

No. 1 in the Russian ball bearing industry

European Bearing Corporation (EBC) controls 37% of the Russian ball bearing market. EBC operates five ball bearing plants in Russia and one in Kazakhstan and produces more than 2,700 types of ball bearings for more than 500 customers. EBC controls 98% of Russia's high-precision (aviation) ball bearing market and 95% of the railroad ball bearing market. These two business segments accounted for 65% of EBC's revenues in 2005.

Long-term relationship with Russian Railroads

The company has a supply contract worth USD560 mn with Russian Railroads that secures EBC average annual revenue of USD100 mn to 2010.

Solid financial standing, moderate leverage

In 2005, EBC reported revenues of USD250mn, up 22% y-o-y. EBITDA margin stood at 21%, while the debt/EBITDA ratio was only 0.9. Factoring in the planned CLN issue, debt/EBITDA should not exceed 2.5 at year-end 2006, and gradually decline thereafter.

Adequate level of transparency and disclosure

EBC has been preparing IFRS financials since 2004. Since its ruble bond issue in 2005, the company has complied with all necessary disclosure requirements for Russian bond issuers and has disclosed its ultimate shareholders.

Sufficient financial flexibility to withstand downside scenario

We consider a rise in prices for steel – the core input for EBC – as the key risk to the company's performance. Our sensitivity analysis shows that EBC's net debt/EBITDA is unlikely to exceed 3.0, even if the prices for purchased steel were to grow at a CAGR of 15.3% for the next four years (5.8% above inflation).

The company's long-term relationships with Russian Railways and the Defense Ministry secure sufficient cash flow from the railway and precision divisions to service debt and mitigate the impact of a potential drop in revenues from the other divisions.

Summary Financials (USD mn)

	2003	2004	2005	2006E
Sales	160.3	204.7	249.7	279.6
Gross Profit	32.8	69.2	82.8	94.0
EBITDA	14.8	47.4	52.1	61.0
Net Profit	8.4	29.9	30.9	34.8
Fin Debt	9.7	16.9	50.7	153.9
Equity	43.4	82.4	96.3	129.2
Operating CF	12.3	7.7	21.1	45.4
Free CF	(2.9)	(11.3)	(23.2)	19.3

Source: Company data

Ratios

	2003	2004	2005
Gross Margin	20%	34%	33%
EBITDA Margin	9%	23%	21%
Net Margin	5%	15%	12%
Debt/EBITDA	0.7	0.4	0.9
EBITDA/Int. Expense	22.8	35.0	13.7
Financial Debt/Equity	0.22	0.20	0.53

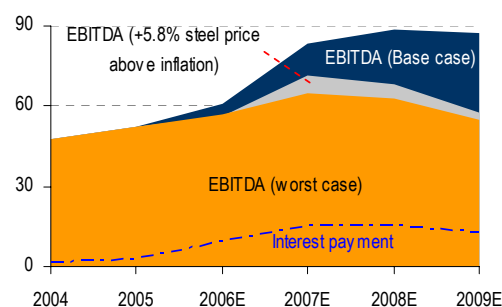
Source: Company data

Forecast ratios, conservative base case

	2006E	2007E	2008E	2009E
Debt/EBITDA	2.5	2.1	1.8	1.4
EBITDA/Int. Expense	6.7	5.5	5.8	6.7
Financial Debt/Equity	1.19	1.08	0.78	0.52

Source: MDM estimates

Historical and forecasted performance



Source: company data, MDM estimates

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SWOT analysis

Strengths

- The undisputed leader on the Russian ball bearing market, with an estimated 37% market share. EBC's revenues are 1.5 times higher than the combined revenues of its main domestic competitors, Samara Bearing Plants Group (SPZ Group) and Vologda Bearing Plant.
- A USD560 mn long-term supply contract with Russian Railways. The contract allows for price increases in accordance with the Economic Development and Trade Ministry's deflator indicator (8-10% annually) and guarantees annual revenues of at least USD100 mn until 2010.
- Extensive distribution network. We consider EBC's distribution and service network to be its main competitive asset, setting it apart from the other participants on the Russian market. The company's service centers cover 10 Russian cities (St. Petersburg, Nizhny Novgorod, Volzhsk, Omsk and others) and five cities abroad (in Slovakia, Ukraine, Belarus and Kazakhstan). The company has 235 sales representatives, 11 certified dealers.
- Rapid growth. Since its establishment in 1998, the company has been expanding through acquisitions. In 2000, EBC acquired a controlling stake in Moscow Bearing Plant, and in 2001 it bought a controlling stake in Kazakhstan's Stepnogorsk Bearing Plant. The company's latest acquisition was in August 2005, when it bought Samara Aviation Bearing Plant. From 2002-05, EBC's revenue expanded at a CAGR of 39% through an increase in output volumes and the overhaul of its product line in favor of higher margin products.
- A monopoly position in two niche markets. EBC reports that it controls 98% of the domestic market for high-precision (aviation) ball bearings (mainly for Defense Ministry orders) and 95% of the domestic railroad ball bearing market (under a supply contract with state-owned Russian Railways). In 2005, EBC created a separate division concentrating on high-precision bearings that combines production facilities at the Moscow, Volzhsky and Samara plants. Underlining the company's emphasis on specialization, the Stepnogorsk plant focuses on railroad ball bearings and the Volzhsky plant specializes in automotive conic ball bearings.
- Margins above sector average. Proximity to cheap resources and low wage costs help EBC achieve higher margins vs. international peers: in 2005, the company posted an operating margin of 19% vs. an average of 9% for global peers. In 2002, the company implemented a wide-scale restructuring program, which resulted in: (a) increasing direct sales as a proportion of total sales to bypass third-party distributors; (b) a shift in the product range towards higher margin products; (c) the optimization of production processes; and (d) the modernization of production assets. These steps have a positive impact on company's margins in 2003-05.
- Diversified product range. EBC makes more than 2,700 types of bearings, ranging from 20 mm to 2,200 mm in diameter, and can switch production between different types of products to meet customer demands.
- Moderate leverage¹. The company maintains an industry-average leverage level. Its 2005, its debt/equity ratio stood at 0.53, exactly corresponding to the average for global majors such as SKF, Timken, Koyo, NTN Japan and NSK.
- Own R&D center. In 2005, the company opened a scientific research center to develop new ball bearings to meet growing demand. According to EBC, the center develops up to 10 new types each month, mainly by upgrading existing products. The company has developed analogues of 100 foreign-designed ball bearings, and it has registered 15 patents that are valid in Russia². While EBC's investments in R&D significantly exceed those of domestic competitors, they are much smaller than those of international peers³.

¹ Debt data on EBC's domestic competitors is not publicly available.

² EBC's research center has produced a new (for Russia) cassette type of railroad ball bearing (TBU) used in railroad cars. In 2003, the company produced an integral ball bearing assembly for sale to AvtoVAZ, UAZ and GAZ.

³ According to EBC, Germany's INA-FAG's research center employs 300 people and has an annual budget of USD150 mn, and U.S. Timken's research center has 200 employees and a budget of USD200 mn.

- **Brand loyalty.** Since 2002, the company has been promoting a single national EBC brand, which it says enjoys high recognition and loyalty among consumers. This helps to protect EBC's strong market position
- **Transparency and experience in the bond market.** EBC has been preparing IFRS financials since 2004. Since its ruble bond issue in 2005, the company has complied with all necessary disclosure requirements for Russian bond issuers and has disclosed its ultimate shareholders. EBC was the first domestic bearing manufacturer to tap the local bond market. EBC's debut three-year, USD35 mn ruble bond was issued in October 2005 with a coupon of 8.75%.

Weaknesses

- **Dependence on one supplier.** EBC buys more than 50% of its specialty steel needs from Oskol Electrometallurgical Plant. EBC is thus heavily dependent on Oskol. A change of supplier would imply risk that new supplies could be of lower quality steel and/or could be delivered in insufficient amounts.
- **Inability to raise selling prices if raw material costs suddenly increase.** This is because the steel market is characterized by a small number of raw material suppliers and a wide range of customers. Thus, EBC holds an unfavorable negotiating position. If faced with growing steel prices, EBC can usually raise prices on end products with a 3-month lag and very seldom more than 10% a year.
- **Product quality is inferior to that of world leaders.** Russian ball bearing plants are generally in need of an overhaul, as there was 10-year hiatus in funding following the collapse of the Soviet Union in 1991. Russian manufacturers use outdated technology and very often operate well below capacity, unlike foreign peers. EBC invested USD78.3 mn over 2003-05 to modernize its production assets, making it perhaps the best-equipped bearing manufacturer in Russia. However, foreign-made bearings are still of higher quality.
- **Low quality of input steel.** Due to a lack of domestic demand for quality steel, leading Russian steel producers (Severstal, MMK, NLMK and others) do not produce the premium class steel used to manufacture ball bearings. Insufficient steel quality is reflected in the company's inability to meet rising requirements for quality ball bearings on the global market.
- **Concentration of ownership and management.** The group is beneficially controlled by its key shareholders. EBC's owners play a significant role in management decision-making. In our view, this weakens management's ability to make prompt decisions and hampers the company's competitiveness.

Opportunities

- **Continued domestic market growth.** Over the last five years, the Russian ball bearing manufacturing segment and the machinery sector as a whole have demonstrated sustained growth against a background of overall economic expansion. We forecast revenue growth of between 6% and 12% per year for automotive, railroad, metallurgic and precision ball bearings markets through 2010, which is in line with the overall growth of the Russian ball bearing market. In comparison, according to Freedonia Group (an international business research company), average global growth will reach 5.5% over the next five years. This should create favorable conditions for EBC to grow its revenues further.
- **Wider geographic diversification of sales.** EBC is exporting automobile bearings to East and West European markets via its representative office in Slovakia. Its bearings offer an attractive price/quality ratio, and the company is planning to develop the export of cassette railroad ball bearings (TBU) in the future. EBC is also considering acquiring or establishing a joint venture in an Asian country.
- **More efficient distribution model.** The company makes full use of its wide network of warehouses, representative offices and dealers by distributing output from other large Russian bearing manufacturers, such as Lutsky GPZ. EBC plans to further expand its sales network and distribute other producers' bearings under its own brand for a commission (if their bearings meet quality standards). EBC is also planning to develop innovative products and additional services in order to strengthen customer loyalty.

- Better access to up-to-date technology. EBC could gain access to more modern technology via a cooperation agreement or the establishment of a joint venture with a global bearing manufacturer, such as Sweden's SKF Group, INA of German or U.S. Branco. The company says it is in negotiations to gauge interest in such a deal.
- Further industry consolidation. The company's low leverage means it could raise additional debt to acquire domestic competitors, thereby expanding its operations and reducing competition.

