

MOTOR SICH

February 11, 2008

Russia risk overplayed, we confirm Strong Buy

Highlights

- **Russia's helicopter engine production plan...** Motor Sich shares have lost 14% of their value in the past week after Russia announced plans to launch by 2015 domestic production of two types of helicopter engines. Motor Sich is currently the monopoly producer of the engines, BK-2500 and TV3-117, which power medium and heavy helicopters Mil and Kamov.
- **...poses no threat to Motor Sich's short- and mid-term outlook.** We believe there is more politics than economics in this announcement given Ukraine's recent moves towards NATO membership strongly opposed by Russia. The news does not imply any short-term risks for Motor Sich as the company recently confirmed it had filled its order book for 2008, with most of it pre-paid. Mid-term, we see no threat to Motor Sich's positions in Russia either since series production of helicopter engines requires up to 10 years to develop. As an alternative, the company could start supplying its engine assembly kits to Russia for final manufacture (a similar production scheme is employed for military jet engine AI 222-25, which is assembled by Russia's Salut plant). Still, as Motor Sich's participation in the engine assembly accounts for up to 95% of the product's total price, this does not imply any drastic revision for the company's mid-term operating and financial outlook.
- **The company has posted strong 2007 results...** Motor Sich has reported preliminary financial results for 2007, posting net revenues of \$346.5m (up 41% y-o-y and 4% above our forecast), EBITDA of \$78.1m (+97% and -9%, respectively) and net income of \$46.8m (+528% and +16%), implying EBITDA and net margins of 22.5% and 13.5%, respectively (up 6.3pp and 10.5pp y-o-y).
- **...supporting our recommendation.** We thus maintain our positive view on Motor Sich and reiterate our price target, which currently implies a Strong Buy.

Financial Summary

	2006 (\$m)	2007 (\$m)	Change (%, y-o-y)	2007E (\$m)	Change (%, 07/07E)	2008E (\$m)	Change (%, 08E/07)
Net Sales	245.1	346.5	41%	334.4	4%	465.6	34%
EBITDA	39.8	78.1	97%	86.1	(9%)	119.4	53%
EBIT	21.7	60.1	177%	68.1	(12%)	102.0	70%
NI	7.5	46.8	528%	40.3	16%	68.2	46%
Ratios							
EBITDA Margin	16.2%	22.5%	6.3 pp	22.5%	(3.2 pp)	25.6%	3.1 pp
EBIT Margin	8.8%	17.3%	8.5 pp	17.3%	(3.0 pp)	21.9%	4.6 pp
Net Margin	3.0%	13.5%	10.5 pp	13.5%	(1.5 pp)	14.6%	1.1 pp

Valuation Summary

Year	2006	2007	2008E	2009F	2010F
P/E	76.1	12.1	8.3	6.4	6.1
EV/EBITDA	15.4	7.3	4.2	3.1	2.5
EV/Sales	2.50	1.64	1.07	0.77	0.57
P/Book	2.06	1.59	1.25	1.05	0.90
DPS (\$)	0.3168	0.2946	0.3241	0.4217	0.464
Dividend Yield (%)	0.1%	0.1%	0.1%	0.2%	0.2%

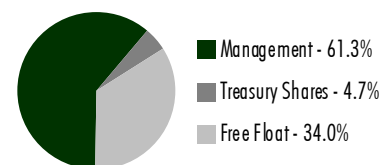
Price Target (\$)	402
Upside (%)	47%

Strong Buy

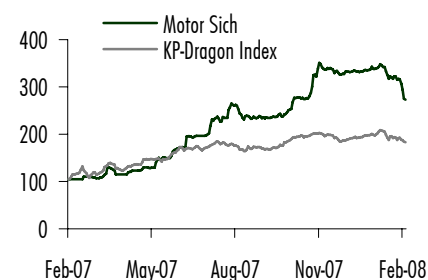
Company Data

Market Price (\$)	273
Market Cap (\$m)	567
Enterprise Value (07; \$m)	568
Free Float (%)	34.0%
Free Float (\$m)	193
Shares Outstanding	2,077,990
Nominal Value (UAH)	135
Bloomberg Code	MSICH UZ
DR Ratio	5:1
Number of Employees	23,028

