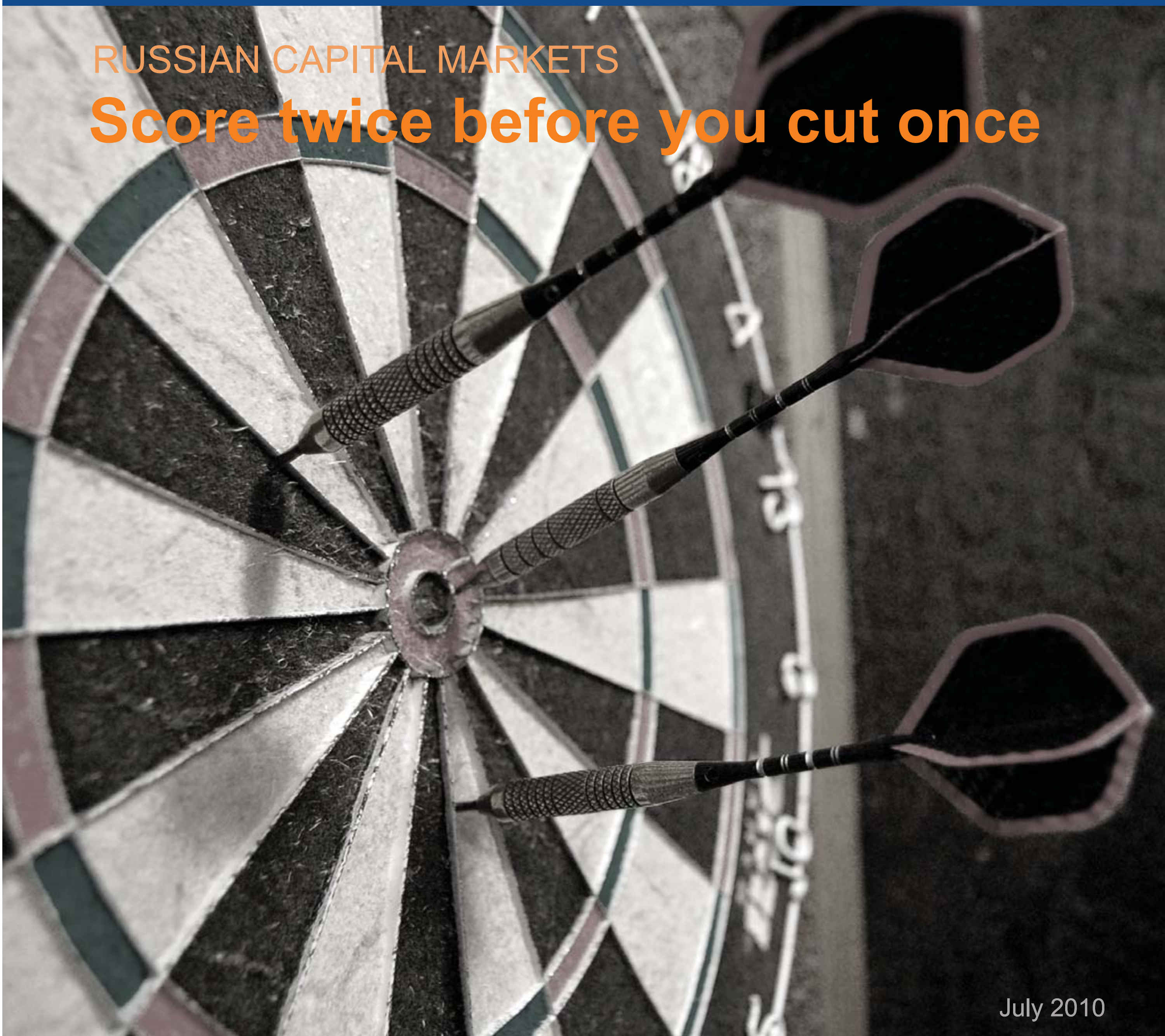
2H2010 STRATEGY

RUSSIAN CAPITAL MARKETS

Score twice before you cut once



July 2010

TKB Capital

www.tkbc.ru

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Strategy 2H2010

Score twice before you cut once

Choose Dollar over Ruble

Bearing in mind the existing risks, we bet on less risky US dollar, which may take the leading position among investment assets in 2H10, while ruble as well as other EM currencies will be under pressure. Our view on ruble may change, function of the oil price dynamics.

Choose Eurobonds over Ruble Bonds

The risks of ruble devaluation diminish attractiveness of the ruble-denominated bonds, which rallied over the last 12 months. We recommend choosing short- and medium-term Eurobonds of high-quality issuers. Investors who need to have ruble assets in their portfolio would be better off by choosing new placements with floating coupon rates.

Choose Gold over Oil

In 1H10, a period of high volatility, gold was a safe haven. Going forward the demand for gold should be supported by inflation risks. Oil remains sensitive to the market trend that determines higher volatility and uncertainty.

Choose Soya and Corn over Sugar

Lower than expected crops, as well as growing demand from China, should support soya and corn prices. We expect sugar price to continue the downward trend.

Choose Return over Risks

Excessive liquidity on the market will continue to support equities, but investors have learnt to see the risks and now should choose safe plays. We recommend betting on attractive fundamental value stories, avoiding risky stocks.

Choose Play on recovery over Highly regulated industries

We recommend choosing sectors which are best positioned to capitalize on the economic recovery, growing consumption and long-term investment demand. Meanwhile, we expect sectors with high degree of government involvement to be under pressure due to uncertainty in regulation.

Choose Banks, Retail, Infrastructure over Oil and Utilities

Among the Russian stocks we recommend banking, retail and infrastructure plays, which offer 30-50% upside potential driven by economic recovery and domestic demand. We expect weaker returns in oil and gas and utilities names on the back of uncertainty in regulation (possible tax hikes and tariff changes as well as delays in RAB schedule).

Russian economy

Recovered from crisis, life goes on

	Old		New	
	2010	**2011**	**2010**	**2011**
Urals crude, $/bbl	***74.0***	***71.0***	***76.5***	***78.0***
EUR/USD (annual average)	***1.46***	***1.41***	***1.26***	***1.25***
GDP, RUR bn	45370	50126	45553	50138
GDP, $ bn	1593	1716	1546	1780
GDP, % y-o-y	3.4%	3.2%	4.1%	3.6%
Investments, % y-o-y	7.8%	7.1%	3.9%	7.9%
Retail trade, % y-o-y	7.2%	4.9%	6.6%	6.4%
Real wage, % y-o-y	3.1%	3.6%	4.2%	4.0%
Real disposable income, % y-o-y	7.8%	3.4%	7.5%	4.7%
CPI, % Dec./Dec.	7.9%	8.4%	7.0%	7.5%
PPI, % Dec./Dec.	8.3%	11.1%	13.7%	9.1%
Federal budget, % GDP	-5.2%	-1.7%	-5.5%	-2.1%
CBR reserves, $ bn	461	515	477	532
Reserve Fund, $ bn	36	75	18	25
National Wealth Fund, $ bn	92	92	90	90
Export	350	370	380	390
Import	240	260	240	270
Current account, % GDP	2.9%	2.3%	4.6%	2.6%
Capital/Financial account, % GDP	-1.0%	2.0%	-1.5%	0.7%
RUR/USD, year-end	29.5	28.6	28.9	28.6
RUR/USD (annual average)	29.0	29.2	29.5	28.2

As XIV St. Petersburg International Economic Forum indicated, slightly more than 60% of its participants keep rather moderate positive stance on Russian economy for coming years and even believe that its stagnation is likely. Despite better economic conditions, questions on sustainability of key recovery growth drivers remained unanswered though we have no doubts that domestic demand as an engine for the economy will be replaced by external one. Meanwhile, there are still uncertainties over state support while demand incentives and risks, with inflationary ones being on the forefront, are associated with budget. Further economic growth will primarily depend on the governmental ability to balance these contradictory factors. With oil prices moving up Russian government would be tempted to increase state spending, while the best strategy is not to expand liabilities, but to enhance their efficiency, as reserves for this are indeed considerable.

We upgraded our economic growth forecast for 2010-2011 as a result of expectations of higher oil price and positive dynamics of key macro indicators, released in April-May. Low-base effect would come into force this year, as 1H09 was the most difficult for the Russian economy.

Hope is for income growth as a basis for consumer demand… Increased pensions spurred personal incomes, and from now on, performance of the latter would depend in a greater degree on wages growth. Against the backdrop of lower unemployment rate rebound of wages should continue that coupled with gradual credit growth brings moderate optimism regarding consumer demand.

…while risks have not been eliminated. Risks for consumer incomes are low labor productivity on the back of increased labor cost per unit and insufficient reserves to increase wages of public-sector employees by the comparable rates. Risks for consumption are increased and high households' savings, though under stable inflation, would continue declining gradually.

Investments are pending for certainty. With sustainable demand recovery outlook remaining uncertain and capacities staying underutilized, companies are not in a hurry to invest. However, earnings growth would bring back demand for credits and improve access to them, while investment demand should also recover.

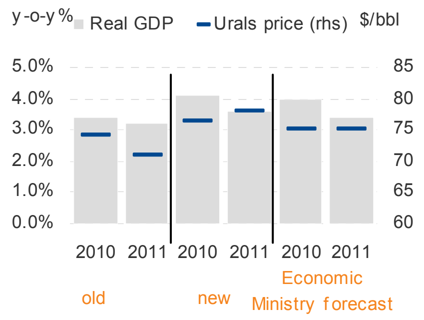
Much would depend on budget, but the intrigue is ahead. Before crisis, budget supported domestic demand. With oil prices staying above $65-70/bbl, we expect budget deficit to stay below official forecasts, provided by the Finance Ministry of Russia, which would strengthen its abilities in budget planning. However, increased demand from governmental agencies requires not only conservative approach to spending planning from monetary authorities, but additional measures aimed at improving cost efficiency.

Interest and ruble rates: no sharp movements are expected. Stable inflation would help the Central Bank of Russia (CBR) to keep interest rates at current levels at least till 2Q11 and to reduce cost of borrowings. Upgrade of oil price forecast is favorable for ruble rate, however we made minor changes to our RUR/USD estimate owing to unstable capital flows and changed forecasts of EUR/USD rate.

Economic growth is recurring

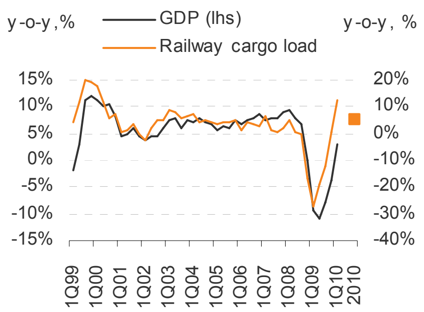
We revised our GDP growth forecast upwards from 3.4% to 4.1% in 2010. Owing to update of expected oil price performance in 2010-2011 we upgraded our GDP growth forecast to 4.1% and 3.6% in 2010-2011, respectively (our previous estimates are 3.4% and 3.2%). The Russian economy showed weak performance (up by 2.9% y-o-y vs. down by 9.4% in 1Q09), while released in May macro readings showed economic growth had accelerated. More optimistic estimates of energy consumption and cargo loads – a couple of indirect indicators of economic activity – support our expectations. For example, Russian Railways (RZhD) upgraded its forecast for cargo volumes from 3.7% to 5.0% in 2010, while we foresee energy consumption to edge up 2.2% (Energy Ministry forecast looks even more upbeat – about 2.6%).

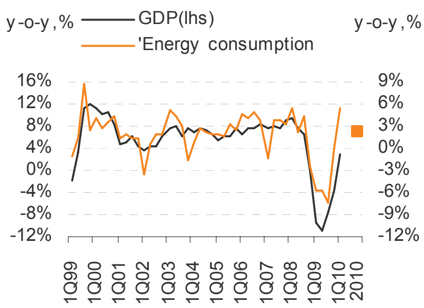
GDP growth and oil prices



Source: Federal Statistics Service, TKB Capital estimates

Expected railway cargo load and energy consumption reflect economic recovery





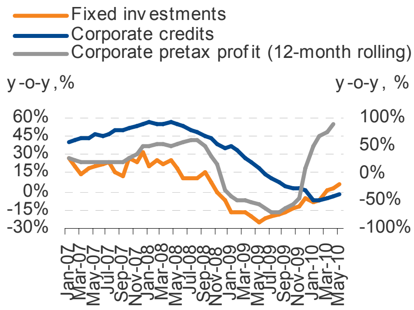
Source: Federal Statistics Service, RZhD, TKB Capital estimates

Investments favor certainty

Investment demand still lags behind. Based on 5M10 (down by 0.4% y-o-y), it would take more time than we expected at the end of 2009 for investment demand to rebound. The reasons behind this are ongoing uncertainty over sustainable rebound of domestic demand, capacity underutilization and high credit rates (around 13-15%, based on the Institute for the Economy in Transition surveys (IET)). This explains lackluster demand for credits and banks' willingness to issue credit only to large companies. According to May IET survey, some companies experience lack of working assets, that is why they need borrowings firstly to operate existing business and secondly for their future development. Foreign direct investment inflows to Russia (up by $2.6 bn, or down by 17.6% y-o-y in 1Q10) highlight high risks for investments still persist in Russia.

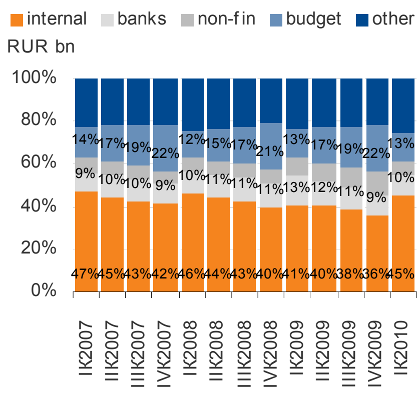
More hope for own resources... Borrowed funds gained major role in capex financing due to significant reduction of corporate profits during financial turmoil. In 2007 only 37% of investment were financed via borrowed funds (excluding state budget), while in 2009 they accounted for more than 40%. However, in 1Q10 the situation started changing: a share of capex needs which were covered by companies' own funds soared to 42% (46% in 1Q09). In other words, the rates of financial condition stabilization in private sector become more important for rebound of investment activity. Moreover, if profits continue showing stable growth, then with lower credit risks, growth rate of credit volumes will accelerate, as banks have sufficient financial resources.

Investment demand to restore, but later



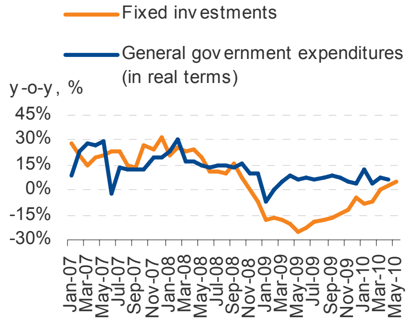
Source: Federal Statistics Service, TKB Capital estimates

Financing resources for investments



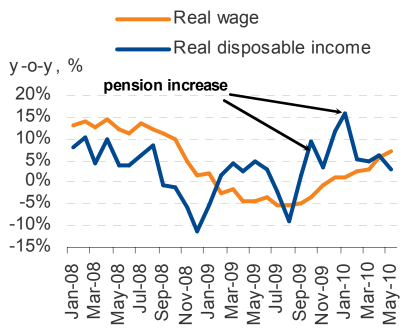
Source: Federal Statistics Service, TKB Capital estimates

Consolidated budget expenses and investments



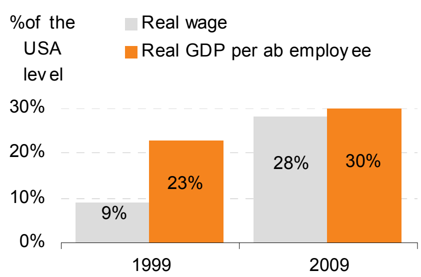
Source: Federal Statistics Service, TKB Capital estimates

Real wages and real disposable incomes



Source: Federal Statistics Service, TKB Capital estimates

Labor productivity and wages in Russia



Source: Federal Statistics Service, US Bureau of Economic Analysis, TKB Capital estimates.

...and for the state, as before. Importance of state investments increased during the crisis (state funding accounted for 21.5% of total capex in Russia in 2009, which is record high since 2000), but this support is likely to subside in coming years. Increasing volume of state funds would be required to cover pension fund deficit and higher social benefits ahead of presidential election campaign in 2011-2012. Undoubtedly, with gradual oil price growth and lower budget deficit, state may expand its investments from budget funds. According to our estimates (please, see our report “Simple maths or growth prospects”, released on 31 May, 2010), there remain significant reserves to improve cost efficiency in public sector. If the state uses budget funds, state spending growth of not above pre-crisis rates will promote GDP growth and eliminate risks of higher tax burden even under stable or lower oil prices (that is rather better for the economy).

