



### Stock Price of M+S Hydraulic



- A surprisingly good quarter for Bulgarian producer of hydraulic elements M+S Hydraulic (5MH) pushed its revenues above the pre-crisis level. Although the recent economic downturn in Europe and USA could have negative short-term impact on revenues, the current strength is the reason to update our expectations on the upside. The company faced increasing number of orders and cannot forecast a stable level of demand during the second half of the year.

- Profits also soared this year due to the improved scale of production that pushed down the depreciation costs from 10% of all revenues to 6.5% for just two quarters. Labor costs also fell sizably and are at the average levels for 2007 of 20%. Our expectations of declining percentage of labor costs proved to be right since the beginning of 2011. However, this should be long-term process and we don't expect additional decline this year. Costs of materials are stable at 45% of total revenues.

- 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.

- Current assets are rising this year as receivables and inventories jumped. This is consequence of growing revenues and is not sign for troubling business relations with clients. Moreover, cash is also rising which increase substantially the working capital but the company does not need it for its current operations.

- Shareholders' equity remained the primary source of funding for the company. It was above 70% 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 last jump followed the positive report for the second quarter but the price retreated from its high due to the negative market environment in August.

- Valuation ratios improved significantly as the previous year was weaker. M+S Hydraulic is currently traded at P/E of 8, which is among the excellent multiples for Bulgarian industrial companies. The correction so far is small as comparing to the total market as the position is not owned by foreign institutional investors.

## Multiples Valuation

*Table 1  
Multiples  
comparison*

	2009	2010	1H 2011
Last Price	5.36	7.10	8.36
Number of Shares	13 018 400	13 018 400	13 018 400
Market Capitalization	69 765 606	92 430 640	108 859 861
Net Profit	38 000	7 456 000	12 626 000
P/E	1835.94	12.40	8.62
Equity	37 653 000	43 862 000	48 828 000
P/B	1.85	2.11	2.23
Sales	38 093 000	62 819 000	78 660 000
P/S	1.83	1.47	1.38
EV	70 713 606	90 962 640	100 204 861
EBITDA	7 033 000	15 292 000	20 861 000
EV/EBITDA	10.05	5.96	4.80
RoE	0.10%	17.00%	25.86%
RoA	0.08%	13.12%	18.95%

Source: M+S Hydraulic  
Calculations: ELANA Trading

The first two quarters of 2011 were extremely good and managed to improve the multiples as compared to year ago. The stock price rose less than profits and revenues. Currently, M+S Hydraulic is traded at lowest multiples among industrial companies. 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 used largest companies in Eastern Europe by market cap for the comparison, excluding the companies with extremely high multiples. 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 as we changed the region of peers.

*Table 2  
Peers'  
Comparison*

Multiples	P/E	P/B	P/S	EV/EBITDA
Median	15.12	0.97	0.66	8.24
Market Capitalization	190 949 122	47 538 794	52 275 705	180 509 587
Price	14.67	3.65	4.02	13.87
Weight	20%	20%	30%	30%
Current Price		8.36		
Fair Price		9.03		
Premium (Discount) to Current Price		7.97%		

Source: Bloomberg  
Calculations: ELANA Trading

M+S Hydraulic is undervalued in terms of the median P/E and EV/EBITDA. Domestic investors could focus on the good profitability of the company as book value is usually below the costs of replacement of buildings and equipment, whereas revenues are still below the 2008 peak. However, multiples comparison is showing that the stock is fairly valued. The change in peers list and the improvement of financial data resulted to higher relative price as compared to the beginning of 2011.

**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 averages for the last 4 years. We don't expect that the strong profitability will be maintained in the following years but rising cost for materials will also support the hefty increase of revenues.