Shareholder Structure



Price Performance (\$)



12-month Performance	161%
12-month Rel. Perform. (KP-Dragon)	49%
12-month Low/High	105-350
All-time Low/High	58-350
12-month PFTS Trading Volume (\$m)	126
12-month Relative Liquidity (% of SO)	28.4%

Comparative Valuation: Motor Sich vs. Russian and Developed Markets (DM) Peers

Company	Country	MC \$m	EV/Sales			EV/EBITDA			P/E		
			07E	08E	09F	07E	08E	09F	07E	08E	09F
Motor Sich	Ukraine	567	1.64	1.07	0.77	7.3	4.2	3.1	12.1	8.3	6.4
<i>Motor Sich Premium (Disc.) to Russian Peers</i>			<i>52%</i>	<i>2%</i>	<i>(9%)</i>	<i>22%</i>	<i>(24%)</i>	<i>(42%)</i>	<i>65%</i>	<i>12%</i>	<i>27%</i>
<i>Motor Sich Premium (Disc.) to DM Peers</i>			<i>122%</i>	<i>33%</i>	<i>14%</i>	<i>24%</i>	<i>(38%)</i>	<i>(42%)</i>	<i>(27%)</i>	<i>(41%)</i>	<i>(47%)</i>
Irkut	Russia	736	1.04	0.88	0.85	6.0	5.5	5.3	9.2	7.5	5.1
Kazan Helicopter Plant	Russia	250	1.28	1.11	0.90	9.6	9.1	6.2	28.6	16.2	8.7
Ulan-Ude Aviation	Russia	115	0.56	0.47	0.34	4.0	2.4	1.4	7.4	3.8	1.9
Ufimskiy Motors	Russia	426	1.08	1.05	0.83	3.5	3.6	2.8	7.0	7.1	4.4
Saturn Research & Prod	Russia	478	1.78	1.27	1.01	18.6	9.2	5.9	neg.	132.2	43.3
Russian Peers Median	-	426	1.08	1.05	0.85	6.0	5.5	5.3	8.3	7.5	5.1
Boeing	USA	63,563	0.94	0.93	0.79	7.9	7.7	6.5	15.7	14.1	11.9
Bombardier	Canada	8,574	0.69	0.55	0.41	8.3	6.4	4.3	41.1	15.0	10.6
Dassault Aviation	France	8,606	0.44	0.35	0.29	2.9	2.3	2.0	17.0	16.0	16.5
Safran	France	7,122	0.41	0.45	0.42	4.0	4.6	3.9	10.5	10.8	8.5
European Aeronautic Defense	Holland	21,233	0.27	0.25	0.24	5.9	2.3	2.4	52.2	9.5	9.5
General Dynamics	USA	34,338	1.26	1.10	0.97	na	8.4	7.2	16.5	14.7	13.2
Rolls-Royce	GB	17,566	na	0.96	0.86	na	7.0	6.4	na	13.6	12.6
Saab	Sweden	2,535	0.74	0.68	0.57	5.4	5.1	4.2	11.0	10.8	9.9
Textron	USA	14,272	1.21	1.04	0.93	na	7.5	6.5	15.6	14.2	12.3
United Technologies	USA	73,268	1.45	1.32	1.22	9.7	8.6	7.8	17.3	15.4	13.8
DM Peers Median		15,919	0.74	0.80	0.68	5.9	6.7	5.3	16.5	14.1	12.1

Note: *Prices as of February 8, 2008; Sources: Thomson, Bloomberg, Companies, Dragon Capital estimates

Financial Summary

Profit & Loss Statement (\$m)