All hope for the consumption

Increase in pensions underpinned acceleration of personal incomes, while wages still lag behind. As we expected at the end of 2009, increased pensions supported strong performance of real disposable incomes from the year beginning (up by 6.2% for 5M10). We forecast pensions to rise almost 40% in real terms in 2010 that with a 15% share of social benefits in personal incomes may provide for additional 5-6 ppt to income increase in real terms. Meanwhile, wages post more moderate dynamics (up by 4.4% for 5M10), and we do not foresee their accelerated growth by the year-end. Despite better labor market conditions (unemployment rate was down to 7.3% in May vs. 9.2% in January, 2010). Among other options, companies would continue optimizing costs thanks to limited increase in wages. Thus, increase of real disposable income by 7.5% is likely in 2010 with a consequent slowdown to 4.5-5.0% in 2011.

Steady wage growth in public sector is in the past, return to pre-crisis rates requires higher efficiency. Pre-crisis growth of welfare was due to stable increase in public sector wages thanks to steadily increasing revenues to state budget. It also spurred growth of wages in private sector. Now some changes have occurred: the companies continue optimizing their costs, while sharply increased pension payments and budget deficit restrain from wage indexation by previous rates in public sector. We assume, in order to improve wage dynamic either oil price should rebound to pre-crisis highs and budget should register surplus (that is unlikely in coming years), or public and private entities should improve their efficiency. Russian labor productivity is still just 30% of US level, while labor costs are almost the same (please, see our report “Simple maths or growth prospects”, released on 31 May, 2010). Expected increase in insurance contribution from 26% to 34% in 2011 will increase labor costs of companies, so the state should enhance labor productivity (especially in public sector) to retain profitability.

Increasing costs are the support for consumption which may suffer only from high savings... Consumer spending is on the rise, but recovery of consumption does not look so stable. Retail sale growth (by 2.9% for 5M10) mainly accounts for food products (up by 4.6%), while in May, 2010 consumption of non-food items and services slightly surpasses 2009 level (up by 1.3% and 0.1%, respectively). The reason was that incomes grew primarily in low-paid categories of employees and retirees mainly thanks to pensions rather than wages. Consumer credit stagnation and high personal savings, which along with purchases of currency by households accounted for 20% of consumer incomes, also contributed. This figure will go down as economy recovers, but the steepest decline is expected in 2011. Provided this, we downgraded retail sales growth forecast from 7.2% to 6.6% in 2010, while upgraded it from 4.9% to 6.4% in 2011.

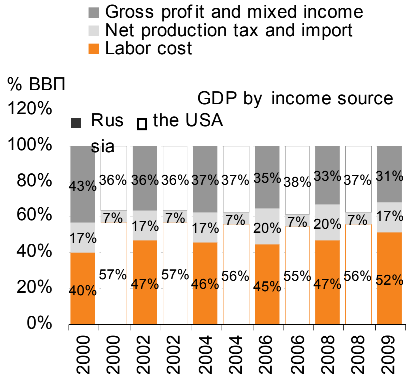
...or from accelerated inflation, which Russia is likely to prevent. For 2010 we forecast inflation at not more than 7% with its increase to 7.5% in 2011. Despite higher inflation in manufacturing and producers' intention to continue increasing prices (according to recent IET survey), inflation in food industry and other vital sectors of economy remains moderate (at 0.8-2.5% for 5M10). With consumer credit moderate recovering (not more than 15% in 2010) and banks preferring to keep spare liquidity in the CBR as well as high savings and lack of opportunities to increase state spending sharply, ample banking liquidity is unlikely to result in abrupt acceleration of inflation. Decline in core inflation in May to 4.5% indirectly supports this view. More moderate hike of regulated tariffs in 2011-2012 would also favorably impact inflation, though this would depend not only on monetary policy but on budget conditions as well. Low tariffs would limit the scope for investments in key infrastructure industries that is highly likely to be compensated from budget funds (for example, RZhD requires from the government to compensate for unearned revenues of RUR50 bn).

Approved growth rates of regulated tariffs in 2010-2013

% average y-o-y		2010	2011	2012	2013
Old official forecast					
Electricity					
	All categories of consumers	12.5-14	13.5-16	12.5-14	
	Households	10	10	10	
Natural gas					
	All categories of consumers	23.7	16.5	15.9	
	Households	27.4	20.8	16	
Rail cargo transportation		12.4	9.2	7	
Passenger transportation		10	10	10	
New official forecast					
Electricity					
	All categories of consumers	16.2-16.6	13-15	11-12	10-11
	Households	10	10	10	10
Natural gas					
	All categories of consumers	26.5	15.3	15.7	15
	Households	27.8	17.1	19.2	15
Rail cargo transportation		12.4	8	7.4	6.4
Passenger transportation		10	10	10	10

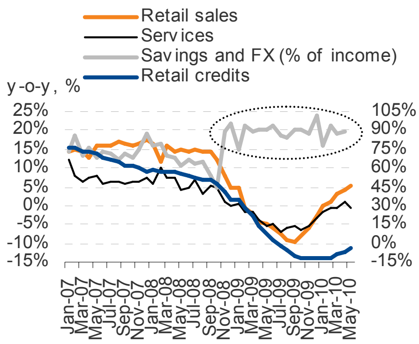
Source: Economics Ministry

Labor cost per unit in Russia and the USA



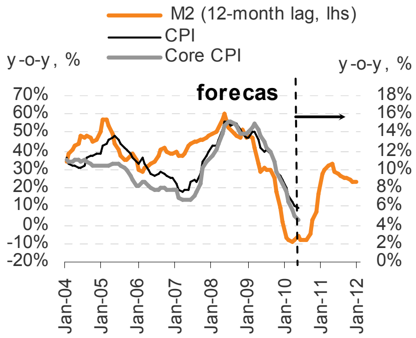
Source: Federal Statistics Service, US Bureau of Economic Analysis, TKB Capital estimates

Private consumption, retail credits and savings



Source: Federal Statistics Service, TKB Capital estimates

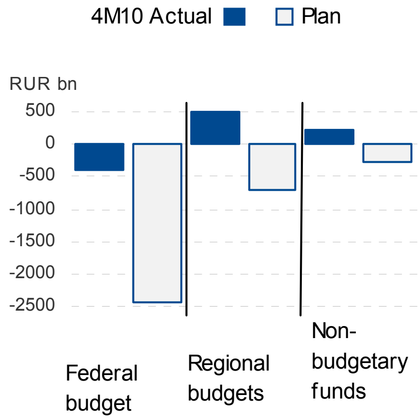
Consumer prices and money supply



Source: Federal Statistics Service, TKB Capital estimates

Budget wars: to be continued

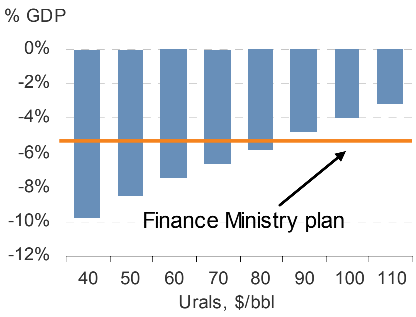
Budget performance, YTD



Source: Finance Ministry, TKB Capital estimates

Russia is unlikely to follow the worst-case budget scenario. High oil price (on average $76/bbl YTD vs. initially stipulated $58/bbl in budget law) provided the state budget with less than a half of planned revenues and confirmed authorities' belief in stable oil prices. Official forecast was revised upward to $75/bbl for 2010-2011, and respective amendments were made to this year budget, which envisaged a decline in budget deficit to 5.4% of GDP (vs. previous estimate of 6.8%) mainly thanks to increase in oil and gas revenues even with insignificant growth of spending. Taking into account our forecast of oil price ($77/bbl for 2H10) budgets of Russian regions would achieve zero surplus in FY2010, while total budget deficit would amount to about 5.5% of GDP, given higher-than-expected deficit of non-budgetary funds (excluding them, the state budget deficit is expected at around 5.0% of GDP). However, with oil prices falling below planned $75/bbl, the issue of unearned revenues to the budget would come to the forefront and safety cushion potential is quite limited. With average oil price of around $60/bbl in 2H10 and average RUR/USD rate of RUR31.5, budget deficit, including unearned revenues of other level budgets may climb to 8% of GDP.

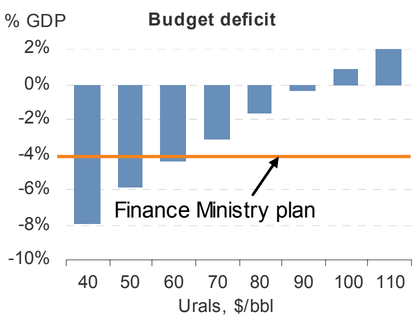
Federal budget deficit in 2010E



Source: Finance Ministry, TKB Capital estimates

In 2011 all will depend on oil, ruble rate... Next year (under the current planned spending and oil price of $78/bbl), federal budget is estimated at about 2% of GDP that is considerably better than maximum possible deficit for 2011 (4% of GDP) and updated forecast of Finance Ministry (3.6% of GDP). However, with average annual oil price declining to $65/bbl and close to a fair level ruble rate (about RUR30.5-31.0/$), budget deficit would approach the maximum acceptable by the Finance Ministry of Russia level and with considerably cheaper commodities, budget deficit would even top it. Meanwhile, these calculations are justified under approved spending of budget and non-budgetary funds, stable spending of Russian regions and close to balanced ruble rate. Let us assume with a sudden decrease in oil price weaker ruble would be inevitable development, the CBR may again opt for a smooth ruble devaluation that would result in budget losses. At the same time, with stable or rising oil prices budget conditions would depend on Finance Ministry's stance, as governmental agencies require for more and more funds.

Federal budget deficit in 2011E



...as well as on appetite of authorities. In addition to budget amendments in 2010, Finance Ministry formulated its basic parameters for 2011 given needs of governmental agencies, as well as President's and government requirements. Financial needs are preliminary estimated at RUR2.3 trln. Under current macroeconomic forecasts, their full coverage would increase budget deficit to 8% of GDP, while its retention at 4% of GDP would allow reallocating only RUR300 bn, which are planned for increase in defense outlays and in wages for public sectors. To cover the remaining part of spending will be quite difficult even with revoked tax breaks for oil produced in East Siberia (RUR120-150 bn) and materialized initiatives on changes to taxation (introduction/increase of crude export duties for other commodities, increase of excises for alcoholic beverages, gasoline etc.). Planned increase of insurance premium in 2011 could cost almost RUR1 trln. As the Finance Ministry aims to reduce budget deficit by canceling existing tax holidays and improving cost efficiency, with steady oil prices tax burden on economy is unlikely to increase. In case of lower oil prices, it is easier to change ruble rate – if its rate loses RUR1 to US dollar, then budget receives additional RUR120-140 of revenues. However, the government should not bank solely on this tool, as excessive ruble devaluation would result in inflation growth, and authorities are unlikely let it materialize.

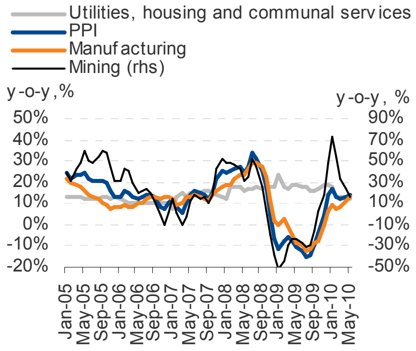
Interest and ruble rates: no sharp movements are expected

Stable inflation promises low interest rates remaining unchanged. As far as the main intrigue on the scale of possible decline of the CBR refinancing rate is resolved, markets become more concerned by exact time when the watchdog will raise the rate. We assume it would come not earlier than in the beginning of 2011, and even in this case, the refinancing rate is unlikely to add 0.5 ppt. As we have already mentioned, we do not foresee strong growth of inflation in the absence of substantial increase in global commodity prices, steadily fast economic recovery, sharp increase in budget spending and accelerated credit dynamics (first of all, that of consumer credit). Gradual increase in inflation in 2H10-1H11 would result in decline in real interest rates going forward (nominal rate minus inflation), which remain high in Russia compared to most of emerging and developed countries. We believe it is unlikely that the CBR will again lose control over inflation, especially now when inflation is so low and in light of announced plans to move towards inflationary targeting. In our view, growth rates of credit outpacing regulator's forecasts (of about 15%) and inflating of budget spending may be signals of possible revisions of monetary policy.

Current account surplus to support ruble… Taking into account upgrade of oil price forecast for 2H10, we revised upward our trade balance estimate from \$110 bn to \$140 bn. This coupled with deficit of services and other components of current account (about -\$60 bn totally) gives its total balance of around \$80 bn or 4.6% of GDP (\$50 bn or 2.9% GDP as per our previous guidance). Under relatively stable environment on foreign markets, it would be contributing to upward pressure on ruble rate which would have every chance to continue its ascending after 2008-2009 devaluation. However, as we assumed at the end of last year, despite a significant current account surplus, capital flows have remained the major factor determining ruble rate movement and weighing on its volatility.

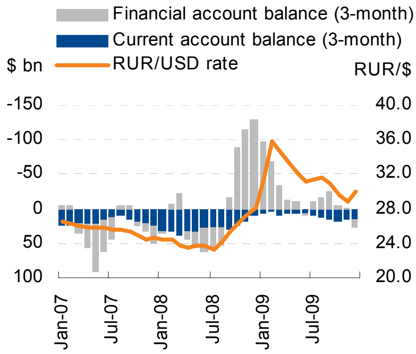
…but due to net capital outflow expected in 2011, ruble rate remained almost unchanged. Despite we increased current balance forecast, we still expect net capital outflow at not below \$20 bn in 2010 (-\$5.5 bn in 1Q10 excluding "net errors and omissions" item of -\$12 bn, which also reflect illicit capital outflows. The companies will have to repay \$115 bn of foreign debts under still restrained opportunities to borrow money abroad. Against the backdrop of ongoing uncertainty over economic growth rates, foreign direct investment balance is likely to be close to zero, private sector, as 1Q10 indicated, continued increasing foreign assets slightly outpacing its liabilities' growth (though not so aggressively, as before), and gradual increase of CBR reserves in 2Q10 might have been supported by capital inflow as a result of Eurobond issues in Russia in April, 2010 (\$5.5 bn). That is why along with our EUR/USD forecast changed from 1.46 to 1.22 we slightly improved our RUR/USD forecast for end-2010 from 29.5 to 28.9. We expect RUR/USD at around 28.0-28.5 in 2011.

Inflation and key interest rates



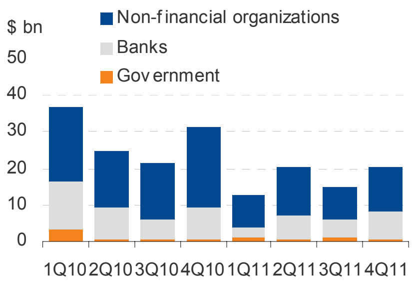
Source: Federal Statistics Service, CBR, TKB Capital estimates

Balance of payment and ruble rate



Source: CBR, TKB Capital estimates

Foreign debt repayment schedule in 2010-2011



Source: CBR, TKB Capital estimates

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Commodity markets

Reality check

The bubble is inflating...

Correction or collapse? Fast falling of the major commodity markets from their April highs was just partly justified. On the one hand, significant growth of prices in 1Q10 was backed by speculative purchases, and oil as well as industrial metals appeared to be overbought in April. On the other hand, the first signs of economic recovery became more mature. Demand for commodity strengthened that supported the markets.

Running ahead the train. But positive investment sentiments brought prices up fairly above their fundamentally justified levels even taking into account demand recovery. Upbeat market expectations were strongly backed by excessive liquidity, which flooded the market as a result of soft monetary policy introduced by the largest global economies. Low rates helped revive economic recovery, but their effect on the stock and commodity market became even more pronounced.

Speculative influx. Statistics from the US Commodity Futures Trading Commission (CFTC) strongly supports hypothesis of speculative nature of the growth of commodities price. Thus, net speculative position in oil futures contracts (calculated as total position opened by hedge funds, some other large speculative players as well as other market participants, which use these instruments for non-hegding operations) had grown considerably since March 2009 pushing prices up. In January, 2010 speculative long position reached their maximum level, and in April again the total position came close to those numbers.

	Current price	Target price (end of 2H2010)	Upside
Urals crude oil, $/barrel	73.5	76.5	4.08%
Gold, $/once	1242.25	1300	4.65%
Copper, $/tonne	6515	6800	4.37%
Nickel, $/tonne	19745	22500	13.95%
Corn, $/bushel	3.54	4.4	24.29%
Wheat, $/bushel	4.65	5.6	20.43%
Soy beans, $/bushel	9.48	11	16.03%

**current price on 30.06.2010*

Source: Bloomberg, TKB Capital estimates

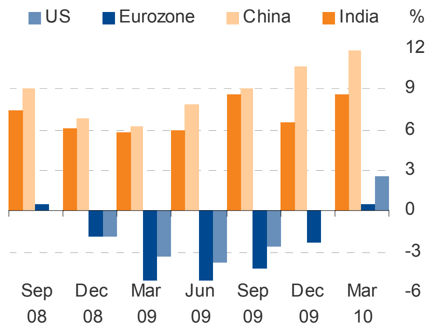
...and deflating

Music is getting quieter. There were many reasons for correction on commodity markets in April. Pressure on the oil prices came from increasing oil stocks in the US as well as from tightening of monetary policy in China, robust growth of which gave a strong impulse for resource prices growth. As usually Chinese factor had greater influence on the metal markets. But a real reason behind prices decline had global nature. It was expanding credit risks in Europe.

