

Research  
June 9, 2009

Machinery  
Russia

**ZMZ**

*Together with GAZ? – Not any more!*

Recommendation: **REDUCE**

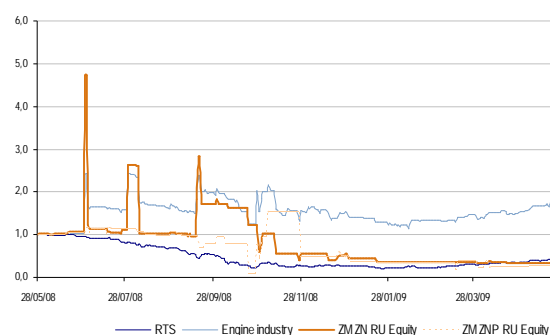
Analyst: Marina Irkly  
E-mail: [Mrkly@veles-capital.ru](mailto:Mrkly@veles-capital.ru)

## Bullet moments

- In 2008 ZMZ earned 553 mn USD, which is 10% lower than in 2007. Reduction of ZMZ' sales was related to the decrease of supplies to the main consumer of plant – GAZ group. At the same time the supplies in physical terms dropped 28%. However, due to upping of shipping engines to UAZ by 20% in physical terms, and due to price growth, the sales dynamics was graded.
- In 1Q 2009 the financial situation at ZMZ got even worse. Sales of ZMZ within the first 3 months lowered by 73% in ruble terms to 964 mn RUR. At the same time the expenses reduced by lower rates, which led to loss at the operating level. So, operating loss totaled 116 mn RUR versus profit of 439 mn RUR within the similar period of 2008.
- The main reason of financial estimates worsening was the radical change of distribution structure. We would like to remind that this year ZMZ did not manage to negotiate with GAZ on the prices for products, due to that GAZ refused from ZMZ' engines and transferred to LCV complication with UMZ' engines. In 2009 GAZ will buy just about 2 thousand engines from ZMZ within the frames of the state order versus 132 thousand, which were bought by the group last year. As a result, engines' sale might drop this year by 3.5 times to 57 thousand. At the same time the non-loss point of ZMZ is at the level of 60 thousand engines. So, within 2009 ZMZ will likely gain first loss.
- Along with that ZMZ has its own plans on further development, related to elaborating petroleum engine for Fiat Ducato, which is currently being kit up with diesel engines F1A1. However its production will begin in 2012 only and likely by 2015 it will enter the project capacity levels of 7.5 thousand engines annually. However the selling volumes of ZMZ without GAZ will still be more than twice lower than the estimates of the past years.
- Positive moment worth noticing is the level of debt load of ZMZ. In 2008 the financial leverage formed 0.21, this year it might reduce to 0.05. Credit portfolio of ZMZ as of early 2009 totaled 1.8 bn RUR (64 mn USD), ratio of debt/EBITDA was lower than 1. In 2009 the given estimate might raise to 1.28 considering the income, which nevertheless is a low level.
- We updated the evaluation of ZMZ considering the new data and prospects. As a result, we estimated the company at the level of 204 mn USD, which correlates with 1.451 USD per common share and 1.088 USD per preferred one. According to the current market quotes that means overestimation of the common shares by 10.7% and underestimation of the preferred ones by 17.6%. However, due to the worsened conditions of ZMZ' operating we lower the recommendation to REDUCE for the common and preferred share of the company.

## Principal estimates

Company's shares vs. the RTS index



### Company profile

	ZMZN / ZMZN P
RTS ticker	
Common share price, USD	1,625
Preferred share price, USD	0,925
Min/max com. share price in 52 weeks, USD	1,630 / 23,300
Min/max pref. share price in 52 weeks, USD	0,280 / 5,200
Fair value of the com. share by the year end, USD	1,451
Fair value of the pref. share by the year end, USD	1,088
Growth potential (com.), %	-10,73
Growth potential (pref.), %	17,62
Total number of com. shares, items	112 734 490
Total number of pref. shares, items	37 578 123
Market capitalization, mn USD	218
EV, mn USD	89

### Financial results (RAS)

	2008	2009 (F)	2010 (F)
Sales, mn USD	553	155	203
EBITDA, mn USD	65	9	15
Net profit, mn USD	44	-8	2
EBITDA margin, %	11,7	5,5	7,5
Net profit margin, %	8,0	neg.	1,2
NOPAT, mn USD	41	1	5
ROIC, %	13,6	0,2	1,8
ROE, %	14,1	-2,6	1,0

### Coefficients

	2008	2009 (F)	2010 (F)
P/E	5,0	neg.	90,1
P/S	0,4	1,4	1,1
P/BV	0,7	0,9	0,7
EV/EBITDA	1,4	10,3	5,8
EV/S	0,2	0,6	0,4
EV/IC	0,3	0,3	0,4
ROIC/WACC	0,8	0,0	0,1

Given analytic materials of Veles Capital can only be used in information purposes. The company does not guarantee completeness of given information and its reliability, as well as it is not responsible for any straight or consequential loss resulting from a non-purpose use. Given document cannot be considered as the reason for buying or selling either, one or another shares.

