Europe, a highway in Saint-Petersburg, a highway to Vladivostok and the development of the entire Far East transport network, as well as roads in the Polar Urals area within the framework of the Industrial Urals – Polar Urals' project. Moreover, we anticipate new large-scale projects to develop the transport network in Sochi, which was chosen to host the Olympic Winter Games in 2014.

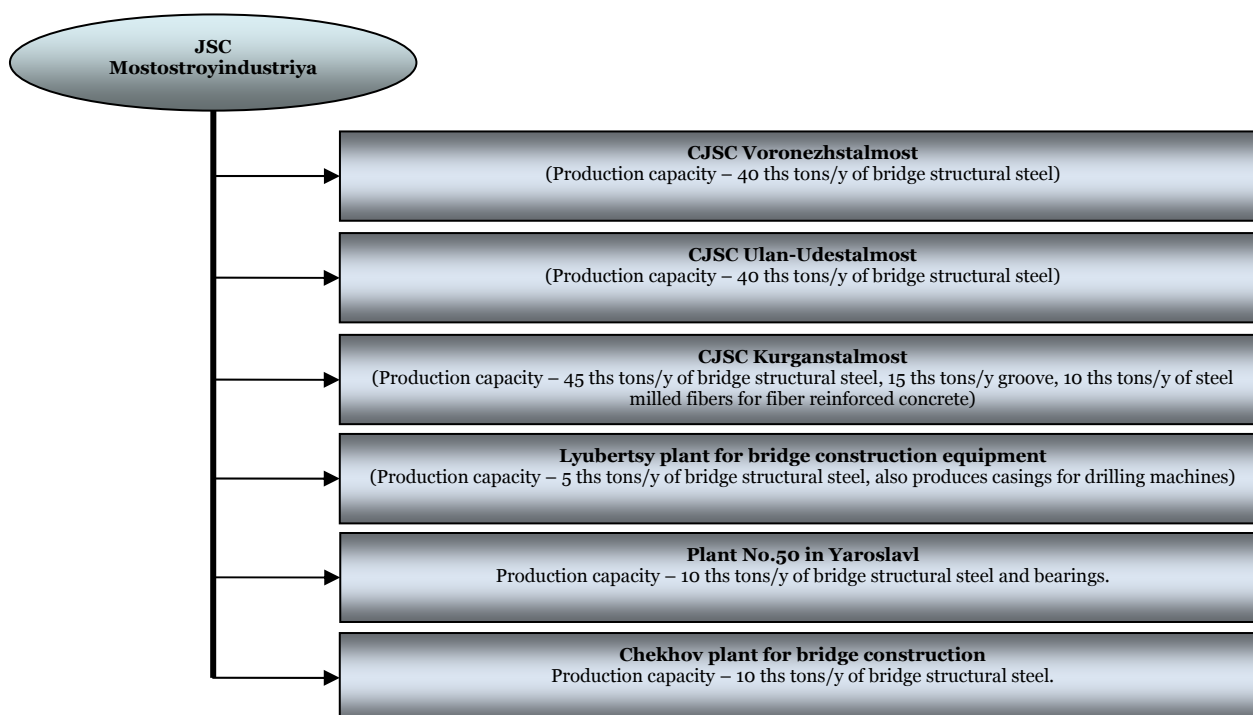
• In 2007, the federal budget increased its financing of the bridge construction industry by 75% to RUR 21 bn (\$792 mn). We believe that the federal budget's financing will be further increased to RUR 30 bn (\$1.13 bn). At the same time, we expect an increased level of financing of the bridge construction industry from regional budgets, which will lead to a 25% increase of the sector's revenues on a y-o-y basis:

### The Russian bridge construction industry

	2005	2006	2007E	2008E	2009E	2010E
The Russian bridge construction industry, \$ mn.	1,200	1,450	2,000	2,500	2,750	3,025
Annual growth rate, %	20%	21%	38%	25%	10%	10%