Déjà vu. European credit crisis led to increasing uncertainty on the markets. Economic recovery, which appeared to be sustainable, became doubtful, while fast correction on the financial markets remembered the crisis of 2008. And even though bad sovereign debts and potential default of Greece are hardly comparable to default of the Lehman Brothers, feelings of the crisis 2008 were quite far-fetched. Thus, investors' attitude to get rid of risky assets preferring a safe heaven looked quite reasonable.

Storm aftermath. During the summer the markets are calming down, and fundamental factors are getting more important to determine the future trend. Oil and metals markets will get substantial support from the growing demand both in emerging and developed countries, while the year highs may be exceeded only with new inflow of speculative capital. We keep a positive view on the gold price performance, which was playing role of safe heaven during the period of correction in May and is likely to outperform on the back of growing inflation concerns. Among soft commodities we bet on soybeans and corn, while sugar price will continue its negative trend.

GDP growth dynamics for developed and emerging economies



Source: Bloomberg

Oil: Growing stocks vs. growing demand

Facing uncertainty. Oil market is one of the best indicators of situation in the global economy. Growth of the world GDP figures was perfectly correlated with expansion of demand for fuel, while expectations regarding consumption of oil and oil products shaped prices on the oil market. European financial crisis put stability of world economic recovery under question, and contraction of spending in Europe may hold back further development of Asian growth, which is driving the global growth. In this context weaker numbers on the Chinese industrial growth in April-May are getting more negative sense. As a result, favorable macro data over 1Q10 was not enough to support positive sentiments regarding future growth. But it is not a fact of growth or contraction itself adds uncertainty to oil market, we also should bear in mind possible changes in the energy sources mix in the future.

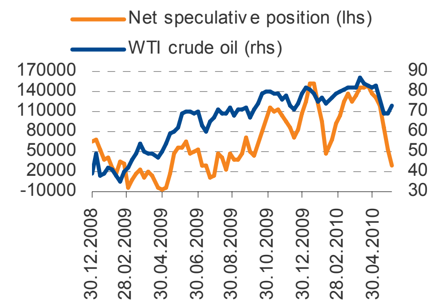
Oil is losing its role of the unique energy source. In the US gasoline consumption reached its pick in the beginning of 2007. The crisis definitely determined fast demand contraction, but the real reasons lie deeper. It is quite natural that the trend turned to a negative direction well before we saw first signs of crisis. The main factors of this down turn were energy efficiency and alternative energy resources. Over last years increase of efficiency of energy resources utilization developed from a number of measures to safe energy into an industry, which creates new technologies and work places. That immediately brought desired results. In developed countries consumption of energy per dollar of GDP is constantly reducing and the trend will continue in the long term.

Gas attack. Utilization of alternative sources of energy is expanding constantly. That is reflected in growing consumption of ethanol and biodisel as well as in increasing popularity of hybrid and electric engines. According to the data from International Energy Agency, more than 60% of oil are consumed by transport and growing utilization of electric engines will strongly affect oil consumption. Definitely for this transition from oil to electric engines production of electricity will increase significantly, but initial sources for electricity production may be different including nuclear stations, coal and gas. With new technology of natural shale gas extraction its supply increased strongly and it will be used further for electricity production. Thus, predominant utilization of oil as motor fuel may be shaken. We consider this as a long term risk for oil prices, while currently oil prices are determined mainly by pace and stability of the global economic recovery.

The market is searching for equilibrium... Economic situation is changing quite fast, while the market expectations with support of excessive liquidity often tend to extrapolate a short term trend for a longer period. Record volumes of oil export to China and economic stabilization in the US led to expansion of speculative demand on the oil market early in 2010. Prices exceeded fundamentally justified levels, while consumption was lagging increasing production volumes that led to oil stocks growth in the US. In spring stocks were constantly growing proving speculative nature of the trend. It is obvious that when there appeared a reason for correction, speculative positions were closed immediately. But the fall was too fast and deep, as demand is growing, and in June oil consumption in the US exceeded 20 mn bbl per day. That was the first time since the crisis of 2008. Thus, the price at $70/bbl seems unreasonably low.

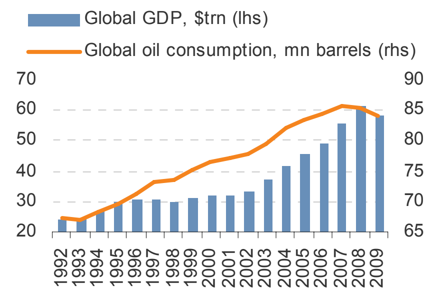
Fundamentals are getting stronger. Oil market remains sensitive to any news and comments, which may change expectations of stable economic recovery and, and to fluctuations of the dollar exchange rate. But we believe that in 2H10 emotional drivers will be replaced by fundamental factors supporting the market. Demand will continue growing in the US and in China despite the state measures to restrain economic growth. By the end of 2010 prices will go up back to $75-80/bbl. At the same time, we do not rule out the level of $90/bbl driven by speculative sentiments.

Speculative influence on oil market



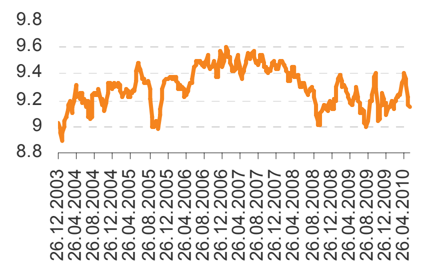
Source: Bloomberg

Global economy power consumption



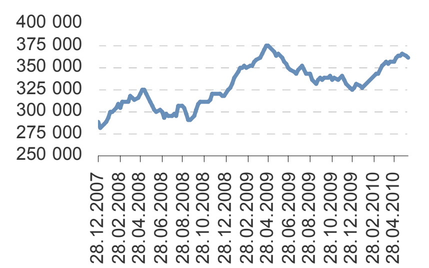
Source: Bloomberg

Gasoline demand in US, mn barrels/day



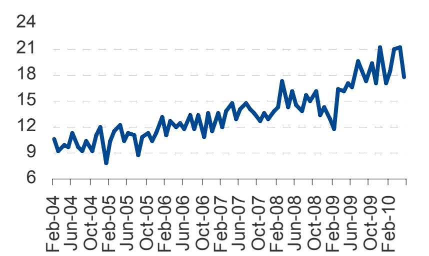
Source: Bloomberg

US commercial crude oil inventories, thou barrels



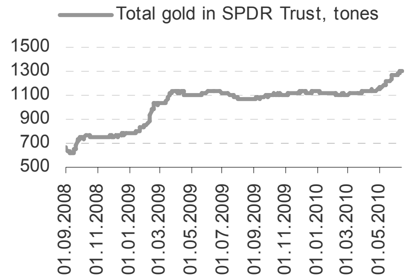
Source: Bloomberg

China crude oil import, mn tones



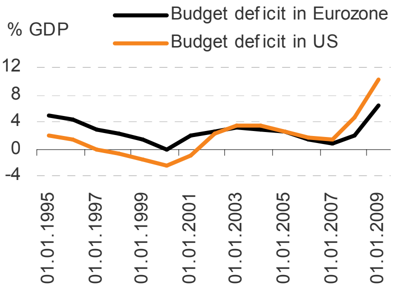
Source: Bloomberg

Gold investment demand



Source: Bloomberg

Budget deficits race



Source: Bloomberg

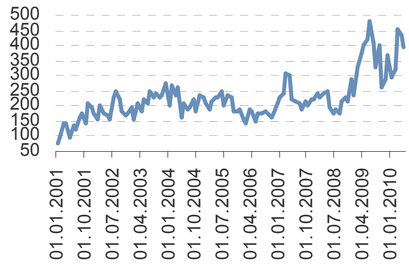
Gold rush

Safe haven. Precious metals showed strong growth in 1H10 backed by strong investment demand. But gold perfectly played its role of non-risky assets during credit crisps in Europe. Price of gold ounce exceeded its all time high (reached at the end of 2009) on the back of appealing purchases from the part of the central banks. That means gold took a function of a traditional safe haven. We expect that in the second half of the year gold market will calm down that may lead to the metals' sales and outflow of the capital that was invested into gold as a safe haven.

From deflation to price growth. But possible correction does not imply weaker position of gold. In 1H10 inflation pressure was insignificant. Growing consumer prices were considered as a threat for economic development only in overheated Asian countries. In developed countries the governments were facing deflation, but further economic recovery will raise inflation risks again. Costs cut in Europe to reduce budget deficit would have minor influence in the global scale especially taking into account euro weakening that will support price growth in Europe.

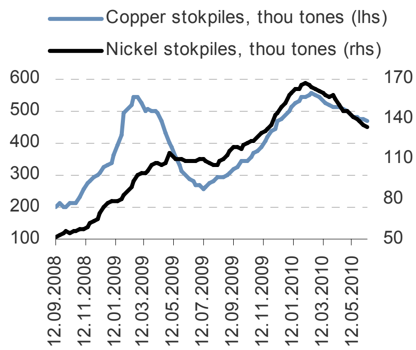
Strength and weakness of dollar. We also should keep in mind recovery of gold consumption from the central banks, which were buying gold at the end of 2009 in order to diversify their reserves on the back of risks associated with US dollar. Undoubtedly now dollar has recovered and strengthened, but that might appear unsustainable, as now we are facing not really dollar strengthening, but euro weakening. Risks associated with dollar do still exist, and the US contrary to the European countries are not planning to cut budget spending. Risk of weaker dollar may again become the main concern on the currency market. And if a year ago euro was considered as an alternative reserve currency, then now no one treats euro as alternative to dollar. Thus, the central banks have limited number of assets to diversify their reserves, and gold will become the key investment idea again. Expansion of demand for gold will drive the price up to $130/oz.

China copper import, thou tones



Source: Bloomberg

Metals exchange stockpiles



Source: Bloomberg

Metal resistance

Always ahead. Prior to the Greek debt problems, industrial metals outperformed the market since the year beginning. Stably high demand for metals in China, backed by $600 bn investment program and tremendous economic growth determined the general trend on the market, while expectations of sustainable growth in Asian countries supported upward bias of metal prices. Metal prices suffered severly from fears that situation is actually less optimistic. And the main factor was not the credit crisis in Europe, but expectations of monetary policy tightening in China.

Chinese bubbles. The Chinese support of an artificially low rate of yuan by means of money supply increase can not happen without any side effects, and real estate market as well as other available assets markets bubbles are a logical consequence of this policy. Chinese authorities have already increased reserves requirements and undertaken other severe measures to curb crediting. In other words, while allowing the money supply to grow, they have made all the efforts to slow down the money circulation and to soften the inflation effect. But all these measures can affect the economy growth negatively, which raises concerns amongst the industrial metals market players.

Inventories decline inspires optimism. Nevertheless, the production is rebuilding slowly, even without any artificial stimulation. Stock inventories of copper and nickel have decreased steadily since February, 2010 which is related to the demand, but not to the state purchases, as it was in 2009. Inventories level remains high, and the pre-crisis price levels, which copper was approaching at the end of April, is not justified. But the metal markets are supported by the increasing demand rather firmly, and we consider it to be possible for copper prices to reach $6,800 per ton, and nickel prices – $22,500 per ton.

The grain spring

Market under inventories pressure. Agricultural commodities appeared to be, perhaps, the only group of markets, which did not demonstrate any growth in 1H10. While in the crude oil or industrial metals markets the speculative capital has pushed the prices up, the grain market has been affected by bearish sentiments. It is clearly seen from the CFTC data that these were the hedge funds and other speculators that pushed the wheat prices down in 1H10. The reason for these different trends in prices for grains and industrial raw materials is a high level of grain global inventories making the deficit of grain to be almost impossible in the medium-term perspective. At the same time, grain production in the USA, under the current price level is balancing on the verge of profitability, thus, there is almost no space for further prices decline. The market now is like a stretched spring which is pressed by the inventories level, but the resistance to this pressure is getting stronger.

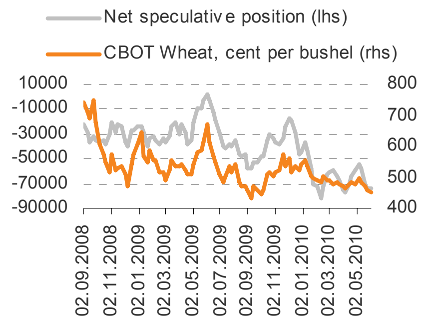
Bearish weather. In addition to the economical factors, some seasonal factors have appeared. The weather conditions in summer and autumn of 2009 in the USA, Europe and South America have been extremely favorable for the major grain-crops and soybeans yields. Record crops of corn and soybeans in the USA and Brazil have led to the new price maximums globally. Thanks to the high yield of wheat in Europe its world production appeared to be to only a small extent lower than the 2008-2009 maximum. It is remarkable that the initial estimates of the world grain production presented by the US Department of Agriculture (USDA) were not so optimistic. But as the weather conditions were getting better, these estimates have steadily been upgraded, which, in turn, led to revision of inventories forecasts and provoked speculative game for price decrease.

The demand may overbalance. In 2H10 quite the opposite scenario may unfold. The warm and dry spring in the US Midwest has allowed the corn planting to be very quick and early, and the first yield estimates were rather high. But this summer is not very favorable to the farmers neither in the USA, nor in Europe. As early as in June, the USDA has been forced to become less optimistic, and this tendency is likely to remain. At the same time, grain demand can increase noticeably vs. the 'crisis' 2009. The record pork prices will possibly lead to livestock growth and thus the increase of the feed-crop consumption. But biofuel sector would be again a major contributor to the consumption growth. The share of corn used for ethanol production in the USA has increased over the past 10 years from almost 0% to 40% of the total yields. High crude oil prices allow the tendency to remain. As a result, in spite of the record yields, the corn stock to use ratio remains rather low. Under these conditions, even sort breaks on the supply can lead to prices increase.

Chinese factor. Traditionally, China, being the world leader in terms of grain production and consumption, is aiming to be self-sufficient and thus is not influencing world grain markets intensively. But in the soybeans and vegetable oils markets, China is one of the major players due to the fact the country is unable to cover the exceeding demand for soybean oil, driven by the urbanization and welfare growth. Steadily growing soybeans import (from the USA mainly) has supported the world soybeans prices in the past years. Similar situation is expected to appear in the corn market in the 2H10.

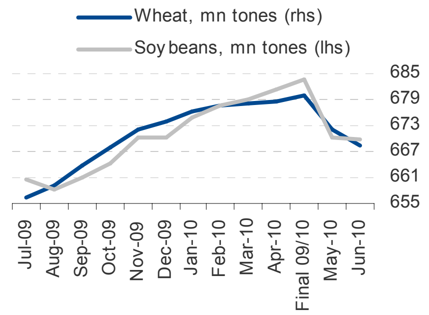
The trigger. Unlike in Europe and the USA, in China the current and the past years were not favorable for grain production. Cold weather in the Northern provinces and the severe drought in the south part of the country, which was caused by the El Nino phenomenon, have damaged the grain production heavily. 500 bn tons in 2010, which were targeted by the Communist party, are unlikely to be achieved, and China will be forced to enter the world grain market. To be honest, this is what is happening now. Unlike the world prices, internal Chinese price for corn have hit its maximum in June, and the state was forced to sell out its inventories to cool off the market. To rebuild the inventories, Chinese companies started to buy corn in the USA. Copper prices increase in the spring of 2009 have shown what is possible when China is buying copper, thus, Chinese purchases can become a trigger that releases the spring of the grain markets. Wheat prices can reach $5.6, corn and soybeans prices – $4.4 and $11.0 per bushel respectively.

Speculative influence on wheat market



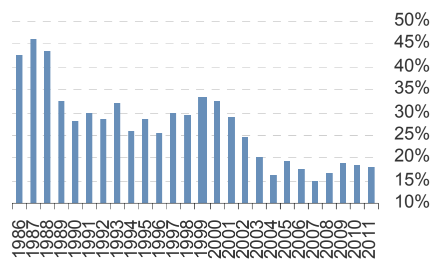
Source: USDA

Wheat production reviews in the season 09/10 and in the beginning of season 10/11



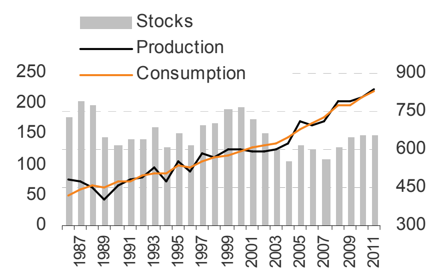
Source: USDA

Corn stock to use ratio



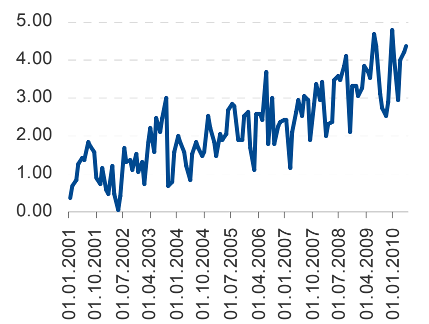
Source: USDA

Corn production, consumption and stocks dynamics, mn metric tones



Source: USDA

China soybeans import, thou tones



Source: Bloomberg

Only volatility is certain

Markets earthquake will continue, but the fundamentals become stronger. The recovery of the world economy and stronger raw materials demand in 2H10 will support all the commodity markets across the board – from industrial raw materials to agricultural commodities. Meanwhile, the doubt in stability of economic growth could lead to the significant price oscillations as it was in spring. European budget troubles and the possible cooling down of Chinese economy are still the main and traditional concerns. But in autumn the markets might focus on negative reaction of the US economy on stimulus withdrawing and credit rates growth. That is why the significant growth of crude oil and metal prices is unlikely. Only the grain markets may surge as much as 20-25% if corn and soybeans yield in the US declines. However, all commodity markets have rather strong fundamental support that creates conditions for the high volatility of prices.