**Table 3, DCF**

<b>M+S Hydraulic</b>											<b>Terminal</b>
<i>BGN'000</i>	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Year
<b>EBIT</b>	11 659	13 408	12 715	13 732	14 693	15 575	16 353	17 089	17 773	18 395	19 039
<b>EBIT(1-T)</b>	10 493	12 067	11 443	12 359	13 224	14 017	14 718	15 380	15 995	16 555	17 135
<b>Add: D&amp;A</b>	6 031	6 935	7 629	8 239	8 816	9 345	9 812	10 253	10 664	11 037	11 423
<b>Less: Investments</b>	4 824	6 935	7 629	8 239	8 816	9 345	9 812	10 253	10 664	11 037	11 423
<b>Less: Change NWC</b>	-1 853	1 809	1 387	1 221	1 153	1 058	934	883	820	746	800
<b>FCF</b>	13 552	10 258	10 056	11 138	12 070	12 959	13 783	14 497	15 175	15 809	16 335
<b>PV FCF</b>	12 921	8 892	7 924	7 979	7 860	7 672	7 418	7 093	6 750	6 392	
<b>Sum of PV FCF</b>	80 902										
<b>PV of Continuing Value</b>	101 620										
<b>Total PV Free Cash Flows</b>	182 522										
<b>Less: Outstanding Debt</b>	3 096										
<b>Plus: Financial Assets</b>	11 751										
<b>PV of Equity</b>	191 177										
<b>Number of Shares</b>	13 018										
<b>Price Per share</b>	14.69										
			<b>WACC</b>								
				<b>SA</b>	<b>Growth Rate</b>						
				8.0%	2.0%	3.0%	3.5%	4.0%	5.0%		
				9.0%	17.49	19.50	20.85	22.52	27.56		
				10.0%	15.05	16.37	17.20	18.21	20.98		
				11.0%	13.22	14.13	14.69	15.34	17.03		
				12.0%	11.81	12.45	12.84	13.28	14.39		
					10.68	11.15	11.43	11.75	12.51		

Calculations: ELANA Trading

We made several significant changes in the model to cover the rising revenues and improved profitability of the company. Our expectations for 2011 revenues are influenced by the strong performance so far but we prefer to be a bit conservative in our call for 28% growth. We also assumed EBITDA margin of 22%, which is below the level of 2010 and is insurance for possible disappointment in revenues and costs.

Our expectations for the growth of sales of M+S Hydraulic are based on the inflation threat in raw materials. The forecasted EBIT margin for the long-term is set at 12.5%, which is higher than our previous expectations and we also assume 14.5% for the high growth years of 2011 and 2012.

The calculated intrinsic value per share is BGN 14.69 or 75% 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 for the moment. Thus main risk is possible decrease of EBITDA margin due to higher replacement costs of machines. We also made mid-year adjustment to discounting but this added only BGN 0.68 to the price.

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. Correction of the stock price is possible after the solid gains since the beginning of the year but we expect that volumes will remain very low.

**Financial data**

Statement of Income (in '000 BGN)	2008	2009	2010	1H 2011
Sales	82 178	38 093	62 819	44 936
Production expenses	51 010	21 623	32 167	23 036
Personnel expenses	17 003	9 314	15 405	9 684
Net income from financial activities	(204)	(123)	25	51
Other revenues and expenses	0	0	0	0
<b>EBITDA</b>	<b>13 961</b>	<b>7 033</b>	<b>15 272</b>	<b>12 267</b>
Depreciation	5 796	6 572	6 690	3 306
<b>EBIT</b>	<b>8 165</b>	<b>461</b>	<b>8 582</b>	<b>8 961</b>
Interest expense	688	419	297	72
<b>Pretax income</b>	<b>7 477</b>	<b>42</b>	<b>8 285</b>	<b>8 889</b>
Taxes	850	4	829	889
<b>After-tax income</b>	<b>6 627</b>	<b>38</b>	<b>7 456</b>	<b>8 000</b>
Minority interest	0	0	0	0
<b>Net income</b>	<b>6 627</b>	<b>38</b>	<b>7 456</b>	<b>8 000</b>
<b>Earnings per share in BGN</b>	<b>0.51</b>	<b>0.00</b>	<b>0.57</b>	<b>0.61</b>