Source: SOVLINK estimates

## JSC Mostostroyindustriya – company structure



Source: Company data

• JSC Mostostroyindustriya consists of 6 enterprises, which manufacture bridge structural steel and bridge construction equipment. Three of the enterprises are subsidiaries of JSC Mostostroyindustriya. The ownership structure of the remaining companies is more complicated:



- CJSC Voronezhstalmost – JSC Mostostroyindustria holds a 34% stake in the company, and a 60% stake is held by the General Director and his son.
- CJSC Ulan-Udestalmost – the General Director is the largest shareholder, holding a 47.2% stake, with JSC Mostostroyindustria holding 14.1% and CJS Vuk-Service 10%. (Vuk-Service also owns a significant stake in JSC Mostostroyindustria.)
- CJSC Kurganstalmost – the General Director holds a 55% controlling stake, and the General Director of JSC Mostostroyindustria holds a 45% stake.

• We note that over many years the directors of all six plants have also been members of JSC Mostostroyindustria’s Board of Directors. Perhaps, such a complicated system of crossholdings has been developed over time and has been kept in place, as it ensures protection against a possible hostile takeover. At the same time, membership of the holding company’s board of directors results in a manageable structure, and allows directors of different enterprises (within the holding) to coordinate their actions for large orders.

### JSC Mostostroyindustria – Shareholder structure:



Source: Company data

• The current shareholder structure implies increasing levels of liquidity in case of investor interest due to the fairly large free float (almost 20%).

### Current trend: rising costs of construction materials

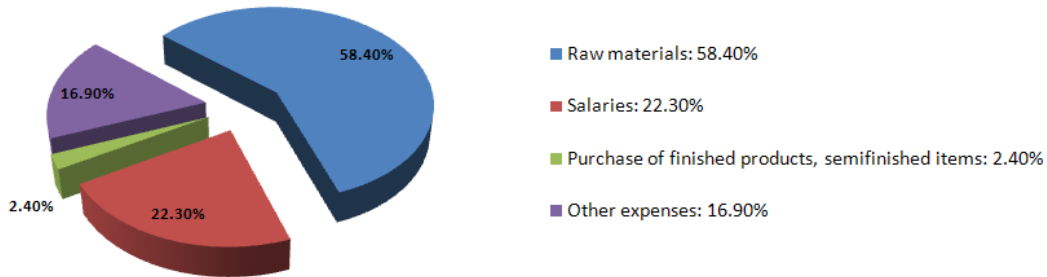
• Last year, prices for cement on the Russian market increased by 90-140%, and for metals – by 70%. Clearly, such drastic price increases for construction materials affect the revenues of companies in the bridge construction industry. The contractors cannot fully transfer the higher prices for materials onto customers due to the peculiarities of contracts for the construction of infrastructure facilities.

• As the chart below shows, materials, (predominantly steel) account for over 50% of the company’s production costs. The company can partially transfer the higher prices for steel on to its clients. Besides, JSC Mostostroyindustria purchases 80% of the amount of steel required from Urals Steel LLC, a large wholesale trader, which is able to offer more competitive prices.

• Given the anticipated growth of construction activity and in the absence of information regarding the launch of new facilities for the manufacture of construction materials, we expect prices for materials, including steel, will continue to grow in 2008. The average price for steel products grew by 4.1% in January 2008, with rolled steel prices increasing by over 5%. In 2008, we expect prices for steel products increasing by 15-20% y-o-y.



## JSC Mostostroyindustria - Cost structure



Source: Company data

## Potential developments

- At present JSC Mostostroyindustria works with a variety of companies. However, its main clients are Transstroy Corporation, the Russian Railways, JSC Mostotrest, JSC Mostootryad No.19 and a number of regional construction companies.

Given the higher prices for construction materials, these companies continuously face higher production costs for their products which affect their revenues. In our meeting with the heads of these construction companies, they told us that they are considering a takeover of one of their suppliers as it would enable them to influence the prices of products used by them.

