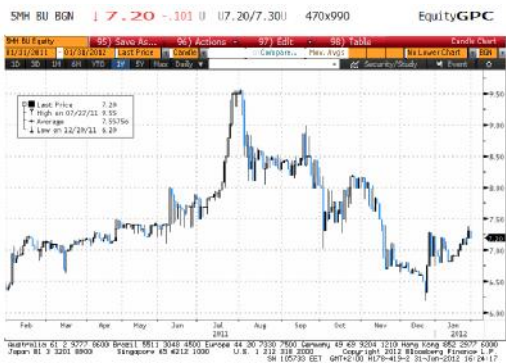


- The second half of the year showed more stable results of the Bulgarian producer of hydraulic elements M+S Hydraulic (5MH). The company posted growth on yearly basis, although it could not exceed the strong performance of the second quarter. M+S Hydraulic performed very well in light of the recent economic events in Europe and the slowdown of its main markets. Sales grew 46.2% in 2011 whereas the increase during the fourth quarter was a slight below a 40% year over year.
- M+S Hydraulic is a barometer for the export-oriented Bulgarian companies. Recently, the economic group that owns the largest stake in the company published a warning of a probable decrease of revenues due to declining demand. However, the recession in Europe had so far very mild effect on the revenues. The profit margin returned to the levels of the second half of 2010 due to the solid price pressure from materials and the increase of labor costs. We expect that EBIT margin will also remain near the average for the last two years. Moreover, the negative impact of the European slowdown should be noticed, which means that foreign markets are less susceptible of the debt crisis as compared to the expectations.
- Another positive sign is the decline of receivables during the fourth quarter. They remain above the 2010 level, which correspond to the rising revenues and are close to the nominal values of 2008. The company is not facing increased delays from its clients. The turnover ratios are improving in 2011.
- M+S Hydraulic is investing in new machines and equipment and part of its investment program is subsidized by EU funds. The company was approved to receive grant of BGN 2.46 million for its investment program during the first half of 2011.

Stock Price of M+S Hydraulic



- Shareholders' equity remained the primary source of funding for the company. It stood at 80% of total assets. Banks loans were 5% of assets and M+S Hydraulic is among the least indebted Bulgarian companies on the stock exchange.
- The stock was supported constantly by bids from small investors in 2011. However, the optimism in July, following the stronger than expected results for the second quarter, faded out due to the overall market weakness. The stock continued to trade at very low multiples, reflecting also the decrease of liquidity.

Multiples Valuation

*Table 1
Multiples
comparison*

| | 2009 | 2010 | 2011 |
|-----------------------|------------|------------|------------|
| Last Price | 5.36 | 7.10 | 7.20 |
| Number of Shares | 13 018 400 | 13 018 400 | 13 018 400 |
| Market Capitalization | 69 765 606 | 92 430 640 | 93 732 480 |
| Net Profit | 38 000 | 7 456 000 | 14 478 000 |
| P/E | 1835.94 | 12.40 | 6.47 |
| Equity | 37 653 000 | 43 862 000 | 55 308 000 |
| P/B | 1.85 | 2.11 | 1.69 |
| Sales | 38 093 000 | 62 819 000 | 91 851 000 |
| P/S | 1.83 | 1.47 | 1.02 |
| EV | 70 713 606 | 90 962 640 | 81 561 480 |
| EBITDA | 7 033 000 | 15 292 000 | 22 694 000 |
| EV/EBITDA | 10.05 | 5.96 | 3.59 |
| RoE | 0.10% | 17.00% | 26.18% |
| RoA | 0.08% | 13.12% | 20.83% |

Source: M+S Hydraulic
Calculations: ELANA Trading

The stock price of M+S Hydraulic finished 2011 hardly changed as compared to year ago, whereas all financial data improved substantially. Multiples decreased to very attractive levels. However, the strong growth in 2011 is unlikely to be repeated in near-term due to the economic slowdown in Europe. Thus the market is pricing in some risks of deterioration of multiples. EV/EBITDA is also historically low due to the large depreciation costs and the small debt of the company.

Peers' comparison

We compared M+S Hydraulic to similar companies in the machine building sector. We changed our list of peers to include more emerging markets as the previous comparison was made to the largest companies in Eastern Europe by market cap. P/S and EV/EBITDA have the biggest weight in the calculations as they are better representation for the market positions and the company's results. We used the median of multiples.