## Financial results of ZMZ for 2008

### Financial results of ZMZ for 2008

	2007		Change, %		2008	
	mn RUR	mn USD	RUR	USD	mn RUR	mn USD
Sales	15 727	616	-12,5	-10,1	13 756	553
Cost of sales	(12 290)	(481)	-11,2	-8,8	(10 915)	(439)
Amortisation	(277)	(11)	4,1	7,0	(289)	(12)
Gross Profit	3 437	135	-17,4	-15,1	2 840	114
<b>Gross profit margin, %</b>	<b>21,9</b>		<b>-1,2</b>		<b>20,6</b>	
Distribution expenses	(221)	(9)	6,8	9,7	(236)	(9)
Administrative expenses	(1 305)	(51)	-1,4	1,3	(1 287)	(52)
EBITDA	2 187	86	-26,6	-24,6	1 606	65
<b>EBITDA margin, %</b>	<b>13,9</b>		<b>-2,2</b>		<b>11,7</b>	
EBIT	1 910	75	-31,0	-29,2	1 317	53
<b>EBIT margin, %</b>	<b>12,1</b>		<b>-2,6</b>		<b>9,6</b>	
Financial income	244	10	56,2	60,5	381	15
Financial expenses	(1)	(0)	6 526,2	6 707,4	(55)	(2)
Other non-operating income / loss, net	33	1	-490,3	-501,0	(130)	(5)
EBT	2 186	86	-30,8	-28,9	1 514	61
<b>EBT margin, %</b>	<b>13,9</b>		<b>-2,9</b>		<b>11,0</b>	
Income tax	(555)	(22)	-36,5	-34,8	(352)	(14)
Deferred income tax	(6)	(0)	944,7	973,3	(67)	(3)
Net profit	1 625	64	-32,6	-30,8	1 094	44
<b>Net profit margin, %</b>	<b>10,3</b>		<b>-2,4</b>		<b>8,0</b>	
Net debt	(4 129)	(168)	-22,5	-35,3	(3 198)	(109)

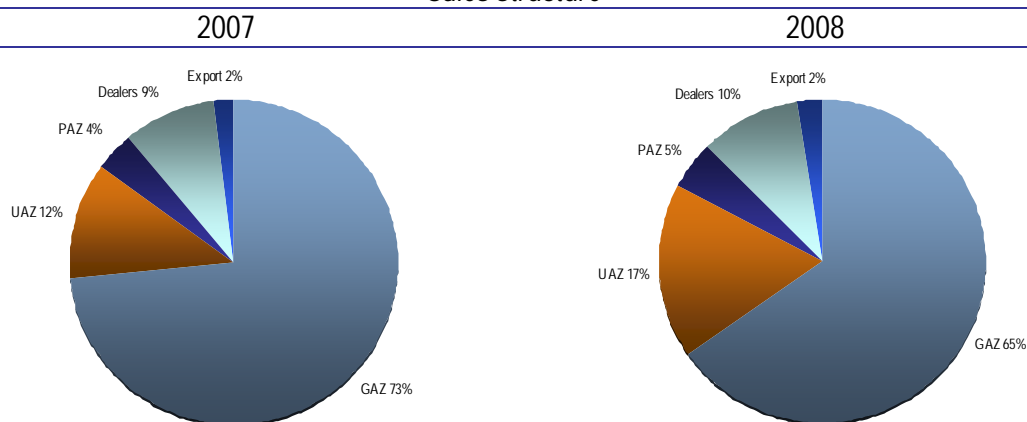
Source: company's data, Estimation: Veles Capital

### ZMZ sales structure in 2008, th units

	2007	Change, %	2008
GAZ	185	-28,65	132
UAZ	29	20,69	35
PAZ	10	0,00	10
Dealers	23	-13,04	20
Export	5	0,00	5
<b>Total</b>	<b>252</b>	<b>-19,84</b>	<b>202</b>

Source: company's data, Estimation: Veles Capital

### Sales structure



Source: company's data, Estimation: Veles Capital

## Financial results of ZMZ for 1Q 2009

	1Q 2008		Change, %		1Q 2009	
	mn RUR	mn USD	RUR	USD	mn RUR	mn USD
Sales	3 570	147	-73,0	-81,0	964	28
Cost of sales	(2 756)	(114)	-67,2	-76,9	(904)	(26)
Gross Profit	814	34	-92,6	-94,8	61	2
<b>Gross profit margin, %</b>	<b>22,8</b>		<b>-16,5</b>		<b>6,3</b>	
Distribution expences	(52)	(2)	-49,4	-64,3	(26)	(1)
Administrative expences	(324)	(13)	-53,4	-67,1	(151)	(4)
EBIT	439	18	n/m	n/m	(116)	(3)
<b>EBIT margin, %</b>	<b>12,3</b>		<b>n/m</b>		<b>neg.</b>	
Financial income	85	3	134,6	65,4	199	6
Financial expences	(0)	(0)	35 837,5	25 241,2	(81)	(2)
Other non-operating income / loss, net	(2)	(0)	775,1	517,0	(15)	(0)
EBT	522	22	n/m	n/m	(13)	(0)
<b>EBT margin, %</b>	<b>14,6</b>		<b>n/m</b>		<b>neg.</b>	
Income tax	(127)	(5)	n/m	n/m	0	0
Deffered income tax	(5)	(0)	n/m	n/m	0	0
Net profit	390	16	n/m	n/m	(12)	(0)
<b>Net profit margin, %</b>	<b>10,9</b>		<b>n/m</b>		<b>neg.</b>	
Net debt	n/d	n/d	-	-	(3 391)	(99)

