

Research
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ZMZ

We are responsible for what we have tamed

**Recommendation: CS – HOLD
PS – HOLD**

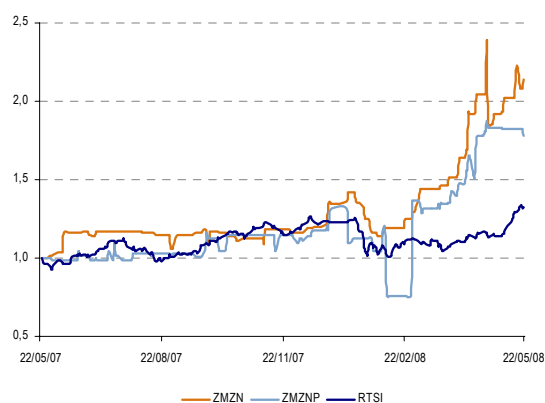
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Bullet moments

- We have reviewed ZMZ' (Zavolzshky Motorny Zavod – Zavolzshky Motor Plant) financial model, adding the data of 2007, as well as company's plans of future development. Note that ZMZ sales of 2007 rose +20%, operating income expanded by 23%, whilst net income upped by +48%. Though company's business is still close to level of 2006.
- The primary risk of plant's operations is the upcoming reduction of engine shipments for GAZ. Do remember that GAZ is unsatisfied with monopoly position of ZMZ and in various ways attempts to diversify its engine supply for assembled vehicles. This year a 3-year contract signed between ZMZ and GAZ will end. Therefore, the engine production for GAZ in 2008 would remain at similar level, i.e. about 195 th units. However, to year 2012 shipments for GAZ could drop down to 90 th units. At the same time, the production of engines for UAZ would rise. The resulting output of plant in 2012 may form up to 150 th engines, versus 250 th units produced in 2007. Besides of that ZMZ and Severstal-Avto are currently in development of F1A engines for Fiat Ducato. However, this project is likely to receive its own, newly built production facility.
- During 2008 ZMZM plans to allocate bond loan worth 3 bn RUR. Loan features are still unknown, though loan-term is estimated to form 6 years. Considering this loan, ZMZ' net debt as of late 2008 may form up to 216 mn USD.
- The resulting renewals brought a new fair price of one common stock of ZMZ at 4.45 USD, and 3.34 USD per preferred stock. In accordance with current market quotes this forms -6.75% and -1.05% growth potential respectively. We recommend "HOLD" on stocks of Zavolzshy Plant.

Principal estimates

Company's shares vs. the RTS index



Company profile

	ZMZN / ZMZN P
RTS ticker	
Common share price, USD	4.78
Preferred share price, USD	3.38
Min/max com. share price in 52 weeks, USD	2.2 / 5.3
Min/max pref. share price in 52 weeks, USD	1.4 / 3.4
Fair value of the com. share by the year end, USD	4.45
Fair value of the pref. share by the year end, USD	3.34
Growth potential (com.), %	-6.75
Growth potential (pref.), %	-1.05
Total number of com. shares, items	112,734,490
Total number of pref. shares, items	37,578,123
Market capitalization, mn USD	675
EV, mn USD	659

RAS financial values	2007	2008 (F)	2009 (F)
Sales, mn USD	616	698	664
EBITDA, mn USD	86	98	91
Net profit, mn USD	64	65	58
EBITDA margin, %	13.9	14.0	13.7
Net profit margin, %	10.3	9.4	8.7
NOPAT, mn USD	56	66	59
ROIC, %	26.1	22.1	12.0
ROE, %	27.8	20.9	15.4

Coefficients	2007	2008 (F)	2009 (F)
P/E	10.6	10.3	11.6
P/S	1.1	1.0	1.0
P/BV	2.2	1.8	1.5
EV/EBITDA	7.7	6.7	7.2
EV/S	1.1	0.9	1.0
EV/IC	3.1	2.2	1.3
ROIC/WACC	1.9	1.9	1.0

