



Bamstroymekhanizatsia

Flash
Note

BUY

Upside: 85.6%
Target Price: 928.2\$

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Stock data

Ticker	bmsm	M.Cap, \$ mn	70.5
Shares Ords	136,269	Free float	20.6%
Shares Prefs	15,141	Free float, \$ mn	14.5
Bid Ords, \$	250	Offer Ords, \$	500
Bid Pref, \$	50	Offer Pref, \$	150

Financials, 2007E

Revenue, \$ mn	232	P/S	0.19
EBITDA, \$ mn	5.3	EV/EBITDA	7.47
Net income, \$ mn	1.99	P/E	21.65

Financials, 2008F

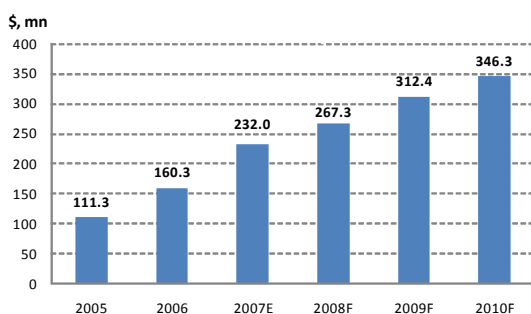
Revenue, \$ mn	267.3	P/S	0.16
EBITDA, \$ mn	18.4	EV/EBITDA	2.14
Net income, \$ mn	18.9	P/E	3.99

BSM – Relative performance



Source: RTS, Sovlink

BSM – Revenue dynamics



Source: Company data, Sovlink estimates

Opportunities in the Far East of Russia

- Bamstroymekhanizatsia (BSM) was incorporated in 1974 as the groundworks contractor for Baikalo-Amursk Line. Currently, BSM is operating in the Khabarovsk, Amur, Chita, Sakhalin and Sakha regions. After Dalmostostroy, it is the second largest company in this sector in the Far East of Russia. The company owns and operates 7 mechanization columns and employs 2,500 people. BSM takes part in most of the significant tenders offered in the Far East region and participates in many large-scale infrastructure construction projects.
- Today, BSM is involved in the largest Russian construction projects: the federal road Amur between Chita and Khabarovsk, the Bureiskaya HPP flooding zone, and the Izvestkovaya-Chegdomin railway line. BSM is also reconstructing the Sakhalin railway system, and in the Yakuts region, the company is constructing the Tommot-Kerdem and Karimskaya-Zabaikalsk sections of the Berkatit-Tommot-Yakuts railway line. BSM also provides pile-sinking services for residential development companies. Sophisticated BSM equipment such as hydro hammers is in demand for high rise building construction.
- BSM could receive new orders in the near future. Vasily Tarasenko, the General Director of BSM, referred to an invitation to take part in a road-building works tender for the Boguchansky aluminum plant. BSM could also assist in the construction of a second airstrip for the airport in Blagoveshensk, and participate in the construction of the Vostochniy space launch facilities. BSM will also take part in railway building tenders for the so called “North-wide line” infrastructure renewal planned by the Russian Railways.
- At the end of 2007, the company announced a private share issuance. According to the company’s information, the number of outstanding ordinary shares increased to 136,269 from 45,423. The number of preferred shares remained the same – 15,141. Shareholders who voted against the private placement were offered the right to increase their stakes by participating in this placement.
- In our opinion, BSM offers a reasonably cheap opportunity to enter the Russian infrastructure construction sector. The company trades on very low multiples and we believe in its growth potential – taking into consideration the impetus provided by the Russian infrastructure boom and also the possibility of BSM becoming an acquisition target. We estimate a target price of \$928.2 per ordinary share, implying potential upside of 85.6% and a target price of \$464.1 for its preferred shares. Consequently, we initiate coverage on BSM by issuing a **BUY** recommendation on its ordinary shares.



