



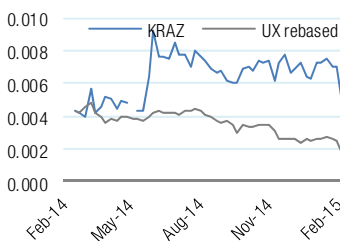
February 12, 2015

Analyst:
Eugene Petrusha

Market data

Bloomberg ticker	KRAZ UK
Share price	USD 0.004 (UAH 0.111)
Target price	USD 0.017 (UAH 0.431)
Market cap, \$ mn	10.1
Net debt, \$ mn	129.0
EV, \$ mn	139.1

KRAZ stock price, \$



Source: Bloomberg

Shareholder structure

Finance & Credit group	87%
Free float (estimated)	13%

Source: ESCP estimates

Key financials, USD mn

	2013	2014e	2015f
Revenue	90	146	152
EBITDA	13	43	61
Net income	2	17	35
Net debt	246	129	62

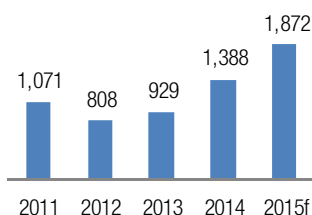
Source: Company data, ESCP estimates

Multiples

	2013	2014e	2015f
EV/EBITDA	11.1	3.2	2.2
EV/S	1.5	0.9	0.9
P/B	0.10	0.16	0.13
P/E	4.2	0.6	0.3

Source: Company data, ESCP estimates

Production volumes in 2010-2014, units



Source: Company data, ESCP estimates

KRAZ: Full Throttle

JSC “AutoKRAZ” is the only Ukrainian producer of heavy trucks. The company produces 34 basic models and more than 300 modifications, including dump trucks, platform trucks, chassis, timber lorries, road tractors, as well as specialized utility vehicles and military-purpose vehicles. KRAZ is well-placed to benefit from the increased demand on military trucks and special-purpose vehicles from the Ukrainian Army in the next couple of years. Moreover, the company also has a promising JV with a Canadian armored vehicles manufacturer Streit Group, which resulted in new models “Shrek One”, “Cougar” and “Spartan” presented to the international public. The company has already increased its production by 50% in 2014, and we forecast it to grow by at least 35% in 2015. Furthermore, KRAZ currently trades at a 58-65% discount to the emerging market peers and global peers based on 2014e EV/EBITDA multiples, and at 94-95% discount based on 2014e P/E multiples due to its low market capitalization. Thus, we issue a BUY recommendation for the company’s shares with a target price of USD 0.017 (UAH 0.431), which corresponds to an upside of 288%.

- ▶ **Ukrainian military orders to boost revenues in the next couple of years.** In 2014, the company produced 1,388 vehicles, up by 50% y/y, and sold 1,428 vehicles, with 50% of total sales going to the domestic market. Ukraine’s National Guard placed one of the biggest orders with the company (UAH 361 mn or USD 23 mn), and we expect another order for 500+ vehicles from the Ukrainian Ministry of Defense this year. **We estimate that the company will produce at least 1,800 vehicles in 2015, which is still lower than 4,000+ produced in 2007.**
- ▶ **New JV with Streit Group a major upside for the company in future.** Recently the company presented a new multi-purpose armored vehicle “Shrek One”, produced in cooperation with Streit Group. In our view, it could attract the attention of international organizations such as the UN Peacekeeping Force. In April 2014, 10 special KrAZ armored vehicles were delivered to Dakar (Senegal).
- ▶ **Export sales margins will improve due to the UAH devaluation.** Aside from the military segment, last year’s confirmed orders included shipments to Azerbaijan, Turkmenistan, Egypt, Cuba, Kazakhstan, Senegal, Russia and the EU. Thus, due to the fact that the company supplies a majority of its trucks abroad (86% in 2013, and more than 50% in 2014), its export prices are fixed in hard currencies, while a large portion of production costs is linked to the UAH.
- ▶ **High level of debt to put a strain on the company’s bottom line.** As of 31.12.2013, KRAZ had UAH 1.5 bn of long-term and short-term debt, and another UAH 530 mn in bank penalties on overdue loans. We believe that this level of debt is manageable, considering the increased amount of orders and future prospects of the company. Moreover, according to the information we have most of the debt is UAH-denominated, so it should go down significantly in USD terms due to the devaluation of UAH. Still, it will significantly decrease net income as a result of high finance costs.
- ▶ **Relative valuation suggests an upside of 288%, or a target price of USD 0.017** based on EV/EBITDA and P/E multiples of global peers in developed countries and emerging markets, and our estimates of the company’s EBITDA and net income in 2014-15.