Forecasted values

Balance sheet, mn USD

	2003	2004	2005	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)
Non-current assets	60	78	93	96	102	120	126	131	131	131	131	131	131
PPE	38	51	72	72	74	92	98	103	103	102	102	102	102
Intangible assets	0	0	0	0	0	0	0	0	0	0	0	0	0
Other non-current assets	22	27	22	23	28	28	28	28	28	28	28	28	28
Current assets	100	132	143	190	279	454	505	553	602	649	575	633	694
Inventories	55	67	51	47	49	49	44	39	34	30	30	30	30
Accounts receivable	32	38	49	49	59	59	53	47	42	36	36	36	36
Short-term financial investments						328	391	451	510	569	495	553	614
Cash and near cash	5	11	23	75	155								
Other current assets	2	7	12	16	14	16	15	14	13	12	13	13	13
	7	7	8	2	2	2	2	2	2	2	2	2	2
Total assets	160	210	237	285	381	573	631	685	733	779	706	764	825
Equity	98	140	169	229	312	377	435	489	537	583	637	695	756
Share capital	25	27	25	26	24	24	24	24	24	24	24	24	24
Reserves	0	0	0	1	1	1	1	1	1	1	1	1	1
Retained earnings	72	114	144	203	287	352	410	463	511	558	612	670	731
Minority interest		0	0	0	0	0	0	0	0	0	0	0	0
Long-term liabilities	19	26	17	3	3	130	130	130	130	3	3	3	3
Long-term debt	16	23	14	0	0	128	128	128	128	0	0	0	0
Other long-term liabilities													
	3	3	4	3	3	3	3	3	3	3	3	3	3
Short-term liabilities	43	44	50	54	66	66	66	66	66	193	66	66	66
Short-term debt	13	4	0	1	0	0	0	0	0	127	0	0	0
Other short-term liabilities	30	40	50	53	66	66	66	66	66	66	66	66	66
Total equity and liabilities	160	210	237	285	381	573	631	685	733	779	706	764	825

Source: company's data; Estimation: Veles Capital

Profit and loss statement, mn USD

	2003	2004	2005	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)
Sales	299	376	443	512	616	698	664	628	589	542	553	564	575
Cost of services	(215)	(265)	(326)	(398)	(481)	(543)	(522)	(498)	(471)	(432)	(440)	(448)	(455)
Gross profit	84	111	117	114	135	154	142	130	118	110	113	116	119
Gross profit margin, %	28.0	29.6	26.4	22.3	21.9	22.1	21.4	20.7	20.0	20.2	20.4	20.6	20.8
General and administrative expenses	(41)	(56)	(58)	(53)	(60)	(68)	(64)	(61)	(57)	(53)	(54)	(55)	(56)
EBITDA	47	61	68	71	86	98	91	84	76	72	75	77	79
EBITDA margin, %	15.7	16.2	15.4	13.9	13.9	14.0	13.7	13.3	12.9	13.4	13.5	13.6	13.7
EBIT	43	55	59	61	75	87	77	69	60	57	59	61	64
EBIT margin, %	14.4	14.6	13.4	11.9	12.1	12.4	11.6	11.0	10.3	10.5	10.7	10.9	11.1
Finance income	0	0	1	4	10	5	10	12	14	15	17	15	17
Finance expenses	(1)	(3)	(2)	(1)	(0)	(5)	(11)	(11)	(11)	(11)	(5)	0	0
Other non-operating income (expenses), net	(5)	(6)	1	(5)	1	0	0	0	0	0	0	0	0
EBT	37	47	59	58	86	86	76	70	63	61	71	76	80
EBT margin, %	12.2	12.5	13.3	11.4	13.9	12.3	11.5	11.2	10.7	11.3	12.8	13.5	14.0
Income tax	(9)	(11)	(13)	(15)	(22)	(21)	(18)	(17)	(15)	(15)	(17)	(18)	(19)
Deffered income tax	36	47	15	35	(0)	0	0	0	0	0	0	0	0
Minority interest	0	0	0	0	0	0	0	0	0	0	0	0	0
Net profit	27	35	35	43	64	65	58	53	48	47	54	58	61
Net profit margin, %	9.0	9.4	7.8	8.3	10.3	9.4	8.7	8.5	8.2	8.6	9.7	10.3	10.6

