

Research
May 6, 2008

Russia, Moscow, 123610, Krasnopresnenskaya nab. 12, 7th gate, 18th fl.
Tel.: 7 (495) 258 1988
Fax: 7 (495) 258 1989

Sitronics

Losses-2007

Recommendation: SELL

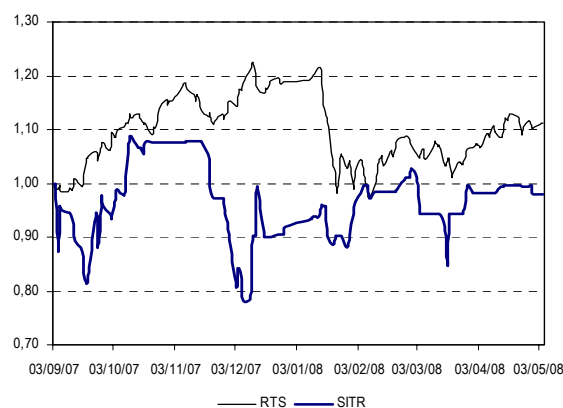
Analyst: Ilya Fedotov
E-mail: IFedotov@veles-capital.ru

Bullet moments

- Last week Sitronics published its financial results of 2007, which clearly indicate last year as the worst in past five years of activities by Sitronics – during the year company suffered losses down at OIBDA level, while net losses have exceeded net income of 2003-2006. Weak results were demonstrated by all segments of company's business – OIBDA growth rates lagged significantly behind income growth rates, while telecoms segment suffered drop of sales (-19.5%) whilst OIBDA output went down negative. Year's results in total – virtually similar income, under almost 20% growth of expenses.
- Though, we must note that actions by new team of managers (current president of company – Sergei Aslanyan was appointed in October 2007) have brought first positive fruits – during 4Q company's ineffectiveness started to decline.
- Along with announcement of results Sitronics also published its forecast for current year. Company expects "growth of market" up +15%, while OIBDA margin should up another +5%. If these forecasts are met, OIBDA margin of 2008 would still remain extremely low, actually lowest throughout all of company's history (excluding unsuccessful year 2007). However, market stopped trusting these statements and forecasts, and now wants solids results.
- In March 2008 Sitronics redeemed 36% stocks of Quasar-Micro, which is also a subsidiary to Sitronics. The value of deal has formed 116.9 mn USD. In our opinion – company is not in the position at the moment to spend such serious funds on expansion of its stake in subsidiaries. This deal merely put more negative pressure on our estimates.
- Now, considering new data we downgrade our estimation of company's stock down to 0.0854 USD apiece (4,2678 per ADR). Current recommendation is cut from "HOLD" to "SELL".

Principal estimates

Company's shares vs RTS index



Information about Sitronics

Ticker RTSILSE	SITR
Market price (cs), USD	0.1278
Min / max price during last year (cs), USD	0.1020 / 0.2080
Fair price at year end (cs), USD	0.0854
Fair price at year end (GDR), USD	4.2678
Upside (downside) (cs), %	-33.2
Number of common shares, total	8,750,310,750
MC, mn USD	1,118
EV, mn USD	1,445

[†] Excluding treasury notes

Financial values (US GAAP)	2007	2008 (F)	2009 (F)
Sales, mn USD	1,620	1,820	1,997
EBITDA, mn USD	-101	120	181
Net income, mn USD	-234	3	36
EBITDA margin, %	Omp.	6.6	9.1
Net income margin, %	Omp.	0.1	1.8

Financial coefficients	2007	2008 (F)	2009 (F)
EV / S	0.89	0.79	0.72
EV / EBITDA	Otp.	12.02	7.99
P / E	Otp.	446.44	30.79
ROIC, %	Omp.	2.2	5.8
ROE, %	Omp.	0.4	6.2