Period	2004	2005	2006	2007E	2008E	2009F	2010F	2011F
Net Sales	203.6	212.8	245.1	346.5	465.6	558.6	627.4	705.7
Materials, Energy & Services	(98.5)	(94.1)	(111.9)	(168.0)	(234.9)	(290.7)	(339.1)	(394.8)
Personnel Costs	(58.9)	(62.7)	(73.2)	(89.2)	(96.3)	(110.7)	(123.0)	(137.3)
Other Operating Costs	(14.8)	(16.0)	(20.2)	(11.2)	(15.1)	(18.1)	(20.3)	(22.9)
EBITDA	31.4	40.0	39.8	78.1	119.4	139.0	145.0	150.7
Depreciation	(16.5)	(17.6)	(18.1)	(18.1)	(17.4)	(17.4)	(18.1)	(18.9)
EBIT	14.9	22.4	21.7	60.1	102.0	121.7	126.9	131.8
Net Financial Income (Loss)	(1.3)	(5.1)	(8.7)	(5.1)	(4.0)	(2.8)	(2.5)	(2.4)
Other Non-operating Income (Loss)	(0.5)	(0.6)	0.9	(0.4)	(0.6)	(1.0)	(1.2)	(1.4)
NIBT	13.1	16.8	13.9	54.5	97.4	117.8	123.1	127.9
Taxes	(3.1)	(7.1)	(6.4)	(7.7)	(29.2)	(29.5)	(30.8)	(32.0)
Net Income (Loss)	10.0	9.6	7.5	46.8	68.2	88.4	92.3	95.9

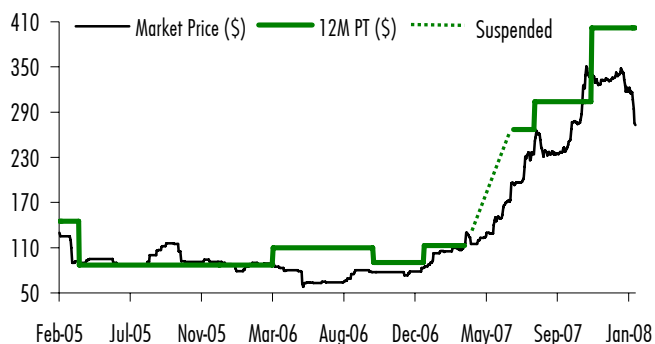
Balance Sheet* (\$m)

Period	2004	2005	2006	2007E	2008E	2009F	2010F	2011F
Total Assets	362.7	407.4	449.0	549.4	655.6	764.0	866.5	976.2
Non-Current Assets	186.4	204.0	207.2	218.4	225.0	233.5	243.3	254.5
PPE	121.7	139.3	142.1	147.1	152.3	159.3	167.6	177.2
Financial Investments	36.8	38.5	37.0	41.9	41.9	41.9	41.9	41.9
Investments in Progress	27.7	25.4	26.5	27.8	29.2	30.7	32.2	33.8
Intangibles & LT Investments	0.3	0.8	1.5	1.5	1.5	1.5	1.5	1.5
Current Assets	176.3	203.4	241.8	331.0	430.6	530.5	623.2	721.7
Inventories	125.9	140.1	164.3	203.7	240.6	268.8	284.7	300.9
Accounts Receivable	33.8	45.8	55.6	73.8	86.5	96.1	102.8	111.7
Cash & Cash Equivalents	12.3	14.6	19.3	50.4	100.5	162.6	232.8	306.1
Total Liabilities & Equity	362.7	407.4	449.0	549.4	655.6	764.0	866.5	976.2
Total Liabilities	116.5	139.4	173.0	192.0	202.3	223.0	233.9	248.6
Accounts Payable	69.8	71.1	96.1	126.4	157.2	180.9	194.6	209.2
S/T Debt	38.5	56.1	63.8	51.0	30.6	27.5	24.8	24.8
L/T Debt	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Liabilities	8.1	12.2	13.1	14.6	14.6	14.6	14.6	14.6
Equity	246.2	268.0	276.0	357.3	453.2	540.9	632.5	727.7

Financial Ratios

Period	2004	2005	2006	2007E	2008E	2009F	2010F	2011F
Sales Growth(y-o-y)	(6%)	5%	15%	41%	34%	20%	12%	12%
EBITDA Growth(y-o-y)	(27%)	27%	(1%)	96%	53%	16%	4%	4%
Net Income Growth(y-o-y)	(55%)	(4%)	(23%)	528%	46%	30%	4%	4%
EBITDA Margin	15.4%	18.8%	16.2%	22.5%	25.6%	24.9%	23.1%	21.4%
Net Margin	4.9%	4.5%	3.0%	13.5%	14.6%	15.8%	14.7%	13.6%
Net Debt/Equity	11%	15%	16%	0%	(15%)	(25%)	(33%)	(39%)
ROE	4.2%	3.7%	2.7%	14.8%	16.8%	17.8%	15.7%	14.1%