Threats

- Increasing competition. Global players could challenge EBC's position on the domestic market. SKF Group, the world's leading bearing producer, has about 100 plants worldwide, including in India and Ukraine. The entry of this company or another major foreign player into the Russian market could potentially cause a decline in EBC's market share. At present new companies face high entry costs due to the nature of the Russian ball bearing industry. To avoid this, international players could seek to cooperate with a Russian ball bearing manufacturer. So far, none of the global competitors has declared its intention to launch production in Russia within the next two years.

In addition, competition in low-price segments from Chinese, Romanian, Czech and Polish manufacturers could increase with Russia's accession to the WTO, which will eventually drive down import duties on all ball bearings.

At the moment, Russian ball bearing producers enjoy gross margins that are far superior to those of international peers (EBC's 2005 EBITDA margin was 21% vs. 9-14% for SKF, Timken, Koyo and NTN Japan), despite the greater share of services in the latter's revenues (up to 32% vs. 5% for EBC). In the medium term, we expect EBC's margins to decline on the back of increased competition and ruble appreciation.

- A decrease in EBC's niche market share or loss of exclusive supplier status. EBC says that it holds 98% of the market for high-precision ball bearings. These bearings could be produced by other Russian or foreign companies once they have been granted a license from the government.
- The risk of Russian Railways terminating its contract. In such a case, there are several mitigating factors, including financial penalties:
 - EBC accounts for 95% of the railroad ball bearing market and is Russian Railways' sole supplier. EBC could only conceivably be replaced by a domestic competitor, and only after that company made considerable investments in setting up production facilities.
 - Bearings made by international players, such as Branco, a U.S.-based global leader in the production of railroad ball bearings, are more expensive and are therefore not priced to directly compete with EBC's products. At least until Russian Railways shifts to producing high-speed trains, which require the use of higher quality cassette brake ball bearings⁴, this kind of competitor is not likely to enter the market.
- Legality of acquisitions. This risk applies to many companies in Russia, so we consider it to be part of country risk. For example, EBC's acquisition of Moscow Bearing Plant has been challenged and the company has won a series of court cases over the issue. Since that time, it has acquired stakes in Stepnogorsk Bearing Plant and Samara Aviation Bearing Plant, and these acquisitions could be challenged, as well.
- Risk of unaccounted tax liabilities. Russian tax legislation is characterized by frequent changes and "flexible" interpretation by tax authorities. Interpretation of tax legislation by the company's management can be challenged by regional or federal authorities. EBC has won several tax cases and has always complied with court decisions on tax payments.

⁴ Cassette ball bearings (TBU) are modern value-added products used in high-speed trains. EBC can produce cassette ball bearings, but not in large quantities. See the Operations and R&D section.

Company Snapshot

EBC is Russia's leading ball bearing manufacturer and was founded in 1998 based on the assets of Volzhsky Bearing Plant. Since then, EBC has proven itself to be a successful industry consolidator: it acquired a controlling stake in Moscow Bearing Plant in 2000; it took over Stepnogorsk Bearing Plant (Kazakhstan) in 2001; and it bought Samara Aviation Bearing Plant in 2005, financed by a three-year, RUB1 bn (USD35 mn⁵) ruble bond with an 8.75% coupon rate.

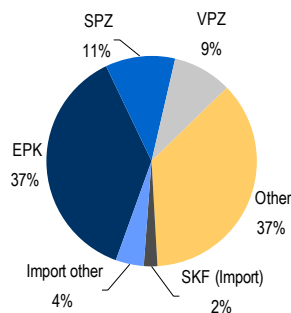
The company launched a major modernization program in 2002, and has invested around USD20 mn each year to renovate its production assets and catch up with the world's leading bearing manufacturers. One result of this restructuring was that EBC split its operations into several separate units and assigned specific types of production to each plant. EBC now has six plants producing more than 2,700 types of bearings for a range of industries, including the railroad, automotive, aviation and defense sectors.

EBC has published IFRS accounts (audited by KPMG) since 2004. Management now plans to transfer to a single share and hold an IPO. Net profit reached USD31 mn on revenues of USD250 mn in 2005, while net assets stood at USD96 mn and debt totaled USD50 mn at year end.

Oleg Savchenko, a Russian entrepreneur who began his career by importing computers from Singapore in 1992, controls EBC. Savchenko currently serves as a member of the State Duma (more information on Mr. Savchenko can be found in Appendix 1).

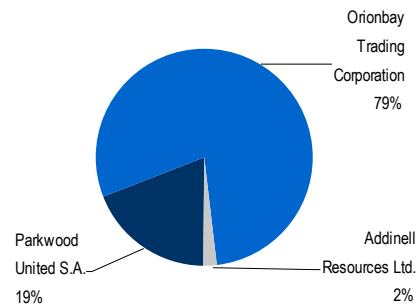
Management is currently developing a company strategy for the next five years. EBC has indicated that the main thrust will be to expand sales on markets in which it does not have much of a presence, such as bearings for the metallurgy, energy, oil extraction and machine-building industries. At the same time, it will seek to retain the leading position in its traditional niche markets for railroad, high-precision and automotive bearings.

Russian ball bearing market, 2004



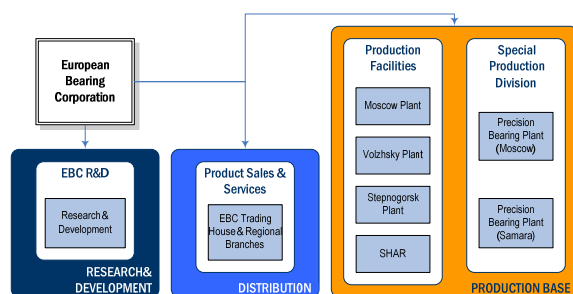
Source: Company data, Spark Interfax. Note: SPZ Group includes only one of the group's two plants due to lack of data

Shareholding structure



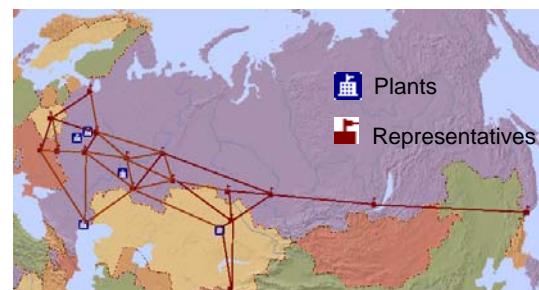
Source: Company data

Company structure



Source: Company data

EBC company geography



Source: Company data

⁵ Rate on the date of issue

Ball bearings

A bearing is a machine part designed to reduce friction between moving parts or to support moving loads. A ball bearing is a bearing assembly that uses spherical bearings as the rolling elements. The term is also used to describe an individual ball for a bearing assembly.

Ball bearings are usually found in light precision machinery, where high speeds are maintained, with friction being reduced by the rolling action of the ball bearings. The balls are caged in an angular grooved track, called a race, and the bearings are held in place by a frame. Ball bearings typically support both axial and radial loads and can tolerate some misalignment of the inner and outer races. Ball bearings are generally cheaper to manufacture than other kinds of rolling elements, although they tend to have a lower load capacity for their size than other types of bearings.

There are several types of ball bearings, each offering specific properties:

- **Radial ball bearings** use inner and outer races that are shaped for a radial load to pass through the bearing. Most radial designs also support modest axial loads.

- **Angular contact ball bearings** use offset races. An angular load passes in a straight line through the bearing, whereas a radial load takes an oblique path that tends to separate the races axially, so the angle of contact on the inner race is the same as that on the outer race. Angular contact bearings allow loading in both the radial and axial directions and the contact angle of the bearing should be matched to the relative proportions of each. The larger the contact angle, the higher the axial load supported, but the lower the radial load.

In high-speed applications, such as turbines, jet engines and dentistry equipment, the centrifugal forces generated by the ball bearings will change the contact angle at the inner and outer race. Ceramics such as silicon nitride are now regularly used in such applications due to their low density (40% of steel, which significantly reduces centrifugal force), ability to function in high temperature environments, and tendency to wear in a similar way to bearing steel (rather than cracking or shattering like glass or porcelain).

- **Axial ball bearings** use side-by-side races. An axial load is transmitted directly through the bearing, while a radial load is poorly-supported and tends to separate the races. Anything other than a small radial load is likely to damage the bearing.

- **Deep-groove radial bearings** have race dimensions that are close to the dimensions of the balls that run in it. Deep-groove bearings have higher load ratings for their size than shallow-groove bearings, but are also less tolerant of misalignment of the inner and outer races. A misaligned shallow-groove bearing may support a larger load than a similar deep-groove bearing with similar misalignment.

- **Slot fill radial bearings** have inner and outer races that are notched so that when they are aligned, balls can be slipped in the slot in order to fill the bearing. A slot-fill bearing has the advantage that the entire groove is filled with balls, called a full complement. A slot-fill bearing has the disadvantages that it handles axial loads poorly, and the notches weaken the races. Note that an angular contact bearing can be disassembled axially and so can easily be filled with a full complement.

The outer race may be split axially or radially, or a hole may be drilled in it for filling. These approaches allow a full complement to be used, but also limit the orientation of loads or the amount of misalignment the bearing can tolerate. Thus, these designs find much less use.

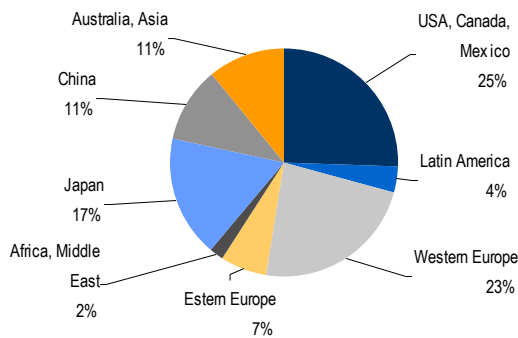
Most ball bearings are single row designs. Some double row designs are available, but they need better alignment than single-row bearings.

The Bearing Industry

The global market

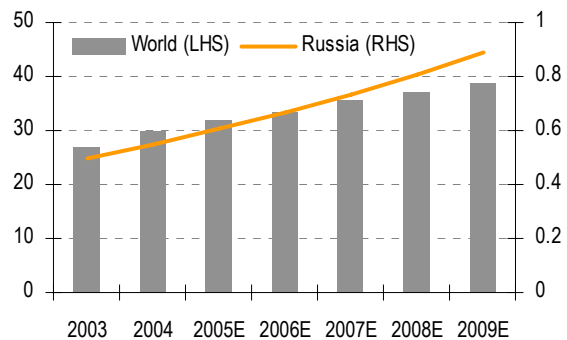
According to estimates by Freedonia Group, an international business research company, the global bearing market was worth USD30 bn in 2004 and USD31.7 bn in 2005. The Russian market was worth USD550 mn in 2004 and accounted for about 1.7% of the global market – less than Latin America (4%) and Africa and the Middle East (2%). The United States, Canada, Mexico, Western Europe and Japan were the top bearing consumers, responsible for 65% of global bearing production.