Balance Sheet (in '000 BGN)	2008	2009	2010	1H 2011
<b>Total Assets</b>	<b>55 633</b>	<b>49 991</b>	<b>56 848</b>	<b>66 625</b>
Equity subscriptions receivable	0	0	0	0
<b>Fixed assets</b>	<b>31 248</b>	<b>32 334</b>	<b>33 895</b>	<b>30 428</b>
Tangible fixed assets	30 422	31 942	33 684	30 307
Financial investments	16	16	16	16
<b>Current assets</b>	<b>24 385</b>	<b>17 657</b>	<b>22 953</b>	<b>36 197</b>
Inventory	11 575	7 896	9 094	10 425
Receivables	11 575	5 192	7 883	13 943
Financial assets	0	0	0	0
Cash and cash equivalents	1 471	4 537	5 915	11 751
<b>Total liabilities + equity</b>	<b>55 633</b>	<b>49 991</b>	<b>56 848</b>	<b>66 625</b>
<b>Equity</b>	<b>38 486</b>	<b>37 653</b>	<b>43 862</b>	<b>48 828</b>
Registered capital	13 018	13 018	13 018	13 018
Capital funds	15 321	14 158	14 114	14 102
Earnings	10 147	10 477	16 730	21 708
<b>Liabilities</b>	<b>17 147</b>	<b>12 338</b>	<b>12 986</b>	<b>17 797</b>
Long-term payables	6 088	4 972	3 947	880
Long-term bank loans	4 685	3 625	2 566	2 566
Short-term bank debt	2 741	1 860	1 881	530
Short-term payables	8 318	5 524	7 158	13 821
Other liabilities	0	0	0	0
<b>Working capital</b>	<b>13 326</b>	<b>10 273</b>	<b>13 914</b>	<b>21 846</b>

<b>Number of shares:</b>	<b>13 004 800</b>	<b>13 018 400</b>	<b>13 018 400</b>	<b>13 018 400</b>
<b>Price in BGN - period end:</b>	<b>4.20</b>	<b>5.36</b>	<b>6.57</b>	<b>8.36</b>
<b>Market cap in BGN - period end:</b>	<b>54 620 160</b>	<b>69 765 606</b>	<b>85 582 962</b>	<b>108 833 824</b>

Financial and Performance Indicators	2008	2009	2010	1H 2011
<b>Valuation Ratios</b>				
Price/Earnings (P/E)	8.24	1 835.94	11.48	13.60
Book Value (BV)	2.96	2.89	3.37	3.75
Price/Book (P/B)	1.42	1.85	1.95	2.23
Sales Per Share	6.32	2.93	4.83	3.45
Price/Sales (P/S)	0.66	1.83	1.36	2.42
Price/Cash per share	4.40	10.55	6.05	9.63
EV (in BGN)	60 575	70 714	84 115	100 179
EV/Sales	0.74	1.86	1.34	2.23
EV/EBITDA	4.34	10.05	5.51	8.17
EV/EBIT	7.42	153.39	9.80	11.18
<b>Liquidity</b>				
Current ratio	2.20	2.39	2.54	2.52
Quick ratio	1.16	1.32	1.53	1.80
<b>Debt Management</b>				
Debt to total assets	0.31	0.25	0.23	0.27
Interest coverage	11.87	1.10	28.90	124.46
LT Debt/Equity	0.28	0.23	0.15	0.07
Total Debt/Equity	0.45	0.33	0.30	0.36
<b>Asset Management</b>				
Inventory turnover	7.10	4.82	6.91	4.31
Days sales outstanding	51	49	45	112
Fixed asset turnover	2.63	1.18	1.85	1.48
Total asset turnover	1.48	0.76	1.11	0.67
<b>Profitability</b>				
Profit margin on sales	8.1%	0.1%	11.9%	17.8%
EBITDA margin	17.0%	18.5%	24.3%	27.3%
Basic earning power	14.7%	0.9%	15.1%	13.4%
Return on assets	11.9%	0.1%	13.1%	12.0%
Return on equity	17.2%	0.1%	17.0%	16.4%
Return on investments	13.5%	0.1%	14.8%	15.3%
<b>Dividend Information</b>				
Dividend Yield	1.50%	1.77%	3.04%	-
Dividend per share	0.06	0.09	0.20	-

\*Calculated ratios for 2011 include only the last reported period

<b>Number of shares:</b>	<b>13 004 800</b>	<b>13 018 400</b>	<b>13 018 400</b>	<b>13 018 400</b>
<b>Price in BGN - period end:</b>	<b>4.20</b>	<b>5.36</b>	<b>6.57</b>	<b>8.36</b>
<b>Market cap in BGN - period end:</b>	<b>54 620 160</b>	<b>69 765 606</b>	<b>85 582 962</b>	<b>108 833 824</b>

**Disclaimer**

**Analyst Certification:** The research analyst(s) certifies that: (1) all of the views expressed in this document accurately reflect his or her personal views about any and all of the subject securities or issuers; (2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this document.