Company Outlook

Bamstroyemkhanizatsia (BSM) was incorporated in 1974 as the groundworks contractor for the Baikal-Amursk Line. Currently, BSM operates in the Khabarovsk, Amur, Chita, Sakhalin and Sakha regions. After Dalmostostroy, it is the second largest company in this sector in the Far East of Russia. The company owns and operates 7 mechanization columns and employs 2,500 people. BSM takes part in most of the tenders offered in the Far East region and participates in many large-scale infrastructure construction projects.

BSM has benefitted from infrastructure development plans in Russia. According to the Russian Railways' (RZD) press release, RZD is going to spend about 113 bn rubles (approx. \$4.8bn) on railway infrastructure reconstruction in the Far East up to 2015. The company holds a leading position in the Far East region in the railway construction business. BSM operates and acquires only high quality and modern construction technology, which helps it maintain a high level of labor productivity and reduces the time required to implement its contracts.

The company's current projects portfolio

On Sakhalin Island, BSM is constructing the only CNG (compressed natural gas) plant. In the port in Korsakovo, BSM's units strew the area lying under oil production capacities. BSM is also reconstructing the Sakhalin railway system. RZD is the company's main customer in Sakhalin.

Berkakit-Tommot-Yakutsk – is an extension of the BAM (Baikal-Amur) line, and BSM is currently working on the second stage of building a railway line on the Tommot-Kerdem sector. In 2008, BSM will continue building the Elginskoe coal field spur track in the Yakutsk region. Currently, the Russian railway system's development concept provides for the construction of new branches. These branches are expected to connect Zeya to the trans-Siberian line.

Izvestkovaya-Chegdomin – is another BSM project. The company is constructing a bypass railway line in the flooding zone of the Bureisk storage pond.

The Amur road between Chita and Khabarovsk – here, BSM has built roads for the past 15 years. The Chita-Khabarovsk road will stretch out over 2,165 km. The main contractors are Bamstroyemkhanizatsia, Dalspetsstroy and Ilan-L. The full cost of the project is 71 bn rubles (approximately \$3 bn). The road is planned to be completed by the end of 2009.

In reply to increased demand for residential buildings in Khabarovsk (boosted by the government's "Accessible housing" project), the company has purchased new equipment – pile hydro hammers, which allow it to carry out construction in small, restricted areas. In Khabarovsk, BSM provides residential building foundation works and in future plans to construct entire buildings independently.

The company provides pile-sinking services for development companies and its orders portfolio is completely full. This is due to its sophisticated equipment (hydro hammers), capable of sinking piles to depths of 14 meters, which is extremely important for high rise buildings. BSM can also implement orders in regions that are remotely located from Habarovsk.

Future building projects

According to management, the company could take part in the construction of the Vostochniy space launch facilities. Moreover, BSM could assist in the construction of a second airstrip at the airport in Blagoveshensk. Vasily Tarasenko, BSM's general director, has referred to an invitation to take part in a road-construction works tender for the Boguchansky aluminum plant.

Tarasenko also stated that it is not worthwhile for the company to participate in tenders for projects, valued at under 300 mn rubles. BSM prefers to win large projects, costing over 1 billion rubles (\$42 mn).

The "North-wide line" infrastructure renewal project has already started. The first stage is related to the construction of the Izvestkovaya-Chegdomin railway line. In accordance with Russian Railway's transport strategy development plan 2030, they expect to build the Kuznetsovky tunnel and a new



railway line to it (25 km in length). In addition, they also plan to construct the main railway lines between Visokogornaya-Selikhin (36.6 km) and Visokogornaya-Toki (43.2 km) in order to accommodate the higher levels of cargo traffic arriving at the Vanino and Sovetskaya Gavan ports. The company is going to take part in tenders for the construction of the North-wide line as it is a large, well financed project. According to the company, orders from Russian Railways form up to 70% of its order portfolio.