Note: *assuming placement of remaining 4.7% of treasury stock at market price in 2008

HISTORICAL PRICE TARGETS**Motor Sich (MSICH)****DRAGON CAPITAL STOCK RATINGS**

Dragon Capital employs three basic recommendations to rate stocks under coverage: Buy, Hold and Sell. The recommendations are assigned according to the table below.

12-m Upside from Current Market Price	Recommendation
>20%	Buy
0% - 20%	Hold
<0%	Sell

In addition, the Buy recommendation has two variations, Strong Buy and Speculative Buy. We rate a stock as a Strong Buy if its upside exceeds 40% and we see no material risks that could jeopardize our valuation. We assign a Speculative Buy recommendation to stocks whose valuation justifies a Buy or Strong Buy recommendation but is vulnerable to downside risks, particularly adverse corporate governance developments. Stocks that are either suspended from trading or do not have price target and recommendation assigned by Dragon analysts are designated as Not Rated.

We put a stock Under Review if its price target and/or recommendation are subject to change based on latest financial results, newly arisen risk factors, or other important events. We make all reasonable effort to reinstate recommendations and price targets on stocks under review in the shortest possible time. Finally, we suspend a traded company from coverage if Dragon Capital signs an investment banking mandate with the said company (for example, to place its shares on the market). Coverage is reinstated after the relevant investment banking transaction is closed.

Current Rating Distribution

Companies Covered	Recommendation					
	Buy*	Hold	Sell	Under Review	Not Rated	Suspended
117	37	18	37	13	11	1
% of Total	32%	15%	32%	11%	9%	1%

Note: *Stocks rated as Buy, Strong Buy and Speculative Buy

Dragon Capital

36D Saksahanskoho,
01 033 Kyiv, Ukraine
Tel.: (+380 44) 490 7120
Fax: (+380 44) 490 7121
www.dragon-capital.ua

Managing Director

Tomas Fiala
fiala@dragon-capital.com

SALES

Managing Director, Head of Trading and Domestic Sales

Dmytro Tarabakin
tarabakin@dragon-capital.com

Managing Director, Head of International Sales

Sandro Salsano
salsano@dragon-capital.com

Director, International Sales

Peter Bobrinsky
bobrinsky@dragon-capital.com

Director, Equity Sales

Andriy Dmytrenko, CFA
dmytrenko@dragon-capital.com

Director, Trading and Domestic Sales

Denis Matsuyev
matsuyev@dragon-capital.com

Senior Associate, International Sales

Fyodor Bagnenko
bagnenko@dragon-capital.com

RESEARCH

Head of Research

Andriy Bespyatov, PhD, CFA
bespyatov@dragon-capital.com

Economics

Vitaliy Vavryshchuk
vavryshchuk@dragon-capital.com

Politics

Viktor Luhovyk
luhovyk@dragon-capital.com

Banking, Insurance

Oleg Pronin
pronin@dragon-capital.com

Metals & Mining

Ivan Kharchuk
kharchuk@dragon-capital.com
Sergiy Gayda

gayda@dragon-capital.com

Chemicals, Food & Beverage Pulp & Paper, Retail

Tamara Levchenko
levchenko@dragon-capital.com

Machine-Building, Real Estate, Telecommunications

Taisiya Shepetko
shepetko@dragon-capital.com

Energy

Dennis Sakva
sakva@dragon-capital.com

Oil & Gas

Andriy Bespyatov
bespyatov@dragon-capital.com

Fixed Income

Andriy Bespyatov
bespyatov@dragon-capital.com
Olga Slyvynska
slyvynska@dragon-capital.com

Editing

Viktor Luhovyk
luhovyk@dragon-capital.com

Research Assistants

Volodymyr Skepsky
skepskiy@dragon-capital.com
Olga Slyvynska
slyvynska@dragon-capital.com

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