Global bearing market, 2004



Source: Freedonia Group, MDM estimates

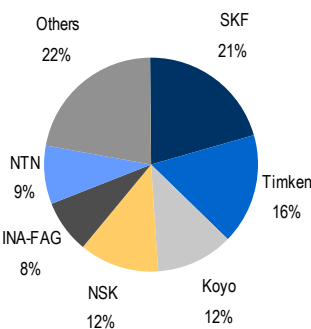
Russian vs. world bearing market: higher growth, USD bn



Source: Freedonia Group, MDM estimates

According to MDM Bank and Freedonia Group estimates, global demand for bearings is set to grow at an average of 5.5% to about USD42 bn in 2006-10. Worldwide economic growth, increased investment activity and rising aerospace and automotive output will be the main drivers. The center of consumption growth is gradually shifting toward the rapidly growing economies of China and Southeast Asia, which accounted for more than 15% of the global market in 2004.

Major world ball bearing producers, 2005



Source: Timken, Freedonia Group

Globally, the production of ball bearings is highly concentrated: the six largest companies produce 80% of worldwide output, while the remaining 22% is produced by smaller players, such as EBC.

Growth in the Russian bearing sector has outpaced the global average with a CAGR of 10.4% vs. 8.4% in 2004-05. Since 2002, Russia's GDP has grown at an average of 6.8% (average global GDP growth was 3.9%), and bearing consumption is closely linked to overall economic growth. We expect Russia's share of the global bearing market to continue to grow further, although it will likely remain around 2-4% in the medium term.

The Russian market

We anticipate that domestic ball bearing consumption will grow at 7.5-12.1% per year and more than double over the next 8-12 years from its current size. The resulting supply deficit will likely be offset by one or both of the following factors:

- International bearing producers are likely to gain a greater share of the Russian market. We expect global players to increase import volumes and seek to establish production assets in the country. In 2004, imports accounted for only 6% of the total Russian market, and as yet no foreign manufacturer has in-country production assets. This situation is not typical: according to B&K Securities, in India, for example, SKF's local subsidiary accounted for 28% of the organized market in 2005.

■ **Increasing capacity utilization among domestic producers.** EBC is not the only Russian producer improving its business processes and modernizing its production assets – SPZ Group is doing so, as well. The increased attention of global players to the Russian and CIS markets is causing domestic companies to consider restructuring and modernizing, and even to commission new production facilities. For example, since its acquisition by SKF in 1998, Lutsk Bearing Plant has been gradually implementing a modernization program.

The relative importance of these two factors will be determined by:

- the penetration rate of global industry players into Russia
- the rate of import tariffs on foreign ball bearings
- tax incentives for international players and manufacturers carrying out capital expenditures
- the speed at which domestic companies restructure their operations and their ability to match rising quality demands from Russian customers.

Compared to foreign peers, Russian plants generally use older, outdated equipment. Tens of millions of dollars must be spent before Russian plants can be certified to meet international quality standards. At present, Russian bearings are sold at a discount to foreign bearing to reflect the difference in quality. Therefore, in the medium term, we would expect any international player looking to establish operations in Russia to launch greenfield projects rather than acquire existing production facilities.

EBC vs. other Russian market players

The Russian ball bearing market is more consolidated than the global market. EBC holds the largest share (37%), and together the top three domestic companies controls approximately 60% of the market.

EBC's main competitors in terms of size are:

- **SPZ Group**, which operates two ball bearing plants in the Samara region and is a significant player in the market for ball bearings in the metals industry.
- **Vologda Bearing Plant**, the leading domestic producer of bearings for the automotive industry, most of which are delivered to automaker AvtoVAZ.
- **Lutsk Bearing Plant**, a Ukrainian company that specializes in ball bearings for the automotive industry.

We expect the Russian market to become more competitive as EBC expands its presence in segments where it is currently weak. According to EBC, only SPZ Group can match it in terms of technology or productivity (EBC has the highest production per employee ratio among domestic peers). Moreover, EBC began its modernization program before other Russian manufacturers and thereby gained an edge in terms of costs. We expect it to maintain this advantage in the medium term. In this way, we believe EBC is well positioned to compete with other local producers.

EBC vs. global players

Foreign-made ball bearings currently account for 6% of the domestic market, but this share is expected to grow as international automakers such as Ford, Toyota and General Motors plan to expand their output of locally assembled cars. We believe that Japanese ball bearing maker Koyo is looking to follow Toyota and Nissan in setting up a production facility in Russia. Once these automakers have launched production in Russia and are producing at least 200,000 units per year (expected by 2007), we believe international ball bearing manufacturers will begin actively seeking a foothold in the Russian market.

We do not believe that EBC is ready to compete with global peers, as the quality of its products is inconsistent due to the lower quality feedstock supplied by Russian steelmakers and inefficiencies in its business processes.

Russia's pending entry to the World Trade Organization will likely lead to an increase in imported bearings. For example, a customs duty of USD0.49-0.59 per kilogram is currently levied on imports of cheap Chinese ball bearings, constituting up to 30% of their cost. With WTO accession, this duty is likely to be reduced or even removed, which will cause a surge in foreign

competition in certain segments, in particular the market for bearings used in the mining industry, where price is much more important than quality. EBC estimates that grey imports of Chinese bearings already account for around 4% of total Russian bearing consumption. If true, this would likely raise the total share of foreign imports from 6% to 10%. This share will increase once Russia enters the WTO. However, in the long run, we do not foresee Asian imports offering stiff competition for domestic manufacturers, as they are of inferior quality and Asian manufacturers face higher transport costs in bringing their goods to the Russian market.

EBC's key competitive position

EBC's competitive advantages include:

- Brand loyalty among customers
- EBC products offer a better price/quality tradeoff than those made by global players. The company's product range complies with all local standards and is substantially cheaper than foreign equivalents
- A well-developed distribution network
- EBC is the exclusive supplier for profitable niche markets (including the RUB12 bn long-term contract with Russian Railways and EBC's license to supply the Defense Ministry)
- State regulation – EBC benefits from local market protection, for example prohibitive customs duties levied on certain types of imported bearings.

Looking forward, we envisage the greatest threat to EBC's domestic market share coming from international ball bearing producers. We believe the company's future market share and sales prospects will largely depend on its ability to complete its modernization program and streamline its production processes by the time these foreign players have built a market presence. We think EBC has at least two years before any global competitor begins to focus on the Russian market. However, if international producers establish assembly facilities in Russia, it is unlikely to help EBC, as these producers are likely to use imported bearings in their products.

We expect EBC's share of the automotive bearings market to decline once international producers enter the Russian market, although it will most likely retain its leading position in the high-precision ball bearing segment, as foreign competitors are not very strong in this area. For a more detail discussion of EBC's markets, see Appendix 2.

Operating Activity

Products

EBC's products can be divided into seven segments according to the type of ball bearing produced.

Product range, 2005				
Bearing division	Share of revenues	Gross margin	Description	Main clients
Railroad	51%	40%	For mounted wheels on wagons and locomotives; braking systems	Russian Railways
Automotive	14%	15%	Integrated car subassemblies, drive shafts, transmission units, etc.	AvtoVAZ, RusPromAvto, UAZ
Secondary market	12%	8.4%	Servicing, mostly automotive bearings and bearings used in agricultural equipment	Car servicing companies, small dealers
Export	4%	(1.25%)	Mostly automotive bearings for export	European countries
Metallurgy (smelting industry)	3%	26%	Rolling presses	Severstal, MMK
High precision	14%	35%	Used in military and aerospace applications, engineering, shipbuilding and nuclear power industries	NPO Saturn, Ribinsk Motors, Irkut
Other	2%	45%	For turbines and applications in the oil extraction and refining industry and engineering sector	UES

Source: Company data

The railroad and automotive divisions are the company's main revenue drivers, representing over 65% of total sales. The railroad division is also one of the most profitable, generating a 40% gross margin.

EBC's strategy calls for greater emphasis to be placed on developing the company's metallurgical and energy divisions. EBC is currently weak in these markets, but they offer higher gross margins – 26% and 45%, respectively.

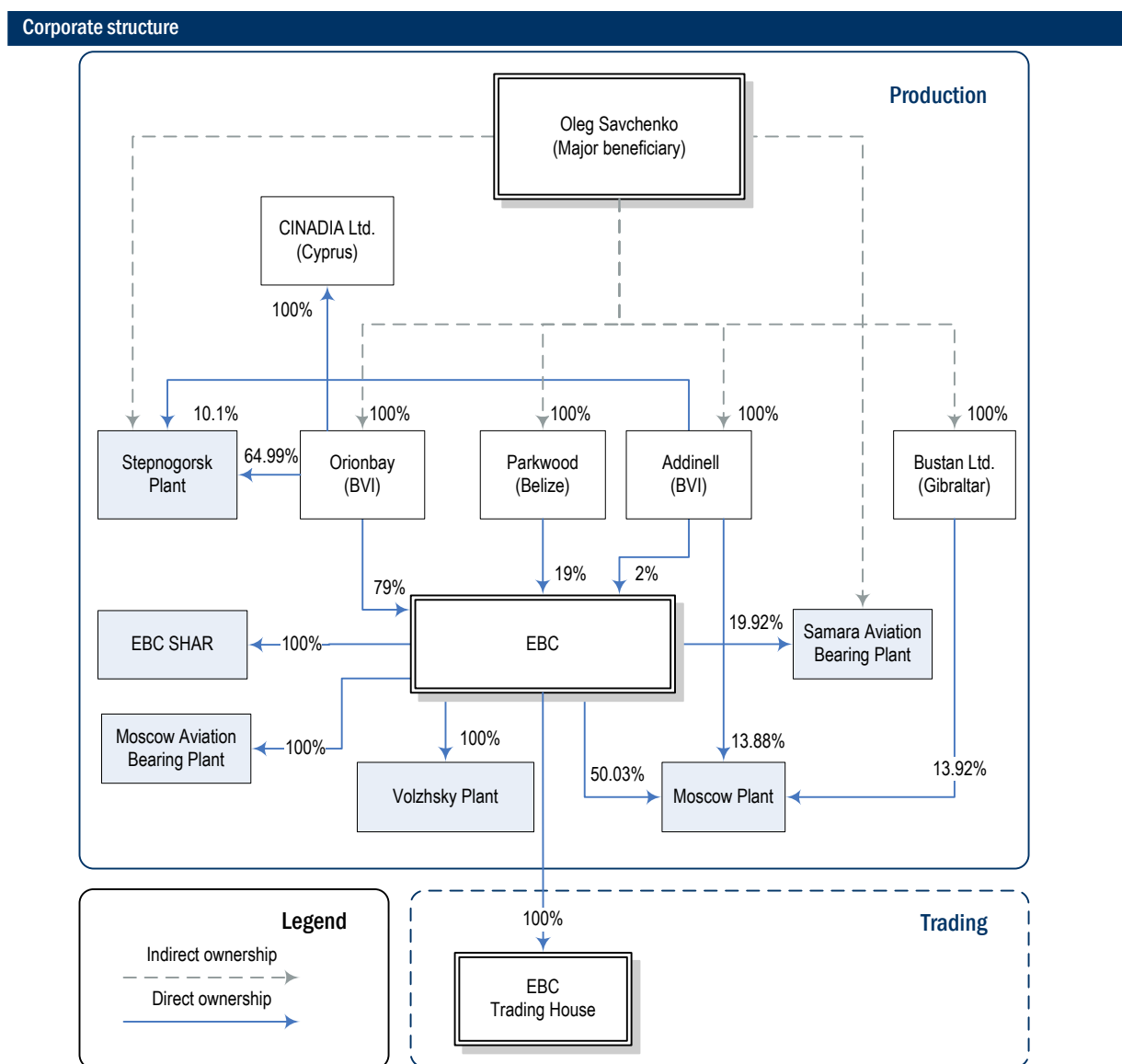
The negative gross margin posted by the export division in 2005, according to the company, was a temporary situation that will be turned around by the end of 2006, as the company stops to use of intermediaries and begins to export bearings directly.