*Table 2
Peers'
Comparison*

| Multiples | P/E | P/B | P/S | EV/EBITDA |
|-------------------------------------|-------------|------------|------------|-------------|
| Median | 11.49 | 0.95 | 0.59 | 5.61 |
| Market Capitalization | 166 328 150 | 52 313 570 | 53 827 717 | 139 526 982 |
| Price | 12.78 | 4.02 | 4.13 | 10.72 |
| Weight | 20% | 20% | 30% | 30% |
| Current Price | | 7.20 | | |
| Fair Price | | 7.81 | | |
| Premium (Discount) to Current Price | | 8.54% | | |

Source: Bloomberg
Calculations: ELANA Trading

M+S Hydraulic is undervalued in terms of the median P/E and EV/EBITDA. This is due to the good profitability of the company as book value is usually below the costs of replacement of buildings and equipment. There is also substantial change in the fair value of the stock, according to the previous comparison to peers. The fair price is currently BGN 7.81, compared to BGN 9.03 six months ago. The change in the scope of peers could be the reason for the lower price

but we consider as more important that multiples in emerging markets declined during the second half of 2011. Moreover, emerging markets are usually lagging the recovery of developed markets, which is confirming the attractive valuation of M+S Hydraulic, despite the small difference to the fair price.

Discounted Cash Flows

The DCF is better valuation method as it includes the future growth opportunities. Our DCF is based on moderate growth and margins that correspond to the average for the last 4 years. We don't expect that the strong profitability will be maintained in the following years.

Table 3, DCF

| M+S Hydraulic | | | | | | | | | | | Terminal |
|--------------------------|---------|--------|--------|--------|--------|--------|--------|--------|--------|--------|----------|
| BGN'000 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | Year |
| EBIT | 17 429 | 17 231 | 16 339 | 17 647 | 18 882 | 20 015 | 21 015 | 21 961 | 22 840 | 23 639 | 24 466 |
| EBIT(1-T) | 15 686 | 15 508 | 14 705 | 15 882 | 16 994 | 18 013 | 18 914 | 19 765 | 20 556 | 21 275 | 22 020 |
| Add: D&A | 7 922 | 8 912 | 9 804 | 10 588 | 11 329 | 12 009 | 12 609 | 13 177 | 13 704 | 14 183 | 14 680 |
| Less: Investments | 7 922 | 8 912 | 9 804 | 10 588 | 11 329 | 12 009 | 12 609 | 13 177 | 13 704 | 14 183 | 14 680 |
| Less: Change NWC | 2 468 | 2 377 | 2 139 | 1 882 | 1 779 | 1 631 | 1 441 | 1 362 | 1 265 | 1 151 | 1 233 |
| FCF | 13 218 | 13 131 | 12 567 | 14 000 | 15 215 | 16 382 | 17 473 | 18 403 | 19 291 | 20 124 | 20 787 |
| PV FCF | 12 016 | 10 852 | 9 441 | 9 562 | 9 447 | 9 247 | 8 966 | 8 585 | 8 181 | 7 759 | |
| Sum of PV FCF | 94 057 | | | | | | | | | | |
| PV of Continuing Value | 123 295 | | | | | | | | | | |
| Total PV Free Cash Flows | 217 352 | | | | | | | | | | |
| Less: Outstanding Debt | 2 613 | | | | | | | | | | |
| Plus: Financial Assets | 14 784 | | | | | | | | | | |
| PV of Equity | 229 523 | | | | | | | | | | |
| Number of Shares | 13 018 | | | | | | | | | | |
| Price Per share | 17.63 | | | | | | | | | | |
| | | | WACC | | | | | | | | |
| | | | | SA | 2.0% | 3.0% | 3.5% | 4.0% | 5.0% | | |
| | | | | 8.0% | 21.22 | 23.68 | 25.32 | 27.38 | 33.54 | | |
| | | | | 9.0% | 18.15 | 19.75 | 20.77 | 22.00 | 25.37 | | |
| | | | | 10.0% | 15.85 | 16.95 | 17.63 | 18.42 | 20.47 | | |
| | | | | 11.0% | 14.08 | 14.86 | 15.33 | 15.87 | 17.20 | | |
| | | | | 12.0% | 12.67 | 13.24 | 13.58 | 13.95 | 14.87 | | |

Calculations: ELANA Trading

Our expectations for 2011 proved to be more conservative than the strong performance during the second half. Although revenues were little changed, risks persist. The model includes now only modest growth that is gradually declining toward the long-term rate of 3.50%. In terms of EBITDA margin we assume a decline toward 20%, which is below the current levels.