Source: company's data, Estimation: Veles Capital

## Financial model of ZMZ

### Income statements, mn USD

	2005	2006	2007	2008	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)
Sales	433	512	616	553	155	203	224	243	274
Cost of services	(325)	(398)	(481)	(439)	(137)	(175)	(189)	(205)	(226)
Amortisation	(9)	(10)	(11)	(12)	(8)	(10)	(10)	(11)	(11)
Gross profit	107	114	135	114	18	28	35	38	48
<b>Gross profit margin, %</b>	<b>24,8</b>	<b>22,3</b>	<b>21,9</b>	<b>20,6</b>	<b>11,7</b>	<b>13,9</b>	<b>15,8</b>	<b>15,6</b>	<b>17,6</b>
Distribution expenses	(7)	(7)	(9)	(9)	(3)	(3)	(4)	(4)	(5)
Administrative expenses	(50)	(46)	(51)	(52)	(15)	(19)	(21)	(23)	(26)
Gain on disposal of PPE and IA	0	0	0	0	(0)	(0)	(0)	(0)	(0)
EBITDA	58	71	86	65	9	15	21	22	29
<b>EBITDA margin, %</b>	<b>13,5</b>	<b>13,9</b>	<b>13,9</b>	<b>11,7</b>	<b>5,5</b>	<b>7,5</b>	<b>9,3</b>	<b>9,1</b>	<b>10,5</b>
EBIT	49	61	75	53	1	6	10	11	18
<b>EBIT margin, %</b>	<b>11,4</b>	<b>11,9</b>	<b>12,1</b>	<b>9,6</b>	<b>0,6</b>	<b>2,8</b>	<b>4,7</b>	<b>4,5</b>	<b>6,5</b>
Finance income	1	4	10	15	0	0	0	0	0
Finance expenses	(2)	(1)	(0)	(2)	(11)	(3)	0	0	0
Other non-operating income (expenses), net	1	(5)	1	(5)	0	0	0	0	0
EBT	49	58	86	61	(10)	3	10	11	18
<b>EBT margin, %</b>	<b>11,3</b>	<b>11,4</b>	<b>13,9</b>	<b>11,0</b>	<b>neg.</b>	<b>1,5</b>	<b>4,7</b>	<b>4,5</b>	<b>6,5</b>
Income tax	(13)	(15)	(22)	(14)	2	(1)	(2)	(2)	(4)
Deferred income tax	(2)	(1)	(0)	(3)	0	0	0	0	0
Minority interest	0	0	0	0	0	0	0	0	0
Net profit	35	43	64	44	(8)	2	8	9	14
<b>Net profit margin, %</b>	<b>8,0</b>	<b>8,3</b>	<b>10,3</b>	<b>8,0</b>	<b>neg.</b>	<b>1,2</b>	<b>3,7</b>	<b>3,6</b>	<b>5,2</b>

Source: company's data; Estimation: Veles Capital

### Balance sheet, mn USD

	2005	2006	2007	2008	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)
Non-current assets	93	96	102	96	82	99	115	117	116
PPE	72	72	74	64	55	66	82	83	82
Intangible assets	0	0	0	0	0	0	0	0	0
Other non-current assets	22	23	28	32	27	33	33	34	34
Current assets	143	190	279	315	188	217	217	233	249
Inventories	51	47	49	48	16	21	23	25	28
Accounts receivable	49	49	59	93	31	41	45	48	55
Short-term financial investments	23	75	155	164	140	154	148	158	165
Cash and near cash	12	16	14	8	0	1	1	1	1
Other current assets	8	2	2	1	1	1	1	1	1
<b>Total assets</b>	<b>237</b>	<b>285</b>	<b>381</b>	<b>411</b>	<b>270</b>	<b>316</b>	<b>332</b>	<b>350</b>	<b>366</b>
Equity	169	229	312	298	242	295	308	325	337
Share capital	25	26	24	20	17	20	20	21	21
Reserves	0	1	1	1	1	1	1	1	1
Retained earnings	144	203	287	277	225	274	287	303	315
Long-term liabilities	17	3	3	4	1	2	2	2	2
Long-term debt	14	0	0	0	0	0	0	0	0
Other long-term liabilities	4	3	3	4	1	2	2	2	2
Short-term liabilities	50	54	66	109	26	20	22	23	26
Short-term debt	0	1	0	64	11	0	0	0	0
Accounts payable	0	0	0	39	13	17	19	20	23
Other short-term liabilities	50	53	66	7	2	3	3	3	4
<b>Total equity and liabilities</b>	<b>237</b>	<b>285</b>	<b>381</b>	<b>411</b>	<b>270</b>	<b>316</b>	<b>332</b>	<b>350</b>	<b>366</b>