TKB Capital

Fixed income market

It is better to fall short of gains than lose them completely

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As we were aggressive in the first half of 2010, so we are conservative for the rest six months of the year. We have no illusions and recommend investors to choose the maximum hedge positions in assets (only quality) and in currencies, which are capable of becoming safe havens.

Sovereign and quasi sovereign Eurobonds issued by the countries having comfortable debt loads offer the best bets for speculative players. Participants with extensive ruble funding, welcome to the primary market! Bet only on quality, focus on floating coupons. Here, one can bargain for higher rates and shorter-dated bonds.

Indicator	Actual 30.06.10	Forecast 31.12.10
FED Rate	0-0.25%	0-0.25%
ECB Rate	1.0%	1.0%
BoE Rate	0.5%	0.5%
TED-spread (3m UST vs. 3m Libor)	40 bps	50+ bps.
UST-10 Yield	3.00%	2,7-3,0%
Spread UST-10 vs. RUS-30	235 bps.	260 bps
RUS-30 Yield	5.30%	5.3-5.6%
CBRF Rate	7.75%	7.5-7.5%
Overnight Rate	3-5%	3-5%
First Tier Yield	7.0-8.0%	8.5-9.5%
Second Tier Yield	8.0-9,0%	9.5-11.0%
Other Tiers Yield (1Y)	12.0-13.0%	15+%

Source: Reuters, TKB Capital estimates

Liquidity

There will be cheap money on the market, but whether it helps is a big question for us. The liquidity pie was cooked a year ago – global financial system was injected with cheap money. Who could bite from the liquidity pie already did it... Even third-tier names managed to stage rally.

FOREIGN MARKET: forced reshuffle

We assume free-risk instruments would be in favor of investors in 2H10. UST-10 yield of 2.5% is coming closer. Oversold Eurobonds during the financial crisis mainly played out. With the uncertainty, turbulence, stricter trading rules and unsolved debt issues of some large countries, bets on stronger emerging market assets look risky. Key countries' federal budgets are scarce of money, so we may expect "bogeymen".

CURRENCY MARKET:
weak dollar is still a myth, ruble devaluation is looming again?

Having analyzed overseas newsflow, we concluded that turbulence of the foreign financial market will increase and major risks will come from the EU.

On this background, we still bet on riskless US dollar which is likely to take the lead in terms of investments in 2H10.

DOMESTIC MARKET:
Attention! The train stops here

Domestic debt market has approached 2H10 hitting its local highs with plenty of cheap money, qualitative offers on the primary market. Price growth is unlikely to continue, especially given expected weaker ruble, heightened volatility of national currency, regulator's and monetary authorities' expected moves aimed at absorbing the liquidity in order to prevent the inflationary scenario.

WHAT TO BUY? The best Eurobonds and ruble bonds on the primary market

Amid increasing risks of insignificant ruble devaluation which will put pressure on ruble assets, we recommend dollar-denominated Eurobonds for speculative players who hunt for the biggest gains. An investor can bargain for higher rates and shorted-dates bonds.

SECOND HALF OF 2010: it is better to fall short of gains than lose them completely

There is money, but not for all and not for cheap. Struggle for global financial resources is looming. The USA need to raise funds, the European Central Bank has to rescue European countries, while Russia has to sell its crude oil. These processes can not go together: the USA will have to draw attention to problems of Europe and other issues in order to navigate investors to the right safe haven, while Russia needs economic recovery for oil to be consumed and factories to be at work. We do not cherish illusions and advise investors to opt for risk-free positions in high-quality assets and currencies which are capable of becoming safe havens.

As we were aggressive in the first half of 2010, so we are conservative for the rest six months of the year. We have no illusions and recommend investors to choose the maximum hedge positions in assets (only quality) and in currencies which are capable of becoming safe havens.

Sovereign and quasi sovereign Eurobonds issued by the countries with acceptable debt loads offer the best choice for speculative players. Participants with massive ruble funding, welcome to the primary market! Bet only on quality, focus on floating coupons. On the quiet, one can bargain for higher rates and shorter-dated bonds.

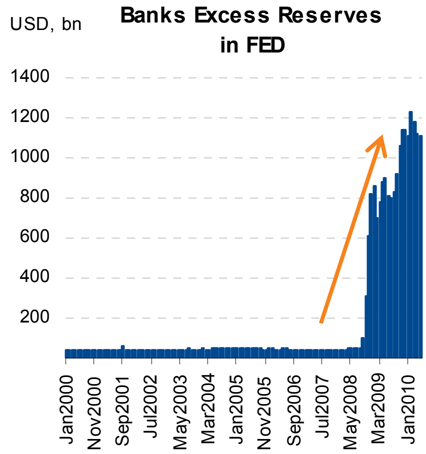
SO WHAT DO WE HAVE? LIQUIDITY…

There will be money, but whether it helps is a big question

Governments and monetary authorities of key global economics are doing their best to prevent deflationary scenario – auctions are held strictly in time. When European countries started rolling down to a debt hole, even the ECB, which has the most conservative stance on excess liquidity, did not manage to fight out a storm.

While the ECB does not pursue quantitative easing policy, key rates do not move towards a zero point and funds for purchasing of Greece bonds and other PIIGS' members are accumulated in EU banks deposits, but there are other auctions of the ECB.

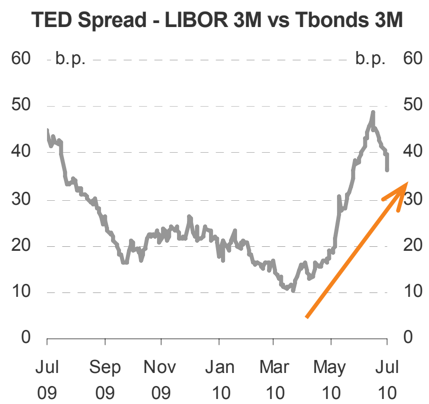
Long money is unlikely to emerge. One-year put is schedule for 1-2 July, 2010, 3-month put will follow, but it will not change the situation. The most important is the functioning of a credit mechanism, which is unlikely, in our view. It is proved by a number of indicators, which we have monitored recently: TED spread, LIBOR vs. OIS (in dollars and euros). Their performance reflects increasing fears on the interbank credit market.

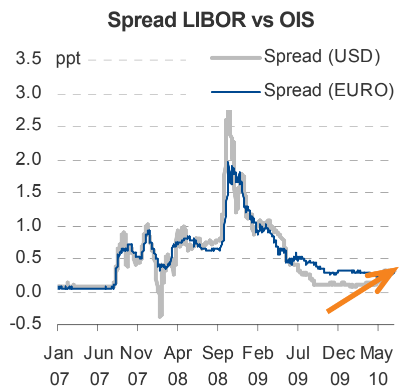


The banks do not trust each other, let alone lending in real sector of economy. Investors are scared by some statements made by the ECB representatives (in particular by European Central Bank governing council member Christian Noyer) about some European banks face funding challenges. In addition, we see high volumes of credit organizations' deposits in central banks

The ECB carries out stress tests of banking system, and the Finance Ministers of EU countries will discuss the initial results on 12-13 July, 2010.

However, we do not expect them to come out timely. As per history guidance, last time at the height of financial crisis, the results were disclosed with delay and after the approval of credit organizations themselves subjects for surveys. We believe the impending outcomes to provide the markets with support.





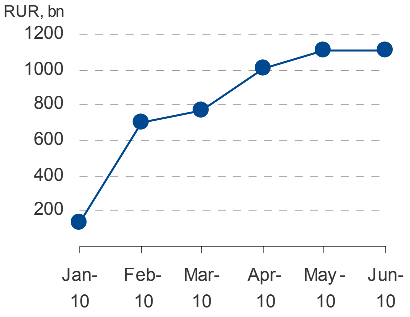
Liquidity crisis is around the corner

We assume latent negative trends of interbank credit market may translate into liquidity crisis. This development is believed to be unlikely in Russia, while it may be the case in Europe and the USA. As for Russia, we see this unlikely as the CBR has learnt to provide the financial system with funds, and banks' losses on the interbank credit market in case of their defaults are secured by the CBR. In addition, there are auctions of different durations, while budget funds are allocated to commercial banks' accounts.

The demand for PIIGS members' debts from the ECB is waning that may result in gloomy developments, e.g. for the banking system of France. There are circulating rumors on the downgrade of country's credit rating on the market. Revoke of marked-to-market revaluation partly offsets these risks. One should not freeze money in reserves, re-qualify assets or swap margin calls with contractors.

We may start out long discussions, but a number of factors, for example, European banks' accumulated funds on the ECB's accounts, point to high risks, which are latent at the moment.

Volume of bond issues in 1H10, including Eurobonds



Liquidity pie was cooked. Who could bite from it already did it

In our strategy for 2010, we assumed that this year would set the record straight and become the reality check for low-quality issuers. We were awaiting a signal indicating global credit market recovery and saw this scenario as likely.

Our idea played out only for 50%. In general, most of players bit a piece of the liquidity pie, restructured their loans and those, who did not manage to do it, left the market forever. There will not be any chances to receive the financial support.

Some of third-tier names staged rally

We expect more extensive rally – billions of dollars which were injected into the financial system, went in a wrong direction, while there were few irresponsible speculators.

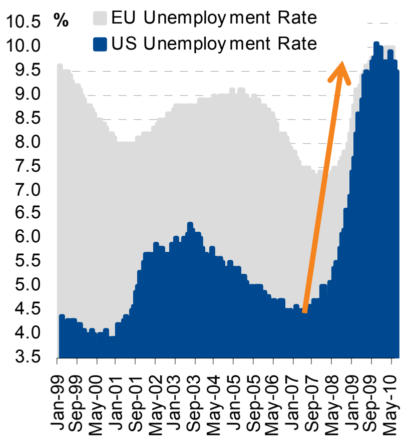
The market structure has changed: high-quality issuers are dominating, rates are low and investment ideas are scarce except for widening of yield vs. repo rates spread. We are back from the start, but overhang on the primary market still exists, banks' balances are piled with bonds, while the authorities are stimulating credit market.

Weak third-tier names did not come out to the market, unlike the strongest players and even managed to raise funds under low rates. Among them are U-Tair, TGK-2, third-tier banks (Rus Bank), Transaero and others, which are based on their financials and operating numbers look vulnerable in servicing their debt obligations as compared to first- and second-tier companies.

FOREIGN MARKET
FORCED RESHUFFLE

Risk-free instrument will be in favor. We foresee steady demand for Tbonds and Bunds as a result of "safety bids"

Unemployment rate in euro zone and US

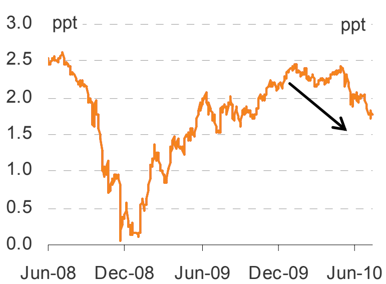


The need of funding budget deficits of most of developed countries, in particular of EU and PIIGS members, led to the revision of justified premiums for credit risk relatively to benchmarks. As a result, we saw spreads widening and credit default swaps across the board accompanied by higher cost of short-term liquidity (LIBOR vs. OIS spreads in dollars and euros). Increased refinancing risks pushed money market rates up, and this trend is likely to continue, despite key rates growth cycle in major regions is not the case for 2H10.

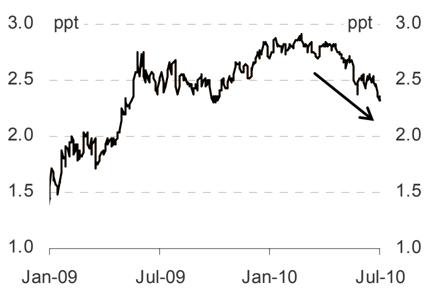
Statistics from the US, especially on labor market and indicators which reflect demand level and economic recovery, leaves much to be desired, and this is not surprisingly, given US Fed's large programs and government's steps to stimulate economic activity were partially ceased, while unemployment rate was up owing to the end of national census.

Arisen in early 2010, inflationary expectations were minimized, and Fed's rhetoric on the speed of future recovery became gloomier due to troubles in euro zone. As a result, UST-10 vs. UST-2 spread narrowed to 230 bps, and demand for risk-free instruments protected against inflation, such as TIPs, declined, as well as Treasuries vs. TIPs spread narrowed to minimal 178 bps (annual record low).

Tbonds vs. TIPs



UST-10 vs. UST-2



Hence, global deflationary risks are coming more to the forefront that coupled with authorities' willingness to cut budget spending and with increase in debt burden can hardly encourage investors G20 Summit in Toronto indicated lack of concerted actions regarding this issue, and the US stance was quite obvious – it is prematurely to curb governmental stimuli.

Market regulation is inevitable, but the process to be smooth. Introduction of stricter trading rules on the financial market along with Basel-3 standards and changes in accounting feared market participants and only some time later it became obvious that populist intentions triggered the tough rhetoric of monetary authorities of Europe and the USA. For instance, famous Obama's plan stipulates higher transparency of derivatives market via its transition from the OTC to established exchange trading and finally envisages the creation of regulatory bodies.

Above-mentioned factors, in our view, will create favorable conditions for UST placements. Obama's government needs to finance budgets expenses (accumulated budget deficit accounts for $0.94 trln from the start of financial year (and may achieve $1.4 trln in September, 2010), and possible escalation of debt issues in Europe either problems in banking sector will create sufficient safety bids for Tbonds.

Thus, Tbonds market looks like the only risk-free asset nominated in risk-free currency.

We also have an assumption on a non-market factor, which can support our general hypothesis of heightened demand for the US debt over the short-term. If we correctly understand the strategy of large players on the market which are funds and if they were accumulating positions in Treasuries when their yield was 2.5-2.7% based on UST-10 adjusted TNX index at the end of 2008 – in the first half of 2009 (we mentioned this in our strategy-2010), than funds look reluctant to post losses. Besides, late exit from the positions may become even more complicated issue. Anyway, after some time inflation and growth rates will come, so now, when the EU is in budget troubles, it is the best chance for funds to sell their positions at a price equaling a purchasing price, with these developments in force we expect Tbonds yield to decline.

It is worth noting that growth will be short-lived and speculative, while the US debts are far from low, and yield curve growth may resume already in 2011.

Bid to cover in UST-auctions

год\ср.знач	2Y	5Y	10Y	30Y
2007	2.86	2.45	2.47	2.47
2008	2.30	2.14	2.30	2.30
2009	2.94	2.35	2.63	2.63
2010	**3.15**	**2.69**	**3.17**	**3.17**

Adjusted TNX Index

EM sovereign spreads: separating the wheat from the chaff. Further revision is ahead!

Time to revise spreads is far from over. This trend, in our view, will remain intact for at least another 1.5-2 years. But be prepared to mend your sails while the weather is fine. In other words, we do not recommend trying to catch "falling knives". We advise to avoid debt of countries in a high risk zone, where PIIGS are. We believe that only the first part of farce has been over and the list of countries, credit risks of which are likely to be revised, may be expanded both from qualitative and quantitative sides. The budgetary systems of these countries look imbalanced, and banking ones, because of unclear composition of assets and exposure to problem areas carry the risk of increasing problems with funding. We do not rule out a similar trend to develop in the USA, but some time later.

The risks of the countries with "AAA" investment grade (the best rating) may be included into a non-investment category following the path of Greece. At the same time, we believe that fundamentally undervalued risks of some developing countries (based on Debt/GDP ratio, budget deficit etc.) from non-investment and speculative category may be assigned "A-" rating. Hence, for long-term investors we recommend to keep an eye on bond issues of such countries, especially in light of aggressive sovereign risks revaluation which opens the way to debt market of developing countries. This revaluation would be accompanied by sporadic widening of spreads and capital inflows.

The investment idea stated in our strategy-2010 has played out and has been up-to-date even for 2H10. The alternative for a bet on sovereign risks may be a bet on corporate risks in inflexible to lower demand sectors. Out top picks are utilities, telecoms, infrastructure and mining.