BSM's main projects

Sakhalin	CNG Plant Sakhalin railway system reconstruction Oil production capacities for the Korsakovo port
Yakutsk region	The Tommot-Kerdem railway line The Elginskoe coal field spur-track
North-wide line	The Izvestkovaya-Chegdomin railway
Khabarovsk region	The Amur (Chita-Khabarovsk) road Foundations for high rise residential buildings

Possible BSM contracts

North-wide line	Visokogornaya-Selikhin Visokogornaya-Toki
The Boguchanskiy aluminum plant	Road construction
Blagoveshensk airport	Additional airstrip
Spaceport Vostochniy	

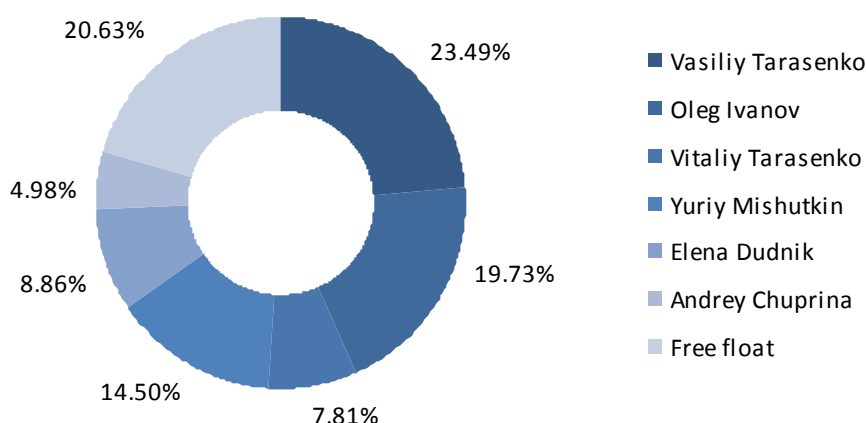
Source: Company data

Additional share issue

In 2007, the company announced an additional private share issuance. The company planned to issue the new shares to: Vasiliy Tarasenko (General Director), Oleg Ivanov (Board member) and Vitaliy Tarasenko (Board member). During the issuance process the company issued 15,858 shares (of the total amount of the placement) to shareholders (in proportion to their existing stakes), who voted against the private share placement.

According to the company, the number of outstanding ordinary shares increased to 136,269 from 45,423. The number of preferred shares remained unchanged. We have given below the (voting) shareholder structure after the private placement.

Shareholder structure



Source: Company data

Vasiliy Tarasenko is the general director of BSM. Oleg Ivanov, Vitalily Tarasenko, Elena Dudnik and Andrey Chuprina are BSM board members. According to information based on the company register, Yuriy Mishutkin bought his shares from Vasiliy Tarasenko.



Valuation

Peer valuation

In order to estimate a fair value for BSM, we conducted a peer analysis based on a comparison of its P/S and EV/EBITDA multiples with its Russian and international peers.