Production line

Dump trucks

The company produces 8 models and 19 modification of dump trucks used for transporting loose materials on hard-surface roads including cobblestone and macadam pavement, as well as earth roads.

KRAZ-65055 dump truck



KRAZ-6510 dump truck



Chassis

The company produces 12 models and 20 modification of chassis designed to be fitted with industrial body equipment for use on hard-surface roads including cobblestone and macadam pavement, as well as earth roads.

KRAZ-63221 chassis



KRAZ H23.2M chassis with MAN cabin



Platform trucks

The company produces 7 models of platform trucks designed for carrying various loads and personnel as well as for towing transport, special trailers and airplanes on the airfields on all kinds of roads and off-road.

KRAZ B6.2MEX platform truck



KRAZ 65053 platform truck





Production line (continued)

Road tractors

The company produces 3 models and 5 modification of fifth-wheel tractors designed for towing semitrailers and heavy-duty trailers on public roads.

KRAZ-64431 fifth-wheel tractor



KRAZ-6442 fifth-wheel tractor



Specialized vehicles

The company produces 65 models of specialized vehicles for utility works (snow plows, water dispersers, garbage trucks), construction industry (cranes, concrete mixers, diggers), and agriculture (road train for grain transportation).

KRAZ-5401K2 vacuum cleaner vehicle



KRAZ-6511C4 "Caravan" road train



Military-purpose vehicles

The company produces 28 military-purpose vehicles, ranging from military trucks to armored vehicles and ambulance trucks. KRAZ also produces two military vehicles designed for operation under enemy fire ("Cougar" and "Spartan"), as well as one mine resistant ambush protected vehicle ("KRAZ Shrek One"), designed in cooperation with the Canadian armor vehicles manufacturer Streit Group.

KRAZ "Shrek One" truck



KRAZ "Cougar"



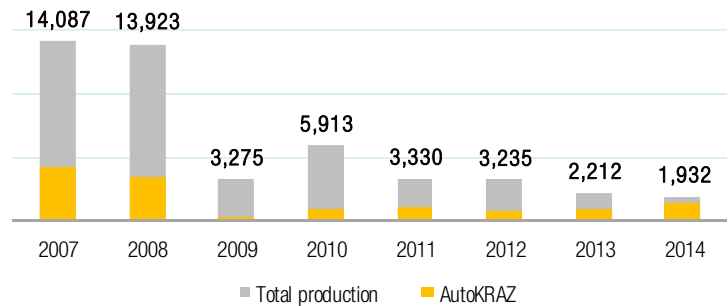


Market overview

Ukrainian market

The Ukrainian market of commercial vehicles (CVs) is stagnating. The Zaporozhye automobile building plant (ZAZ) contracted production of CVs by 58% y/y to 317 units in 2014, along with Bogdan Motors, which decreased its CVs production by 57% y/y to 122 units for the same period. The only producer that showed an increase was JSC "AutoKRAZ": the company's production in 2014 amounted to 1,388 vehicles, up 49% y/y, which can be explained by the high share of exports of the company and additional demand from the Ukrainian Military Forces.