Investors should avoid betting on recovery of retail, construction sector, small banks, heavy industry names and enterprises with long production cycle – those companies which are long-money pegged. In reality they may not receive these funds.

Given the sovereign bond curves provoke the similar movement in corporate bonds, buying market risks look unjustified. Credit risks would come to the forefront, and strategy would be "buy and hold".

Russian corporate Eurobonds are safe haven-2? Under high volatility of global markets, we advise the conservative approach and recommend bonds with clear credit risks and low market ones (if we consider investments into short- and medium-term issues), while currency risks would provide investors with additional gains.

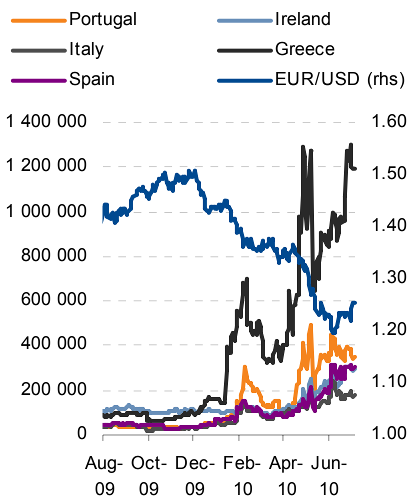
CURRENCY MARKET: WEAK US DOLLAR IS STILL A MYTH, RUBLE DEVALUATION AGAIN?

Turbulence to increase going forward: the major risks will come from the EU. US dollar is a safe haven

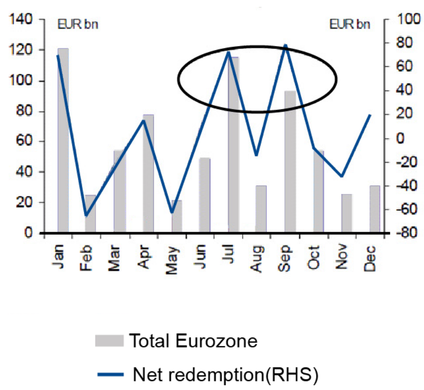
Pundits believe that budget imbalance and debt leverage issues of the EU countries are far from over, based on their CDS and euro performance in December, 2009. It is difficult to say whether this story has hit its high in May-June, 2010 when PIIGS redeemed EUR26.6 bn in total by using their own financial resources and funds raised from the European Stabilization Fund. We believe this story to be continued.

The market provides mixed valuation of the bail-out package. The one thing is obvious – euro zone debts are much bigger: EUR720 bn (EUR60 bn hard money contingency fund + EUR440 bn special purpose vehicle + EUR220 bn IMF funding) vs. EUR4 trln debt of large economics only. Based on Debt/GDP and budget deficit, we may expect similar steps from Portugal, Spain and Italy which are much bigger than rescued Greece and funds themselves altogether.

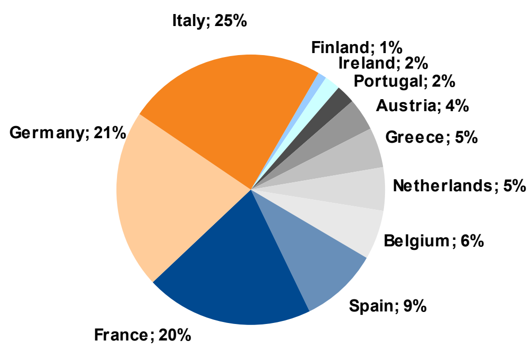
PIIGS CDSs & Euro



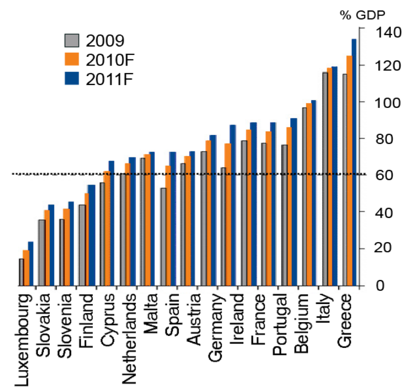
Euro zone bond redemptions 2010



Euro zone government debt outstanding, EUR bn



Euro zone debt vs. GDP



Source: Reuters, Bloomberg, Eurostat

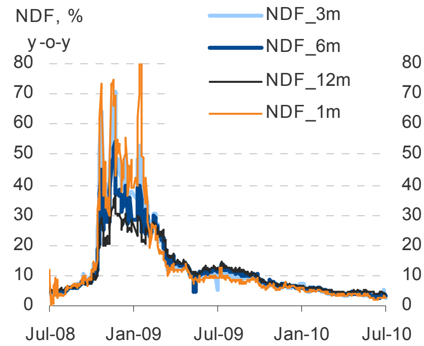
Meanwhile, rescue of economics is not a free-of-charge aid. Donors and IMF require adhering to Maastricht treaty and keeping budget deficit of not more than 3%. The EU members started submitting drafts on state spending cuts to parliaments, while Spain, for example, is showing deflationary trends. Expenses have not declined though! All these developments are incapable of bringing optimism to commodities markets. If we assume no defaults in Europe, consumption would decline anyway due to state spending cut programs.

Commodities market could rescue China from national currency devaluation. But two-day summit of China and the USA proved there is no yuan revaluation on the agenda, and the authorities are more concerned with the balance of payments on the back of weaker euro which is the currency of China's main trading partner.

These major factors coupled with upcoming regulation – the US Senate approved financial system reform, strict rules for derivatives and other financial instruments' trading – are unlikely to increase risk appetite.

Taking above-state factors into account, we expect increased turbulence on the markets with commodity one being no exception. Given our understanding of risk-free instruments, riskless US dollar may take the lead in attracting investments in 2H10.

NDFs remain stable



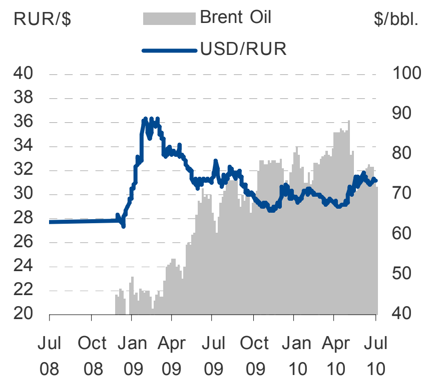
Source: Bloomberg.

Ruble under pressure: devaluation is looming again?

We are unlikely to avoid negative ruble performance. The CBR is authorized to offset national currency fluctuations but not to constrain market trends, which we see as not long-term ones. Currently we can point to the resistance of local currency market during the global financial market correction – when prices were collapsing on the commodity market, ruble remained strong, and later even managed to reverse some of its losses following the upward trend evidenced in stock indices and oil prices.

Based on 6-month non-delivery forwards (NDFs), RUR/USD consensus is around 32.5. Oil price per barrel which is still the key benchmark for local currency trading dropped considerably, if to discount short-term bounces, while RUR/USD or RUR/bi-currency performance was quite different.

RUR/USD vs. Brent price

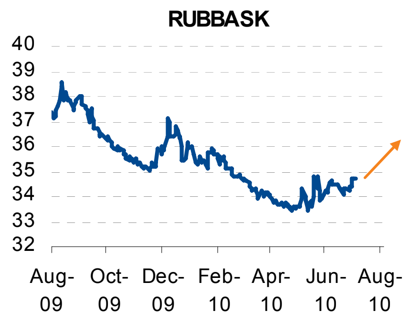


Source: Bloomberg.

Despite volatility on the foreign markets, the situation on the local currency market does not look aggressive. Moreover, the chances for ruble to bi-currency basket to return to the previous levels are high following other assets performance, however, we believe the drivers behind global markets' collapse did not vanish but took a back seat for some time, and investors should gain the momentum.

We expect the downward trend to restore in the short run, so we recommend hedging the positions in ruble assets, especially in case of ruble appreciation which would follow technical rebound of demand for risks and key markets rally.

Bi-currency basket, rub.



DOMESTIC MARKET:
ARRIVED AT ITS FINAL DESTINATION

The behavior mode of key participants does not reflect confidence

Instead of issuing corporate loans, banks were buying bonds. It is virtually impossible to grant a loan to a high-grade issuer under a reasonable interest rate. The public debt market, on the contrary, provided such a possibility.

Securities portfolio extended by 85.7% (y-o-y, based on May banks' financial reports). As high-margin credit market unfreezes, banks will be selling off their bond portfolios which were up by 92.4% y-o-y from RUR1.89 trln in May, 2009 to RUR3.63 trln in May, 2010.

Banks, which obtained subordinated loans, will have to pay them back to the CBR that may push money market rates up (Sberbank, VTB, Russian Agricultural Bank, large private banks).

Trying to avoid excessive currency risks, issuers (mainly banks and resource-based companies) would prolong early obtained currency debts nominated in rubles. For instance, the companies, which attracted loans under LIBOR + margin with actual and expected LIBOR rates growth, would increase pressure on the primary debt market with creating additional demand for rubles.

Watchdog and monetary authorities: less liquidity = less inflation

CBR is absorbing excessive liquidity via placement of Bank of Russia zero-coupon bonds and contraction of unsecured lending. We believe that the cut of Lombard and loan collateral lists are looming. All this may push the rates up to traditional levels of 4-5% from historic lows of 2-3% (weekly Mosprime rates).

Implementation of state lending program is required to keep the state budget balanced mainly on the local market in order to cut expenses and mitigate currency risks. In particular, as per the Finance Ministry of Russia guidance and based on our estimates, federal loan bonds (OFZs) and state treasury bonds (GKOs) would be issued for a total amount of RUR600 bn till the end of this year. This would partly absorb the liquidity, increase the competition among issuers and perhaps send the quotes on the secondary market down.

Market inefficiencies – there is no room for further growth

Amid cheap money and record low CBR refinancing rate (7.75% y-o-y) one-year issues of high quality issuers have been already trading in the range of negative interest rates, based on the refinancing rate, but not on accumulated inflation or CPI.

Further cut of interest rates is limited by direct funding costs, and on the back of repo forming-up price growth rates have already hit all-time highs (above RUR4 trln) with market volume posting insignificant growth in terms of money.

Deferred supply on the primary ruble debt market is increasing: upcoming placements of Norilsk Nickel, Rusal, TKB and of other issuers of total amount exceeding RUR 250 bn put pressure on the issues in outstanding.

There is one thing questioning all the facts. It is the ongoing soft monetary policy, resulting in a huge amount of cheap money. However, an increasing number of experts expect almost free-of-charge financial resources to be depleted soon in 2H10 that may fuel yield growth of the ruble interest rates up by 1-2 ppt.

WHAT TO BUY?

IT IS TIME TO SWITCH THE FOCUS!

We advise to switch focus of investors' portfolios to high-grade Eurobond issues as opposed to local ruble issues. The core investment idea is hedging from risks related to weaker ruble and mitigating the market risks against the backdrop of exacerbating euro zone debt crisis which led to capital flight into quality across the globe.

In this environment, the safest bets are Eurobonds issued by strategically important Russian companies which are state-controlled, have credit ratings and excellent credit history and/or have own defensive mechanisms against exchange rate growth – revenue from export and hedge positions.

WHY EUROBONDS?

Currency risk mitigation + hedge

In the current conjuncture, all ruble assets would stay under pressure even with ample ruble liquidity, money market low rates and relatively cheap NDFs.

Therefore, the optimal investment bet, in our view, is short- and medium-term Eurobonds (of 1-1.5-year duration) of Russian companies with transparent credit risks.

Hence, the purchase of dollar-denominated bonds before maturity date allows avoiding risks associated with ruble depreciation that owing to lower oil prices and flight to quality provides investors with fixed yield and enables them to avoid market risks, since investors can hold the bonds of short-dated issues till their maturity dates. In this case, the priority is not to lose money, rather than to earn it.

Costs for hedging strategy (futures, option strategies) would be much lower as compared to a potential gain in case of considerable ruble weakness (its moderate weakness). The potential gain would compensate for possible losses related to negative revaluation of ruble assets which became cheaper.

Among reasonable options for hedging we suggest:

1) put/call options on RTS/MICEX – correlation is strong, market capacity is sufficient

2) indices futures

3) RUR/USD forwards

4) TRS (total return swaps)

Minimal credit risks of selected issuers

Under these conditions, the safest bets are Eurobonds issued by strategically important and state-controlled Russian companies which have credit ratings and excellent credit history and/or have own resources to solve the problems related to currency debt servicing.

Resource-based sectors could increase profits and cash flows, as well as repay currency debts and expand their businesses. Vertically integrated companies would benefit the most from expenses nominated in rubles (Mechel, Evraz, Severstal and mining segment).

Banking is the only sector abilities of which to serve its debts directly depend on funds timely provided by the CBR to the financial system.

We do not see any risks for investments into the telecom sector (MTS, Vimpelcom and MegaFon). Our stress tests for companies' business models based on their current debt leverages, credit portfolio mix from the currency diversification point of view and generation of cash flows indicate that mobiles are capable of serving their debt obligations even under the scenario of sharp ruble devaluation. As such, MegaFon has negative net debt, its debt obligations are related to purchases of new equipment; 70% of MTS credit portfolio is nominated in rubles; Vimplecom has mainly USD nominated debt (accounts for 60% of its total credit portfolio), however, the mobile operator is hedged against currency risks.

Consumer and retail sector is likely to fall into a high-risk zone – with low margins, growing cost of currency debt servicing without a hedge may raise concerns over the ability to timely refinance nominated in currency debt liabilities. We do not recommend buying bond issues of sector's companies in the short run.

We think the best bets of this sector are Tatfondbank-12, AK Bars-11. AK Bars-12, Bank of Moscow-13, Gazprombank-13, MTS-12, Raspadskaya-12. Play on call-option: AlfaBank-15-call, Bank St. Petersburg-17-call and others. Play on spreads: sell of Lukoil yield curve vs. Gazprom one. On the one hand, they have favorable market parameters (high coupons and/or short duration) and, on the other hand, they are protected from exchange rates growth (revenue is received in currency). Oil and gas, metal and banking sectors have all these advantages.

Additional gain

Positive currency revaluation

Purchase of bonds denominated in dollar would bring investors additional ruble gains in case of stronger dollar and offset risks of ruble weakness on the back of lower commodity prices and speculative capital flight from the emerging markets.

For investors who anticipate weaker ruble, we advise buying call-options on a currency pair, while keeping positions in ruble instruments. Alternatively, investors may use duration-effect to build-up defensive portfolios. We consider this strategy as the most attractive on the back of expected stagnation of ruble bonds market, while this very trend is likely to prevail in 2H10.

High yield in the wave of panic

The fact that corporate and sovereign bonds' quotes on the emerging markets are lagging behind the other market assets' performance is due to a form of trading (OTC). When some participants fix the profits, the others have a chance to benefit from cheap purchases. For example, when economic crisis peaked in 2008, the yield of some bonds reached 100% y-o-y while at present the yield of 10% seems being unattainable (TMK dollar-nominated bonds).

Eurobond primary market promises additional premium

In case of some issuers tap into Eurobond market under unfavorable environment, investors may receive additional benefits from higher coupon rate or commission. In particular, Tatneft, MTS, MegaFon, large state-controlled companies and private credit institutions expressed their intentions to enter this market.

Ruble bonds look appealing on the primary market only

Investors, who are not interested in nominal yield of any ruble asset, do not pay much attention to currency market performance. So ruble bonds are one of the possible bets which provide a decent yield of investment portfolio.

Given our expectations of ruble rate dynamics, high rates and the domestic major trading idea “under the CBR rate cut”, we draw investors’ attention to participating in auctions on the primary market. Here they may get solid coupon rates and bonds with shorter duration, but the most important is high quality of issuers which offsets credit risks. As for long-dated bonds, we prefer floating rate notes.

On the secondary market we advise to reduce the positions in short-dated ruble debt instruments with limited upside potential.

We advise to switch focus towards fixed-yield dollar-denominated instruments. Short-dated issues are protected against any market risks and would defend investors from potential negative performance of domestic currency market.

The most interesting issues are: Tatfondbank-12, AK Bars-12, Bank St. Petersburg-17-call, issues of metal companies, currency risks of which are offset by revenues from export (Severstal, Evraz) and reliable issues of mobile operators (MTS-10 and MTS-12).