- JSC Mostostroyindustria (or one or more of its enterprises), being a supplier of structural steel for the leading Russian construction companies, is one of the potential acquisition targets. At the moment, industry giants such as Transmashholding, Dalmostostroy, Basic Element through its company Transstroy and Mostotrest are interested in the company, as the inclusion of a structural steel manufacturer within their company structure will enable them to reduce the cost of producing structural steel used in construction projects and, hence, increase the competitiveness of their bids for state orders.

- Furthermore, these companies are considering the acquisition of JSC Mostostroyindustria's divisions as individual companies rather than purchasing JSC Mostostroyindustria itself. They would prefer to purchase separate structural steel production capacities, which are located near their construction sites. (They have already tried to acquire Kurganstal-most and Voronezhstal-most.)

So far, JSC Mostostroyindustria's management has been able to defend itself against such takeover attempts due to the above mentioned holding structure. However, in order to prevent the collapse of the holding, in our opinion, JSC Mostostroyindustria may decide to consolidate its independent units into one company. This may also result in a higher valuation of the company due to synergy benefits.

**Comparative valuation**

Company	Country	M.Cap, \$ mn.	P/E	P/S	EV/EBITDA
GOLD BRIDGE ENGINEER & CONST	MALAYSIA	58.11	-2.53	1.86	-1.64
HO HUP CONSTRUCTION CO BHD	MALAYSIA	27.54	27.00	0.60	13.03
ABENGOA SA	SPAIN	1873.60	22.84	0.75	6.03
AF GRUPPEN ASA	NORWAY	1858.90	136.49	2.87	6.56
BOSKALIS WESTMINSTER-CVA	NETHERLANDS	2973.80	38.14	2.07	9.10
LUDAN ENGINEERING CO LTD	ISRAEL	122.50	112.38	3.08	7.24
INTRACOM S.A TECHNICAL & STE	GREECE	39.37	24.45	0.67	17.15
PFLIEDERER AG-REGISTERED SHS	GERMANY	704.97	19.67	0.68	13.49
MOURY CONSTRUCT S.A.	BELGIUM	36.87	10.44	0.38	3.78
MOSTOTREST-BRD	RUSSIA	1334.23	20.88	2.13	25.64
DORMOST-BRD	RUSSIA	43.47	90.57	0.26	13.64
MOSTOSTROY-11 -BRD	RUSSIA	260.01	13.88	1.37	10.73
<b>Weighted average</b>			<b>50.88</b>	<b>1.83</b>	<b>10.67</b>
MOSTOSTROYINDUSTRIYA	RUSSIA	152.23	25.67	1.00	19.90
<b>Weight</b>			<b>40%</b>	<b>35%</b>	<b>25%</b>

<b>Fair M.Cap, \$ mn.</b>	<b>238.79</b>
Number of Ords	358,192
Last trade, \$	425
<b>Target price, \$</b>	<b>667</b>
Upside, %	56.86%

Source: SOVLINK estimates

- Based on a comparison of JSC Mostostroyindustriya with its foreign peers in the bridge construction industry, we have estimated a fair value of \$667 (per share) for the company, giving potential upside of 57% from the current price. At the same time, we note that JSC Mostostroyindustriya is under valued in terms of its P/E and P/S multiples, whilst its EV/EBITDA ratio roughly corresponds to our fair value estimate.

- We, therefore, initiate coverage on the company by issuing a **BUY** recommendation with a target price of \$667 per share, which gives potential upside of 57% from the current price.