Production of commercial vehicles in Ukraine, units



Source: Company data, UkrAutoProm

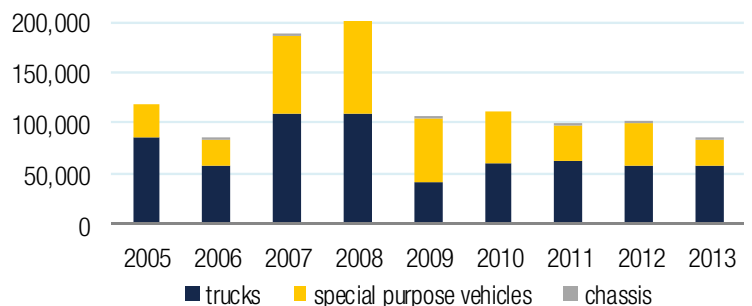
Imports

In spring of 2014 the Russian trucks producer Kamaz has stopped importing its products in Ukraine due to the devaluation of local currency which resulted in a higher relative price of the company's products for the end consumer. The same reason caused a 60% y/y drop in the overall volume of commercial vehicle imports in Ukraine in 9M2014. In our view, this presents a perfect opportunity for AutoKRAZ to expand its domestic sales and win over a higher market share.

Exports

In 9M2014 the Ukrainian producers exported USD 46 mn of commercial vehicles, up 29% y/y. Most of the sales were attributed to Africa (50%), with another 37% exported to CIS countries, and 10% to Turkey. Moreover, the Ukrainian exports of specialized vehicles accounted for another USD 18 mn in 9M2014, down 3% y/y, while export of chassis amounted to USD 3.2 mn for the same period (up 22% y/y). We believe that the majority of these exports could be attributed to AutoKRAZ.

Dynamics of Ukrainian exports of commercial vehicles, USD ths.



Source: UN Comtrade

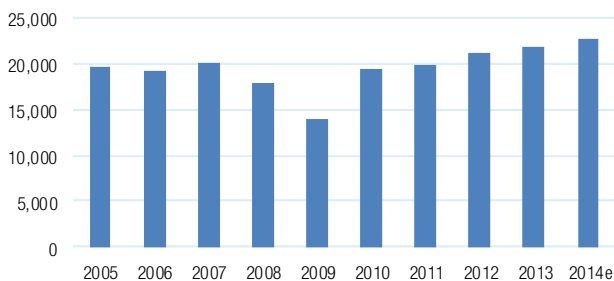


Market overview

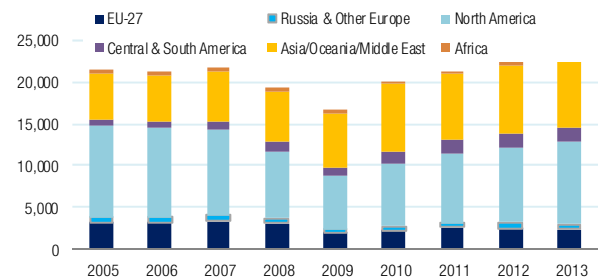
International market

The world production of commercial vehicles was rising steadily for the past 5 years (CAGR: 4%), with an estimated production in 2014 of 22.6 mn units (+3.4%). The top-3 producers in 2013 were USA (31%), China (18%) and Japan (7%). In terms of sales, there is a clear upwards trend in China (+6.5% in 2013) and the US (+10%), while European sales were sluggish (-0.5%). The sales of commercial vehicles in Russia were down by 8% in 2013-1H2014, and should continue their decline in 2015 as the devaluation of the ruble eroded the purchasing power of consumers.

World production of commercial vehicles, ths



Commercial vehicle sales, ths units



The global advisory firm AlixPartners projects that the commercial vehicles industry will grow with a CAGR of 5.4% through 2016, mostly due to the high growth in emerging markets, particularly BRICS countries. Thus, we believe that the best strategy for KRAZ would be to expand sales through existing channels (Africa, Middle East, CIS), while simultaneously entering into new markets (Latin America, EU) as a cost-effective producer.