Financial model

Income statements of Sitronics, mn USD

	2003	2004	2005	2006	2007 (F)	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)
Sales	99	474	953	1,611	1,620	1,820	1,997	2,237	2,375	2,522	2,686
Costs	(85)	(441)	(799)	(1,438)	(1,721)	(1,700)	(1,817)	(1,937)	(2,061)	(2,188)	(2,326)
OIBDA	14	33	154	172	(101)	120	181	299	314	334	360
<i>OIBDA margin, %</i>	13.8	6.9	16.1	10.7	Neg.	6.6	9.1	13.4	13.2	13.2	13.4
Amortization	(4)	(6)	(11)	(44)	(56)	(86)	(90)	(82)	(75)	(75)	(76)
EBIT	10	26	142	128	(158)	34	90	218	238	259	284
<i>EBIT margin, %</i>	10.2	5.5	14.9	8.0	Neg.	1.9	4.5	9.7	10.0	10.3	10.6
Interest expenses	(3)	(7)	(10)	(32)	(40)	(31)	(37)	(33)	(24)	(20)	(21)
Non-operating income (losses)	1	0	(2)	2	4	0	0	0	0	0	2
EBT	9	19	130	98	(193)	4	53	185	215	239	264
<i>EBT margin, %</i>	8.8	4.1	13.7	6.1	Neg.	0.2	2.6	8.3	9.0	9.5	9.8
Income tax	(3)	(3)	(35)	(32)	(27)	(1)	(14)	(44)	(51)	(57)	(63)
Minority interest	(1)	(5)	(26)	(5)	(13)	(0)	(3)	(10)	(11)	(13)	(14)
Net income	5	11	69	61	(234)	3	36	131	152	169	186
<i>Net income margin, %</i>	5.1	2.4	7.3	3.8	neg.	0.1	1.8	5.8	6.4	6.7	6.9

Source: company's data, Estimation: Veles Capital

Balance sheet, mn USD

	2003	2004	2005	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)
ASSETS											
Non-current assets											
PPE and intangible assets	45	69	115	359	570	545	520	512	515	523	535
Other non-current assets	12	11	23	159	79	79	79	79	79	79	79
Total non-current assets	57	79	138	518	650	624	599	591	594	602	614
Current assets											
Inventories	42	122	176	353	426	479	526	589	625	664	707
Accounts receivable	20	46	159	658	617	693	760	851	904	960	1,022
Other current assets											
Short-term investments	0	14	10	29	9	0	0	0	0	51	197
Cash and equivalents	5	40	83	90	185	159	148	131	189	289	308
Total current assets	67	222	428	1,130	1,238	1,331	1,434	1,571	1,718	1,964	2,234
Total assets	125	301	566	1,647	1,887	1,955	2,033	2,162	2,312	2,566	2,848
LIABILITIES											
Shareholder's equity											
Authorised capital	74	103	135	334	679	679	679	679	679	679	679
Other	2	3	-1	27	67	67	67	67	67	67	67
Retained earnings	-52	-41	28	87	-160	-157	-121	10	161	330	516
Total shareholder's equity	24	65	163	448	586	588	625	755	907	1,076	1,262
Minority interest	2	27	29	178	206	90	92	102	114	126	141
Long-term liabilities											
Long-term borrowings	29	17	9	344	259	340	291	160	78	77	77
Other	2	7	9	22	27	27	27	27	27	27	27
Total long-term liabilities	30	24	18	366	286	368	318	187	106	104	104
Current liabilities											
Accounts payable	14	38	104	297	294	330	363	406	431	458	488
Short-term loans and credits	29	69	105	158	254	286	314	351	373	396	422
Other	26	78	147	202	260	293	321	360	382	406	432
Total current liabilities	69	184	357	656	809	909	997	1,117	1,186	1,259	1,341
Total liabilities	125	301	566	1,647	1,887	1,955	2,033	2,162	2,312	2,566	2,848