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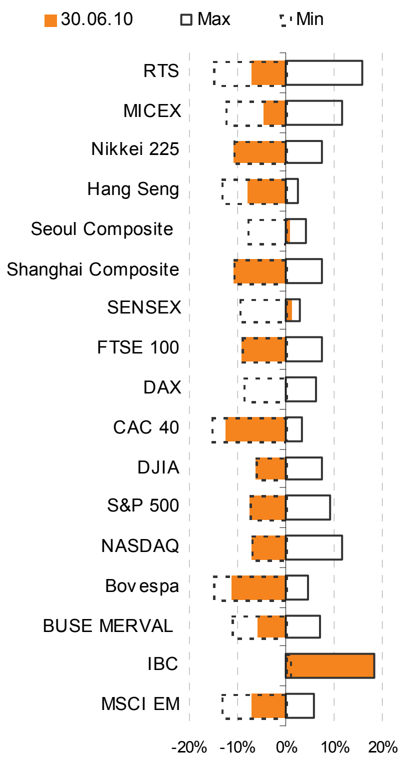
Stock market

Be selective

External news as the driver

World indices dynamic in 1H10



Source: Bloomberg, TKB Capital estimates

1H10 – liquidity vs. risks. Stock market started the year with rally, which already in January changed to a negative correction that continued through February. Later in 1H10 the market grew again and reached its local pick at 1,676 on RTS Index on 15 April, approaching the level of August, 2008 and our target for 1H10 (1,650 points on RTS). But in the whole the first half of a year was quite unsuccessful. The market ended the 1H10 with 4% decline comparing to the beginning of the year 2010. Positive expectations about economic recovery changed with poor statistic and growing credit risks, while the market trend in 2Q10 was driven mainly by speculative operations and sales from the part of foreign investors.

External news flow was setting the trend. 1H10 was full of events, news, believes and fears. The year beginning brought positive reports in financial sector, which bottomed out fast. Optimistic statistics in the US indicating economic recovery boosted demand for risky assets that supported the stock markets. But as we wrote in our strategy for 2010 (please, see "Run, Russia, Run!". Released in December, 2009) risks came from Europe. Growing budget deficit and national debt of Greece along with worsening situation in other European countries scared investors and caused selling of the Russian assets. These risks will continue limiting economic growth forecasts, putting pressure on assets price and boosting demand for less risky alternatives. 1H10 already started with negative sentiments from Europe regarding credit risks in Spain.

Chinese factor – good and bad in one. China is the fastest growing economy driving the global recovery. At the same time, the country is facing with risks of overheating, while low transparency does not allow predicting further development of the economic trend. In 1H10 the Chinese government started strengthening its monetary policy to curb economic growth. China increased reserves requirements for the banks to absorb liquidity and limit loan portfolio growth and changed rules of loans issuing to prevent overheating of the real estate market. Impact of those measures was detrimental for the markets. And any further news on economy contraction will be treated negatively, while continuation of growth is associated with a bubble, which development is hardly predictable. Thus, Chinese growth drives the whole world and scares the global economy simultaneously. We still consider risks in China as high and important for the further economic growth as well as for the world market performance.

Excess liquidity strengthens markets. Despite existing risks financial markets strengthened in 1H10. Significant volume of liquidity boosted demand for assets both on equity and fixed income markets. Interest rates stood at the bottom level and sometimes were even below pre-crisis numbers. That helped companies and banks to attract financing and repay expensive debts. But demand for resources to finance investment projects was low due to vague prospects of the future development, while in reality only high quality borrowers were able to attract funds at low rates or to raise money via equity placement.

Interest rate policy is unlikely to change soon. In our strategy for 2010 we expected to see strengthening interest rate policy starting from autumn, but it is unlikely to be the case now. Despite large amount of spare liquidity on the market inflation risks are still low, while growth rates do not prove stable recovery of the global economy. Thus, we expect to see first signs of interest rate growth not earlier than in 2011. Tightening of monetary policy will lead to correction on the market, while signs of economic growth will support longer-term positive prospects.

Russian stock market

Strong ruble and high interest rates vs. risks. In the beginning of 2010, ruble appreciation and relatively high interest rates on the market fueled demand for ruble denominated assets. That together with strong recovery in 1Q10 from the bottom level of 1Q09 boosted Russian stocks. Funds inflow in 1H10 exceeded $3 bn comparing to approximately $5 bn in 2009 reflecting the trend. But higher risks on the global markets limited demand for the Russian equities and shifted it towards less risky assets. Domestic demand was not enough to replace money inflow, and the trend transferred to speculative players with liquidity and short-term horizon.

Russian market was better than some others in 1H10. RTS and MICEX indices outperformed most of developed markets and some emerging markets in 1H10 that proves high investors' interest to the Russian assets and demand from the part of domestic players. The worst performer was the Chinese index Shanghai Composite, which lost 26.8% YTD. The US indices declined by 6.3-7.3%. RTS Index was down by 7.3%, while MICEX lost 4.4% YTD, and weak dynamics in 2Q10 was attributed both to negative external sentiments and to the government interventions in a number of areas. The Russian stocks are traded with a discount to EM peers on multiple basis, but it is not always enough to start the rally.

But the prospects are gloomy. Since the crisis beginning investors learnt to understand existing risks and take them into account. High level of free liquidity supports the market, while fundamental factors are not strong enough to drive up prices for risky assets. High volatility and still existing risks, uncertainty regarding stability of Chinese economy, budget crisis in Europe and unsteady recovery of the US economy – all these factors reduce value of low prices and fundamental factors. We believe that the most appropriate strategy under the current conditions is a selective play betting on less risky stories and high dividend yield. Either investors have to stick to speculative operations playing our just short-term market tendencies.

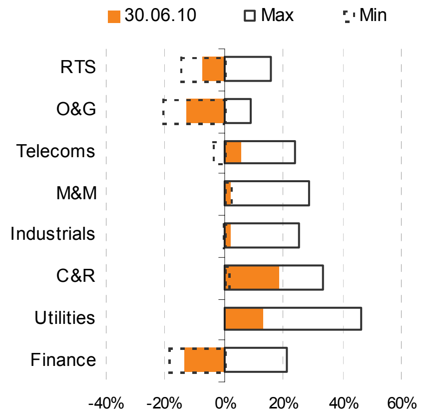
Where we see risks. **Domestic risks – taxes and tariffs.** Despite relatively high price of oil, investors are not in a hurry to buy Russian oil and gas names. The state's decision to revoke crude oil export duty holidays for East Siberian greenfields, increased government regulation in downstream, growing Transneft tariffs, and possible further tax hikes reduce attractiveness of Russian oil companies. Given the state's growing appetite for cash flows of the oil and gas companies, it becomes increasingly difficult to detect sound investment stories. Change of the tariff regulation in utilities and postponing of RAB-tariffs increase uncertainty in the segment and eliminate investment story for now.

*In what we believe***. Local demand and value stories**. We bet on further recovery of domestic demand driven by growing disposable income, low inflation and low interest rates on the market. That will be reflected in retail, infrastructure and transportation sectors. Financial sector is close to start faster growth after almost flat 1H10 that will be priced in the stocks. Improvement of the loan portfolio quality will lead to income growth, while the most efficient will outperform. We also prefer interesting dividend stories (in oil, banking and telecoms) as a safe play on the volatile market as well as gold companies to defend from risks.

RTS Index – volatility with no trend widens forecast. Our previous forecast of RTS Index for the end of 2010 was 1,900 points that implies 40% growth in 2H10. Under conditions of high volatility on the market, strong liquidity volumes and improving fundamentals vs. existing risks, we are getting less optimistic on the stock market growth. At the same time, the target may be touched during the period supported by positive news flow as we already saw local high at 1,675 in spring 2010. We do not provide any new 2010-target for RTS Index and expect to see it in the **range of 1,650-1,900** by the end of 2010 if the mentioned risks do not realize.

Stock picking play

Sector indices dynamic in 1H10



Source: Bloomberg, TKB Capital estimates

Oil and gas – focus on dividend plays and Gazprom. Stocks with history of healthy dividends – ordinary and preferred shares of **TNK-BP Holding** (TNBP, TNBPP), preferred shares of **Bashneft** (BANEP) and preferred shares of **Tatneft** (TANPP); fundamentally undervalued **Gazprom** (GAZP).

Power industry – efficient generation is valued high. Hydro generation (**RusHydro**, HYDR) and effective thermal companies (**OGK-4**, OGKD), which will benefit the most from their competitive advantages in light of the electricity market liberalization and rising fuel prices, are the top picks.

Metals and mining – bet on coal sector as a growth story and on gold as a safe play. Our top picks **are Severstal** (high level of vertically integration, promising gold segment, North American assets potential, the cheapest stock in steel universe) and **Raspadskaya** (negative developments caused by mine failure are priced in, strong coking coal prices and high efficiency to support in the long term).

Transport – economic recovery drives cargo turnover up. Top pick is **Globaltrans** (GLBT) with perfect operating and financial results, diversified business, possible M&A deals, the only liquid stocks in the rail sector for now.

Telecoms – efficiency and reorganization. Vimpelcom Ltd (VIP) and **MTS** (MBT, MTSS) look attractive owning to efficiency of business models in comparison with DM and EM peers. Consolidated **Rostelecom** (RTKM) will be new blue chip on the Russian stock market and the most liquid share at local TMT segment.

Consumer and retail – recovery is evident, betting on solid financials in a high season. Our top picks are **Magnit** (MGNT) and **X5 Retail Group** (FIVE) (high pace of stores openings, M&A and gains on more efficiency), **Wimm-Bill-Dann (WBDF) and Pharmstandard** (PHST) (technically suppressed, but fundamentally strong and event driven) and **Veropharm (VRPH)** (import substitution in niche segments; financials turnaround).

Banking sector – stronger growth just around the corner, efficient to win. **Sberbank (SBER)** is our top pick as a bet on economic recovery, high efficiency ratios, loan portfolio growth and stabilization of credit quality. **VTB (VTBR), Vozrozhdenie (VZRZ)** and **Bank St. Petersburg** will follow the leader.

Machinery – focus on financials improvement and strategic industries. We bet on **AVTOVAZ (AVAZ) and Sollers (SVAV)** financials growth due to Russian car market recovery and prefer helicopter producers among key strategic industries **(Kazan Helicopters (KHEL) and Ulan-Ude Aviation Plant (UUAZ)).**

Real estate sector – bet on residential real estate. Top pick is **LSR Group (LSRG)** – the top-performer on St. Petersburg real estate market expanding to Moscow region, stable growth of production capacities, significant volumes of state orders, strong fundamentals, transparent and clear development strategy.

TKB Capital

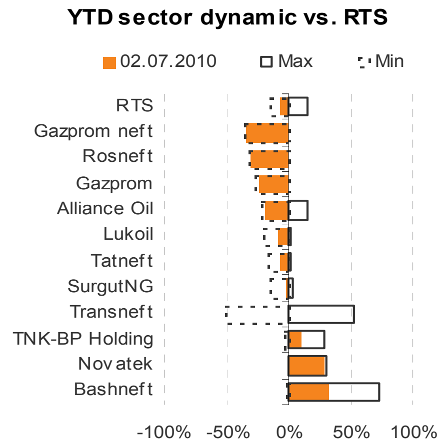
Oil and gas

In the palm of the state's hand

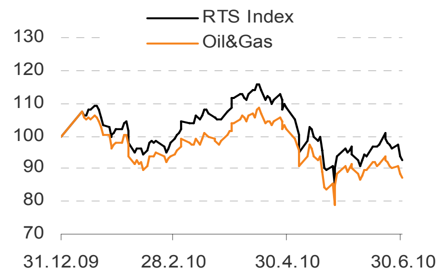
Evgenia Dyshlyuk e.dyshlyuk@tkbc.ru

Rosneft's performance ruined by tax changes. In 1H10, two of our top oil and gas picks – Novatek and TNK-BP Holding – demonstrated strong performance, up by 29% and 11%, respectively, YTD (see Figure 1). Our third pick – Rosneft, – on the contrary, experienced major volatility and finished 1H10 in the negative territory, losing a third of its value. Such disappointing performance, in our view, is primarily attributed to the Russian government's news stance on taxes.

Figure 1. Oil and gas stocks performance, YTD, %



Source: Bloomberg, TKB Capital estimates



Source: RTS, TKB Capital estimates

The state's grip is getting stronger. The first half of 2010 was marked by the state's decision to revoke tax holidays for East Siberian greenfields, discussions about further tax hikes in upstream and increased government regulation in downstream. The state's steps towards higher oil and gas taxes contradict our expectations: we supposed that the state would ease the tax levy to build production platform for future tax revenues.

Export duty holidays for East Siberia cancelled out. The government has decided to revoke crude oil export duty holidays for East Siberian greenfields, including already producing Vankor (Rosneft), Verkhnechonsk (TNK-BP Holding) and Talakan (SurgutNG). Starting from 2H10 these projects should pay special crude oil export duty until they reach a certain rate of return (15-17% threshold return has been discussed).

Rosneft gets hurt the most, less impact on SurgutNG and TNK-BP Holding. The decision on East Siberian taxation will have a major adverse impact on financials of Rosneft, which has the largest exposure in this region and is the main supplier for the East Siberia – Pacific Ocean pipeline (ESPO). The proposed tax changes trigger roughly 25-30% downward revision of Rosneft's forecasted EBITDA in 2011-2012. The impact on SurgutNG' and TNK-BP Holding's financials should be less severe: we estimate downward revision of their forecasted EBITDA in 2011-2012 at 11-16%.

Further upstream tax hikes on the way? Currently, the Finance Ministry is considering increasing oil and gas mineral extraction tax (MET) – a measure that will adversely affect performance of the Russian oil stocks. Heavy tax burden may force oil companies to withhold new projects domestically and seek investment opportunities outside of Russia.

Looking for tax relief. Lukoil has requested the government to grant it export duty holidays for its Caspian projects. Also, the state has been considering reducing MET for small oil fields – a measure that would benefit producers with highly fragmented upstream asset base (e.g., Tatneft, Bashneft, Russneft, Alliance Oil). Yet, given the recent trends in the oil and gas taxation, the likelihood of new tax breaks is debatable.

Increased government regulation in downstream. Federal Antimonopoly Services (FAS) introduced new initiatives aimed at reducing price-setting power of oil majors and increasing transparency of pricing at the domestic market of oil products. In particular, FAS is proposing to bring domestic prices for gasoline and other products to the export parity by introducing a price formula and to impose restrictions on the retail market share.

Bashneft, Alliance Oil and Gazprom neft affected the most. We estimate that the FAS initiatives will affect primarily remote inland refineries focusing on local markets with high share of gasoline in the product mix. On a company level, we expect players with the high refining leverage and large exposure to the domestic sales – Bashneft, Alliance Oil and of Gazprom neft – to be affected the most. We estimate potential losses from the FAS initiatives at roughly 15-30% of 2010E EBITDA for these companies.

Pipeline tariffs on the rise. Another area of government regulation – transportation tariffs – is also causing trouble for Russian oil companies. In 2001-2009 average Transneft's pipeline tariff in dollar terms grew at CAGR of 14%. Given that Transneft has expensive projects pending and needs to service its debt, further rise in pipeline tariffs across all the routes is likely to continue.

New target price for Rosneft – $8.5/share, for Lukoil – $74/share, BUY. We have incorporated the tax changes discussed above, our new macroeconomic forecast and assumptions into the financial models for Rosneft and Lukoil. As a result, we have revised down Rosneft's DCF-based 12-month target price by 15% from $10.0/share to $8.5/share, which implies a 40% upside. We have upgraded Lukoil's DCF-based 12-month target price by 10% from $67/share to $74/share, which implies a 45% upside. We retain our Buy recommendation on both stocks.

Uncertainty with taxes calls for a conservative investment approach. Due to the state's growing appetite for cash flows of the oil and gas companies, it becomes increasingly difficult to detect sound investment stories. Following the tax changes, Rosneft has lost its unique investment story. While at the current price levels Russian oil names look appealing (trading, on average, at 2010E P/E of 5.8), ongoing debates on further oil and gas tax hikes call us to focus on selected dividend plays and Gazprom in 2H10.

Top picks for 2H10 – dividend plays and Gazprom. In 2H10, we advise investors to focus on stocks with a history of healthy dividend yields – ordinary and preferred shares of **TNK-BP Holding** (**TNBP**, **TNBPP**), preferred shares of **Bashneft** (**BANEP**) and preferred shares of **Tatneft** (**TANPP**). In particular, TNK-BP Holding is well-positioned to offer attractive dividends: in 2010 the company's cash flow is helped by tax savings from its East Siberian Verkhnechonsk project. We also include **Gazprom** (**GAZP**) as a top pick – it is now the cheapest stock in our universe, trading at 2010E P/E of 4.1 and 60% of its book value.