It is worth mentioning that KRAZ already has a developing JV project in Bolivia to assemble high-tonnage trucks locally. Thus, the company may build upon this base to expand its presence in the Latin America. As for the EU market, the company is currently increasing its supplies of specialized utility vehicles (snow plows, garbage trucks, road cleaners), which are equipped with Katmerciler rigging (Turkey).



Risk analysis

Operational risks

We view the operational risks as low as the company's production facilities are located in the Kremenchuk city (Poltava oblast), more than 350 km away from the conflict area. In our view, the Ukrainian military forces have enough resources to repel the attacks of the pro-Russian rebels and prevent their advancements deeper into the Ukrainian territory, which is confirmed by the fact that the terrorist-held area had barely increased during the last 6 months.

Financial risks

The company had a pretty high leverage level (2013 D/E ratio of 2.7x and Net debt/EBITDA higher than 20x as the company was barely breakeven in 2013). According to the information we have, AutoKRAZ had several loans with overdue payments, most notably to Oschadbank (UAH 500 mn), with the overall debt including fines and penalties reaching UAH 2 bn. However, most (if not all) of the debt was UAH-denominated, which means that the company stands to benefit from the devaluation as it receives export revenues. Moreover, with the increased profitability and production levels, we envision overall leverage going below 2.0x in 2015, which is quite sustainable.

As for the overdue loans, earlier in 2014 the company's CEO Roman Chernyak mentioned that the company managed to refinance three of its loans and is actively working with the banks to achieve a mutually beneficial solution. It should also be noted that Finance and Credit bank, which belongs to the sphere of influence of Mr. Zhevago (a major shareholder of AutoKRAZ) has been actively financing the company and we see no reasons for the bank to discontinue this practice.

Corporate governance risks

In our view, the company has rather high corporate governance risks due to the transfer pricing activity and financial transactions between different companies in the sphere of influence of Mr. Zhevago. As far as we can tell, this has resulted in rather strange activity with the financial instruments that is reflected on the company's balance sheet as "other current assets" and "other current liabilities", although the net position was below USD 25 mn (with the positive sign). This may have resulted in some additional costs incurred by the company, but at this point we cannot adequately measure the exact impact of such practices.

In future, however, we see corporate governance risks decreasing substantially, as the current government and the parliamentary coalition plans to improve the investors' rights protection, including some precautionary measures preventing the management from entering into agreements that may hurt the company financially. The legislative base on transfer pricing has already been improved in late 2014 to be closer to the OECD guidelines. Moreover, as Mr. Zhevago is currently a member of the parliament, there would be an increased attention of the media and the public to any wrongdoings from his side, which allows us to say that we do not expect any infringement of investors' rights.



Valuation

We base our valuation on market multiples of global peers in emerging markets and developed countries, that are involved in the production of trucks, specialized vehicles or armored vehicles. Currently KRAZ trades at a 79% discount to emerging markets peers and at a 89% discount to developed countries peers based on 2014e P/E multiples. The company trades at a 42% and a 38% discounts to its emerging markets and developed countries peers, respectively, based on 2014e EV/EBITDA multiples.

Key assumptions

As the company doesn't publish interim reports, we base our 2014 forecast on the operational results for 2014 (1,388 vehicles produced and 1428 sold), and the information we have on revenues (according to the statement of the company's CEO Roman Chernyak, AutoKRAZ received UAH 1,752 mn of revenue last year). We estimate that the company could further increase the production volume by at least 35% in 2015 on back of increasing order book.

We estimate EBITDA margin to be around 30% in 2014, up from 14% in 2013, due to the lower share of fixed costs as a result of the increased production volumes, and the positive effect of the Ukrainian currency devaluation on costs expressed in the USD terms. This results in an estimated 2014 EBITDA of USD 40 mn. Moreover, we estimate net income to be around USD 17 mn in 2014 based on the assumption of a 18% income tax and USD 19 mn of finance costs.