Source: company's data, Estimation: Veles Capital

Statements of cash flow of Sitronics, mn USD

	2003	2004	2005	2006	2007 (F)	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)
Cash flows from operating activities											
Net income	5	11	69	61	(234)	3	36	131	152	169	186
Minority interest	1	5	26	5	13	0	3	10	11	13	14
Amortization	4	6	11	31	56	86	90	82	75	75	76
Other	2	(8)	(5)	1	60	0	0	0	0	0	0
Changes in working capital	(18)	(18)	(43)	(243)	79	(60)	(53)	(72)	(42)	(44)	(49)
Net cash provided by operating activities	(7)	(3)	59	(146)	(25)	28	76	150	197	212	227
Cash flows from investing activities											
CapEx	(6)	(7)	(47)	(88)	(236)	(60)	(66)	(74)	(78)	(83)	(89)
Other	0	6	(25)	(71)	(22)	(107)	0	0	0	(51)	(145)
Net cash provided by investing activities	(6)	(1)	(72)	(159)	(258)	(167)	(66)	(74)	(78)	(134)	(234)
Cash flows from financing activities											
Proceeds from borrowings	25	53	103	370	410	367	314	351	373	396	422
Repayments of borrowings	(7)	(28)	(78)	(222)	(419)	(254)	(335)	(444)	(433)	(374)	(396)
Other	0	0	32	198	318	0	0	0	0	0	0
Net cash provided by financial activities	17	25	57	346	310	113	(22)	(93)	(60)	22	26
Net change of cash	5	22	41	55	30	(26)	(12)	(17)	59	99	19
Cash at the beginning of period	2	5	40	83	90	185	159	148	131	189	289
Cash at the end of period	5	40	83	90	185	159	148	131	189	289	308

Source: company's data, Estimation: Veles Capital
Discount rate (WACC) of Sitronics, %

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Cost of equity (k_e)	16.23	13.13	12.71	14.08	13.50	14.03	13.79	13.14	12.82	12.78
Risk-free rate	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2
10 year US Treasures yield	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6
Russia risk	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Stock market risk	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Coefficient β	1.5	0.9	0.8	1.1	1.0	1.1	1.0	0.9	0.8	0.8
Corporate risk	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Share of equity, %	30.8	51.6	62.8	55.5	60.7	52.0	54.3	62.7	69.3	71.8
Cost of debt (k_d)	10.99	10.99	10.99	10.99	10.99	10.99	10.99	10.99	10.99	10.99
Risk-free rate	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2	6.2
Debt premium	4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8
Tax rate	16.7	27.0	32.9	30.7	28.4	26.2	24.0	24.0	24.0	24.0
Share of debt, %	69.2	48.4	37.2	44.5	39.3	48.0	45.7	37.3	30.7	28.2
WACC	11.33	10.66	10.72	11.20	11.29	11.19	11.30	11.35	11.45	11.53

Estimation: Veles Capital

Cash flows of Sitronics, mn USD

	2003	2004	2005	2006	2007 (F)	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)
Net income (corr.)	9	23	105	98	(181)	15	51	147	163	181	200
Depreciation and amortization	4	6	11	44	56	86	90	82	75	75	76
CapEx	(6)	(7)	(47)	(88)	(236)	(60)	(66)	(74)	(78)	(83)	(89)
Changes in working capital	(18)	(18)	(43)	(243)	79	(60)	(53)	(72)	(42)	(44)	(49)
Free cash flow	(12)	5	26	(189)	(282)	(20)	22	82	118	129	138
Discount rate, %						11.3	11.2	11.3	11.4	11.4	11.5
Discount coefficient						1.00	0.90	0.81	0.73	0.65	0.58
Discounted cash flow						(20)	20	67	86	84	81

Source: company's data, Estimation: Veles Capital

Sitronics' stocks valuation

TGR, %	3.0
Sum of cash flows, mn USD	479
Terminal value, mn USD	2,050
Discounted terminal value, mn USD	848
Enterprise value, mn USD	1,328
Net debt, mn USD	467
Shareholder's equity (incl. minority interest), mn USD	861
Minority interest, mn USD	114
Shareholder's equity, mn USD	747
Number of shares, mn units	8,750
Fair value of common stock at the year end, USD	0.0854
Upside (downside) of common stock, %	-33.2