Source: company's data; Estimation: Veles Capital

## Cash flow statement, mn USD

	2005	2006	2007	2008	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)
<b>Operating activities</b>									
Net profit	35	43	64	44	(8)	2	8	9	14
Depreciation and amortisation	9	10	11	12	8	10	10	11	11
Minority interest	0	0	0	0	0	0	0	0	0
Change in current assets	(130)	(88)	(195)	(59)	72	(5)	(5)	(4)	(10)
Change in short-term liabilities	78	45	167	(11)	(23)	2	2	1	3
Gain on disposal of PPE and IA	0	0	0	0	0	0	0	0	0
Other adjustments	36	58	(127)	0	0	0	0	0	0
Operational cash flow	28	68	(80)	(15)	49	9	15	17	19
<b>Investment activities</b>									
CapEx	(24)	(7)	(17)	(28)	(9)	(10)	(25)	(11)	(11)
Change in non-current assets	(27)	(4)	(3)	(11)	0	0	0	0	0
Change in short-term financial investments	30	2	(0)	(1)	(2)	15	9	(7)	(8)
Other adjustments	5	(45)	(63)	(29)	0	0	0	0	0
Investment cash flow	(17)	(54)	(84)	(68)	(10)	4	(16)	(17)	(19)
<b>Financial activities</b>									
Loans gained	26	1	0	175	11	0	0	0	0
Loans paid	(37)	(14)	(0)	(100)	(53)	(13)	0	0	0
Dividends paid	0	0	0	0	0	0	0	0	0
Other flows	5	1	0	2	(2)	0	0	0	0
Financial cash flow	(6)	(12)	(0)	77	(45)	(13)	0	0	0
Effect of exchange rates	(0)	2	150	(2)	(1)	0	0	0	(0)
Cash change	5	3	(164)	(7)	(7)	0	0	0	0
Cash assets by the beginning of reported period	7	23	28	14	8	0	1	1	1

Source: company's data; Estimation: Veles Capital

## Valuation of ZMZ

### Weighted average cost of capital calculation (WACC)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
<i>Risk-free yield:</i>									
$k_{rf}^{RUR}$ , %	7,41	7,41	7,41	7,41	7,41	7,41	7,41	7,41	7,41
<i>Required yield of shareholders:</i>									
Share premium, %	6,00	6,00	6,00	6,00	6,00	6,00	6,00	6,00	6,00
$\beta$ coefficient	0,78	0,78	0,78	0,78	0,78	0,78	0,78	0,78	0,78
Premium for quality of corporate management, %	5,40	5,40	5,40	5,40	5,40	5,40	5,40	5,40	5,40
$k_S$ , %	17,51	17,51	17,51	17,51	17,51	17,51	17,51	17,51	17,51
<i>Required yield of creditors:</i>									
Premium for credit risk, %	13,80	13,80	13,80	13,80	13,80	13,80	13,80	13,80	13,80
$k_D$ , %	21,21	21,21	21,21	21,21	21,21	21,21	21,21	21,21	21,21
<i>Capital structure:</i>									
Source fraction: own capital, %	92%	100%	100%	82%	96%	100%	100%	100%	100%
Source fraction: borrowed capital, %	8%	0%	0%	18%	4%	0%	0%	0%	0%
<b>WACC, %</b>	<b>17,37</b>	<b>17,50</b>	<b>17,51</b>	<b>17,29</b>	<b>17,48</b>	<b>17,51</b>	<b>17,51</b>	<b>17,51</b>	<b>17,51</b>

Source: company's data; Estimation: Veles Capital

### Calculation of free cash flows, mn USD

	2005	2006	2007	2008	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)
NOPAT	37	45	56	41	1	5	8	9	14
Depreciation and amortisation	9	10	11	12	8	10	10	11	11
Gross operating cash flow	45	55	67	52	8	14	19	20	25
CapEx	(24)	(7)	(17)	(28)	(9)	(10)	(25)	(11)	(11)
Change in working capital	(52)	(43)	(28)	(71)	49	(3)	(3)	(3)	(7)
<b>FCFF</b>	<b>(30)</b>	<b>6</b>	<b>22</b>	<b>(47)</b>	<b>49</b>	<b>1</b>	<b>(9)</b>	<b>6</b>	<b>8</b>
Discount rate, %					17,48	17,51	17,51	17,51	17,51
Discount coefficient					1,00	0,85	0,72	0,62	0,52
<b>Discounted FCFF</b>					<b>49</b>	<b>1</b>	<b>(7)</b>	<b>4</b>	<b>4</b>

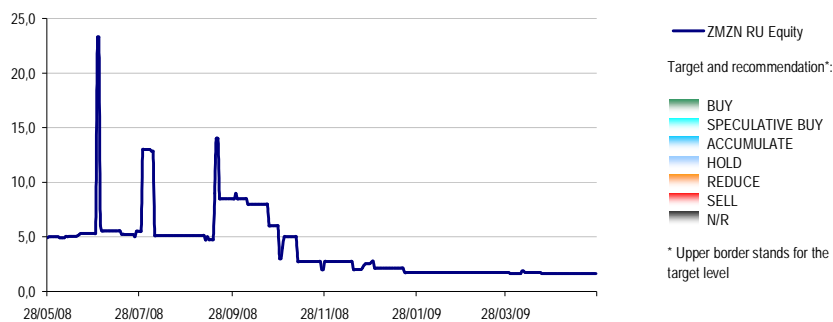
Source: company's data; Estimation: Veles Capital

### Estimation of shares fundamental price

Target growth rate, %	3
Cash flow amount, mn USD	50
Terminal value, mn USD	55
Discounted terminal value, mn USD	25
Company's cost, mn USD	75
Debt cost, mn USD	-129
Share capital cost with minority interest, mn USD	204
Minority interest, mn USD	0
Share capital cost, mn USD	204
Number of common shares, units	112 734 490
Number of preferred shares, units	37 578 123
Preferred to common shares discount, %	25
<b>Common share's fundamental cost, USD</b>	<b>1,451</b>
<b>Preferred share's fundamental cost, USD</b>	<b>1,088</b>
<b>Underestimation (overestimation) of common shares, %</b>	<b>(10,73)</b>
<b>Underestimation (overestimation) of preferred shares, %</b>	<b>17,62</b>