**Financial Interest:** ELANA Trading may trade or own shares of the analyzed companies. The research analyst(s) is not holding shares of the analyzed companies, unless otherwise noted.

**Regulatory Authority:** Financial Supervisory Commission, *Shar Planina* Street 33, 1303 Sofia, Bulgaria

**Information Disclosure:** All reasonable care has been taken to ensure the facts stated are accurate and opinions given are fair and reasonable. Our recommendations are based on information available to the public that we consider to be reliable but for the completeness and accuracy of which we assume no liability. Neither ELANA Trading, nor its directors, officers or employees shall in any way be responsible for its contents. The views expressed may differ from the views of other firm departments or representatives. Additional information is available upon request. Unless otherwise noted, sources for all information in charts and tables are ELANA Trading's calculations.

**Risks for Investors:** Information in this document should not be regarded as an offer to buy or sell any financial instruments. The investment possibilities discussed in this document may not be suitable for certain investors depending on their specific investment objectives and time horizon or in the context of their overall financial situation. In particular, the risks associated with an investment in the securities or the financial instruments under discussion are not explained in its entirety. The prices or values of the securities may go down as well as up and can fluctuate and fall against the investor. The securities or investments may cause the investor to lose the amount invested. Past performance is not a guide to future performance. Changes in exchange rates may have an adverse effect on the value, price or income of the securities or investments.

**Valuation Methods:** Company valuations are based on the following methods: multiple-based (P/E, P/B, EV/EBITDA), historical valuation approaches, peer comparisons, discount models (DCF, DDM) or asset-based evaluation methods. Valuation models are dependent on macroeconomic factors, including interest rates, foreign exchange rates, prices of raw materials, and any expectations about the economy, the market sentiment. The valuation is based on expectations that might change rapidly and without notice, depending on developments specific to individual industries and countries. Recommendations and target prices derived from the models might therefore change accordingly. The application of models depends on forecasts of a range of economic variables, thus there is a range of reasonable variations within models. Any valuation is dependent upon inputs that are based on the subjective opinion of the analysts carrying out this valuation.

**Recommendations:** Analyst(s) recommendations are based on the specific factors for the company, sector, country and global developments, as compared to market indices. Recommendations and opinions reflect ELANA Trading's expectations over the 12-month period following publication from the perspective of long-only investment clients. ELANA Trading reserves the right to express different or contrary recommendations and opinions for different timescales or for other types of investment client. Except as otherwise noted, expected performance over next 12 months vary for different recommendations for Bulgarian stocks as follows:

---

<b>Outperform</b>	More than 5% higher as compared to SOFIX and BG40 performance
<b>Market Perform</b>	Market performance, +/-5% as compared to SOFIX and BG40
<b>Underperform</b>	More than 5% lower as compared to SOFIX and BG40 performance

---

**Frequency of Recommendations:** No schedule of recommendations is available. The frequency of recommendations depends on specific factors to individual companies and the opinion of the analyst(s) for the necessity of minor or major changes.

**Copyrights:** The copyrights of ELANA Trading analyses belong to the Research Department of the brokerage and their content cannot be used for commercial purposes. Replication and redistribution of ELANA Trading analyses content is expressly prohibited without the prior written consent of the appointed contacts listed below.

**For more information, please contact:**

Research analyst  
Tsvetoslav Tsachev  
Tamara Becheva

Phone:  
+359 2 810 00 23  
+359 2 810 00 27

E-mail:  
[tsachev@elana.net](mailto:tsachev@elana.net)  
[becheva@elana.net](mailto:becheva@elana.net)

Internet:  
[www.elana.net](http://www.elana.net)  
[www.elana.net](http://www.elana.net)