Source: company's data, Estimation: Veles Capital

Recommendations for shares within sector

Our recommendations

Share	Ticker	Current price, USD	Target for year end, USD	Current growth potential, %	Recommendation	Date of recommendation revision	Investment idea
Traditional telephony							
Volgatelecom, cs	NNSI	4.5500	6.0110	32.1	BUY	3/14/2008	High effectiveness and low debt make company into an attractive subject for investing
Volgatelecom, ps	NNSIP	3.2000	4.5083	40.9	BUY	8/28/2007	
Dalsvyaz, cs	ESPK	4.5200	7.4457	64.7	BUY	8/28/2007	Prospects of improving the effectiveness of activity due to the new services
Dalsvyaz, ps	ESPKP	3.8000	5.5842	47.0	BUY	8/28/2007	
NWT, cs	SPTL	1.2010	1.5002	24.9	HOLD	8/28/2007	The company's management takes the maximum from regulated services, however the prospects are limited
NWT, ps	SPTLP	1.1400	1.1251	-1.3	HOLD	10/16/2007	
Sibirtelecom, cs	ENCO	0.0895	0.1140	27.4	BUY	2/5/2008	High share of non-regulated services allows company to improve its financial results
Sibirtelecom, ps	ENCOP	0.0595	0.0855	43.7	BUY	8/28/2007	
Uralsvyazinform, cs	URSI	0.0495	0.0573	15.8	BUY	3/13/2008	High debt load limits growth potential
Uralsvyazinform, ps	URSIP	0.0300	0.0430	43.3	ACCUMULATE	8/28/2007	
Centrtelecom, cs	ESMO	0.6800	1.0357	52.3	ACCUMULATE	11/15/2007	Aggressive investment program halts growth of quotes
Centrtelecom, ps	ESMOP	0.0000	0.7768	#ДЕЛ/0!	BUY	11/15/2007	
STC, cs	KUBN	0.1400	0.2465	76.0	BUY	11/28/2007	New rules of industry define company's prospects
STC, ps	KUBNP	0.1175	0.1848	57.3	BUY	11/28/2007	
Alternative telephony							
Comstar-UTS	CMST	10.2000	13.4790	32.1	BUY	4/24/2008	Growth potential due to development of regional markets
Long-distance communication							
Rostelecom, cs	RTKM	11.4000	4.8300	-57.6	SELL	2/14/2008	An extremely high market price, resulted from buyup of shares, yet unsupported by fundamental factors
Rostelecom, ps	RTKMP	2.2500	3.6200	60.9	BUY	2/14/2008	
Cellular communication							
Vimpelcom	VIMP	29.98	30.80	2.7	HOLD	3/17/2008	Market price had dropped to fair level, fair to absorption of GT
MTS	MTSS	12.15	16.53	36.1	BUY	4/21/2008	Sound financial results, prospects of 3G technology use, fundamental underestimation of shares
Media							
CTC Media	CTCM	24.85	32.90	32.4	BUY	4/30/2008	Growth of ad market and prices
RBC	RBCI	8.50	9.86	16.0	BUY	10/2/2007	Separation of IT business and improvement of primary business' effectiveness
Other							
Sitronics	SITR	0.13	0.09	-34.3	SELL	5/6/2008	Company demonstrates record losses and low effectiveness, determining its low fundamental value

Data: Bloomberg; Estimation: Veles Capital

Brief investor's guide

Methods, used for company's share evaluation				
Income approach		Comparables approach	Expenses approach	
	DCF method	EVA method	Multiplicative method	Net assets method
Concept of evaluating the unified object (EV) *	FCFF discounting	EVA discounting		
Shareholders' value direct calculation (SV) **	FCFE discounting	EVA for shareholders discounting (Edwards-Bell-Ohlson method)		

*

Debt cost is calculated separately and then subtracted from the sum total cost of business (target EV), formed considering the cash flows/ economic profits of firm.