Source: company's data; Estimation: Veles Capital

### Recommendation history



## Financial analysis of ZMZ

### Business efficiency analysis

	2005	2006	2007	2008	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)
Invested capital at year's beginning (IC), mn USD	159	171	214	298	353	253	294	308	324
Share capital at year's beginning (IC), mn USD	140	169	229	312	298	242	295	308	325
EVA spread, %	5,55	8,93	8,60	-3,68	-17,29	-15,71	-14,65	-14,68	-13,13
EVA, mn USD	9	15	18	-11	-61	-40	-43	-45	-43
ROIC, %	22,9	26,4	26,1	13,6	0,2	1,8	2,9	2,8	4,4
ROE, %	24,7	25,1	27,8	14,1	-2,6	1,0	2,8	2,8	4,4
ROA, %	14,6	14,9	16,7	10,7	-2,9	0,8	2,5	2,5	3,9
EBITDA margin, %	13,5	13,9	13,9	11,7	5,5	7,5	9,3	9,1	10,5
EBIT margin, %	11,4	11,9	12,1	9,58	0,57	2,79	4,69	4,48	6,47
Net profit margin, %	8,0	8,3	10,3	7,96	neg.	1,19	3,75	3,58	5,18

Source: company's data; Estimation: Veles Capital

### Financial state analysis

	2005	2006	2007	2008	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)
<b>Leverage:</b>									
Financial leverage	0,08	0,00	0,00	0,21	0,05	0,00	0,00	0,00	0,00
Financial leverage effect	1,04	1,02	1,00	1,04	neg.	1,87	1,00	1,00	1,00
<b>Financial leverage characteristics:</b>									
Interest-bearing debt / EBITDA	0,24	0,01	0,00	0,99	1,28	0,00	0,00	0,00	0,00
Interest-bearing SR debt / EAT	0,00	0,02	0,00	1,45	neg.	0,00	0,00	0,00	0,00
Interest-bearing debt / sales	0,03	0,00	0,00	0,12	0,07	0,00	0,00	0,00	0,00
Interest-bearing debt / assets	0,06	0,00	0,00	0,15	0,04	0,00	0,00	0,00	0,00
EBITDA / Interest payments	27,58	49,55	2 654,57	29,41	0,80	5,80	-	-	-
<b>Company's liquidity:</b>									
current ratio (>2)	2,88	3,53	4,25	2,89	7,23	11,03	10,01	9,92	9,42
quick ratio (>1)	1,23	1,21	1,12	0,93	1,21	2,09	2,09	2,09	2,09
absolute liquidity ratio (>0,2)	0,25	0,30	0,21	0,08	0,02	0,03	0,03	0,03	0,03
<b>Turnover estimates of (days):</b>									
accounts receivable	41	34	35	61	72	72	72	72	72
inventories	43	33	29	31	37	37	37	37	37
non-operating assets	119	133	163	205	435	384	348	345	328
net current assets	119	133	163	163	410	384	348	345	328

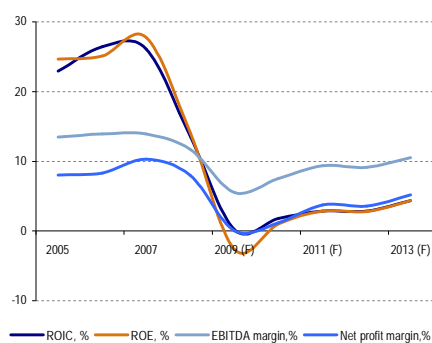
Source: company's data; Estimation: Veles Capital

### Balance sheet structure analysis

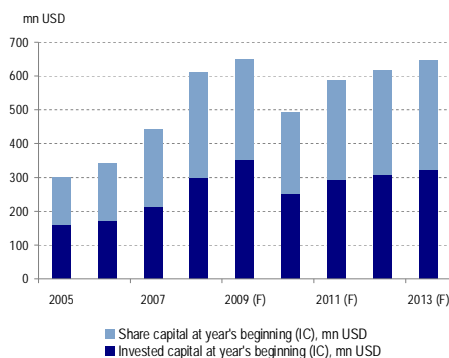
	2005	2006	2007	2008	2009 (F)	2010 (F)	2011 (F)	2012 (F)	2013 (F)
<b>Non-current assets</b>	39	34	27	23	30	31	35	34	32
PPE	30	25	19	16	20	21	25	24	22
Intangible assets	0	0	0	0	0	0	0	0	0
Other non-current assets	9	8	7	8	10	10	10	10	9
<b>Current assets</b>	61	66	73	77	70	69	65	66	68
Inventories	22	17	13	12	6	7	7	7	8
Accounts receivable	21	17	16	23	12	13	13	14	15
Short-term financial investments	10	26	41	40	52	49	45	45	45
Cash and near cash	5	6	4	2	0	0	0	0	0
Other current assets	3	1	0	0	0	0	0	0	0
<b>Total assets</b>	100	100	100	100	100	100	100	100	100
<b>Equity</b>	72	80	82	72	90	93	93	93	92
Minority interest	0	0	0	0	0	0	0	0	0
<b>Long-term debt</b>	6	0	0	0	0	0	0	0	0
Short-term debt	0	0	0	15	4	0	0	0	0
Accounts payable	0	0	0	9	5	5	6	6	6
<b>Total equity and liabilities</b>	100	100	100	100	100	100	100	100	100

