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Analyst's Notebook

Ukraine/Machine Building
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****Editor's Note:** In order to keep our coverage of the Ukrainian market as up to date as possible Concorde Capital is launching a new product – Analyst's Notebook. Unlike our more in-depth desk notes and reports, Analyst's Notebook provides rapid feedback on breaking news in the Ukrainian market. Analyst's Notebook gives you our analysts' first impressions of a situation and may set the table for further investigation. Our analysts will use their experience in their sectors to take a look at the situation and provide insight or speculate on possible scenarios. We want to emphasize however, this product consists mostly of the analyst's intuition and may require further analysis.

Motor Sich Feels The Heat Of Ukraine-Russia Conflict

Bloomberg	MSICH UZ	Target	USD 115
Current Price	USD 75.3	Upside	53%
Current MCap	USD 156.5 mln	Free Float	2.5%
Number of shares	2.1 mln	Free Float MCap	USD 3.9 mln

Engines for Russian helicopters to be made in Russia: The CEO of the Klimov plant (one of the largest developers of aviation engines in Russia) announced that due to Ukraine's decision to join Nato, Motor Sich would no longer produce military helicopter engines for Russia. Serial production is to be conducted first at Klimov plant, and starting from 2009 – at the Chernyshov plant (Tushyno, Russia).

The news has not been confirmed by any high ranking Russian officials, but it looks likely that this will be the year Russia makes good on its long-standing threats to stop purchasing engines from MSICH, meaning an aircraft war may follow the gas, lighthouse, milk and meat battles.

The Klimov plant produces VK-2500 and TV3-117 helicopter engines, jointly designed by the plant and Motor Sich. Until this latest announcement serial production of these engines was done only by Motor Sich. The Klimov plant has made several attempts to launch serial output, all of which failed due to lack of financing. Now we believe they will be successful, firstly – due to the deepening political rift between Ukraine and Russia, and secondly – because Russia wants to take advantage of the opportunity to reap profits from exports of Klimov-designed engines.

The VK-2500 is a modernized version of the TV3-117. Both engines are used on Mi-8/Mi-17, Mi-24, Mi-28, Ka-27/Ka-28, Ka-32, Ka-50 helicopters. VK-2500 allows a 1 ths meter higher height floor – to 4.5 ths meters, providing unique operating efficiency at this height at temperatures of up to +45 Celsius. The engine's technical characteristics tend to draw interest from countries with mountainous regions and hot climates including China, India and some countries in South America.

MSICH risks losing up to 20% of its revenues: At first glance, it looks like Russia will rob MSICH of ~20% of its sales. In 9M05 Motor Sich exported TV3-117 and VK-2500 helicopters, and spare parts to Russia for USD 27.4 mln (19% the company's net revenues for this period). There is little which distinguishes a military helicopter from a civil helicopter, as nearly all of them can be used for both purposes. Therefore, we believe, Russian plants will produce as many engines for both civilian and military helicopters, as

their capacities and domestic and foreign demand will allow it. In the long-run this means, Russia will be able to elbow Motor Sich out of the Russian helicopter engine market.

BUT

Russia faces capacity constraint: Reportedly, the Klimov plant will not be able to satisfy demand for Russian helicopters. In 2004, when Klimov's production of helicopter engines was negligible, Motor Sich sold Russia 119 units (TV3-117 and VK-2500), in 2005, when the Klimov plant announced plans to produce 100 engines, estimated sales of Motor Sich's helicopter engines fell by 19% in unit terms, but still stayed high - at 96 engines. This makes us believe that even in the worst case, Motor Sich will deliver at least half the number of helicopter engines and spare parts it did in 2005 to Russia in 2006.

MSICH will compensate with new orders for plane engines: Even if MSICH loses all its helicopter engine orders, orders of D-436 engines for the An-148 airplane (serial production started in late 2005) can cover it. Ukraine's Antonov corporation plans to produce seven planes, and Russia's Voronezh plant intends to make six An-148 in 2006. These plans imply demand for 26 engines in total, with an estimated total cost of ~USD 36 mln – the same amount, by the most pessimistic estimates which MSICH's sales may decrease in 2006 (if the company delivers no helicopter engines to Russia in 2006).

Effect on share price: Being moderately optimistic, we expect MSICH's sales of USD 211 mln in 2005 (3% growth yoy) to rise to USD 235 in 2006 due to new orders for airplane engines, and under the assumption that half of helicopter segment will be lost.

We see no reason to alter our **BUY** recommendation or USD 115 target price.

	Sales			EBITDA Mgn		Net Mgn		MCap	P/S			EV/EBITDA		P/E	
	2004	2005	2006	2004	2005	2004	2005		2004	2005	2006	2004	2005	2004	2005
Motor Sich	204.3	211.0	235.0	15%	17%	5%	6%	156.5	0.8	0.7	0.7	5.4	5.5	15.6	13.1
Rolls-Royce Group PLC	11,402.3	11,256.7	12,103.2	11%	15%	3%	7%	13,133.7	1.2	1.2	1.1	10.9	8.1	33.5	16.3
United Technologies Corp.	36,700.0	45,754.5	48,246.6	15%	15%	8%	8%	59,845.8	1.6	1.3	1.2	12.1	9.5	21.5	16.8
Snecma	9,258.8	8,490.1	8,971.8	10%	13%	3%	5%	8,329.3	0.9	1.0	0.9	8.8	7.5	26.2	20.3
Mitsubishi Heavy Industries Limited	22,813.9	23,585.7	23,886.7	7%	6%	1%	1%	15,293.2	0.7	0.6	0.6	14.4	15.3	73.0	61.7
Honeywell International Inc	25,601.0	30,169.7	31,901.1	10%	13%	5%	7%	31,864.7	1.2	1.1	1.0	13.8	8.9	24.9	15.3
Sequa Corp.	1,864.1	n/a	n/a	9%	n/a	1%	n/a	891.8	0.5	n/a	n/a	8.9	n/a	84.1	n/a
Mean				10%	12%	3%	6%		1.01	1.03	0.98	11.48	9.84	43.86	17.17
Median				10%	13%	3%	7%		1.03	1.06	1.00	11.47	8.89	29.86	16.54
Prem/discnt to mean									-0.24	-0.28	-0.32	-0.53	-0.44	-0.64	-0.23
Prem/discnt to median									-0.25	-0.30	-0.33	-0.53	-0.38	-0.48	-0.21
Implied Target Price at mean									99.6	104.8	110.7	167.35	171.5	211.1	98.4
Implied Target Price at median									100.8	107.2	113.0	167.33	154.9	143.7	94.7
Upside by mean									32%	39%	47%	122%	128%	180%	31%
Upside by median									34%	42%	50%	122%	106%	91%	26%

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