**

Debt is accounted integrated -via annual coverage. So the fair cost of shareholders' value (target SV) is formed directly - considering the cash flow / economic profits for holders.

Note:

DCF methods differ from the methods of economic profit by the way of investments calculation. The methods of unified object evaluation concept differ from these methods of direct calculation of shareholders' value costs - by the way of accounting cost and maintenance of debt liabilities.

Cost calculation within the frames of income approach:

	Business cost calculation (EV) within the frames of united object cost evaluation	Shareholders' capital value calculation (SV)
DCF method (FCFF)	$EV = \sum_{i=1}^n \frac{FCFF_i}{(1+WACC_i)^i} + \frac{TV}{(1+WACC_i)^n} + NA$	$SV = EV - D$
DCF method (FCFE)		$SV = \sum_{i=1}^n \frac{FCFE_i}{(1+k_{si})^i} + \frac{TV}{(1+k_{si})^n} + \text{Cash} + NA$
EVA method	$EV = IC_1 + \sum_{i=1}^n \frac{EVA_i}{(1+WACC_i)^i} + \frac{TV}{(1+WACC_i)^n} + NA$	$SV = EV - D$
EBO method		$SV = BV_1 + \sum_{i=1}^n \frac{SVA_i}{(1+k_{si})^i} + \frac{TV}{(1+k_{si})^n} + \text{Cash} + NA$

Signs:

EV	- Enterprise Value
SV	- Shareholders Value
TV	- Terminal Value
Cagr	- development rates within the target period
BV, E	- Balance Value, Equity
EBIT	- operational profit from selling, profit before payments of credit interest and income tax
EBITDA	- operational profit before payment of credit interest, income tax and amortization
EBT	- Earnings Before Tax
EAT	- Earnings After Tax
EPS	- Earnings Per Share
NOPAT	- net operational profit, free from effects of debt financing $NOPAT = EBIT * (1 - \text{income tax effective rate})$
FCFF	- Free Cash Flow to Firm $FCFF = \text{gross cash flow} - \text{gross investments}$ $\text{Gross cash flow} = NOPAT + \text{amortization}$
FCFE	- Free Cash Flow to Equity $FCFE = \text{gross shareholders' cash flow} - \text{gross investments}$ $\text{Gross shareholders' cash flow} = EAT \text{ of operational profit (including interest payoffs) } - \text{annual debt coverage} + \text{attracted borrowed assets} + \text{amortization}$
EVA	- Economic Value Added $EVA = \text{economic profit spread} * IC = (ROIC - WACC) * IC$
SVA	- Shareholders Value Added $SVA = \text{spread} * E = (ROE - k_s) * E$
WACC	- Weighted Average Cost of Capital
k_s	- required shareholders' yield
D	- fair (market) cost of net debt
Cash	- cash assets, along with market securities on the balance
NA	- non-operational assets
IC	- Invested Capital
ROIC	- Return on Invested Capital $ROIC = \frac{NOPAT}{IC}$
ROE	- Return on Equity
ROA	- Return on Assets

Information disclosure

The statement of an analyst and confirmation of the responsibility withdrawal

The given report is prepared by the analyst (-s) of the Investment Company Veles Capital. The given estimations in the present report reflect personal opinion of the analyst (-s). The award of the analysts does not depend, never depended and will not depend upon the specific recommendations or estimations, provided in the present report. The award of the analysts depends upon the general efficiency of the business of the Investment Company Veles Capital, determined by the investment benefit of the company's clients and also upon the incomes from other types of activity of the Investment Company Veles Capital.

The given report, prepared by the Research Department of the Investment Company Veles Capital, is basing on the public information. The present review was prepared independently from other Departments of the Investment Company Veles Capital, and any recommendations and judgments, presented in the given report reflect only the view point of the analyst (-s), participated in making of the present review. Due to that consideration, the Investment Company Veles Capital considers being necessary to state that the analysts and the Company are not responsible for the content of the given report. The analysts of the Investment Company Veles Capital do not take overall responsibility to regularly up-date the information, contained in the present report, and also to announce about all changes, introduced to the present review.