Figure 2. Relative valuation

		Target price as of 02.06.2010 , $/sh							EV/EBITDA			P/E			
Company	Ticker	Old	New	Change, %	Current price, $/share	Upside, %	MCap, $ mn	EV, $ mn	2010E	2011E	2012E	2010E	2011E	2012E	P/BV
Oi and gas companies															
Rosneft (KIT Finance)	ROSN RX	10.0	8.5	-15%	6.1	40%	58,286	77,098	4.4	5.6	5.3	6.0	8.8	8.2	1.2
Lukoil (KIT Finance)	LKOH RX	67.0	74.0	10%	51.0	45%	43,146	50,905	3.5	3.8	3.3	5.1	5.6	4.6	0.5
SurgutNG	SNGS RX	-	1.1	-	0.88	25%	34,607	21,003	2.9	3.0	3.1	7.3	7.6	7.8	0.9
TNK-BP Holding	TNBP RU	-	2.7	-	2.0	36%	30,477	32,224	3.4	3.1	2.9	5.0	4.7	4.5	1.6
Gazprom neft	SIBN RX	-	5.0	-	3.6	38%	17,138	22,548	3.9	3.5	3.3	5.2	4.8	4.6	1.0
Tatneft	TATN RU	-	5.4	-	4.6	17%	10,040	11,950	4.6	3.5	3.2	5.9	4.7	4.3	0.9
Bashneft	BANE RU	-	50.0	-	35.3	42%	6,795	9,295	3.5	3.1	2.7	5.8	4.6	3.8	-
Alliance Oil	AOIL SS	-	18.3	-	11.4	61%	1,954	2,458	4.9	3.7	2.5	7.6	5.3	3.3	1.1
Russian oil & gas companies – weighted-average									**3.7**	**4.0**	**3.8**	**5.8**	**6.6**	**6.1**	**1.0**
ExxonMobil (US)	XOM US	-	77.5	-	56.6	37%	289,330	288,073	4.4	3.7	3.7	10.4	8.7	7.8	2.5
RoyalDutchShell (Netherlands/UK)	RDSB LN	-	32.1	-	23.9	34%	154,135	179,449	4.0	3.3	3.0	8.4	6.7	5.9	1.1
Chevron (US)	CVX US	-	90.5	-	67.3	34%	135,208	136,994	2.9	2.6	2.4	7.6	6.7	6.0	1.5
Total (France)	FP FP	-	59.0	-	45.4	30%	106,623	127,520	3.7	3.3	3.1	8.2	7.3	6.8	1.4
ConocoPhillips (US)	COP US	-	61.5	-	48.8	26%	72,660	100,771	3.6	3.2	3.0	8.0	6.7	6.1	1.2
Marathon Oil (US)	MRO US	-	37.0	-	30.8	20%	21,874	28,349	3.6	2.8	2.6	9.8	6.1	5.1	1.0
International super majors – weighted average									**3.8**	**3.3**	**3.1**	**9.0**	**7.5**	**6.8**	**1.7**
Petrochina (China)	601857 CH	-	2.0	-	1.5	28%	247,014	268,592	5.9	5.8	5.3	12.1	10.9	9.9	1.9
Petrobras (Brazil)	PETR3 BZ	-	27.0	-	17.0	58%	142,127	189,733	5.1	4.5	4.5	8.5	7.1	7.0	2.6
Sinopec (China)	386 HK	-	1.0	-	0.80	22%	130,235	164,144	7.4	6.7	6.3	13.5	12.7	11.8	2.2
CNOOC (China)	883 HK	-	1.9	-	1.7	16%	74,160	69,272	6.0	5.3	4.9	11.4	10.2	9.6	2.9
ONGC (India)	ONGC IN	-	28.4	-	27.9	2%	59,714	56,128	6.2	5.1	4.9	14.6	11.4	10.7	3.2
GEM oil & gas companies – weighted average									**6.1**	**5.6**	**5.2**	**11.8**	**10.4**	**9.7**	**2.3**
Gas producers															
Gazprom	GAZP RX	-	8.3	-	4.8	75%	111,773	155,685	3.6	3.2	2.8	4.1	3.8	3.1	0.6
Novatek	NVTK RU	-	7.3	-	7.0	4%	21,346	22,099	12.1	9.9	7.7	17.4	13.8	10.6	5.0
Russian gas producers - weighted-average									**5.0**	**4.3**	**3.6**	**6.3**	**5.4**	**4.3**	**1.3**
GDF Suez (France)	GSZ FP	-	39.2	-	29.2	34%	66,007	113,099	6.1	5.6	5.4	12.2	10.8	10.1	0.7
BG Group (UK)	BG/ LN	-	20.3	-	15.6	30%	52,669	57,732	6.5	5.7	5.1	13.4	11.7	10.3	2.3
Anadarko Petroleum (US)	APC US	-	78.0	-	38.1	105%	18,835	28,052	3.9	3.3	2.8	17.8	13.3	9.6	0.9
Apache (US)	APA US	-	126.0	-	82.9	52%	27,943	30,962	3.6	2.8	2.5	8.4	6.3	5.3	1.8
Devon Energy (US)	DVN US	-	84.0	-	60.7	38%	27,131	33,764	5.1	5.0	3.9	9.5	9.4	7.0	1.7
Encana (Canada)	ECA CN	-	35.7	-	30.5	17%	22,529	26,022	4.6	4.7	4.0	15.5	18.9	13.9	1.4
Chesapeake Energy (US)	CHK US	-	34.0	-	20.5	66%	13,350	25,338	5.0	4.6	3.9	6.7	6.6	5.3	1.1
Murphy Oil (US)	MUR US	-	67.0	-	48.4	38%	9,275	9,548	3.3	2.7	2.4	10.0	7.5	6.5	1.3
Pioneer Natural Resources (US)	PXD US	-	80.0	-	57.3	40%	6,638	9,372	6.9	5.5	4.4	22.1	17.0	11.6	1.8
Ouicksilver Resources (US)	KWK US	-	16.0	-	11.1	45%	1,882	4,307	7.3	6.6	5.4	13.4	14.0	11.0	2.7
International gas producers – weighted average									**5.4**	**4.8**	**4.3**	**12.3**	**11.1**	**9.2**	**1.4**

Note: Weighted by market cap. Consensus data except for Rosneft and Lukoil

Source: Company data, Bloomberg, TKB Capital estimates

Upstream buried by taxes

Export duty holidays for East Siberia cancelled out. Contrary to our expectations, the Russian government has decided to revoke crude oil export duty holidays for East Siberian greenfields, including already producing Vankor (Rosneft), Verkhnechonsk (TNK-BP Holding) and Talakan (SurgutNG). Previously, we expected that these projects will be exempt from the export duty in 2010-2012. Now, according to the state officials, starting from 2H10 East Siberian greenfields will pay special crude oil export duty (see the formula below). At average Urals price of $76.5/bbl in 2H10, the special crude oil export duty will be, on average, $12/bbl vs. standard rate of $37/bbl. Most importantly, the special export duty will be applied only until East Siberian projects reach a certain rate of return (threshold of 15-17% has been discussed), afterwards the standard rate will apply.

Standard crude oil export duty formula at Urals price above $25/bbl, $/bbl	Special crude oil export duty formula for East Siberian greenfields, $/bbl
[Urals price – 25] x 0.65 + 4	[Urals price – 50] x 0.45

The rate of return rule to be introduced. It remains unclear whether the Russian government can develop a unified (and fair) methodology for evaluating the projects' rate of return. Given that the state has already adopted an ad-hoc approach to tax changes in the oil and gas sector, we believe it is entirely possible that the state will carry on with individual tax adjustments, making it more challenging for the companies to formulate long-term investment decisions. We rely on the conservative scenario, assuming that the export duty holidays for the producing East Siberian projects will cease completely starting from 2011.

Rosneft gets hurt the most. The government's decision on East Siberian taxation will have a major adverse impact on Rosneft's financials, as the latter has the largest exposure in this region. Rosneft is the main supplier for the new pipeline ESPO (East Siberia – Pacific Ocean), first phase of which with capacity of 30 mn tn p.a. (around 600 Kbpd) has already completed (see Figure 3). Rosneft's Vankor field, launched in 3Q09, is forecasted to reach peak production of 25 mn tn (500 Kbpd) by 2015, while TNK-BP Holding's Verkhnechonsk and SurgutNG' Talakan (both launched in 2H08) are targeting 6-7 mn tn (120-140 Kbpd) by 2013-2015.

Figure 3. East Siberian greenfield projects – crude oil production forecast, Kbpd

	2008	2009	2010E	2011E	2012E
Rosneft	**0.2**	**73**	**251**	**341**	**391**
% of the company's total production	*0%*	*4%*	*12%*	*15%*	*18%*
SurgutNG	**30**	**50**	**62**	**74**	**85**
% of the company's total production	*2%*	*4%*	*5%*	*6%*	*8%*
TNK-BP Holding	**3**	**24**	**46**	**80**	**100**
% of the company's total production	*0%*	*2%*	*3%*	*5%*	*7%*
ESPO capacity	602	602	602	602	602
Crude oil supplies to the ESPO	33	147	359	495	586
utilization rate, %	*6%*	*24%*	*60%*	*82%*	*97%*
Exports to China (Rosneft's contract)	0	0	0	301	301

Source: Company data, TKB Capital estimates

Over $10 bn of 2010-12 Rosneft's EBTIDA vanishing. We estimate that crude oil export duty holidays for East Siberian greenfields were to generate roughly $14 bn of tax savings for Rosneft over the next three years (see Figure 4). Under the new tax regime, Vankor's savings from the export duty holidays will amount only to $2.8 bn in 2010. The tax changes will have marginal impact on forecasted Rosneft's 2010 EBITDA (downward revision of 3%) but trigger significant downward revisions of EBITDA in short-term (25-30% in 2011-2012). Meanwhile, Rosneft's savings from Vankor's mineral extraction tax (MET) holidays will end shortly: we estimate that its cumulative output will reach the MET threshold (first 25 mn tn) already in 2011.

Less significant impact on SurgutNG and TNK-BP Holding. The impact of revocation export duty holidays for East Siberian greenfields should be less significant for SurgutNG and TNK-BP Holding, as the scale of their projects in this region is smaller than that of Rosneft's (see Figure 3). We estimate that the tax changes trigger marginal changes in EBITDA of SurgutNG and TNK-BP Holding this year (downward revision of 1-3%). The impact will be more tangible beyond 2010: we estimate 11-16% downward revision of EBITDA in 2001-2012 (see Figure 4).

Figure 4. East Siberian greenfield projects – tax savings

	2008	2009	2010E	2011E	2012E
$/bbl					
Urals price	95	61	76	78	85
Crude oil MET	19	9	13	14	15
Crude oil export duty - standard rate	48	24	37	38	43
Crude oil export duty for - East Siberia	0	0	12	13	16
Rosneft					
mn tn					
Crude oil production in East Siberia	0.0	3.6	12.5	17.0	19.5
Output exempt from MET	0.0	3.6	12.5	8.9	0.0
% of total production	*0%*	*4%*	*12%*	*8%*	*0%*
Output exempt from export duty	0.0	0.0	12.5	0.0	0.0
% of total production	*0%*	*0%*	*12%*	*0%*	*0%*
$ mn					
MET savings	(1)	(250)	(1,225)	(897)	0
Export duty tax savings - old	*0*	*0*	*(3,421)*	*(4,791)*	*(6,146)*
Export duty tax savings - new	0	0	(2,842)	0	0
Total tax savings (greenfields)	**(1)**	**(250)**	**(4,064)**	**(897)**	**0**
SurgutNG					
mn tn					
Crude oil production in East Siberia	1.5	2.5	3.1	3.7	4.3
Output exempt from MET	1.5	2.5	3.1	3.7	4.3
% of total production	*2%*	*4%*	*5%*	*6%*	*8%*
Output exempt from export duty	0.0	0.0	3.1	3.7	4.3
% of total production	*0%*	*0%*	*5%*	*6%*	*8%*
$ mn					
MET savings	(203)	(172)	(301)	(371)	(474)
Export duty tax savings - old	*0*	*0*	*(844)*	*(1,033)*	*(1,340)*
Export duty tax savings - new	0	0	(711)	0	0
Total tax savings (greenfields)	**(203)**	**(172)**	**(1,013)**	**(371)**	**(474)**
TNK-BP Holding					
mn tn					
Crude oil production in East Siberia	0.2	1.2	2.3	4.0	5.0
Output exempt from MET	0.2	1.2	2.3	4.0	5.0
% of total production	*0%*	*2%*	*3%*	*5%*	*7%*
Output exempt from export duty	0.0	0.0	2.3	0.0	0.0
% of total production	*0%*	*0%*	*3%*	*0%*	*0%*
$ mn					
MET savings	(22)	(91)	(226)	(405)	(557)
Export duty tax savings - old	*0*	*0*	*(630)*	*(1,127)*	*(1,576)*
Export duty tax savings - new	0	0	(520)	0	0
Total tax savings (greenfields)	**(22)**	**(91)**	**(745)**	**(405)**	**(557)**

Source: Company data, Bloomberg, InfoTEK, TKB Capital estimates

Full utilization of ESPO by 2013. We estimate, assuming there will be no delays in the ongoing East Siberian greenfield projects as a result of revocation of the export duty holidays, the three already producing projects – Vankor, Verkhnechonsk and Talakan – should be able to utilize the first phase of ESPO by 2013 (see Figure 3). Until then the state may have to rely on West Siberian fields to fill in the pipeline. We estimate that in 2011, when, according to Rosneft's contract with China, Russia should start exporting 15 mn tn p.a. to China, ESPO utilization will be roughly 80%.

Investment decisions delayed. The destiny of the second phase of ESPO (ESPO-2) that envisages expansion of the pipeline capacity to over 50 mn tn p.a. is under question now, as oil majors may be reluctant to accelerate development of East Siberia under the existing fiscal regime. For instance, TNK-BP Holding is not ready to invest in its Yamal projects, which are supposed to feed the ESPO, until it is completely clear how much it will have to pay in taxes. Rosneft is delaying investment decision on Yurubcheno-Takhomskoye, another East Siberian greenfield that is similar by size to Verkhnechonsk.

Further tax hikes on the way? Most recently, the Finance Ministry of Russia communicated that it is considering increasing oil and gas MET starting from 2011. For crude oil, a new MET formula is proposed (see the formula below and Figure 5). If this tax change is approved, it will have a major adverse impact on performance of Russian oil stocks. We estimate that in 2011 alone this change in MET triggers a roughly 10% decrease in EBITDA of Rosneft and Lukoil. For natural gas MET may be raised from the current RUR 147/mcm (around $5/mcm) to RUR 294/mcm (around $10/mcm). In the past, the Finance Ministry made numerous attempts to raise this tax and in our models we have already assumed that natural gas MET will increase by five times to around $25/mcm in 2015.

Current crude oil MET formula, RUR/tn	New crude oil MET formula, RUR/tn
419 x [Urals – 9] x exchange rate / 261	468 x [Urals – 9] x exchange rate / 261

Figure 5. Proposed mineral extraction tax for crude oil

	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Urals price, $/bbl	61	76	78	85	83	80	84	89	94	99	105	111
Average exchange rate, RUR/$	32	30	28	28	30	31	30	29	28	28	27	27
Current MET, $/bbl	**10.1**	**13.4**	**13.8**	**15.3**	**14.9**	**14.2**	**15.2**	**16.2**	**17.3**	**18.5**	**19.7**	**21.0**
Proposed MET, $/bbl	**11.3**	**15.0**	**15.4**	**17.1**	**16.6**	**15.9**	**17.0**	**18.1**	**19.4**	**20.6**	**22.0**	**23.4**
difference, $/bbl	*1.2*	*1.6*	*1.6*	*1.8*	*1.7*	*1.7*	*1.8*	*1.9*	*2.0*	*2.2*	*2.3*	*2.5*

Source: TKB Capital estimates

Looking for tax relief

Lukoil's tax benefits from Timan-Pechora to end this year. Lukoil, which has no exposure in East Siberia, has been benefiting from MET holidays applicable to its greenfield project in Timan-Pechora – South Khylchuya. Lukoil's MET savings from South Khylchuya were around $500-600 mn p.a. in 2009-2010 (see Figure 6). However, the field, which has already reached its peak output, is forecasted to cross the MET threshold (first 15 mn tn) already this year and will be required to pay MET going forward.

Northern Caspian as main source of tax savings for Lukoil. Northern Caspian offshore projects, exempt from MET (first 7 years of the project of 10 mn tn of crude oil production, whichever comes first) will replace Timan Pechora as the main source of tax savings for Lukoil. In 1Q10, Lukoil put on stream its first out of six Caspian fields – Yury Korchagina – that is relatively small and is forecasted to reach its peak output of 2.5 mn tn of crude oil p.a. (50 Kbpd) by 2012. We expect Lukoil to launch the second, much bigger field – Vladimir Filanovskogy, which can deliver over 10 mn tn p.a. (200 Kbpd) at peak, in 2014. The timeline and production profile of Lukoil's Caspian projects may be adjusted for tax changes.

Hoping for crude oil export duty holidays. Lukoil has requested the Russian government to grant crude oil export duty holidays for its Caspian projects and may adjust its development program in this region accordingly. Given the government's recent efforts to increase oil and gas taxes, in our view, the likelihood of new tax breaks for Lukoil is debatable. Any relief on export duty will have a positive impact on the company's financials in long-term. For instance, we calculate that, if Lukoil's Caspian projects were to pay the same special export duty rate as the East Siberian greenfields, the export duty tax savings would reach over $1 bn in 2015 (at production level of 5.5 mn tn p.a., or 110 Kbpd).

