

13 September 2011

Motor Sich

Lowering target price to USD 544; maintain BUY

- We lower our aggregate revenue projection for Motor Sich by 6.5% to USD 10.8 bln in 2011-20F based on improved order visibility.
- We expect the EBITDA margin to remain flat y-o-y in 2011 at 35.0%, supported by 1H11 financials. However, due to increased competition, we downgrade our EBITDA margin forecast in 2012-20F by 2 pp each year to 28%-33%.
- We raise the company's cost of equity from 15.0% to 16.5% in 2011-20F due to the rise in the yield of Ukraine's Eurobond maturing in 2020 to 7.5%.
- Our new DCF-based target price is USD 544 per share (from USD 680), which implies 125% upside, and we retain a BUY rating.
- The stock has steep upsides to prices implied by aircraft engine manufacturer peers: 154% on 2011E EV/EBITDA and 5.2x on 2011E P/E.

Peer multiples

	EV/EBITDA			P/E		
	10	11E	12F	10	11E	12F
Motor Sich	2.35	2.17	2.03	3.20	2.08	1.94
Aircraft engine peers						
IHI Corporation	5.09	5.21	4.55	9.30	9.15	8.45
Magellan Aerospace Corporation	3.05	2.86	2.68	2.56	2.39	1.92
Sichuan Chengfa Aero-Science & Tech.	29.84	34.75	31.23	84.98	54.45	44.27
MTU Aero Engines Holding	6.25	5.50	4.73	16.85	12.96	10.91
SIA Engineering Company	21.46	19.83	18.57	17.19	14.72	13.82
Median	6.25	5.50	4.73	16.85	12.96	10.91

Source: Bloomberg, UX, Concorde Capital

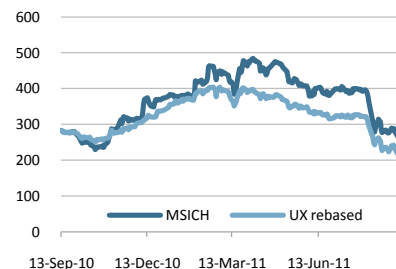
Vitaly Gorovoy

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Bloomberg	MSICH UK
Reuters	MSICH=UA
Recommendation	BUY
Price (12 Sept 11), USD	242
12M price target, USD	544
Upside	125%
No of shares, mln	1.98
ADR/GDRs per ord share	0.2:0.1
Market Cap, USD mln	503
52-week performance	-14%
ADT, 12M, USD mln	1.75
Free float, %	26
Free float, USD mln	131

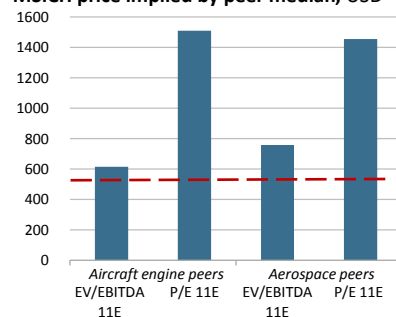
Prices as of Sept. 12, 2011

Price performance vs. UX



Source: Bloomberg, UX

MSICH price implied by peer median, USD


 Note: Red dashed line indicates our new target price
Source: Bloomberg, Concorde Capital

Order visibility leads us to revise sales forecasts

Date	News	Affected engines	Comment & Forecast revisions
June 29	United Engine-Making Corporation (Russia) announced plans to double the capacity of its subsidiary Klimov to 450 helicopter engines p.a. In June Vnesheconombank opened a USD 180 mln credit line to fund the project.	TV3-117, VK-2500	<i>We expect the plans to evolve slowly and eventually contribute about 50% of engines required for the Russian military by 2020. We cut our forecast of TV3-117 engine sales from USD 4.7 bln to USD 4.1 bln in 2011-20F.</i>
July 15	Motor Sich CEO Vyacheslav Boguslayev said at a press conference he expected only 4-5 An-148/158 aircraft to be built in 2011, vs. the previously expected 10.	D-436	<i>Due to Russia's active promotion of the rival Sukhoi Superjet 100 in recent months, we decrease our expectations of sales of engines for An-148/158 from USD 2.3 bln to USD 1.9 bln in 2011-20F.</i>
July 18	Boguslayev announced a contract to supply 250 AI-222 engines to China over the next three years.	AI-222	<i>We estimate this contract at USD 170 mln, in line with expectations. Unofficially, management told us China could try to produce substitute engines in the mid-term. Russia has also made attempts to obtain the rights to some Motor Sich engines. We conservatively cut our projections of AI-222-25F sales from USD 361 mln to USD 273 mln in 2011-20F.</i>
July 22	Boguslayev in interviews said he believed An-124 Ruslan serial production would be delayed from 2014 to 2016. According to him, Russia plans to buy 20 An-124s in 2016-20.	D-18	<i>We increase our estimation of D-18T engine sales from USD 1.6 bln to USD 2.4 bln in 2012-20F based on the volume of the Russian order.</i>
July 25	Boguslayev said Russia's military 2020 defense plans provides to buy dozens of An-70s in 2011-20.	D-27	<i>We raise expected sales of D-27 engines by 2.2x to USD 433 mln in 2012-20F.</i>