Provided analytical material of the Investment Company Veles Capital could be used only with information aims. The company does not guarantee the completeness and preciousness of provided information in the given report and its reliability, and also is not responsible for direct and indirect losses from using of the given materials. This document cannot serve as a basis for purchase and selling any securities, and cannot also be considered as an offer from the part of the Investment Company Veles Capital. The Investment Company Veles Capital and (or) its subsidiaries along with the staff, directors and analysts of the Investment Company Veles Capital have the right to purchase and sell any securities, mentioned in the given review.

The Investment Company Veles Capital and (or) its subsidiaries can serve as a market-maker or have the liabilities for underwriting of companies' securities, mentioned in the given review, can purchase or sell them for clients, and also make any actions, which do not contradict the Russian law. The Investment Company Veles Capital and (or) its subsidiaries can also be interested in the possibility of providing the companies, mentioned in the present review, with the investments and bank or any other services.

All rights for the given bulletin belong to the Investment Company Veles Capital. The reproduction and/or distribution of the analytical materials of the Investment Company Veles Capital are prohibited without the written permission of the Company. © Veles Capital 2008.

The principle of recommendation assignment

The investment recommendations are given based on the evaluation of the company's share yield. The basis for the calculation of the expected company's cost is the evaluation by the discounted cash flows method (DCF). In some estimations the method of comparable coefficients, and also the mixed estimation (by DCF method and by comparable coefficients method) are applied. All recommendations are assigned based on the determined by us the fair cost of the shares within the nearest 12 months.

At the present moment the investment scale of the Investment Company Veles Capital is the following:

BUY – corresponds to the growth potential of the shares within the nearest 12 months by 15% or more.

ACCUMULATE – corresponds to the growth potential of the shares within the nearest 12 months for 5-15%.

HOLD – corresponds to the growth (reduction) potential of the shares within the nearest 12 months from -5% to 5%.

REDUCE – corresponds to the reduction potential of the shares within the nearest 12 months from 15% to 5%.

SELL – corresponds to the reduction potential of the shares within the nearest 12 months by 15% or more.

In some cases the deviations from the evaluation scale given above, based on which the recommendations are assigned, are possible. That fact relates to the high volatility of some securities in particular, and market in the whole, and also to the individual characteristics of one or another issuer.

In order to get additional information and specifications please contact the Research Department of the Investment Company Veles Capital.

Research Department*research@veles-capital.ru*

Mikhail Zak
Head of Department
Strategy
MZak@veles-capital.ru

Ivan Manaenko
Fixed income market,
Macroeconomics
IManaenko@veles-capital.ru

Ilya Fedotov
Telecommunications
IFedotov@veles-capital.ru

Stanislav Fomenko
Metallurgy
SFomenko@veles-capital.ru

Marina Irlkly
Transport, machinery
Mirkly@veles-capital.ru

Oleg Zotikov
Energy
OZotikov@veles-capital.ru

Dmitry Lyutyagin
Oil and gas
DLyutyagin@veles-capital.ru

Oleg Salmanov
Fixed income
OSalmanov@veles-capital.ru

Shawn Gizatulin
Editor/Interpreter
SGizatulin@veles-capital.ru

Sales and Trading Department*sales@veles-capital.ru*

Yury Pavlov
Director (VIP clients)
YPavlov@veles-capital.ru

Sergey Vetoshkin
Corporative Clients
SVetoshkin@veles-capital.ru

Alexander Taran
Trading (Ukraine)
ATaran@veles-capital.com.ua

Ekaterina Tochilkina
Trading
ETochilkina@veles-capital.ru

Strategic Investments Department

Andrey Lee
Head of department
ALee@veles-capital.ru

Assets Management*am@veles-capital.ru*

Beyshen Isaev
Head of Department
BIsaev@veles-capital.ru

Vadim Labeled
Investor relations
VLabeled@veles-capital.ru

Stanislav Brodsky
Investment products
SBrodsky@veles-capital.ru