For 2015, we estimate that the company's sales will grow by 4% to USD 152 mn, as the UAH devaluation will partially erode some of the growth related to production volume increase. Nevertheless, we project that EBITDA will increase by USD 18 mn (+41%) to USD 61 mn. Net income in 2015 is forecasted to be USD 35 mn.

It should also be noted that to calculate the current enterprise value of KRAZ we use the net debt of the company as of 31.12.2013, adjusted for the change in the USD/UAH exchange rate, arriving at an estimate of USD 129 (conservatively using the official interbank rate of 15.77 as of end-2014). According to the information we have, most of the company's debt is UAH-denominated, which increases the potential upside for KRAZ as the UAH devaluation decreases the value of debt in USD terms.

Moreover, we apply a 50% discount to the target price implied by the market multiples due to a limited amount of information published by the company.

Results

Thus, using the 50/50 weights for the multiples of companies from emerging markets and developed countries, and applying a 50% company-specific discount, we arrive at a target price of USD 0.017 (UAH 0.431), or a 288% upside to the current price of USD 0.003 (UAH 0.111).



Multiples valuation

Company	Country	Current price, USD	Mcap , USD mn	EV USD mn	P/E		EV/EBITDA	
					2014e	2015f	2014e	2015f
KRAZ	Ukraine	0.004	10	139	0.6	0.3	3.2	2.3
Emerging markets								
KAMAZ	Russia	0.481	340	695	5.5	2.9	5.4	3.1
KATMERCILER ARAC	Turkey	1.545	39	101	12.5	11.8	-	-
CNHTC JINAN T-A	China	2.803	1,176	1,868	15.9	13.0	9.7	8.6
QINGLING MOTOR-H	China	0.335	415	-218	6.1	5.7	neg.	neg.
Emerging markets peers, median					9.3	8.7	7.6	5.8
Developed markets								
OSHKOSH CORP	USA	45.770	3,576	4,158	12.0	11.2	6.6	6.4
HINOPAK MOTOR	Japan	9.316	116	128	-	-	-	-
HINO MOTORS LTD	Japan	13.793	7,925	9,050	10.4	12.7	6.0	6.8
VOLVO AB-B	Sweden	11.108	17,943	32,613	18.4	12.4	12.0	8.8
CNH INDUSTRIAL N	Italy	7.780	10,544	34,975	12.8	16.0	11.4	12.7
ISUZU MOTORS	Japan	13.407	11,375	10,435	10.3	12.2	5.0	5.5
KYOKUTO KAIHATSU	Japan	10.709	458	418	12.0	10.7	4.6	4.7
SPARTAN MOTORS	USA	5.360	183	157	281.1	28.1	18.7	8.1
SUPREME INDS-A	USA	7.840	116	119	13.1	9.6	7.0	5.5
NAVISTAR INTL	USA	28.179	2,294	6,416	neg.	51.8	20.1	9.8
MAN SE	Germany	107.245	15,119	18,551	103.7	67.8	18.2	16.1
SINOTRUK HK LTD	Hong Kong	0.565	1,560	2,508	20.0	14.5	6.5	5.6
RABA PLC	Hungary	4.352	59	100	7.5	8.2	-	-
PACCAR INC	USA	63.155	22,363	28,951	16.5	14.5	12.8	11.2
Developed markets peers, median					12.9	12.7	9.2	7.5
KRAZ premium / (discount)								
to Emerging peers					(94%)	(97%)	(58%)	(61%)
to Developed peers					(95%)	(98%)	(65%)	(70%)
KRAZ upside					2014e	2015f	2014e	2015f
vs. Emerging peers, median					1,491%	2,883%	136%	156%
vs. Developed peers, median					2,102%	4,233%	187%	228%
KRAZ target price					2014e	2015f	2014e	2015f
Implied by Emerging peers multiples		50%			0.07	0.13	0.01	0.01
Implied by Developed peers multiples		50%			0.10	0.19	0.01	0.01
Target price, weighted					0.085	0.163	0.012	0.013
Weights					10%	10%	40%	40%
Implied price, USD				0.035				
Company-specific discount				-50%				
Target price, USD				0.017				
Current price, USD				0.004				
Upside				288%				



