



CONCORDE CAPITAL

Ukraine / Aerospace

Motor Sich

Cool your jets and stay the course

February 8, 2008

Current price: USD 274
12M Target: USD 375

BUY

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Ticker

Bloomberg	MSICH UZ
GDR (Frankfurt/Xetra)	BC21 GR

Market information

No of shares, mln	2.07
DRs per common share	5:1
Market price, USD	274.0
MCap, USD mln	569.3
52 Wk H/L, USD	350.4/104.0
Free float	24.3%
Free float, USD mln	138.3

Corporate governance

Concorde Rating*	AA
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* The rating is based on Concorde capital's corporation governance survey. Q denotes quality corporate governance standards, AA – above average standards, A – average, BA – below average, P – for poor

Shareholders

Management	61.3%
Treasury stock	4.7%
Bartence Alliance	9.7%
Other	24.3%

The market overreacted to news that Russia was speeding up the start of domestic helicopter engine production - MSICH shed 15% over the last two weeks. In reality, this commotion only confirms that it is not a snap to start rolling out engine production for Russia. We estimate it will be no earlier than five years before the planned capacities begin eating into Motor Sich's market share, a process accounted for in our operating model since May 2007. We stick to our long-term forecasts on the company and our target of USD 375.

Dissecting the hullabaloo...

Back in 2005, the Russian Ministry of Industry & Energy, backed by several Russian aircraft producers, resolved to launch serial production of the Ukrainian VK-2500 helicopter engine. On January 22, 2008 Minister Viktor Khristenko noted the absence of progress in regards to the 2005 initiative, and ordered "prompt actions be taken" to launch production of the VK-2500 and TV3-117 powerplants. The news would hardly have been noticed if not for the reaction of Motor Sich's CEO, Viacheslav Boguslayev, who said a week later that the news implied questions about further cooperation with Russia.

Our vision: Value of Motor Sich's business remains intact

Our target price has all along been derived with the assumption that the share of Motor Sich engines in Russian consumption would gradually fall from 90-95% to 30-50% by 2016. Russia will remain dependent on Motor Sich engines for at least the next five years.

Three years without progress on their 2005 program demonstrates that Russian companies are not well positioned to launch domestic serial engine production. We estimate it will take five years before these production capacities come onstream. Especially difficult is duplicating the production of gas generators, which account for more than 50% of value added in manufactured engines. They are designed by Motor Sich's partner, Ukrainian design bureau Progress. Motor Sich will remain the monopoly supplier of components for VK-2500 in the long-term.

The budget for the Russian project is USD 120 mln, while our estimation of the total cost of launching new production capacities is at least USD 500 mln (for reference, Motor Sich spent USD 37 mln in 2007 to replace an engine blade production facility alone).

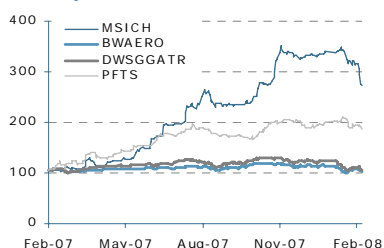
Last, but not least, Russia's dependence on Motor Sich engines to realize more than 50% of civil and cargo airplane projects (see the list in our May 2007 report) is a good reminder when dealing with helicopter issues.

Our conclusions from the case:

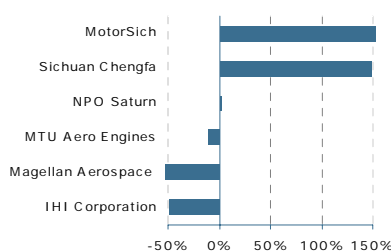
Russia seems to be trying hard to find arguments to make Boguslayev sell off a controlling stake in Motor Sich.

We confirm our long-term forecasts for the company.

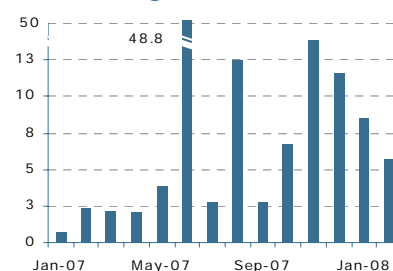
Stock performance, 12M



Sector Performance, 12M



PFTS Trading Volumes, USD mln



Note: June trading volume of USD 48.8 mln included the placement of an 11% stake. Source: PFTS, Bloomberg

Key financials, USD mln

	Sales	EBITDA margin	Net margin	EV/Sales	EV/EBITDA	P/E
2006	245	16%	3%	2.5	15.9	77.5
2007E	333	23%	12%	1.9	8.1	14.2
2008E	379	23%	13%	1.6	7.1	11.6

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Investment Ratings

The time horizon for target prices in Concorde Capital's research is 12 months unless otherwise stated. Concorde Capital employs three basic investment ratings: Buy, Hold and Sell. Typically, Buy recommendation is associated with an upside of 15% or more from the current market price; Sell is prompted by downside from the current market price (upside <0%); Hold recommendation is generally for limited upside within 15%. Though investment ratings are generally induced by the magnitude of upside, they are not derived on this basis alone. In certain cases, an analyst may have reasons to establish a recommendation where the associated range given above does not correspond. Temporary discrepancies between an investment rating and its upside at a specific point in time due to price movement and/or volatility will be permitted; Concorde Capital may revise an investment rating at its discretion. A recommendation and/or target price might be placed Under Review when impelled by corporate events, changes in finances or operations. Investors should base decisions to Buy, Hold or Sell a stock on the complete information regarding the analyst's views in the research report and on their individual investment objectives and circumstances.

Concorde Capital rating universe

Buy	40	38%
Hold	29	27%
Sell	13	12%
Under Review	24	23%
Total	106	100%

Investment banking clients*

Buy	7	78%
Hold	1	11%
Sell	0	0%
Under Review	1	11%
Total	9	100%

* Within the last twelve month period, Concorde Capital has obtained compensation from these companies for investment banking services.

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