The calculated intrinsic value per share is BGN 17.63 or 145% above the current market price. The difference between both methods for valuation is significant and could be explained with the high P/B and P/S ratio of M+S Hydraulic and its excellent profitability at the moment. Thus main risk is possible decrease of EBITDA margin due to higher replacement costs of machines.

The strong 2011 created solid base for larger earnings even if the company enters in period of moderate growth. The calculated intrinsic value per share increased by BGN 3 as compared to mid-2011.

We consider M+S Hydraulic at attractive levels at the moment despite the probability of lower financial results in near term. Moreover, any negative surprise will provide buying opportunities.

Financial data

| Statement of Income (in '000 BGN) | 2008 | 2009 | 2010 | 2011 |
|--------------------------------------|---------------|--------------|---------------|---------------|
| Sales | 82 178 | 38 093 | 62 819 | 91 851 |
| Production expenses | 51 010 | 21 623 | 32 167 | 47 919 |
| Personnel expenses | 17 003 | 9 314 | 15 405 | 21 385 |
| Net income from financial activities | (204) | (123) | 25 | 147 |
| Other revenues and expenses | 0 | 0 | 0 | 0 |
| EBITDA | 13 961 | 7 033 | 15 272 | 22 694 |
| Depreciation | 5 796 | 6 572 | 6 690 | 6 453 |
| EBIT | 8 165 | 461 | 8 582 | 16 241 |
| Interest expense | 688 | 419 | 297 | 143 |
| Pretax income | 7 477 | 42 | 8 285 | 16 098 |
| Taxes | 850 | 4 | 829 | 1 620 |
| After-tax income | 6 627 | 38 | 7 456 | 14 478 |
| Minority interest | 0 | 0 | 0 | 0 |
| Net income | 6 627 | 38 | 7 456 | 14 478 |
| Earnings per share in BGN | 0.51 | 0.00 | 0.57 | 1.11 |

| Balance Sheet (in '000 BGN) | 2008 | 2009 | 2010 | 2011 |
|-----------------------------------|---------------|---------------|---------------|---------------|
| Total Assets | 55 633 | 49 991 | 56 848 | 69 515 |
| Equity subscriptions receivable | 0 | 0 | 0 | 0 |
| Fixed assets | 31 248 | 32 334 | 33 895 | 30 168 |
| Tangible fixed assets | 30 422 | 31 942 | 33 684 | 30 049 |
| Financial investments | 16 | 16 | 16 | 16 |
| Current assets | 24 385 | 17 657 | 22 953 | 39 347 |
| Inventory | 11 575 | 7 896 | 9 094 | 11 462 |
| Receivables | 11 575 | 5 192 | 7 883 | 13 011 |
| Financial assets | 0 | 0 | 0 | 0 |
| Cash and cash equivalents | 1 471 | 4 537 | 5 915 | 14 784 |
| Total liabilities + equity | 55 633 | 49 991 | 56 848 | 69 515 |
| Equity | 38 486 | 37 653 | 43 862 | 55 308 |
| Registered capital | 13 018 | 13 018 | 13 018 | 13 018 |
| Capital funds | 15 321 | 14 158 | 14 114 | 14 099 |
| Earnings | 10 147 | 10 477 | 16 730 | 28 191 |
| Liabilities | 17 147 | 12 338 | 12 986 | 14 207 |
| Long-term payables | 6 088 | 4 972 | 3 947 | 2 405 |
| Long-term bank loans | 4 685 | 3 625 | 2 566 | 1 506 |
| Short-term bank debt | 2 741 | 1 860 | 1 881 | 1 060 |
| Short-term payables | 8 318 | 5 524 | 7 158 | 10 742 |
| Other liabilities | 0 | 0 | 0 | 0 |
| Working capital | 13 326 | 10 273 | 13 914 | 27 545 |