Source: company's data; Estimation: Veles Capital

### Profitability dynamics, %



### Business value dynamics, mn USD



Source: company's data; Estimation: Veles Capital

## Comparables

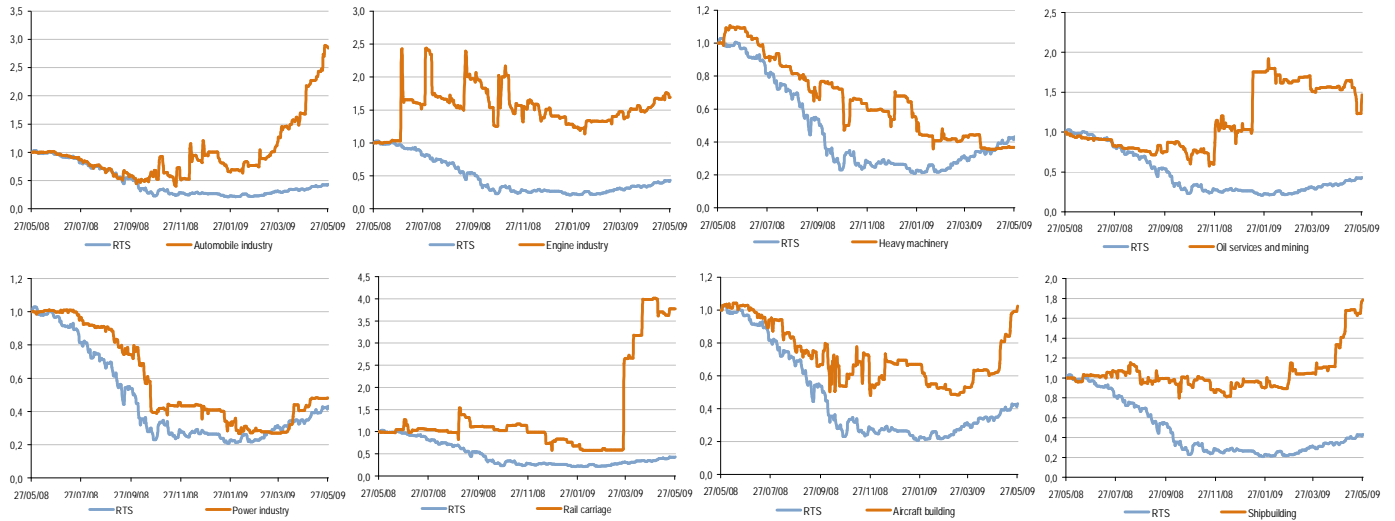
### Sector companies' multipliers and coefficients