Company	Ticker	P/S			EV/EBITDA		
		2007E	2008F	2009F	2007E	2008F	2009F
Russian peers							
Mostotrest	MSTT RU	1.78	1.21	0.79	27.73	12.43	7,18
Mostootryad 19	MSOT RU	0.96	0.42	0.38	16.54	7.85	6,95
Mostostroy 11	MSTS RU	1.48	1.20	0.96	7.09	7.62	5,07
Mosinzhstroy	MIST RU	0.36	0.28	0.26	26.74	16.14	13,61
Dalmostostroy	DMOA RU	1.29	1.15	1.06	6.91	7.38	6,54
Bamtonnelstroy	BTST RU	3.37	1.14	0.88	12.49	10.12	5,96
	<i>Average</i>	<i>1.54</i>	<i>0.90</i>	<i>0.72</i>	<i>16.25</i>	<i>10.26</i>	<i>7,55</i>
International peers							
Strabag SE	STR AV	0.45	0.40	0.35	8.27	6.71	5,77
Hochtief AG	HOT GR	0.26	0.25	0.24	7.50	6.70	6,04
Bilfinger Berger AG	GBF GR	0.27	0.22	0.21	8.79	7.31	6,87
Vinci SA	DG FP	0.80	0.70	0.67	8.85	7.97	7,53
Skanska AB	SKAB SS	0.40	0.37	0.36	7.25	6.25	6,68
Budimex SA	BDX PW	0.69	0.56	0.47	62.53	18.26	10,14
Enka	ENKAI TI	2.56	2.39	2.09	17.11	14.82	12,83
Bouygues	EN FP	0.53	0.48	0.46	5.67	5.14	4,87
Grupo Ferrovial SA	FER SM	0.47	0.43	0.41	12.62	11.30	10,65
Eiffage SA	FGR FP	0.46	0.42	0.40	8.87	7.87	7,46
Koninklijke BAM	BAMNB NA	0.21	0.22	0.21	7.61	7.60	7,37
ACS SA	ACS SM	0.62	0.54	0.51	10.15	8.68	8,07
Balfour Beatty PLC	BBY LN	0.32	0.27	0.25	10.78	9.34	8,43
Technip SA	TEC FP	0.68	0.69	0.65	9.04	5.05	4,48
NCC AB	NCCA SS	0.34	0.31	0.30	6.87	6.32	6,44
Sacyr Valehermoso	SYV SM	1.25	1.13	1.08	21.93	19.73	19,20
Babis Vovos Int.	VOVOS GA	5.44	4.62	3.95	52.59	6.85	3,58
Sadbhav Engeneering	SADE IN	1.75	1.20	0.99	17.00	11.30	9,64
China Railway Group	390 HK	0.88	0.71	0.58	25.13	17.41	12,54
Merko Ehitus	MK01T ET	0.47	0.42	0.37	6.57	6.07	5,81
AS Eesti Ehitus	EEH1T ET	0.57	0.39	0.34	7.14	4.86	4,54
Hellenic Technodomiki Tev SA	ELTEX GA	1.55	1.14	1.04	14.74	12.18	11,06
Terna SA	TERR GA	0.89	0.57	0.52	9.65	5.64	4,50
Arabtec Holding	ARTC UH	1.78	1.31	1.02	10.66	8.34	7,32
Michaniki SA	MHXAK GA	1.90	1.37	1.05	7.24	5.95	3,07
	<i>Average</i>	<i>1.02</i>	<i>0.84</i>	<i>0.74</i>	<i>14.58</i>	<i>9.11</i>	<i>7,79</i>
BSM	BMSM RU	0.30	0.26	0.23	12.62	3.62	2,71
Discount to Russian peers		80.3%	70.7%	68.8%	22.3%	64.7%	64.2%
Discount to International peers		70.3%	68.7%	69.6%	13.4%	60.2%	65.3%

Source: Bloomberg, Sovlink estimates

As can be seen in the table above, the larger and more liquid Russian construction companies are, on average, valued at the about the same level as their international peers. Below, we have summarized the results of our peer comparison.

Fair M.Cap. \$ mn	P/S	EV/EBITDA	Average	Final
<i>Russian peers</i>	240.3	192.8	216.6	207.5
<i>International peers</i>	225.1	171.6	198.4	

Source: Sovlink estimates



DCF valuation

In our DCF model we assume revenue growth to be driven by RZD's investment program as well as the road construction boom prevalent throughout Russia. Based on the nature of BSM's business and its historical data, we assume that its cost of goods sold figure to fluctuate around 88%–90% of its revenues: at the same time, selling, general and administrative expenses are fixed at 7.2% of its sales. We also use a 30% effective historical tax rate for BSM. According to our understanding, the company has no debt, as the company's management prefers to buy construction materials from its suppliers on credit. That is why in our DCF analysis we consider free cash flows based on the company's equity capital instead of the free cash flow of the firm and use the cost of equity as the discount factor instead of WACC.