Balance sheet statement

USD mn	2009	2010	2011	2012	2013	2014e	2015f
Total assets	707	749	711	596	573	354	274
Non-current assets	197	268	260	282	295	153	104
Property, plants and equipment	56	51	46	41	38	20	19
Financial investments	131	207	205	233	249	130	82
Other NCA	10	10	9	8	8	4	3
Current assets	510	481	450	313	277	200	170
Accounts receivable	4	6	10	6	20	24	25
Inventories	42	37	33	43	40	51	43
Cash & equivalents	1	2	2	0	2	13	31
Prepayments and other CA	463	436	406	263	215	112	71
Total liabilities & equity	707	749	711	596	573	354	274
Equity	178	179	156	92	92	65	76
Long-term liabilities	89	92	99	95	99	52	33
Long-term debt	89	86	93	92	97	50	32
Other LT liabilities	0	6	6	3	3	1	1
Short-term liabilities	440	477	455	410	382	237	165
Short-term debt	86	87	86	87	84	56	40
Promissory notes	60	56	55	41	40	21	13
Accounts payable	66	83	85	87	98	77	60
Other ST liabilities	229	252	228	195	159	83	52
Total debt	175	173	223	235	248	142	93
Net debt	174	172	221	234	246	129	62
NCWC	384	341	308	184	136	89	65
Ratios							
Debt/Equity	0.98	0.97	1.43	2.56	2.70	2.18	1.24
Total debt/EBITDA	-49.51	19.06	37.47	-26.26	19.73	3.27	1.53
Net debt/EBITDA	-49.23	18.89	37.19	-26.24	19.56	2.96	1.02
Current ratio	1.16	1.01	0.99	0.76	0.73	0.85	1.03
Quick ratio	1.06	0.93	0.92	0.66	0.62	0.63	0.77
Asset turnover	0.08	0.10	0.12	0.13	0.16	0.41	0.56
NCWC turnover	0.15	0.22	0.28	0.42	0.66	1.64	2.33
Exchange rate							
UAH/USD rate, avg	5.23	8.07	7.95	7.99	8.15	11.98	24.00
UAH/USD rate, eop	7.97	7.96	7.97	8.00	8.20	15.77	25.00



P&L statement

USD mn	2009	2010	2011	2012	2013	2014e	2015f
Sales	57	75	85	77	90	146	152
COGS	-58	-61	-78	-77	-72	-93	-88
Gross profit	-1	14	7	0	17	53	64
SG&A	-11	-13	-10	-13	-10	-20	-14
Other operating income/expense	-1	1	3	1	1	7	8
Operating profit	-13	3	0	-12	9	40	58
EBITDA	-4	9	6	-9	13	43	61
D&A	9	6	6	4	4	4	3
EBIT	-13	3	0	-12	9	40	58
Interest expense, net	-45	-26	-23	-9	-19	-19	-16
EBT	-57	-23	-22	-22	-10	21	42
Other income/expenses, net	63	24	0	22	13	0	0
Income tax	0	0	0	1	0	-4	-8
Net income	6	1	-22	2	2	17	35
Margins							
Gross	-1%	19%	8%	-1%	19%	36%	42%
EBITDA	-6%	12%	7%	-12%	14%	30%	40%
Net	10%	1%	-26%	2%	3%	12%	23%
Ratios							
ROA	1%	0%	-3%	0%	0%	3%	6%
ROE	3%	1%	-14%	2%	3%	18%	28%
ROIC	2%	0%	-6%	1%	1%	5%	10%



EMPIRE STATE
CAPITAL PARTNERS

Important information and company profile

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