	Country	Current capitalization, mln USD	Enterprise value, mln USD	Market multipliers					Financial coefficients							
				EV <sub>S</sub>	EV <sub>EBITDA</sub>	P/E	P <sub>1</sub> /BV	EV <sub>IC</sub>	ROE, %	ROA, %	ROIC, %	EBITDA margin, %	ROIC/WACC	Fin. leverage (ND/S)	Net Debt/ EBITDA	Net Debt/ Sales
<b>Developed markets</b>																
Lockheed Martin Corp	UNITED STATES	32 379	33 848	0,75	6,20	11,12	5,65	4,70	92,28	12,48	71,20	12,03	8,04	0,26	0,27	0,03
Cummins Inc	UNITED STATES	6 755	6 758	0,67	9,19	26,86	1,90	1,90	7,50	3,60	8,75	7,31	0,74	0,00	0,00	0,00
General Dynamics Corp	UNITED STATES	21 665	22 983	0,71	5,60	9,15	1,71	1,65	21,80	10,75	19,49	12,66	2,20	0,10	0,32	0,04
Northrop Grumman Corp	UNITED STATES	15 850	17 697	0,51	5,09	9,65	1,16	1,14	13,02	6,67	66,49	9,95	7,54	0,14	0,53	0,05
Raytheon Co	UNITED STATES	17 568	17 236	0,69	5,14	9,27	1,58	1,60	18,98	10,11	21,43	13,51	2,58	-	-	-
Rockwell Collins Inc	UNITED STATES	6 584	6 797	1,52	6,57	10,90	2,95	2,78	39,04	19,45	32,63	23,10	3,30	0,10	0,21	0,05
Spirit Aerosystems Holdings Inc	UNITED STATES	1 887	2 235	0,53	3,58	6,13	1,13	1,11	20,30	9,44	19,12	14,76	1,87	0,21	0,56	0,08
TransDigm Group Inc	UNITED STATES	1 768	2 812	3,72	7,84	11,15	2,02	1,46	19,12	15,28	11,16	47,38	1,61	1,19	2,91	1,38
Teledyne Technologies Inc	UNITED STATES	1 211	1 524	0,81	6,73	11,90	1,94	1,63	21,00	8,26	13,13	12,10	1,44	0,50	1,38	0,17
Esterline Technologies Corp	UNITED STATES	843	1 194	0,81	5,16	7,14	0,73	0,80	11,00	6,09	10,62	15,62	1,05	0,31	1,52	0,24
Rolls-Royce Group PLC	BRITAIN	9 619	8 212	0,54	4,54	9,64	2,05	2,50	21,25	5,26	50,79	11,80	4,27	-	-	-
Meggitt PLC	BRITAIN	1 645	3 116	1,65	5,93	7,64	0,77	0,86	11,11	6,87	10,05	27,82	1,16	0,69	2,80	0,78
BAE Systems PLC	BRITAIN	20 248	19 129	0,58	4,81	8,46	1,56	1,62	21,25	5,79	22,90	12,06	2,32	-	-	-
Kongsberg Gruppen AS	NORWAY	1 373	1 574	0,77	6,47	10,97	2,67	2,20	37,11	7,60	22,29	11,85	3,42	0,39	0,83	0,10
Saab AB	SWEDEN	975	1 350	0,44	3,88	12,64	0,78	0,83	6,53	3,40	7,38	11,43	1,63	0,30	1,08	0,12
MTU Aero Engines Holding AG	GERMANY	1 865	2 440	0,64	4,86	9,29	1,80	1,51	21,44	4,41	26,80	13,12	3,23	0,56	1,15	0,15
Finmeccanica SpA	ITALY	8 116	13 001	0,52	4,19	7,53	0,88	0,92	12,27	5,47	9,78	12,49	1,78	0,53	1,57	0,20
Thales SA	FRANCE	8 839	9 255	0,51	4,91	9,93	1,36	1,34	15,60	4,36	17,36	10,29	2,90	0,06	0,22	0,02
<b>Developed markets weighted average</b>		<b>8 669</b>	<b>8 958</b>	<b>0,65</b>	<b>5,35</b>	<b>9,81</b>	<b>1,69</b>	<b>1,65</b>	<b>33,05</b>	<b>8,73</b>	<b>35,50</b>	<b>12,90</b>	<b>3,99</b>	<b>0,22</b>	<b>0,52</b>	<b>0,09</b>
<b>Developing markets</b>																
Turbomecanica SA	ROMANIA	10	27	1,10	7,51	12,54	0,40	0,65	2,70	-	3,82	14,64	0,88	0,71	4,81	0,70
<b>Emerging markets weighted average</b>		<b>506</b>	<b>486</b>	<b>3,42</b>	<b>32,87</b>	<b>12,54</b>	<b>3,43</b>	<b>3,81</b>	<b>6,61</b>	<b>2,84</b>	<b>6,35</b>	<b>10,06</b>	<b>0,43</b>	<b>0,71</b>	<b>4,81</b>	<b>0,70</b>
<b>Russia</b>																
SP Korolev Rocket and Space Corp Energia	RUSSIA	169	1 103	0,29	2,34	0,79	0,19	0,61	31,72	10,51	17,52	12,45	8,40	1,08	1,98	0,25
Salurn Research & Production Co	RUSSIA	55	336	0,27	1,10	0,29	0,09	0,38	70,05	20,39	32,11	24,22	7,24	0,46	0,92	0,22
Zavolzhsky Engine Plant	RUSSIA	218	89	0,57	10,35	-	0,90	0,79	14,10	10,71	0,20	5,52	0,01	-	-	-
Kazan Helicopter Plant	RUSSIA	81	2 900	0,65	3,92	0,41	0,03	0,55	9,79	4,19	12,20	16,57	6,10	1,16	3,81	0,63
Ulan-Ude Aviation Plant	RUSSIA	128	138	0,11	0,36	0,58	0,21	0,23	76,65	32,26	54,30	30,39	10,50	0,02	0,02	0,01
Voronezh Aircraft Construction Co	RUSSIA	11	26	0,03	0,11	0,08	0,02	0,05	42,00	21,71	34,15	23,24	9,80	0,03	0,07	0,02
<b>Russia weighted average</b>		<b>99</b>	<b>642</b>	<b>0,39</b>	<b>2,15</b>	<b>0,46</b>	<b>0,13</b>	<b>0,50</b>	<b>20,35</b>	<b>10,53</b>	<b>0,54</b>	<b>9,78</b>	<b>0,03</b>	<b>0,05</b>	<b>0,08</b>	<b>0,02</b>