| Cash Flow Statement (in '000 BGN) | 2008 | 2009 | 2010 | 2011 |
|---|----------------|----------------|----------------|----------------|
| Net income | 6 627 | 38 | 7 456 | 14 478 |
| Depreciation | 5 796 | 6 572 | 6 690 | 6 453 |
| Changes in Working capital | 2 652 | (3 053) | 3 641 | 13 631 |
| Other operating cash flow items | (3 813) | 8 065 | (7 009) | (16 869) |
| Net cash from operating activities | 11 262 | 11 622 | 10 778 | 17 693 |
| Capital expenditures | (9 655) | (5 311) | (6 341) | (5 530) |
| Other investing cash flow items | 0 | 497 | 352 | 1 345 |
| Net cash from investing activities | (9 655) | (4 814) | (5 989) | (4 185) |
| Issuance/ Retirement of Stock, Net | 0 | 0 | 0 | 0 |
| Issuance/ Retirement of Debt, Net | (254) | (1 978) | (1 073) | (1 881) |
| Dividends paid | (1 125) | (953) | (1 492) | (2 593) |
| Other financing cash flow items | (898) | (811) | (846) | (165) |
| Net cash from financing activities | (2 277) | (3 742) | (3 411) | (4 639) |
| Net change in cash | (670) | 3 066 | 1 378 | 8 869 |
| Beginning-of-period cash | 2 141 | 1 471 | 4 537 | 5 915 |
| End-of-period cash | 1 471 | 4 537 | 5 915 | 14 784 |
| Cash per share | 0.11 | 0.35 | 0.45 | 1.14 |

| Financial and Performance Indicators | 2008 | 2009 | 2010 | 2011 |
|--|------------|------------|------------|------------|
| Valuation Ratios | | | | |
| Price/Earnings (P/E) | 8.24 | 1 835.94 | 11.48 | 6.47 |
| Book Value (BV) | 2.96 | 2.89 | 3.37 | 4.25 |
| Price/Book (P/B) | 1.42 | 1.85 | 1.95 | 1.69 |
| Sales Per Share | 6.32 | 2.93 | 4.83 | 7.06 |
| Price/Sales (P/S) | 0.66 | 1.83 | 1.36 | 1.02 |
| Price/Cash per share | 4.40 | 10.55 | 6.05 | 4.48 |
| EV (in BGN) | 60 575 | 70 714 | 84 115 | 81 514 |
| EV/Sales | 0.74 | 1.86 | 1.34 | 0.89 |
| EV/EBITDA | 4.34 | 10.05 | 5.51 | 3.59 |
| EV/EBIT | 7.42 | 153.39 | 9.80 | 5.02 |
| Liquidity | | | | |
| Current ratio | 2.20 | 2.39 | 2.54 | 3.33 |
| Quick ratio | 1.16 | 1.32 | 1.53 | 2.36 |
| Debt Management | | | | |
| Debt to total assets | 0.31 | 0.25 | 0.23 | 0.20 |
| Interest coverage | 11.87 | 1.10 | 28.90 | 113.57 |
| LT Debt/Equity | 0.28 | 0.23 | 0.15 | 0.07 |
| Total Debt/Equity | 0.45 | 0.33 | 0.30 | 0.26 |
| Asset Management | | | | |
| Inventory turnover | 7.10 | 4.82 | 6.91 | 8.01 |
| Days sales outstanding | 51 | 49 | 45 | 51 |
| Fixed asset turnover | 2.63 | 1.18 | 1.85 | 3.04 |
| Total asset turnover | 1.48 | 0.76 | 1.11 | 1.32 |
| Profitability | | | | |
| Profit margin on sales | 8.1% | 0.1% | 11.9% | 15.8% |
| EBITDA margin | 17.0% | 18.5% | 24.3% | 24.7% |
| Basic earning power | 14.7% | 0.9% | 15.1% | 23.4% |
| Return on assets | 11.9% | 0.1% | 13.1% | 20.8% |
| Return on equity | 17.2% | 0.1% | 17.0% | 26.2% |
| Return on investments | 13.5% | 0.1% | 14.8% | 24.4% |
| Dividend Information | | | | |
| Dividend Yield | 1.50% | 1.77% | 3.04% | 0.00% |
| Dividend per share | 0.06 | 0.09 | 0.20 | |
| Number of shares: | | | | |
| | 13 004 800 | 13 018 400 | 13 018 400 | 13 018 400 |
| Price in BGN - period end: | | | | |
| | 4.20 | 5.36 | 6.57 | 7.20 |
| Market cap in BGN - period end: | | | | |
| | 54 620 160 | 69 765 606 | 85 582 962 | 93 732 480 |

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| | |
|-----------------------|---|
| Outperform | More than 5% higher as compared to SOFIX and BG40 performance |
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