The share of EBC's automotive division in total output will slightly decrease over time, as growth in the automotive ball bearings market is expected to slow, with the metallurgical and energy divisions taking up the slack.

EBC's products comply with Russian quality standards and management says that all divisions have been certified by Lloyd's Register. The company intends to increase the share of after-sale services and on-site customer training as a proportion of revenues in line with global industry players. Some 32% of SKF's revenues in 2005 were generated by services, while the equivalent figure for EBC was less than 5%.

Company structure

EBC can be divided into four business areas: management, production, sales and research. Corporate structure is illustrated in the chart below.



Source: company data

Management

The company has no board of directors, reflecting the significant role played by shareholders in day-to-day management. OJSC European Ball Bearing Company provides the holding with strategic management, assists in oversea operations, financial planning and consolidated accounting, and conducts investor and government relations.

Production assets

The company operates seven production facilities: Volzhsky Bearing Plant (VPZ) in Volgograd region; Moscow Bearing Plant (MP) and Moscow Aviation Bearing Plant (MZAP) in Moscow; Stepnogorsk Bearing Plant (SPZ) in Kazakhstan; Aviation Ball Bearing Plant (ZAP) in Samara; and Volzhsky Precision Bearing Plant (VZPP) and SHAR in Volzhsk.

EBC's subsidiaries

Plant	Year founded or joined the group	Production capacity mn. units/year	Capacity utilization, 2005	Output
VPZ	1998	37.0	51%	Conic and cylinder roller bearings for engineering and rail transport, agricultural engineering and the machine-building industry
MP	2000	5.0	62%	Large and special bearings for various engineering applications in the steel, power generation, machine-building and railroad industry
SPZ	2001	2.0	93%	Roller and cylinder bearings for rail transport; supplies about 80% of Russian Railways' needs.
MZAP	2005	0.3	75%	Precision bearings for the aerospace, defense and shipbuilding industries and high-precision engineering
ZAP and VZPP	2005	6.5	34%	Bearings for aircraft engines, precision and high-precision bearings for the machine-building industry
SHAR	2006	68.8	0%	Producing semi-finished products (steel balls) for further use by other plants

Source: Company data

EBC launched a restructuring program in 2002, discontinuing output of a number of loss-making products and refocusing on the production of industrial, railroad and aviation bearings and bearings for the defense industry. It also acquired further production assets and equipment. Moscow Aviation Bearing Plant was formed in April 2005 on the basis of Moscow Bearing Plant. In May 2005, EBC bought Samara Aviation Bearing Plant. These moves increased EBC's domestic market share to 37%. SHAR was formed on the basis of Volzhsky Bearing Plant in 2005. It is 100% owned by OJSC EBC.

Customers

EBC has more than 500 customers. The contract with Russian Railways accounts for about 51% of the company's revenue, so cash flows rely heavily on Russian Railways' creditworthiness. The risk associated with relying on one particular customer is mitigated by the terms of the contract, which runs until 2010 and incorporates predetermined price increases (from 9.7% in 2006 to 5.0% in 2010), resulting in revenue growth at a CAGR of 5.6% for 2005-10.

EBC's top-10 customers, 2005

Company	Industry	Share, %
Sfera	Railroad	29.8%
RPAS (RusPromAvto)	Automobile	7.1%
Veltorg	Railroad	6.8%
Interreid	Railroad	5.9%
Promsbyt	Railroad	5.9%
AvtoVAZ	Automobile	3.8%
UAZ	Automobile	3.0%
Autocentre Volgotechsna	Automobile	1.8%
Autoprompodshipnik	Dealer	1.8%
Kompleksetstroy	Dealer	1.6%
Total		67.7%

Source: Company data

Currently, Russian Railways is using older-design ball bearing for its operations, but demand for these bearings is expected to slow as they are replaced with TBU bearings. Branco is the leading producer of TBU bearings with about 70% of the total market in the United States. Russian Railways plans to shift to TBU bearings in 2012. Given the projected growth in orders for TBU bearings, EBC will have to invest in associated production lines or seek to cooperate with a global producer, such as Branco.

EBC's ability to pass on increases in steel prices to its customers is limited to 10% per year due to specific clauses in contracts with its major clients, Russian Railways and RusPromAvto. There is a time lag, typically 3-6 months, between an increase in input prices and higher selling prices.

Standard contract terms stipulate that payment should be made 30 days after delivery.

Suppliers

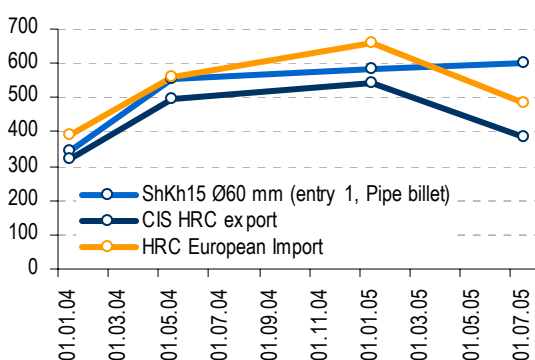
The company uses two main grades of specialty steel to make bearings: ShKh15 (a high-carbon chromium steel) and ShKh15SG (a high-carbon chrome manganese steel). Different types of steel are used to make different types of bearings. EBC's main steel suppliers are listed below.

EBC's main suppliers		
Company	Steel type	Share, %
Oskolskaya Trade-Smelting Company (Oskol Steel Plant)	Hot-rolled steel	51%
Dneprospsstal	Hot-rolled steel	12%
Severstal-metiz	Cold-rolled steel	8%
Other		29%
Total		100%

Source: Company data

Oskolskaya Trade-Smelting Company, a subsidiary of Oskol Steel Plant, supplies 50% of EBC's steel inputs. According to EBC, the steel it buys from Oskol is produced at other plants in Russia and Ukraine, such as Severstal, Dneprosretsstal and Mechel, although in insufficient quality and quantity. Therefore, if EBC wanted to change suppliers, it would likely have to turn to imports. The current supply setup contains significant risk for EBC in that Oskol, which also supplies other CIS and Russian ball bearing manufacturers, could interrupt deliveries or raise prices.

Special grade steel purchase prices vs. hot rolled coil prices



Source: DataStream

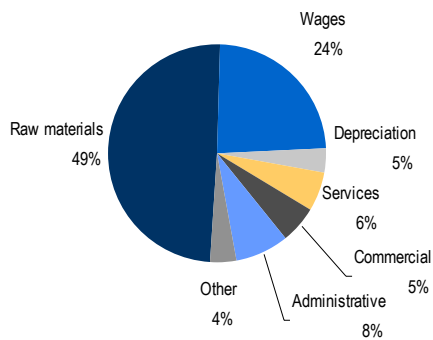
The risk of Oskol interrupting deliveries appears limited in our view, given the company's robust financial performance: in 2005 it generated profit of USD232.8 mn under RAS, up 21% from USD193 mn in 2004. The risk of an unexpected price increase appears to be higher, in our opinion, as steel accounts for such a large share of EBC's cost structure (45% in 2004 and 47% in 2005). In the past, EBC's steel purchase prices have risen with the commodity market, but they have not fallen when prices for rolled coil have gone down, as shown in the graph on the left. EBC says it has experienced no supply disruptions or conflicts over prices with Oskol in the two years since the companies began cooperating together. However, EBC faces a constant input price

appreciation that it must pass on to customers.

EBC's contracts (both supply and delivery) typically last for one year (except for Russian Railways) and include a mechanism to adjust prices every quarter to account for growth in input prices (steel purchases and energy tariffs). With such terms, EBC says it cannot raise its selling prices by more than 10% a year, which represents a risk that margins may be eroded should Oskol raise its prices above this rate.

Cost structure

Total costs, 2005



Steel constitutes 36% of the company's total costs, with wages and social welfare taxes the next-largest cost item (24%). In total, raw materials, wages and energy represent 73% of total costs.

Source: Company data

Strategy

EBC is developing a five-year strategy that is expected to be finalized by year-end 2006.

The main elements will include:

- Continued modernization of production facilities and optimization of business processes to improve quality and production efficiency. This will enable the company to cut costs by lowering consumption of steel and energy and trimming headcount.
- Conducting research on customer demand. Retaining leadership positions on domestic market in the railroad and precision bearings segments.
- Increasing market share in metallurgy, power generation, oil extraction and machine building. Accumulating inventories to cope with any sudden rise in demand.
- Achieving growth through acquisitions, cooperation with a foreign partner (such as SKF, INA or Koyo), building new production facilities and entering new markets. EBC intends to apply for quality certificates so it can start exporting to the Eastern and Western European markets.
- Expanding its sales network in Russia, the CIS and other foreign countries.