Source: company's data; Estimation: Veles Capital

Financial model

Weighted average cost of capital calculation (WACC)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Risk-free yield:												
k_f \$ (GT10 aver(5)), %	4.63	4.63	4.63	4.63	4.63	4.63	4.63	4.63	4.63	4.63	4.63	4.63
Current spread of default of Russia, %	1.56	1.56	1.56	1.56	1.56	1.56	1.56	1.56	1.56	1.56	1.56	1.56
k_f^{RUR} , %	6.19	6.19	6.19	6.19	6.19	6.19	6.19	6.19	6.19	6.19	6.19	6.19
Required yield of shareholders:												
Share premium, %	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
β coefficient	0.57	0.57	0.57	0.57	0.57	0.57	0.57	0.57	0.57	0.57	0.57	0.57
corporate governance level S&P scale	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70	3.70
Premium for quality of corporate management, %	4.60	4.60	4.60	4.60	4.60	4.60	4.60	4.60	4.60	4.60	4.60	4.60
k_s , %	13.62	13.62	13.62	13.62	13.62	13.62	13.62	13.62	13.62	13.62	13.62	13.62
Required yield of creditors:												
Credit rating, S&P scale	B+	B+	B+	B+	B+	B+	B+	B+	B+	B+	B+	B+
Premium for credit risk, %	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80	1.80
k_d , %	7.99	7.99	7.99	7.99	7.99	7.99	7.99	7.99	7.99	7.99	7.99	7.99
Capital structure:												
Source fraction: own capital, %	84%	92%	100%	100%	75%	77%	79%	81%	82%	100%	100%	100%
Source fraction: borrowed capital, %	16%	8%	0%	0%	25%	23%	21%	19%	18%	0%	0%	0%
WACC, %	12.43	13.06	13.59	13.61	11.71	11.91	12.06	12.17	12.26	13.62	13.62	13.62

Source: company's data; Estimation: Veles Capital

Calculation of free cash flows, mn USD

	2005	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)
NOPAT	46	45	56	66	59	53	46	43	45	47	48
Depreciation and amortisation	9	10	11	11	14	15	15	15	15	15	15
Gross operating cash flow	55	55	67	77	73	67	61	59	60	62	64
CapEx	(24)	(7)	(17)	(29)	(20)	(20)	(15)	(15)	(15)	(15)	(15)
Change in working capital	(52)	(43)	1	0	11	11	11	11	0	0	0
FCFF	(21)	6	51	49	63	58	57	54	45	47	48
Discount rate, %				11.71	11.91	12.06	12.17	12.26	13.62	13.62	13.62
Discount coefficient				1.00	0.89	0.80	0.71	0.63	0.53	0.46	0.41
Discounted FCFF				49	56	46	40	34	24	22	20

Source: company's data; Estimation: Veles Capital

Estimation of shares fundamental price

Target growth rate, %	3
Cash flow amount, mn USD	242
Terminal value, mn USD	470
Discounted terminal value, mn USD	169
Company's cost, mn USD	411
Debt cost, mn USD	-216
Share capital cost, mn USD	627
Number of common shares, units	112,734,490
Number of preferred shares, units	37,578,123
Preferred to common shares discount, %	25
Common share's fundamental cost, USD	4.5
Preferred share's fundamental cost, USD	3.3
Underestimation (overestimation) of common shares, %	(6.75)
Underestimation (overestimation) of preferred shares, %	(1.05)

Source: company's data; Estimation: Veles Capital

Efficiency and financial state evaluation

Balance sheet structure analysis, %

	2004	2005	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)
Non-current assets	37	39	34	27	21	20	19	18	17	18	17	16
PPE	24	30	25	19	16	16	15	14	13	14	13	12
Intangible assets	0	0	0	0	0	0	0	0	0	0	0	0
Other non-current assets	13	9	8	7	5	4	4	4	4	4	4	3
Current assets	63	61	66	73	79	80	81	82	83	82	83	84
Inventories	32	22	17	13	9	7	6	5	4	4	4	4
Accounts receivable	18	21	17	16	10	8	7	6	5	5	5	4
Short-term financial investments	5	10	26	41	57	62	66	70	73	70	72	74
Cash and near cash	4	5	6	4	3	2	2	2	2	2	2	2
Other current assets	4	3	1	0	0	0	0	0	0	0	0	0
Total assets	100	100	100	100	100	100	100	100	100	100	100	100
Long-term debt	11	6	0	0	22	20	19	17	0	0	0	0
Short-term debt	2	0	0	0	0	0	0	0	16	0	0	0
Equity	67	72	80	82	66	69	71	73	75	90	91	92
Minority interest	0	0	0	0	0	0	0	0	0	0	0	0
Total equity and liabilities	100	100	100	100	100	100	100	100	100	100	100	100