Source: company's data, Estimation: Veles Capital

## Sector coverage

Machinery sectors vs. RTS index dynamics



Source: RTS, Estimation: Veles Capital

Sector coverage

Stock	BLOOMBERG Ticker	Market capitalization, mln USD	Last price, USD	In a year, USD		Weak	3mth	Change, %	from last recom.	since 01.01.2009	Target price <sup>1</sup> , USD	Upside, %	Recommendation	Last revision
				min.	max.									
<b>Automobile industry</b>														
AvtoVAZ (ord.)	AVAZ RU Equity	923	0.67	0.17	1.68	66.25	232.50	-59.70	-33.00	166.00	-	-	N/R	22.05.09
AvtoVAZ (pref.)	AVAZP RU Equity	25	0.06	0.05	0.78	0.00	0.00	-90.00	0.00	-12.00	-	-	N/R	22.05.09
Sollers	SVAV RU Equity	257	7.50	2.43	65.10	10.29	141.94	-87.68	-77.78	15.38	94.90	1 165.33	BUY	18.09.08
GAZ (ord.)	GAZA RU Equity	352	19.00	4.50	197.25	26.67	237.78	-89.62	58.33	97.40	16.50	-13.16	HOLD	30.03.09
GAZ (pref.)	GAZAP RU Equity	15	10.00	3.25	117.00	11.11	150.00	-91.11	33.33	5.26	9.60	-4.00	HOLD	30.03.09
KAMAZ	KMAZ RU Equity	972	1.38	0.30	6.23	-8.33	189.47	-77.91	-65.19	71.88	5.98	334.91	BUY	28.08.08
NefAZ	NFAZ RU Equity	74	9.20	2.00	46.00	2.79	268.00	-80.00	-72.12	171.79	45.75	397.28	BUY	28.08.08
<b>Engine industry</b>														
RKK Energy	RKKE RU Equity	157	140.00	34.00	697.50	0.72	169.23	-79.93	-78.46	166.67	641.10	357.93	HOLD	06.06.08
Saturn	SATR RU Equity	51	0.01	0.01	0.09	-24.12	76.71	-85.39	-	6.61	0.14	98.89	HOLD	06.07.07
ZMZ (ord.)	ZMZN RU Equity	183	1.63	1.63	23.30	0.00	-7.14	-67.01	-	-24.42	1.45	-10.71	REDUCE	29.05.09
ZMZ (pref.)	ZMZNPR RU Equity	35	0.93	0.28	5.20	0.00	-19.57	-72.59	-	-22.92	1.09	17.62	REDUCE	29.05.09
<b>Heavy machinery</b>														
Kirovsky plant	KIRZ RU Equity	71	6.50	6.50	56.00	0.00	-45.83	-87.06	0.00	-71.11	33.30	412.31	REDUCE	31.10.07
<b>Oil services and mining</b>														
Angeromash	ANGE RU Equity	24	23.50	20.05	60.50	0.00	0.00	-61.16	-	17.21	79.65	238.94	BUY	13.04.07
Origennergaz	OENG RU Equity	26	4.30	3.05	14.10	0.00	14.67	-68.84	-62.05	-36.30	25.20	486.05	BUY	31.07.08
Electrogaz (ord.)	ELGZ RU Equity	14	233.00	20.05	850.00	-0.85	2.30	-66.95	-60.84	935.56	895.70	284.42	BUY	31.07.08
Electrogaz (pref.)	ELGZP RU Equity	3	152.50	101.50	350.00	0.00	-22.39	-20.80	-7.58	-22.39	671.80	340.52	BUY	31.07.08
Centrennergaz (ord.)	CEGZ RU Equity	91	1 000.00	600.00	5 250.00	66.67	0.00	-79.49	-78.49	-35.48	5 693.60	469.36	BUY	31.07.08
Centrennergaz (pref.)	CEGZP RU Equity	6	475.00	462.50	1 475.00	2.70	2.70	-67.24	-61.22	-5.00	4 270.20	798.99	BUY	31.07.08
Gazenergoservice	GZES RU Equity	14	40.05	13.51	162.50	2.56	146.46	-75.35	-67.83	196.56	137.00	242.07	ACCUMULATE	31.07.08
Alnaz	ALNZ RU Equity	19	0.09	0.09	1.00	-54.50	-71.56	-89.89	-88.97	-71.56	1.20	1 218.68	BUY	02.07.08
BENZ (ord.)	BUNZ RU Equity	8	28.50	27.50	52.00	0.00	3.64	-45.19	-45.19	-3.39	81.00	184.21	BUY	02.07.08
BENZ (pref.)	BUNZP RU Equity	0	23.50	23.50	41.00	0.00	0.00	-42.68	-42.68	-2.08	60.70	158.30	BUY	02.07.08
<b>Power industry</b>														
Power machines	SILM RU Equity	762	0.48	0.27	1.01	0.00	113.41	-58.69	0.00	20.69	0.14	65.26	BUY	22.05.09

<sup>1</sup> - calculations at the end of the year  
 Source: RTS, Estimation: Veles Capital

## Brief investor 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 <b>(Edwards-Bell-Ohlson method)</b>		

\*

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)		$SV = \sum_{i=1}^n \frac{FCFE_i}{(1+k_{sj})^i} + \frac{TV}{(1+k_{sj})^n} + Cash + NA$
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		$SV = BV_1 + \sum_{i=1}^n \frac{SVA_i}{(1+k_{sj})^i} + \frac{TV}{(1+k_{sj})^n} + Cash + NA$

### 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 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 2009.

### 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.

## Contacts

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

*Stanislav Fomenko*  
Metallurgy  
SFomenko@veles-capital.ru

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

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

*Marina Irkly*  
Transport, machinery  
Mirkly@veles-capital.ru

*Ilya Fedotov*  
Telecommunications  
IFedotov@veles-capital.ru

*Oleg Zotikov*  
Energy  
OZotikov@veles-capital.ru

## Sales and Trading Department

[sales@veles-capital.ru](mailto:sales@veles-capital.ru)

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

*Sergey Vetoshkin*  
Corporate Clients  
SVetoshkin@veles-capital.ru

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

## Strategic Investments Department

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

## Assets Management

[am@veles-capital.ru](mailto: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

Russia, Moscow, 123610, Krasnopresnenskaya nab. 12,  
Entr. 7, floor 18  
Tel.: 7 (495) 258 1988, Fax: 7 (495) 258 1989  
[www.veles-capital.ru](http://www.veles-capital.ru)

Ukraine, Kiev, 04070, Naberezhno-Kreschatitskaya,  
37/55  
Tel.: 38 (044) 459 0250  
Fax: 38 (044) 459 0251