Financial Analysis and Debt Portfolio

Analysis of historical financial results

We analyzed the following data:

- 2002 management accounts
- 2003 unaudited IFRS accounts, restated by KPMG
- 2004 IFRS accounts audited by KPMG
- Draft 2005 IFRS accounts by KPMG. Audited 2005 IFRS accounts are expected by the end of September. The company says the figures below are not expected to change.

Summary financials						
	2003U	2004	y-o-y growth	1H05	2005U	y-o-y growth
Profit and loss account						
Total sales	160.3	204.7	28%	109.8	249.7	22%
Gross profit	32.8	69.2	111%	36.2	82.8	20%
EBITDA	14.8	47.4	219%	25.1	52.1	11%
Net profit after tax	8.4	29.9	254%	15.6	30.9	3%
Balance sheet						
Equity	43.4	82.4	96.3	95.3	96.3	17%
Financial debt	9.7	16.9	73%	44.9	50.7	201%
Tangible fixed assets	32.3	47.2	46%	88.8	83.3	76%
Total assets	95.9	133.9	40%	183.7	203.5	52%
Cash flow statement						
Change in working capital	n.a.	(22.5)	n.a.	(0.0)	(12.5)	-44%
Operating cash flow	12.3	7.7	-38%	15.9	21.1	175%
Capex	(15.2)	(19.0)	25%	(8.3)	(44.4)	134%
Free cash flow	(2.9)	(11.3)	293%	7.7	(23.2)	106%
Ratios						
Gross margin	20%	34%	65%	33%	33%	-2%
EBITDA margin	9%	23%	150%	23%	22%	-5%
Net margin	5%	15%	177%	14%	12%	-15%
Financial debt/EBITDA	0.63	0.34	-46%	1.79	0.92	170%
EBITDA/interest expense	22.8	35.0	54%	10.7	13.7	-61%
Debt/equity	0.22	0.20	-9%	0.47	0.53	157%
Financial debt/TNW ⁶	0.23	0.21	-9%	0.47	0.52	152%

Source: Company data

Sales

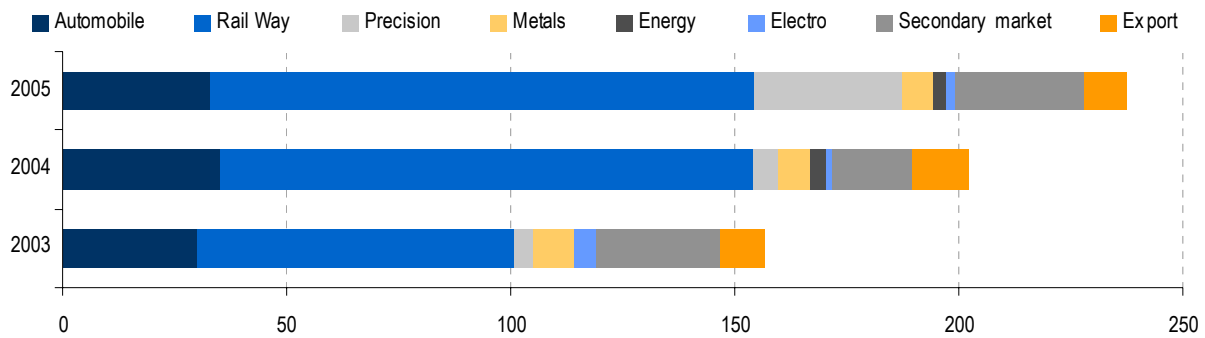
EBC's revenues grew at a CAGR of 39% in 2002-05, on the back of both acquisitions and growth in railroad bearing sales (thanks to the contract with Russian Railways). Revenues from the railroad division accounted for more than half of EBC's total turnover in 2005 and grew at a CAGR of 37% in 2002-05. Railroad division sales accounted for 67% of total sales growth in 2002-05.

Sales in the high value-added precision and metallurgy bearing segments grew at a CAGR of 78% in 2002-05. Growth in this segment started from a low base and was mainly linked to acquisitions.

Automotive bearings were EBC's second-largest revenue source in 2004, although revenues from these bearings demonstrated a less dynamic CAGR of 5.1% in 2002-05.

⁶ Tangible net worth

Sales, USD mn



Source: Company data, MDM estimates

The acquisition of Samara Aviation Bearing Plant in August 2005 helped to increase sales of precision bearings. These bearings accounted for 3% of total revenues in 2004, which climbed to 14% by year-end 2005, making it second-largest revenue source along with automotive bearings. The company says the contract with Russian Railways and other new contracts in the metallurgy and automotive sectors helped push bearing sales up 22% to USD250 mn in 2005.

Gross margin

EBC's gross margin soared from 20% in 2003 to 34% in 2004, and remained relatively flat at 33% in 2005. The significant increase in 2004 was due to a higher proportion of direct sales (as opposed to sales via third parties), a better product mix and lower COGS. The company has been cutting headcount and energy consumption. In addition, EBC reduced its production area at MP from 52 hectares to 39 hectares, and at VPZ by some 10-15%.

Gross margin dropped one percentage point from 2004 to 2005 due to an increase in steel prices (against a background of declining world steel prices).

EBITDA and net profit

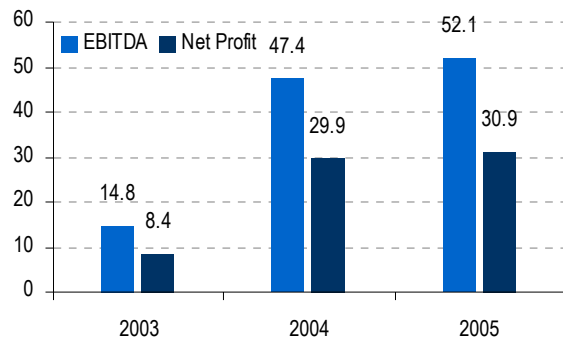
Following the jump in gross margin in 2004, EBITDA rose 3.2 times to USD47 mn and net profit was up 3.5 times to USD30 mn. The ongoing restructuring resulted in a 29% drop in services from other companies, which contributed to a 6% decrease in administrative costs. At the end of 2005, administrative costs were lower than in 2003. While commercial expenses increased 42% in 2004, and another 33% in 2005, EBITDA margin followed gross margin, increasing from 9% in 2002 to 23% in 2004 and dropping slightly to 21% in 2005. Net profit margin also rose significantly in 2004, to 15%, but fell to 12% in 2005 as a result of increased interest expenses.

Cash flow

Working capital increased from 70 days in 2003 to 103 days in 2004, and to 119 days in 2005. Inventories grew rapidly in 2004, by some 32%, and in 2005 they increased a further 25%. Growth in inventories was slowed by growing payables, which expanded from 74 days of COGS in 2004 to 90 days of COGS in 2005.

The company attributed this growth in inventories to the implementation of its strategy, which calls for the accumulation of stocks of high value-added bearings used in the metallurgy and power generation industries. EBC also built up stocks to ensure it had sufficient finished goods to fulfill contracts for delivery 30 days ahead of schedule.

EBITDA and net profit, USD mn



Source: Company data

As a result, despite EBITDA increasing three-fold, cash flow from operations decreased by 38% in 2004 (from USD12.3 mn to USD7.7mn), as working capital increased by USD22.5 mn. In 2005, inventories increased more slowly than in 2004 and working capital increased only USD12.5 mn. As a result, the company closed the year with operating cash flow of around USD21 mn.

EBC invested about USD19 mn in 2004 and USD44 mn in 2005 for modernization and acquisitions. As a result, it posted negative free cash flow of USD11 mn in 2004 and USD23 mn in 2005.

Equity and dividends

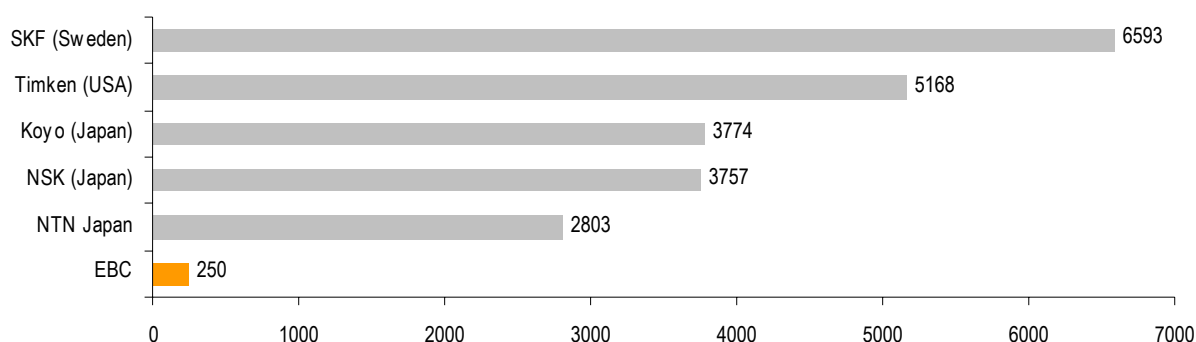
In 2003-05, the company increased equity by 122% – from USD43 mn in 2003 to USD96mn in 2005 – mostly thanks to retained earnings of USD30 mn and a share capital increase of USD17 mn, which came through the distribution of additional shares.

In 2005, EBC paid dividends for the first time, totaling USD7.8 mn. In the future, the company expects to pay no more than 25% of net profit on dividends.

Peer analysis

We compared EBC's financial performance with domestic and global peers. For the domestic peer group, we chose SPZ Group and Vologodsky Bearing Plant, as they are EBC's only true competitors, in our opinion. Global peers included several large companies with a similar product range: SKF, Timken, Koyo, NTN Japan, and NSK. We used 2005 figures for EBC and the global peers, but figures for that year are unavailable for the Russian competitors.

Sales in 2005, USD mn



Source: Bloomberg, company data

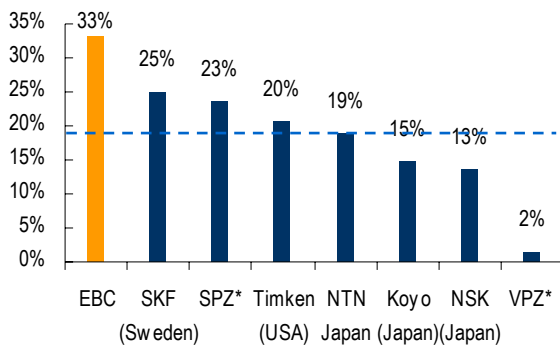
The accuracy of a peer comparison is limited by differences in size, sales geography and accounting methods. The domestic peers are private companies with weak public disclosure. The only figures available are for 2004, which are recorded according to RAS and are not consolidated⁷.