Source: company's data; Estimation: Veles Capital

Financial state analysis

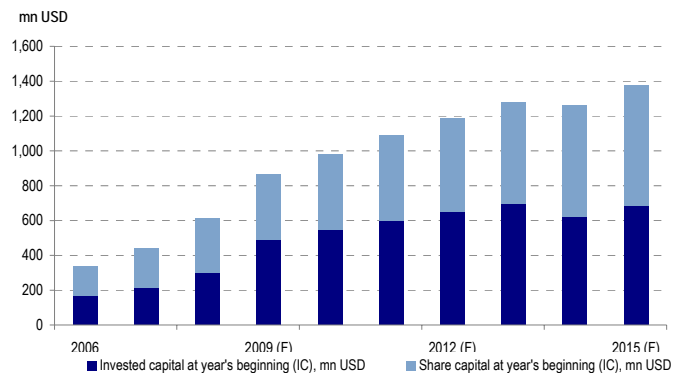
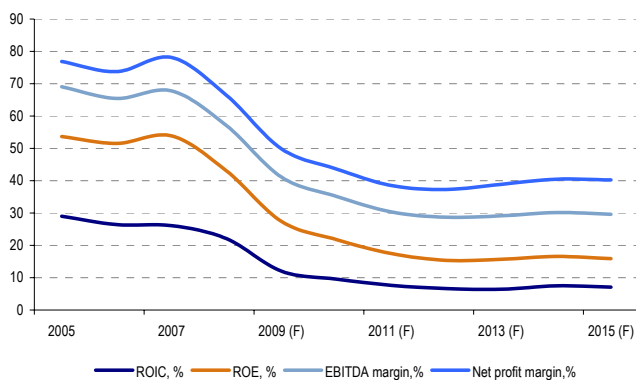
	2004	2005	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)
Leverage:												
Financial leverage	0.19	0.08	0.00	0.00	0.34	0.29	0.26	0.24	0.22	0.00	0.00	0.00
Financial leverage effect	1.05	1.04	1.02	1.00	1.07	1.16	1.19	1.22	1.23	1.10	1.00	1.00
Financial leverage characteristics:												
Interest-bearing debt / EBITDA	0.43	0.20	0.01	0.00	1.31	1.40	1.52	1.68	1.77	0.01	0.01	0.01
Interest-bearing SR debt / EAT	0.10	0.00	0.02	0.00	0.00	0.00	0.00	0.00	2.73	0.00	0.00	0.00
Interest-bearing debt / sales	0.07	0.03	0.00	0.00	0.18	0.19	0.20	0.22	0.24	0.00	0.00	0.00
Interest-bearing debt / assets	0.13	0.06	0.00	0.00	0.22	0.20	0.19	0.17	0.16	0.00	0.00	0.00
EBITDA / Interest payments	22.40	32.13	49.55	-	18.10	8.43	7.75	7.03	6.69	13.79	-	-
Company's liquidity:												
current ratio (>2)	2.99	2.88	3.53	4.25	6.91	7.70	8.43	9.17	3.36	8.77	9.65	10.58
quick ratio (>1)	1.04	1.23	1.21	1.12	1.14	1.04	0.94	0.84	0.25	0.74	0.74	0.75
absolute liquidity ratio (>0,2)	0.17	0.25	0.30	0.21	0.24	0.23	0.22	0.20	0.06	0.19	0.19	0.20
Turnover estimates of (days):												
accounts receivable	37	40	34	35	30	29	27	25	24	23	23	22
inventories	65	42	33	29	25	24	22	21	20	19	19	19
non-operating assets	126	116	133	163	234	274	317	368	431	375	404	435
net current assets	123	116	133	163	234	274	317	368	347	375	404	435