\$ mn	2005	2006	2007E	2008F	2009F	2010F	2011F	2012F	2013F	2014F
Revenue	111.3	160.3	232.0	267.3	312.4	346.3	369.0	388.6	402.7	408.0
CoGS	104.7	149.8	205.0	237.9	274.9	306.3	328.0	347.2	361.7	365.5
SG&A	8.5	11.6	16.7	19.2	22.5	24.9	26.6	28.0	29.0	28.6
Operating income	-1.9	-1.1	10.3	10.2	15.0	15.1	14.4	13.4	12.1	13.9
Other operating income	3.4	2.5	-7.9	5.3	5.6	5.5	5.2	4.7	4.0	4.1
Interest income	0.0	0.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest expense	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1	-0.2	-0.2	-0.3
D&A	1.9	1.8	2.4	2.9	4.1	5.2	6.3	7.4	8.5	9.4
EBITDA	3.4	3.4	5.3	18.4	24.7	25.8	25.8	25.5	24.6	27.3
EBITDA margin, %	3.06%	2.11%	2.28%	6.90%	7.9%	7.5%	7.0%	6.6%	6.1%	6.7%
Change in WC				3.21	6.73	6.76	5.12	3.85	2.11	2.04
Capex				5.74	7.22	6.04	5.49	4.81	3.95	3.45
FCFF				4.85	4.55	6.83	9.35	11.37	13.67	16.45
FCFE				4.82	4.51	6.77	9.28	11.26	13.52	16.23
FCFE discounted				4.07	3.21	4.07	4.72	4.83	4.90	4.97

Source: Sovlink estimates

\$ mn			
Cost of equity, %	18.4%	Risk free	5.93%
Terminal growth rate, %	1%	Implied Beta	1.5
NPV of forecasted years	30.8	Market premium	7%
Present value of TV	28.8	Small cap risk	2%
Equity fair value	59.6	Cost of equity	18.43%

Source: Sovlink estimates

Our cost of equity calculations are based on the Russia-30's YTM of 5.93% as the risk free rate and an implied beta of 1.5, to compensate for the illiquidity of the stock. We also take into consideration a special risk premium of 2% for the company's size and other characteristics. Thus, we obtain a cost of equity of 18.4% for our DCF model. We expect the terminal growth rate for cash flows after 2014 to be at least 1%.

We also note that the company is not running its business in the most efficient way. This is because the company is managed by shareholders holding Soviet-style views on management. The company lacks a strong and value building management team. Our DCF model reflects the consequences of such poor management. In our opinion, the company's valuation could increase in case of a more cost-efficient management team.



Final valuation

In order to obtain a final valuation, we use a combination of our peer analysis and DCF valuation results. We use our peer analysis results for the company's Russian peers only, as its international peers are priced more aggressively in terms of P/S multiples and this significantly biases the eventual valuation.

Final BSM Valuation

	Fair M.Cap, \$ mn	Share price (ord), \$	Upside (ord),%
Multiples	207.5	1,442.4	188.5%
DCF	59.6	414.1	-17.2%
Average	133.5	928.2	85.6%

Source: Sovlink estimates

In this way, we arrive at a fair value of \$133.5 mn for Bamstroyemekhanizatsia, which implies a target price of \$928.2 per ordinary share and \$464.1 per preferred share (based on a 50% discount). For our share price estimate, we assume the company has 136,269 ordinary shares and 15,141 preferred shares outstanding.

In our opinion, BSM offers a fairly cheap opportunity for entry to the Russian infrastructure construction sector. The company trades at low multiples and is not managed as efficiently as it could be. We believe in the growth potential of BSM share price, based on the Russian infrastructure boom and the possibility that BSM could be acquired by a large construction conglomerate. However, the company has a very low transparency level and there is considerable risk of an additional share issuance – hence the acquisition of ordinary shares appears to be a better choice than preferred shares. Accordingly, we initiate coverage on BSM, by issuing a **BUY** recommendation with a target price of \$928.5 per ordinary share, which implies potential upside of 85.6%. We estimate a target price of \$464.1 for the company's preferred 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

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