**Table 1 – Income statement – RUR.**

	Code	2004	2005	2006	3Q07
<b>Profits and losses from common activities</b>					
Sales revenue (excl. VAT, excise tax)	10	1,258,148,000	2,588,537,000	3,000,471,000	2,597,083,000
Cost of goods sold	20	1,062,064,000	2,218,184,000	2,634,458,000	2,248,193,000
Gross profit	29	196,084,000	370,353,000	366,013,000	348,890,000
Selling expenses	30	14,832,000	65,638,000	57,580,000	25,855,000
Administrative expenses	40	127,552,000	155,331,000	173,234,000	144,814,000
Operating profit (loss)	50	53,700,000	149,384,000	135,199,000	178,221,000
<b>Operational income and expenses</b>					
Interest income	60	34,000	1,263,000	725,000	44,000
Interest expense	70	14,026,000	4,829,000	12,572,000	10,724,000
Dividend income	80	2,047,000	1,360,000	216,000	349,000
Other operating income	90	68,317,000	30,115,000	87,403,000	62,207,000
Other operating expenses	100	66,385,000	32,079,000	108,033,000	77,843,000
<b>Non-operating income and expenses</b>					
Non-operating income	120	17,195,000	16,499,000		
Non-operating expenses	130	23,695,000	72,880,000		
Pre-tax profit (loss)	140	37,187,000	88,833,000	102,938,000	152,254,000
Profit tax and other similar compulsory payments	150	11,824,000	30,534,000	30,725,000	44,527,000
<b>Extraordinary income and expenses</b>					
Net profit	190	22,624,000	60,520,000	69,468,000	110,877,000

Source: Company data

**Table 2 – Balance sheet – RUR.**

	Code	2004	2005	2006	3Q07
<b>ASSETS</b>					
Intangible assets	110		38,000	21,000	17,000
Capital assets	120	190,358,000	206,016,000	213,758,000	243,519,000
Construction in progress	130	36,780,000	20,416,000	28,454,000	26,512,000
Long-term investments	140	14,704,000	5,283,000	14,733,000	5,275,000
Other long-term assets	150		213,000	95,000	
LONG-TERM ASSETS	190	243,645,000	236,270,000	262,668,000	284,404,000
Inventory	210	157,855,000	237,058,000	292,880,000	378,031,000
VAT on inventory	220	23,970,000	205,290,000	193,803,000	34,443,000
Accounts receivable (due in more than one year)	230	683,000	683,000	683,000	683,000
Accounts receivable (due within one year)	240	626,111,000	338,806,000	383,124,000	302,064,000
Short-term investments	250	136,572,000	175,243,000	46,531,000	28,192,000
Cash and cash equivalents	260	30,219,000	12,201,000	45,947,000	74,717,000
Other current assets	270	1,042,000	1,163,000	2,293,000	1,958,000
CURRENT ASSETS	290	976,452,000	970,444,000	965,261,000	820,088,000
TOTAL ASSETS	300	1,220,097,000	1,206,714,000	1,227,929,000	1,104,492,000
<b>LIABILITIES</b>					
Charter capital	410	179,000	179,000	179,000	179,000
Paid-in capital, asset revaluation	420	136,414,000	136,414,000	136,414,000	136,414,000
Reserve funds	430	166,000	166,000	166,000	166,000
Retained earnings for the reporting year	470	81,222,000	140,295,000	208,392,000	311,269,000
CAPITAL AND RESERVES	490	217,977,000	277,024,000	345,121,000	447,998,000
Debt and loans	510	48,715,000	48,165,000	10,042,000	24,512,000
Other long-term liabilities	520	5,624,000			
LONG-TERM LIABILITIES	590	62,799,000	54,455,000	18,353,000	32,753,000
Debt and loans	610	18,211,000	62,893,000	73,574,000	94,296,000
Accounts payable	620	920,527,000	811,737,000	790,255,000	528,796,000
Dividends due for payment	630	168,000	176,000	184,000	223,000
Deferred income	640	415,000	429,000	442,000	426,000
CURRENT LIABILITIES	690	939,321,000	875,235,000	864,455,000	623,741,000
Total LIABILITIES	700	1,220,097,000	1,206,714,000	1,227,929,000	1,104,492,000

Source: Company data



## STOCK RATING POLICY

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<b>STRONG BUY:</b>	Upside over 25%; confidence level – high / upside over 100%; confidence level - low
<b>BUY:</b>	Upside between 15 and 25%; confidence level – high / upside between 25% and 100%; confidence level – low
<b>HOLD:</b>	Upside of less than 15%; confidence level – high / upside of less than 25%; confidence level – low
<b>SELL:</b>	Target price at or below current price levels

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