Gross and EBITDA margin

EBC is well ahead of its global peers in both gross margin and EBITDA margin (as mentioned above, a direct comparison with SPZ is complicated by its lack of disclosure). The following graphs demonstrate gross and EBITDA margins for 2005:

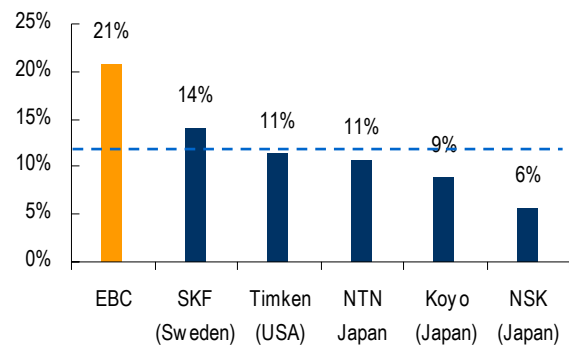
⁷ For example, of SPZ Group's two subsidiaries, only one has publicly available ratios (via Factiva).

Gross margin, 2005



Source: Bloomberg, Factiva
*for 2004 under RAS

EBITDA margin, 2005



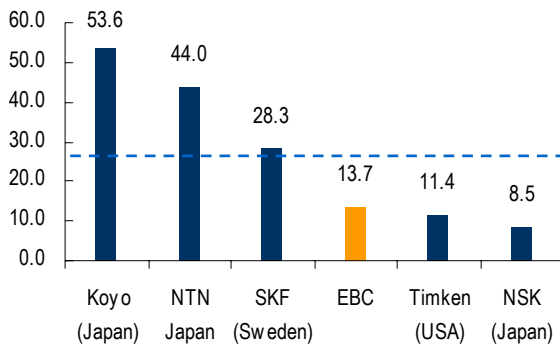
Source: Bloomberg

Our comparison indicates that the global peers are less profitable than Russian producers. For example, EBC's EBITDA margin was almost double the global average. In the long term, we expect the margins of domestic players to gradually decline towards the global average as a result of increased competition.

Financial leverage

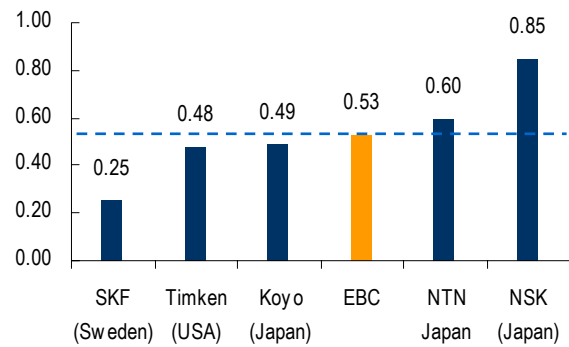
There is no publicly available data on the debt position, assets or interest payments of EBC's domestic competitors, so we can only compare EBC to its global peers. EBC is in line with Timken and Koyo in terms of debt leverage and underleveraged vs. NTN Japan and NSK. Its debt/equity ratio is in line with the industry average⁸. It has financed its operations through equity and retained earnings, but EBC's EBITDA/Interest expense ratio is below the industry average, which maintains a higher average interest rate on a relatively smaller debt burden.

EBITDA/Interest, 2005



Source: Bloomberg

Debt/Equity, 2005



Source: Bloomberg

⁸ No asset revaluation was made

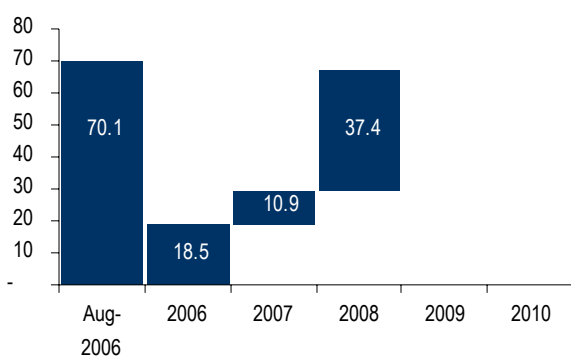
Debt structure and coverage ratios

EBC loan portfolio as of August 28, 2006			
Lender	RUB '000	USD '000*	Tenor
Promsvayzbank	51,612	1,928	5
International Moscow Bank	134,000	5,006	1
Gazprombank	72,096	2,693	1
MDM Bank	100,000	3,736	1
Guarantee - Bank Moscow	142,000	5,304	1
Guarantee - Bank Moscow	40,000	1,494	1
Promsvayzbank	86,960	3,248	5
Guarantee - Bank Moscow	57,900	2,163	1
Alfa Bank	190,820	7,128	1
RUB bond at 8.75%	1,000,000	37,355	2
Total	1,875,388	70,056	n/a

Source: Company data
*RUB/USD rate was 26.7672 as of 29 August 2006

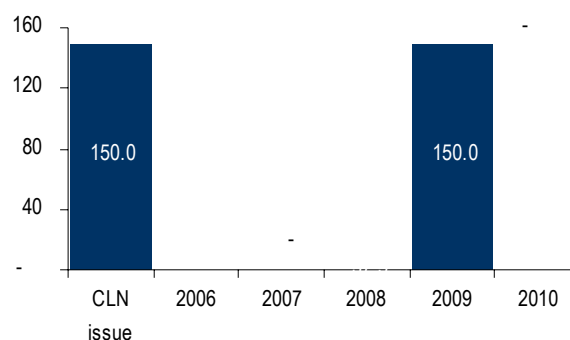
EBC's debt portfolio in dollar terms (calculated according to the Central Bank's official rate) totaled USD70.1 mn as of August 28, 2006. The company's ruble bond, equivalent to USD37.3 mn, represented 53% of the total debt, with the remainder composed of bank loans: USD27.5 mn in short-term credits (84% of the total), and USD5.2mn in loans with terms of 2-5 years (16%), most of which fall due in 2008. We expect that after the CLN issue planned for late 2006, EBC will retire all of its bank loans ahead of schedule along with the ruble bond, leaving only the CLN in its debt portfolio. The company's repayment schedules before and after the CLN issue are illustrated below.

Repayments as of Aug 28, 2006



Source: Company data

Repayments after CLN issue date



Source: Company data

The company enjoyed low leverage in 2002-04. Its debt/equity ratio was 0.23 in 2003 and moved to 0.20 in 2004. The ruble bond issue in 2005 took this ratio to 0.5, but the company's debt/equity ratio was still in line with the average among peers such as SKF, Timken, Koyo, NSK and NTN Japan.

Financial Model

Assumptions under the base scenario

Our assumptions on inflation and the RUB/USD exchange rate are as follows:

Macroeconomic assumptions						
	2004	2005	2006E	2007E	2008E	2009E
Average RUB/USD exchange rate	28.8	28.3	28.1	27.2	27.1	27.4
RUB/USD exchange rate at end of period	27.8	28.9	27.4	27.1	27.2	27.5
Inflation	11.7%	10.9%	10.0%	8.5%	7.0%	6.0%

Source: Central Bank, Rosstat, MDM estimates

Acquisition of new assets

Once EBC's outstanding bank loans and ruble bond are retired, we assume the remaining proceeds of the CLN, some USD79 mn, will be used to finance acquisition of new assets, which should result in higher revenues and expenditures. To model future cash flows, we adopt a conservative approach and assume EBC will spend up to USD75 mn on assets that bring an additional USD40 mn in revenues per year (i.e. an 14% increase on EBC's sales in 2007 and a 11% rise in asset value). We also conservatively assume the margins of the new assets will be at least 10 percentage points lower than for EBC's existing business.

Sales revenue

We make revenue assumptions for each of EBC's eight divisions: automobile, railway, special and precision bearings, metallurgical, power, electro-technical, secondary, and export.

Sales increase by division						
Division	2005U	2006E	2007E	2008E	2009E	Share in gross revenues 2009
Automobile	-8%	3%	0%	3%	6%	15%
Railroad	0%	0%	0%	0%	0%	47%
Special and precision bearings	479%	0%	8%	8%	8%	16%
Metallurgy	-10%	10%	10%	10%	10%	4%
Power generation	-10%	10%	10%	10%	10%	2%
Electro-technical	-12%	10%	10%	10%	10%	1%
Secondary market	65%	0%	0%	0%	0%	12%
Exports	-29%	5%	5%	5%	5%	4%

Source: MDM estimates

- **Railroad:** Divisional revenues continue in accordance with the current Russian Railways contract, so production remains at 2005 levels in 2006-09
- **Automobile:** We forecast increase automobile bearing sales in line with domestic automobile production growth (see Appendix 2)
- **Special and precision bearings:** We model 8% growth in 2007-09 as the government is expected to increase defense orders
- **Metallurgical, power generation and electro-technical:** Revenues grow by 10% per year, in line with the company's own forecasts, as a result of EBC's modernization and restructuring program
- **Secondary market:** Divisional revenues remain at 2005 levels
- **Exports:** 5% annual growth of export sales

COGS

- We conservatively assume the efficiency of metal consumption (the ratio of metal used per ton of finished goods) remains at the 2005 level for the entire forecast period (2006-09), ignoring any benefits of the company's modernization program
- Purchase prices for steel grow at a CAGR of 8.7% (in line with inflation) in 2006-09, despite an anticipated decline in prices for rolled steel during the period
- Labor expenses are comprised of the average wage rate, which grows in line with inflation. The headcount to production ratio is expected to be 10.76 tons of product per worker (up from the current 10.33 in 2005) according to restructuring plans.

COGS forecast, USD mn

	2005U	2006E	2007E	2008E	2009E
COGS	(166.9)	(185.6)	(239.7)	(260.3)	(280.8)

Source: MDM estimates

Operating expenses

- The share of commercial expenses remains constant at 4.5% of revenues, in line with past performance
- Operating expenses grow by 2 percentage points above inflation per year for 2006-09
- Rental payments remain in line with current agreements
- Administrative personnel expenses according to the company's restructuring plans for 2006-09
- Other operating expenses remain in line with historical performance.

Operating expenses forecast, USD mn

	2005U	2006E	2007E	2008E	2009E
Operating expenses	(35.2)	(37.7)	(46.4)	(51.6)	(57.0)

Source: MDM estimates

Investments and working capital

- Our investment assumptions take into account the company's modernization plans and potential asset acquisitions.