Source: Interfax, Wings, Vedomosti, Company data, Concorde Capital estimates

Valuation

DCF model output, USD mln

	2011E	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
PBT	242	259	248	221	245	299	320	317	328	326
Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Income	242	259	248	221	245	299	320	317	328	326
+ D&A	25	29	26	26	27	34	35	37	37	36
- Change in the OWC	(220)	(160)	(113)	(83)	(79)	(103)	(77)	(50)	(25)	15
- CapEx	(68)	(56)	(28)	(24)	(32)	(50)	(32)	(26)	(31)	(44)
FCFF	0	73	134	139	161	179	246	277	309	332
WACC	16.0%	15.8%	16.2%	16.1%	15.8%	15.5%	15.6%	15.6%	15.5%	15.5%
Sum of DCF's	669									
Discounted Terminal Value	529									
Perpetuity Growth Rate	2%									
Equity Value	1,198									
Net Debt	(120)									
Fair value of EV	1,078									

Source: Concorde Capital

Sensitivity Analysis (implied share price, USD)

	Perpetuity Growth Rate					WACC	Exit Multiple (EBITDA)				
	1.0%	1.5%	2.0%	2.5%	3.0%		4.1x	5.1x	6.1x	7.1x	8.1x
WACC						WACC					
-2.0%	657	673	690	709	730	-2.0%	531	583	635	687	739
-1.0%	585	597	611	626	642	-1.0%	492	540	588	636	683
0.0%	523	534	544	556	569	0.0%	457	500	544	588	632
+1.0%	471	479	488	497	507	+1.0%	424	464	504	545	585
+2.0%	425	432	439	446	454	+2.0%	394	431	468	505	542

Source: Concorde Capital

WACC calculation

	2011E	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
Debt/Equity eop	0.21	0.19	0.16	0.14	0.14	0.15	0.15	0.16	0.16	0.15
Average Interest Rate	13.7%	12.1%	14.2%	13.0%	10.4%	9.0%	9.8%	10.0%	9.0%	9.0%
Ukr Eurobonds 2020 YTM	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
Equity premium	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%
Comp.-specif. Prem/Disc	3%	3%	3%	3%	3%	3%	3%	3%	3%	3%
Cost of Equity	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%	16.5%
WACC	16.0%	15.8%	16.2%	16.1%	15.8%	15.5%	15.6%	15.6%	15.5%	15.5%
WACC to Perpetuity	15.5%									