Source: company's data; Estimation: Veles Capital

Business efficiency analysis

	2005	2006	2007	2008 (F)	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)	2014 (F)	2015 (F)
Invested capital at year's beginning (IC), mn USD	159	171	214	298	489	548	602	651	699	625	683
Share capital at year's beginning (IC), mn USD	140	169	229	312	377	435	489	537	583	637	695
	15.94	12.84	12.49	10.38	0.11	-2.47	-4.54	-5.62	-7.18	-6.15	-6.53
EVA, mn USD	25	22	27	31	1	-14	-27	-37	-50	-38	-45
ROIC, %	29.0	26.4	26.1	22.1	12.0	9.6	7.6	6.6	6.4	7.5	7.1
ROIC/WACC	2.2	1.9	1.9	1.9	1.0	0.6	0.6	0.5	0.5	0.5	0.5
ROE, %	24.7	25.1	27.8	20.9	15.4	12.2	9.8	8.7	9.2	9.1	8.8
ROA, %	14.7	14.9	16.7	11.4	9.2	7.6	6.6	6.0	7.6	7.6	7.4
EBITDA margin, %	15.4	13.9	13.9	14.0	13.7	13.3	12.9	13.4	13.5	13.6	13.7
EBIT margin, %	13.4	11.9	12.1	12.4	11.6	11.0	10.3	10.5	10.7	10.9	11.1
Net profit margin, %	7.8	8.3	10.3	9.4	8.7	8.5	8.2	8.6	9.7	10.3	10.6

Source: company's data; Estimation: Veles Capital

Profitability dynamics, %
Business value dynamics, mn USD


Source: company's data; Estimation: Veles Capital

Comparable analysis

Sector companies' multipliers and coefficients

		Current capitalization, mln USD	Enterprise value, mln USD	Market multipliers						Financial coefficients				
				P/S	EV/S	EV/EBITDA	P/E	P/BV	EV/IC	ROE, %	ROA, %	ROIC, %	EBITDA margin, %	ROIC / WACC
Developed markets														
Cummins Inc	UNITED STATES	14,086	13,993	0.92	0.92	7.89	15.54	3.28	3.33	23.63	9.90	23.84	11.63	1.86
Briggs & Stratton Corp	UNITED STATES	743	1,101	0.34	0.50	11.01	28.63	0.86	0.90	7.60	0.01	-	4.51	-
Tognum AG	GERMANY	3,707	4,184	0.77	0.86	5.24	9.44	3.55	2.75	40.55	14.33	29.29	16.50	2.52
Developed markets weighted average		6,179	6,426	0.83	0.86	7.22	13.99	2.99	2.77	26.37	10.39	24.98	12.32	1.99
Developing markets														
Cummins India Ltd	INDIA	1,347	1,298	1.81	1.74	11.41	15.59	4.13	4.69	27.38	22.00	27.84	15.28	2.22
Kirloskar Oil Engines	INDIA	442	483	0.64	0.70	6.27	13.17	1.65	1.57	13.10	14.10	11.95	11.20	0.97
Greaves Cotton Ltd	INDIA	292	287	0.84	0.83	5.99	9.71	3.19	3.31	36.40	21.77	34.02	13.84	2.58
Hyunjin Materials Co Ltd	SOUTH KOREA	604	617	1.83	1.87	10.43	16.91	3.41	3.24	21.53	11.71	14.12	17.98	0.68
Developing markets weighted average		671	671	1.27	1.27	9.01	14.46	3.12	3.12	24.69	18.36	22.81	15.06	1.71
Russia														
Zavolzhsy Engine Plant		675	458	0.97	0.66	4.68	10.32	1.79	2.85	20.94	11.40	22.09	14.02	1.89
Ufimskiy Motors		466	471	0.00	0.86	-	0.00	-	-	18.72	6.94	14.29	25.53	1.97
Объединение машиностроительных предприятий Уфимского машиностроительного завода		63	-	0.00	-	-	0.00	-	-	6.81	4.40	-	8.57	-
Russia weighted average		675	458	0.97	0.75	4.68	10.32	1.79	2.85	19.34	9.30	18.90	18.19	1.92

Source: company's 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 unified 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

$$FCFE = \text{gross shareholders' cash flow} - \text{gross investments}$$

$$\text{Gross shareholders' cash flow} = EAT \text{ of operational profit (including interest payoffs) - annual debt coverage} + \text{attracted borrowed assets} + \text{amortization}$$
- 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 thee 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

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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 5% to 15%.

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.

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