Investment forecasts, USD mn

	2004	2005U	2006E	2007E	2008E	2009E
Moscow Bearing Plant	14.5	7.1	9.1	6.2	5.3	3.5
Stepanogorsk Bearing Plant	1.9	3.2	6.1	5.3	4.2	2.9
Volzhsky Bearing Plant	6.6	6.6	7.0	7.3	8.1	5.7
Moscow Aviation Bearing Plant	-	-	0.4	0.4	0.5	0.2
Samara Aviation Bearing Plant	-	-	3.1	4.5	5.6	4.5
Volzhsky Precision Bearing Plant	-	-	0.4	0.3	0.3	0.1
Purchase of new assets	-	34.0	-	75.0	-	-
Total	23.0	50.9	26.2	99.0	24.0	17.0

Source: Company data, MDM estimates

- We assume working capital remains at 2005 levels in 2006-09.

Working capital assumptions

	2004	2005U	2006E	2007E	2008E	2009E
Debtors (in days)	67	71	67	67	67	67
Creditors (in days)	74	90	80	80	80	80
Inventories (in days)	111	138	111	111	111	111

Source: Company data, MDM estimates

Given our assumptions, we derive the following income statement, balance sheet and cash flow statement forecasts.

Base case financials

Income statement, USD mn						
	2004	2005U	2006E	2007E	2008E	2009E
Total sales	204.7	249.7	279.6	356.1	385.8	409.9
Automobile division	35.4	33.1	37.9	42.0	45.5	49.1
Railway division	118.7	121.4	134.3	147.7	154.4	156.2
Special and precision bearings division	5.6	33.2	36.8	44.1	50.1	55.2
Metallurgy division	7.3	6.7	8.2	10.0	11.5	12.9
Power division	3.4	3.2	3.8	4.7	5.4	6.1
Electro-technical division	1.6	1.4	1.7	2.1	2.4	2.7
Secondary market	17.5	29.4	32.6	36.1	38.0	38.7
Exports	12.5	9.1	10.6	12.4	13.7	14.6
Other revenues	2.6	12.3	13.7	57.1	64.8	74.4
COGS	(135.4)	(166.9)	(185.6)	(239.7)	(260.3)	(280.8)
Gross profit	69.2	82.8	94.0	116.4	125.5	129.1
Operating expenses	(25.6)	(35.2)	(37.7)	(46.4)	(51.6)	(57.0)
Operating profit	43.6	47.6	56.3	69.9	73.9	72.1
EBITDA	47.4	52.1	61.0	83.5	88.7	87.7
Interest expenses	(1.4)	(3.8)	(9.0)	(15.0)	(15.1)	(13.1)
Interest Received	0.1	0.2	-	-	-	-
Profit tax	(12.3)	(12.4)	(12.5)	(13.2)	(14.1)	(14.1)
Exchange Difference	(0.3)	(0.7)	-	-	-	-
Minorities	0.1	5.8	-	-	-	-
Net profit	29.9	30.9	34.8	41.7	44.6	44.8
Dividends	-	(7.8)	(7.9)	(8.2)	(8.2)	(8.2)
Retained earnings	29.9	23.1	26.9	33.5	36.4	36.6

Source: Company data, MDM estimates

Ratios						
	2004	2005U	2006E	2007E	2008E	2009E
Gross margin	34%	33%	34%	33%	33%	32%
EBITDA margin	23%	21%	22%	23%	23%	21%
Net margin	15%	12%	13%	12%	12%	11%
EBITDA/interest expense	35.0	17.0	6.7	5.6	5.9	6.7
Financial debt/EBITDA	0.4	1.0	2.5	2.1	1.8	1.4
Financial debt/equity	0.20	0.53	1.19	1.08	0.78	0.52
ROE	36%	31%	28%	25%	22%	19%
ROA	22%	15%	11%	10%	10%	10%
EBITDA	47.4	52.1	61.0	83.5	88.7	87.7

Source: Company data, MDM estimates

Balance sheet, USD mn						
	2004	2005U	2006E	2007E	2008E	2009E
Cash	4.0	6.2	1.7	-	-	-
ST investments	1.0	0.6	118.6	0.6	0.6	0.6
Receivables and Advance Paid	38.7	48.8	52.8	65.9	70.9	74.9
Inventories	42.6	61.9	57.8	73.1	78.9	84.6
Fixed assets	47.2	81.6	108.3	270.7	278.9	276.5
Intangible assets	0.4	0.4	0.4	0.4	0.4	0.3
Total assets	133.9	199.6	339.6	410.7	429.6	437.1
Short-term debts	16.8	11.2	-	26.0	5.8	5.6
Payable debts	28.4	40.7	42.8	54.6	59.0	67.9
Long-term financial debt	0.1	38.5	153.9	150.8	149.7	115.0
Other long-term liabilities	0.2	1.3	1.4	1.4	1.4	1.3
Shareholders' equity	82.4	96.3	129.2	165.6	201.4	235.1
Minority	6.1	11.6	12.2	12.4	12.3	12.2
Total liabilities	133.9	199.6	339.6	410.7	429.6	437.1

Source: Company data, MDM estimates

Cash flow statement, USD mn						
	2004	2005U	2006E	2007E	2008E	2009E
EBITDA	47.4	52.1	61.0	83.5	88.7	87.7
Income tax paid	(12.5)	(13.4)	(13.0)	(13.2)	(14.1)	(14.1)
Change in working capital	(22.5)	(12.5)	5.3	(16.5)	(6.9)	(7.0)
Interest payments	(1.4)	(3.1)	(7.9)	(14.3)	(14.9)	(8.4)
Cash flow from operating activities	7.7	21.1	45.4	39.5	52.8	58.1
Investments	(18.8)	(44.4)	(26.2)	(174.0)	(24.0)	(17.0)
Intangible assets	(0.2)	-	-	-	-	-
Free cash flow	(11.3)	(23.2)	19.3	(134.5)	28.8	41.1
New loans	58.9	168.4	150.0	27.0	-	115.7
Redemption of loans	(51.2)	(135.0)	(51.1)	(4.8)	(20.6)	(148.7)
Change in Shareholders' equity	5.1	-	-	-	-	-
Dividends	-	(7.8)	(7.9)	(8.2)	(8.2)	(8.2)
Cash flow from financial activity	12.9	25.6	91.0	14.1	(28.8)	(41.1)
Net increase in cash	1.6	2.4	110.3	(120.3)	-	-
Cash at the end of the period	3.9	6.3	116.7	-	-	-

Source: Company data, MDM estimates

Under our base case scenario, gross margin will decline from 33% to 32% in 2005-09 and EBITDA margin will edge down from 21% to 20%, which reflects our rather conservative assumptions.

Sensitivity analysis

Potential risks to the company's ability to service its debt include:

- Failure to acquire any additional assets
- Substantial increase in steel prices, causing a decline in profits (as EBC is restricted in the price increases it can pass on to customers)
- Increased competition, resulting in EBC's market share to decrease as domestic peers become more competitive and foreign companies establish local production or increase import volumes into Russia.

We have created three scenarios in which we model the outcome of one or more of these situations. In this way, we can assess the levels at which EBC's net debt/EBITDA ratio does not exceed 3.0 (as restricted by the covenants).

Scenario 1: Failure to acquire any additional assets

Ratios/indicators				
	2006E	2007E	2008E	2009E
EBITDA/interest expense	6.7	5.0	5.3	10.2
Net debt/EBITDA	0.5	0.4	0.3	0.0
Financial debt/own capital	1.2	0.9	0.8	0.0
EBITDA	61.0	69.0	72.0	69.6
Net profit	35.9	37.5	38.9	41.6
Cash at end of the period	117.8	121.0	128.4	0.0
Changes vs. the base scenario				
EBITDA/interest expense	0%	-17%	-11%	-2%
Net debt/EBITDA	0%	-80%	-83%	-97%
Financial debt/own capital	0%	-12%	1%	-97%
EBITDA	0%	-17%	-19%	-21%
Net profit	0%	-10%	-13%	-7%

Source: MDM estimates

Under this scenario, the company fails to acquire any further assets, so we factor out the annual some USD40 mn in anticipated additional revenues projected under the base case scenario. Consequently, EBITDA, net profit and profitability would be lower, although EBC would have a significant amount of cash at the end of the period. As the CLN funds would not have been used, so it would not experience any difficulties in servicing debt.

Scenario 2: Substantial increase in steel prices

Ratios/indicators				
	2006E	2007E	2008E	2009E
Increase in steel prices in addition to inflation	5.8%	5.8%	5.8%	5.8%
EBITDA/interest expense	6.2	4.5	3.9	3.3
Net debt/EBITDA	0.7	2.7	2.7	3.0
Financial debt/own capital	1.2	1.3	1.1	1.0
EBITDA	56.2	71.2	68.1	57.6
Net profit	32.3	31.8	27.3	18.8
Changes vs. the base scenario				
EBITDA/interest expense	-8%	-15%	-27%	-48%
Net debt/EBITDA	22%	27%	56%	121%
Financial debt/own capital	3%	18%	41%	91%
EBITDA	-8%	-15%	-23%	-34%
Net profit	-10%	-24%	-39%	-58%

Source: MDM estimates

We apply an additional 5.8% annual increase in steel purchase prices (on top of inflation) through 2009. As a result, steel prices would grow at a CAGR of 15.3% over 2005-09. EBC's net debt/EBITDA would grow to 3.0 by the end of the period. We consider this to be a low-probability scenario, particularly as our equity analysts forecast that global steel prices will drop by an average of 2.9% per year in 2005-09.

Scenario 3: Increased competition

Under this scenario, all divisional revenues, except railroad and precision, decline by 10% per year. The revenues from new assets also fall by 10% per year. The revenues of railroad and high precision divisions are maintained at current levels, thanks to the contracts with Russian Railways and the Russian Defense Ministry.

Ratios/indicators				
	2006E	2007E	2008E	2009E
steel prices increase on top of inflation	0.9%	0.9%	0.9%	0.9%
EBITDA/interest expense	6.3	4.2	3.7	3.3
Net debt/EBITDA	0.6	2.9	2.9	3.0
Financial debt/own capital	1.2	1.3	1.1	1.0
EBITDA	56.7	64.9	62.7	55.2
Net profit	32.7	27.3	23.5	17.4
Changes vs. the base scenario				
EBITDA/interest expense	-6%	-20%	-28%	-43%
Net debt/EBITDA	6%	31%	55%	98%
Financial debt/own capital	2%	16%	38%	77%
EBITDA	-6%	-20%	-26%	-33%
Net profit	-8%	-31%	-42%	-54%

Source: MDM estimates

Under this scenario, the most pessimistic that we analyze, EBC's net debt/EBITDA ratio would reach the threshold of 3.0 in 2009, but the company would be able to service its debt as the EBITDA/interest expense ratio would not fall below 3.3 over the forecasted period.