Source: Concorde Capital

Peer multiples

	EV/S			EV/EBITDA			P/E		
	10	11E	12F	10	11E	12F	10	11E	12F
Motor Sich	0.82	0.76	0.67	2.35	2.17	2.03	3.20	2.08	1.94
Aircraft engine peers									
IHI Corporation	0.46	0.39	0.36	5.09	5.21	4.55	9.30	9.15	8.45
Magellan Aerospace Corporation	0.37	0.35	0.34	3.05	2.86	2.68	2.56	2.39	1.92
Sichuan Chengfa Aero-Science & Technology	3.98	3.28	2.92	29.84	34.75	31.23	84.98	54.45	44.27
MTU Aero Engines Holding	0.92	0.80	0.70	6.25	5.50	4.73	16.85	12.96	10.91
SIA Engineering Company	3.46	3.00	2.78	21.46	19.83	18.57	17.19	14.72	13.82
Median	0.92	0.80	0.70	6.25	5.50	4.73	16.85	12.96	10.91
Motor Sich price implied by peer median	272	254	254	645	614	565	1,275	1,508	1,363
Upside (Downside)	12%	5%	5%	166%	154%	133%	427%	523%	463%
Aerospace peers									
Boeing Company	0.75	0.75	0.64	7.19	7.55	6.17	13.98	14.67	11.64
Lockheed Martin	0.58	0.56	0.54	5.14	5.61	4.87	8.29	9.42	8.40
Cobham	1.22	1.20	1.14	6.64	5.53	5.19	13.05	10.96	10.00
EADS	0.23	0.18	0.17	4.25	2.79	2.08	31.19	24.54	11.94
Finmeccanica	0.35	0.32	0.32	3.28	3.28	3.07	5.34	4.23	6.28
Meggitt	2.69	2.22	1.85	8.63	7.47	6.19	17.28	12.57	9.86
Safran	0.98	0.96	0.84	7.06	7.07	5.74	52.07	14.58	11.39
Dassault Aviation	1.91	1.33	1.21	11.36	7.18	6.71	27.00	18.71	18.76
Textron	0.88	0.66	0.53	8.59	6.51	4.62	49.63	12.19	7.76
Zodiac Aerospace	1.57	1.34	1.19	11.33	8.19	7.36	19.57	12.43	11.63
Median	0.93	0.86	0.74	7.13	6.79	5.46	18.43	12.50	10.70
Motor Sich price implied by peer median	275	273	267	735	758	652	1,395	1,455	1,336
Upside (Downside)	14%	13%	10%	203%	213%	169%	476%	501%	452%

Source: Bloomberg, Concorde Capital

Financial statements

Income statement summary, USD mln

	2009	2010	2011E	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
Net Revenues	480	630	798	930	879	862	944	1,155	1,236	1,316	1,356	1,339
Change, y-o-y	23.7%	31.4%	26.5%	16.6%	-5.5%	-1.9%	9.5%	22.4%	7.0%	6.4%	3.1%	-1.3%
Cost Of Sales	(259)	(316)	(431)	(502)	(475)	(466)	(510)	(624)	(668)	(711)	(732)	(723)
Gross Profit	221	314	367	428	404	397	434	531	569	605	624	616
Other Operating Income/Costs. net	5	(11)	7	(12)	11	2	4	(13)	(8)	(30)	(19)	2
SG&A	(68)	(83)	(95)	(109)	(125)	(140)	(155)	(172)	(190)	(207)	(225)	(243)
EBITDA	157	220	279	307	290	259	283	347	371	369	380	375
EBITDA Margin. %	32.7%	34.9%	35.0%	33.0%	33.0%	30.0%	30.0%	30.0%	30.0%	28.0%	28.0%	28.0%
Depreciation	(15)	(20)	(25)	(29)	(26)	(26)	(27)	(34)	(35)	(37)	(37)	(36)
EBIT	142	200	254	278	264	233	256	313	336	332	343	339
EBIT Margin. %	29.5%	31.8%	31.9%	29.9%	30.0%	27.0%	27.1%	27.1%	27.2%	25.2%	25.3%	25.3%
Interest Expense	(11)	(9)	(17)	(24)	(20)	(16)	(15)	(20)	(22)	(21)	(22)	(19)
Financial Income	(0)	2	7	8	8	7	7	9	10	10	10	10
Other Income/(expense)	(3)	0	(3)	(3)	(3)	(2)	(3)	(3)	(4)	(4)	(4)	(4)
PBT	128	193	242	259	248	221	245	299	320	317	328	326
Tax	(33)	(36)	0	0	0	0	0	0	0	0	0	0
Effective Tax Rate	26%	19%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Income	95	157	242	259	248	221	245	299	320	317	328	326
Net Margin. %	19.8%	25.0%	30.3%	27.9%	28.2%	25.6%	26.0%	25.8%	25.9%	24.0%	24.2%	24.3%