Conclusion

Forecasted cash flows should be sufficient to service debt

EBC posted high growth rates in 2002-05 and it plans to further expand its presence on the domestic and export markets. The company holds a near monopoly on the domestic markets for railroad and precision bearings (its market share is 95-98%) and it has a strong position on the automobile bearings market. These three divisions alone should, we believe, generate sufficient cash flow to service the company's debt. The new, USD560 mn contract to supply bearings to Russian Railways signed at the end of 2005 guarantees annual cash flows of at least USD100 mn through 2010. Furthermore, the company's high profitability over the last two years offers additional comfort should there be a significant increase in domestic market competition.

Nevertheless, the company's significant dependence on its main supplier represents a risk that EBC's production costs could rise unexpectedly, causing a fall in profitability.

Our sensitivity analysis indicates that EBC would be capable of servicing its debt even under very adverse conditions, such as a 15.3% annual increase in procurement prices for steel, or a considerable drop in sales throughout all divisions, apart from the railroad and precision bearing divisions.

Appendix 1: Oleg Savchenko and the Formation of EBC

Oleg Savchenko began his business career by importing computers from Singapore in 1992. Since 1997, he has served as adviser to the governor of Chukotka. He acquired a controlling stake in Volzhsky Bearing Plant in 1998, which gave him a seat on the board.

In 2000, Mr. Savchenko established Russian Bearing Company Holding (the precursor to European Bearing Company). He then began accumulating shares in Moscow Bearing Plant, and by autumn 2000, he had acquired a controlling stake. However, Rosavtobank was also accumulating a stake at the same time and it succeeded in building a blocking stake. With support from the Moscow city government, Moscow Bearing Plant issued additional shares to generate funds to service its debts, thereby diluting Rosavtobank's stake. However, a court later ruled the issue was invalid.

Mr. Savchenko then reached an agreement to buy Rosavtobank's stake. The working capital of Moscow Bearing Plant allowed Mr. Savchenko buy Stepanogorskiy Bearing Plant, the largest railroad bearing manufacturer in the CIS, in early 2001. Following the acquisition, Mr. Savchenko focused on restructuring the three plants to enhance efficiency. Production of automotive bearings was transferred from the Moscow plant to Volgograd, while the production of railroad bearings was moved to Stepanogorsk. In December 2003, Mr. Savchenko was elected to the State Duma on the United Russia party list. Mr. Savchenko is a prominent public figure and further information is widely available, in particular at:

■ *Forbes*, April 2005

■ *Vedomosti*, February 13, 2006

Appendix 2: EBC's Markets

EBC is active in the following ball bearing segments:

- Railroad
- Automotive
- Precision
- Metallurgical

Railroad bearings are high value-added products – featuring an average gross margin of 40% – and the company has designated this segment as a priority area. EBC accounts for about 95% of the Russian railroad bearing market, with Ukraine's Kharkovskiy Bearing Plant (HARP) producing most of the remainder.

Breakdown of the Russian railroad bearing market, 2005



Source: Company data

Russian Railways' strategy envisages freight turnover increasing by 1.5 times and passenger turnover rising 1.1-1.2 times by 2010. To achieve these rates, Russian Railways estimates it will need to invest RUB160 bn (USD5.9 bn) in new locomotives, RUB90 bn (USD3.3 bn) in new freight wagons, RUB60 bn (USD2.2 bn) in new passenger cars and RUB50 bn (USD1.8 bn) in electric trains. In 2005, EBC signed a RUB16 bn (USD560 mn) contract to supply Russian Railways with bearings for rolling stock, which runs until 2010. Taking this agreement into account, we anticipate the railroad bearing market will be worth USD140 mn per year by 2010, and EBC alone will supply some USD130 mn of this figure. We do not expect any significant change in EBC's

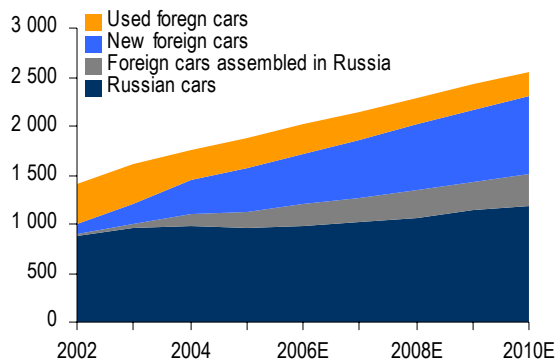
share of the railroad bearing market and the company will likely remain a leader in this segment.

EBC is the only company in the CIS that makes cassette TBU bearings. Branco is the global leader in the production of this type of bearing, and holds about 70% of the TBU market in the U.S. Russian Railways plans to switch to TBUs by 2012. Given the significant increase in demand that will result, EBC would be unable to manufacture the necessary volumes and would either have to invest in TBU production facilities or seek cooperation with a global producer, such as Branco.

Automotive bearing market

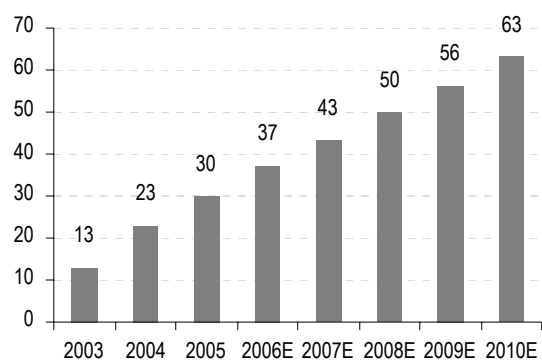
We estimate that the Russian automotive bearing market will grow at an average rate of 12% in 2005-10 and be worth around USD128 mn by 2010. Automotive bearings are lower-margin products: the most successful Western companies have margins no higher than 7%, whereas EBC's margin is around 15%. Due to a huge size of the market (the global automotive bearing market is an estimated 40% of the total bearing market), this segment retains its appeal among most producers. Other major domestic automotive bearing suppliers include VPZ, Minsk Bearing Plant and Soyuzpodshipnik.

Automobile market, '000 units



Source: E&Y, ASM Holding, Autoreview, Autoizvestia, MDM estimates

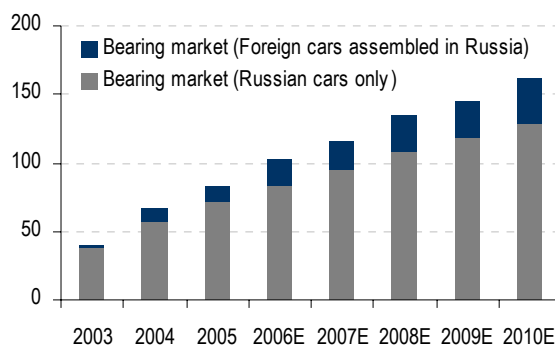
Automobile market, USD bn



Source: E&Y, MDM estimates

In 2004, domestically produced automobiles made up 51% of total car sales, although this share is expected to drop to 47% by 2010. Disposable incomes are rising rapidly, so people can afford more expensive foreign-made cars, and foreign auto makers such as Toyota, Volkswagen and Nissan are looking to build assembly plants in Russia.

Russian automobile bearing market, '000 units



Source: EBC, MDM estimates

Thanks to this rise in disposable income, Russian preferences are switching toward more expensive cars. The average selling price of a car was USD8,150 in 2003; only one year later, the average price had increased 59%, reaching USD13,000. We calculate the average price of a new car will be USD24,793 by 2010. Going forward, we expect a shift in demand towards foreign cars assembled in Russia, and also towards new foreign cars instead of secondhand cars.

By 2010, we believe market volume will double to USD63.3 bn. The share of foreign cars assembled in Russia should grow to 12%, up from 3% in 2003.

We do not think EBC's automotive bearing market share will change drastically by 2010, for the following reasons:

- Russian producers mainly supply bearings for Russian cars, and we estimate that growth in the Russian automobile segment will total 24% by 2010, compared with 34% overall market growth. Even taking into account legislation that sets quotas for the amount of Russian components to be used in cars assembled in Russia, we expect overall domestic output of automobile bearings to remain unchanged. This factor will place a negative pressure on EBC's market share in the automotive bearing market.
- The positions of major automotive industry bearing producers are very strong, while EBC's share is insufficient. In view of the limited growth prospects for Russia's auto market, it will be difficult for EBC to regain positions taken by competitors.

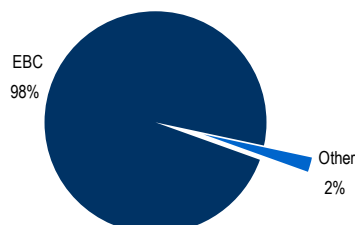
However, if EBC launches the production and sale of integrated car subassemblies (a top-priority project of the company's development center), it will gain a temporary advantage over domestic competitors that should lead to market share growth. Also, EBC supplies conic automotive bearings used in increasingly popular four-wheel drive and off-road vehicles, which should further support its market share.

Precision bearings

EBC accounts for 98% of the Russian precision bearings market, with Samara (SPZ Group) and Saratov making up the remaining 2%. All of EBC's special and precision bearings are produced at MZAP and ZAP.

The Russian high-precision bearing industry is partially protected from foreign competition by import duties and a licensing system. However, EBC is banned from exporting its products directly. The Russian special bearings market was worth an estimated USD35 mn in 2005 and is expected to grow by USD5 mn a year, reaching USD50 mn by 2008.

Russian precision bearings market, 2005



Source: Company data

Metallurgical bearings

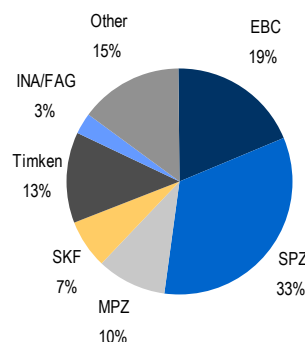
The market for bearings used in metallurgy was worth an estimated USD80 mn in 2005, according to EBC. Smelting plants are currently expanding output and are consequently looking to buy more bearings.

We estimate Russian steel output will expand by an average 5% per year until 2010, so we assume the associated bearing market will increase at a similar rate. We expect EBC to increase output for the metals industry at an average of 10% per year. This above-market growth rate can be explained by:

- a low base effect
- under its strategy, the company will gain market share for Samara and Vologda Bearing Plant, which are widely represented in the segment.

Nevertheless, we think the share contributed by metallurgical bearings to EBC's revenues will remain less than 6% in 2009 (see our base case scenario in the Financial Model Assumptions section).

Russian metallurgical bearings market, 2005



Source: Company data



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