Source: Company data, Concorde Capital

Balance sheet summary, USD mln

	2009	2010	2011E	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
Current Assets	352	535	799	1,010	1,103	1,180	1,290	1,475	1,583	1,664	1,704	1,683
Cash & Equivalents	23	56	40	47	44	43	48	58	62	66	68	67
Trade Receivables	18	41	46	54	51	50	55	67	72	77	79	78
Inventories	199	282	388	452	427	419	459	561	601	640	659	651
Other Current Assets	113	156	324	457	580	667	729	788	848	881	897	886
Fixed Assets	175	238	307	362	390	414	447	497	529	555	586	630
PP&E, Net	115	150	215	267	291	310	338	384	411	432	458	497
Other Fixed Assets	60	88	91	95	99	104	108	113	118	123	128	133
Total Assets	527	773	1,105	1,372	1,493	1,594	1,737	1,972	2,112	2,218	2,290	2,313
Shareholders' Equity	319	477	671	865	1,014	1,125	1,223	1,342	1,438	1,502	1,551	1,583
Share Capital	56	56	56	56	56	56	56	56	56	56	56	56
Reserves and Other	263	421	615	809	958	1,068	1,167	1,286	1,382	1,445	1,494	1,527
Current Liabilities	179	262	392	458	433	424	464	568	608	648	667	659
ST Interest Bearing Debt	67	55	126	146	138	136	149	182	195	207	214	211
Trade Payables	12	8	20	23	22	22	24	29	31	33	34	33
Accrued Wages	5	5	6	7	7	7	7	9	9	10	10	10
Accrued Taxes	6	11	9	10	10	10	10	13	14	15	15	15
Other Current Liabilities	88	183	232	271	256	251	275	336	360	383	395	390
LT Liabilities	29	33	42	49	46	45	50	61	65	69	72	71
LT Interest Bearing Debt	14	14	17	20	19	19	20	25	27	28	29	29
Other LT	15	20	25	29	27	27	29	36	38	41	42	42
Total Liabilities & Equity	527	773	1,105	1,372	1,493	1,594	1,737	1,972	2,112	2,218	2,290	2,313

Source: Company data, Concorde Capital

UAH/USD exchange rates

	2009	2010	2011E	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
Average	7.90	7.94	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00
Year-end	7.99	7.96	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00	8.00

Source: NBU, Concorde Capital

Key risks

- Dependence on demand from Russian helicopter producers (70% of production in 2010). United Engine-Making Corporation (Russia) announced plans to double the capacity of its subsidiary Klimov to 450 helicopter engines p.a. Vnesheconombank opened a USD 180 mln credit line to fund the project. We expect the plans to evolve slowly and contribute about 50% of engines required for the Russian military by 2020: *High Risk*
- Russia's Omsk Engine Union might start producing the AI-222-25 engine, which is currently made exclusively by Motor Sich. In our DCF model, we assume revenues from AI-222-25 engines sales of USD 360 mln in 2011-20E (~6% of total aircraft engine sales): *Medium Risk*
- Competition from rival Sukhoi Superjet 100. Motor Sich's CEO Vyacheslav Boguslayev said at a July 15 press conference he expected only 4-5 An-148/158 aircraft to be built in 2011, vs. the previously expected 10. We project sales of USD 2.3 bln from An-148/158 engines in 2011-20E: *Medium Risk*

Appendices

Analyst certification

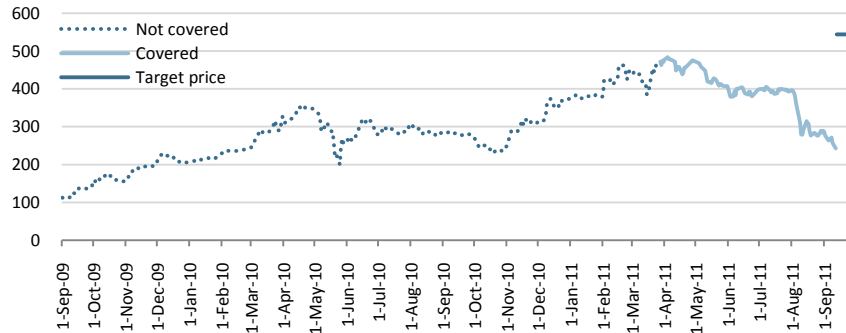
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Motor Sich target price history

Date	12M target price, USD	Market price, USD	Rating	Action
13-Sept-11	544	242	BUY	Maintain

Source: Concorde Capital

Motor Sich: Target Price vs. Share Performance, USD per share



Covered by Vitaly Gorovoy since April 2011

Source: UX, Concorde Capital

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.

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