Figure 6. Lukoil's greenfield projects – tax savings

	2008	2009	2010E	2011E	2012E
$/bbl					
Urals price	95	61	76	78	85
Crude oil MET	19	9	13	14	15
Crude oil export duty - standard rate	48	24	37	38	43
Crude oil export duty - for East Siberia	0	0	12	13	16
mn tn					
Crude oil production:					
Timan Pechora	2.2	7.0	7.2	7.0	6.8
Northern Caspian	0.0	0.0	0.3	1.8	2.5
Subtotal	**2.2**	**7.0**	**7.5**	**8.8**	**9.3**
% of total production	*2%*	*8%*	*8%*	*10%*	*11%*
Output exempt from MET	2.2	7.0	6.1	1.8	2.5
% of total production	*2%*	*8%*	*7%*	*2%*	*3%*
Output exempt from export duty	0.0	0.0	0.0	0.0	0.0
% of total production	*0%*	*0%*	*0%*	*0%*	*0%*
$ mn					
MET savings	(277)	(499)	(600)	(182)	(279)
Export duty tax savings	0	0	0	0	0
Export duty tax savings - potential	*0*	*0*	*0*	*(341)*	*(499)*
Total tax savings (greenfields)	**(277)**	**(499)**	**(600)**	**(182)**	**(279)**

Source: Company data, Bloomberg, InfoTEK, TKB Capital estimates

MET relief for small oil fields discussed

Lower MET for small oil fields discussed. The Russian government has been considering reducing MET rate for small oil fields. The most recent government proposal suggests to introduce special MET formula, which accounts for the size of recoverable reserves, for fields with crude oil reserves up to 5 mn tn (see the formula below). While it is difficult to estimate possible impact of this tax change on particular companies at the moment, we believe, they should be particularly beneficial for oil producers with highly fragmented upstream asset base such as Tatneft, Bashneft, Russneft, Alliance oil and others.

Standard crude oil MET formula, RUR/tn	Special MET formula for fields with crude oil reserves < 5 mn tn, RUR/tn
419 x [Urals – 9] x exchange rate / 261	419 x [Urals price – 15] x exchange rate x [0.121 x recoverable crude oil reserves (mn tn) + 0.389] / 261

Increased regulation of domestic oil products market

New initiatives to regulate domestic market of oil products. In 1H10, FAS introduced new initiatives aimed at reducing price-setting power of oil majors and increasing transparency of pricing at the domestic market of oil products. In the past, FAS accused oil majors of using their dominant position to retain artificially high prices for gasoline and other oil products and initiated legal cases that led to penalties. Now FAS is proposing to bring domestic prices for oil products to the export parity by introducing a price formula and to impose restrictions on the retail market share.

Domestic gasoline and diesel prices above export netbacks. The demand for oil products has been on the rise in Russia, fueled by economic growth. Domestic prices for automotive gasoline and diesel surpassed export netbacks by a good margin (see Figure 7). Further, there was a significant mark-up in the retail. For instance, we estimate that Lukoil's average domestic retail mark-up to the wholesale price was roughly 50% in 2008 and 60% in 2009. Such price level evoked discontent of the regulating authorities.

Figure 7. Oil products pricing in Russia, $/tn

	2004	2005	2006	2007	2008	2009	2010E
Average Urals price, $/bbl	34.2	50.4	61.2	69.3	94.9	61.2	76.2
Gasoline (high-octane) export price	**400**	**530**	**629**	**699**	**842**	**590**	**726**
Transportation	24	30	29	32	44	45	52
Export duty	42	97	143	151	252	133	197
Gasoline netback	**334**	**403**	**458**	**516**	**547**	**411**	**478**
Domestic gasoline price, net of excise	**324**	**417**	**493**	**574**	**711**	**451**	**559**
as % of export netback	*97%*	*104%*	*108%*	*111%*	*130%*	*110%*	*117%*
Diesel export price	**370**	**517**	**596**	**661**	**934**	**555**	**692**
Transportation	24	30	29	32	44	45	52
Export duty	42	97	143	151	252	133	197
Diesel netback	**304**	**390**	**424**	**477**	**638**	**377**	**444**
Domestic diesel price, net of excise	**264**	**388**	**459**	**495**	**677**	**359**	**483**
as % of export netback	*87%*	*100%*	*108%*	*104%*	*106%*	*95%*	*109%*
Fuel oil export price	**148**	**233**	**296**	**336**	**455**	**287**	**362**
Transportation	24	30	29	32	44	45	52
Export duty	37	55	77	82	136	72	106
Fuel oil netback	**87**	**148**	**190**	**222**	**276**	**170**	**204**
Domestic fuel oil price	**80**	**114**	**156**	**169**	**248**	**205**	**242**
as % of export netback	*92%*	*77%*	*82%*	*76%*	*90%*	*121%*	*119%*

Source: InfoTEK, Bloomberg, Petroleum Argus, TKB Capital estimates

Gross margins of refineries may decline by up to 12%. We estimate that FAS decision to bring domestic prices for automotive gasoline to the export parity will result in up to 12% decline of the refineries' gross profits (see Figure 8). The remote inland refineries with high share of gasoline in the product basket, focusing on domestic markets, (Gazprom neft's Omsk refinery, Ufa-based Bashneft's refineries, Rosneft's Angarsk petrochemical plant and TAIF' Nizhnekamsk facility) will be affected the most. As a result of elimination of the domestic premium for automotive gasoline, their per unit gross profit margins (weighted by geography of sales and product mix) may decrease by 10-12%.

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Figure 8. Impact of new gasoline price regulation on refinery profitability

Refinery	2010E through-put, mn tn	Estimated share of gasoline in the product mix, %	Estimated export ratio, %	Status quo: 2010E gasoline export netback, $/tn	Status quo: 2010E weight.-average gross profit*, $/tn	Export parity: 2010E weight.-average gross profit*, $/tn	Export parity: Change, %
Tuapse (Rosneft)	5.2	21%	89%	529	396	395	0%
Kirishi (SurgutNG)	20.4	12%	56%	519	423	415	-2%
Krasnodar (Russneft)	2.5	0%	92%	517	383	383	0%
Khabarovsk (Alliance Oil)	3.0	20%	30%	512	422	395	-6%
Komsomolsk (Rosneft)	7.3	20%	70%	509	395	388	-2%
YANOS (Slavneft)	13.6	22%	57%	502	403	391	-3%
Saratov (TNK-BP Holding)	5.8	17%	59%	499	399	388	-3%
Ryazan (TNK-BP Holding)	14.4	20%	51%	498	412	395	-4%
Volgograd (Lukoil)	11.3	31%	61%	493	434	419	-3%
Moscow (Gazprom neft)	10.0	26%	31%	492	430	408	-5%
Orsk (Russneft)	5.1	14%	57%	479	378	360	-5%
NORSI (Lukoil)	15.8	28%	61%	479	384	372	-3%
Novokuibyshev (Rosneft)	7.4	18%	45%	478	411	388	-5%
Syzran (Rosneft)	6.4	20%	52%	478	385	370	-4%
Kuibyshev (Rosneft)	6.7	18%	57%	478	356	346	-3%
Ukhta (Lukoil)	4.2	29%	61%	463	361	349	-3%
Perm (Lukoil)	12.7	29%	61%	460	413	390	-6%
SalavatNOS	5.7	27%	72%	445	374	358	-4%
Nizhnekamsk (TAIF)	7.8	8%	31%	442	410	366	-11%
Omsk (Gazprom neft)	18.4	20%	26%	441	462	407	-12%
Novo-Ufa (Bashneft)	6.6	27%	37%	438	450	399	-11%
Ufa (Bashneft)	6.5	35%	46%	438	411	374	-9%
Ufaneftekhim (Bashneft)	7.6	30%	56%	438	413	384	-7%
Angarsk (Rosneft)	9.5	25%	46%	427	404	363	-10%
Achinsk (Rosneft)	7.1	22%	55%	409	342	314	-8%

** Realized price net of export duty, transportation costs and excise tax*

Source: Company data, InfoTEK, Bloomberg, Petroleum Argus, TKB Capital estimates

Bashneft, Gazprom neft and Alliance Oil affected the most. On a company level, we estimate that FAS initiative to bring domestic gasoline prices to the export parity will affect producers with high refining cover and large exposure to the domestic sales. Accordingly, profitability of crude-short Bashneft and Alliance Oil and of Gazprom neft, which has high refining leverage and strong focus on local sales, should be affected the most (see Figure 9). We estimate potential losses at roughly 15-30% of 2010E EBITDA for these companies. For companies with average refining cover and share of domestic sales – Rosneft and Lukoil – the new gasoline pricing yields a 5% decrease in 2010E EBITDA. For TNK-BP Holding and SurgutNG, which have less exposure to refining, the impact is estimated at 2-3% of 2010 EBITDA. We should note that in the first five months of 2010 average domestic prices for oil products remained above the export parity.

Figure 9. Impact of new gasoline price regulation on company profitability

	Estimated refining cover in Russia, %	Estimated share of domestic sales of oil products, %	Change in 2010E EBITDA*: $ mn	Change in 2010E EBITDA*: as % of 2010E EBITDA*
Bashneft	170%	54%	(766)	-31%
Gazprom neft	62%	74%	(992)	-17%
Alliance Oil	136%	70%	(78)	-16%
Rosneft	47%	43%	(945)	-5%
Lukoil	49%	39%	(677)	-5%
TNK-BP Holding	40%	47%	(296)	-3%
SurgutNG	34%	44%	(145)	-2%
RussNeft	60%	31%	(87)	n/a
Slavneft	73%	43%	(156)	n/a
SalavatNOS	-	28%	(85)	n/a
TAIF	-	69%	(315)	n/a
Moscow refinery	-	69%	(209)	n/a

** Consensus 2010E EBITDA except for Rosneft and Lukoil*

Source: Company data, InfoTEK, Bloomberg, Petroleum Argus, TKB Capital estimates

Three pricing options proposed by FAS. FAS has proposed three pricing options for regulating domestic prices for oil products that basically set a ceiling for domestic price that is equal to the benchmark export netback:

Base-case scenario. Under the fist option, FAS will calculate export netbacks for individual refineries and use them as the domestic price ceiling.

Kirishi as benchmark. Under the second option, FAS will use Kirishi refinery (SurgutNG) as the benchmark. The plant is located in proximity to Russia's main commercial seaport – Primorsk at the Baltic sea – and has one of the highest gasoline export netbacks in the country. Under this scenario, FAS may allow only a minor (1-2%) deviation from Kirishi export netbacks.

Novo-Ufa as benchmark. Under the third option, the benchmark refinery will be Bashneft's Novo-Ufa refinery (Novoil), which is located equally far from local and overseas markets and has relatively low export netbacks. Under this scenario, FAS may set a premium (a mark-up of RUB 1,500-2,000/tn was voiced) to Novo-Ufa export netbacks.

Little difference in the FAS' pricing options. Based on our estimates, it does not make much difference for the refineries whichever option FAS will choose for regulating domestic gasoline prices (see Figure 10). We calculate that under the second option not a single refinery will lose as compared to the base-case scenario. The second option implies up to 12% upside to the gross margin for several refineries, which are located further away from the export markets than Kirishi, incur higher transportation costs and have lower gasoline export netbacks. This is the case for Rosneft Angarsk and Achinsk refineries, Bashneft's Ufa-based refineries, SalavatNOS and TAIF' Nizhnekamsk. Yet, we do not believe that these plants will be in a position to benefit from a higher domestic price ceiling, as FAS is likely close this loophole with new regulation. The third option compensates for lower margins (export-focused plants located in proximity to international markets generate higher margins than remote inland Novo-Ufa refinery) by allowing at mark-up of RUB 1,500-2,000/tn ($50-$67/tn at the current exchange rate).

Figure 10. Gross refining margins by pricing option

	Base case: individual netbacks	Option 2: Kirishi as benchmark		Option 3: Novo-Ufa as benchmark	
	2010E weight.-average gross profit*, $/tn	2010E weight.-average gross profit*, $/tn	diff. from base case, %	2010E weight.-average gross profit*, $/tn	diff. from base case, %
Volgograd (Lukoil)	419	431	3%	393	-6%
Kirishi (SurgutNG)	**415**	**415**	**0%**	**382**	**-8%**
Moscow (Gazprom neft)	408	420	3%	383	-6%
Omsk (Gazprom neft)	407	450	11%	405	0%
Novo-Ufa (Bashneft)	**399**	**447**	**12%**	**399**	**0%**
Tuapse (Rosneft)	395	393	-1%	376	-5%
Khabarovsk (Alliance Oil)	395	399	1%	358	-9%
Ryazan (TNK-BP Holding)	395	403	2%	371	-6%
YANOS (Slavneft)	391	398	2%	368	-6%
Perm (Lukoil)	390	416	7%	381	-2%
Novokuibyshev (Rosneft)	388	405	4%	372	-4%
Saratov (TNK-BP Holding)	388	393	1%	372	-4%
Komsomolsk (Rosneft)	388	391	1%	366	-6%
Ufaneftekhim (Bashneft)	384	413	8%	384	0%
Krasnodar (Russneft)	383	384	0%	366	-5%
Ufa (Bashneft)	374	410	10%	374	0%
NORSI (Lukoil)	372	386	4%	357	-4%
Syzran (Rosneft)	370	383	4%	357	-3%
Nizhnekamsk (TAIF)	366	399	9%	364	0%
Angarsk (Rosneft)	363	404	11%	368	1%
Orsk (Russneft)	360	373	4%	347	-4%
SalavatNOS	358	385	8%	355	-1%
Ukhta (Lukoil)	349	365	5%	341	-2%
Kuibyshev (Rosneft)	346	356	3%	337	-3%
Achinsk (Rosneft)	314	346	10%	323	3%

** Realized price net of export duty, transportation costs and excise tax*

Source: Company data, InfoTEK, Bloomberg, TKB Capital estimates

Debate over pricing formula continues. As of today, Russian oil companies are still arguing against FAS initiatives and keep coming up with their own formulas for domestic prices of oil products. Meanwhile, the authorities proposed to introduce criminal liability for executives of oil companies violating the antimonopoly laws. Until the final decision is made, oil majors may respond by voluntarily reducing the retail mark-up and selling a higher share of oil products through the Saint Petersburg commodities exchange. For instance, Lukoil's domestic retail mark-up was down at 40% in 1Q10 vs. 60% in 3Q09 and 4Q09, while TNK-BP announced that it is ready to sell all domestic volumes of oil products via the commodities exchange.

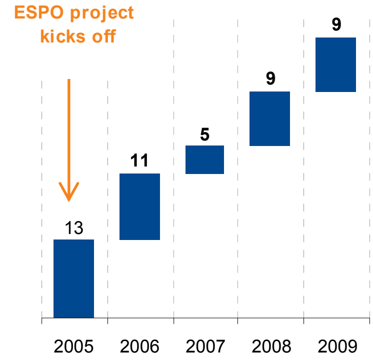
Aligning export duties for distillates. The Finance Ministry is currently discussing alignment of export duties for light/middle (gasoline and diesel) and heavy (fuel oil) distillates, setting them at 60% of the crude oil export duty starting from 2011. The existing fiscal regime favors sales of fuel oil – the core oil product of the Russian refineries: export duty for heavy distillates accounts for around 40% of the crude oil export duty, while export duty for light/middle distillates – around 70%. The government has already considered aligning export duties for distillates to reduce attractiveness of production and exports of fuel oil (see our report "Rosneft, Lukoil – Russia's Refining: Be At The Right Place", released on 3 March, 2010). Yet, eventually it postponed this decision, as the refineries were not prepared to bear the costs of modernization. In our models we assume the alignment staring from 2012. This initiative will benefit oil companies with the most advanced refining facilities such as Lukoil and Gazprom neft and will put at disadvantage the bulk of oil companies, whose refineries are of average complexity.

Transportation tariffs on the rise

Pipeline tariffs grow at 14% p.a. Another area of government regulation – pipeline transportation tariffs – is also causing trouble for Russian oils, which export, on average, 85% of crude oil via Transneft pipeline system. Ever since Transneft's ESPO project with a price tag of over $10 bn kicked off in 2005, the pipeline monopoly revised tariffs 47 times (on average, roughly 10 times p.a.) (see Figure 11) to compensate for the project's cost. We estimate that in 2001-2009 average Transneft's tariff in dollar terms grew at CAGR of 14% (see Figure 12). The only exception was 2009, when it remained unchanged due to ruble depreciation. Given that Transneft has other expensive projects pending (e.g., the $8 bn ESPO-2 and the $3 bn BPS-2) and needs to service its debt (which increased dramatically over the last years), the rise of tariffs across all the routes is likely to continue.

More pressure on oil companies' margins. Transportation costs are now a major cost item in the P&Ls of Russian oil majors: they account for up to 12% of the total sales (see Figure 13). We estimate that in 1Q10 Rosneft had the highest per unit average cost of transporting crude oil domestically ($4.7/bbl) and for exports ($6.9/bbl). This may be explained by the fact that Rosneft has the largest exposure to the ESPO project (discussed above), the new route where Transneft charges above average pipeline tariff (Rosneft paid $7.3/bbl in 1Q10). Rosneft also saw higher transportation costs on traditional routes. For instance, the cost of transporting crude oil from Rosneft's YuganskNG in West Siberia to Primorsk sea port (the Baltic sea) increased from, on average, $5.6/bbl in 2009 to $6.9/bbl in 1Q10. The cost of delivering crude oil from YuganskNG to Rosneft's Komsomolsk refinery is the Far East was record high in 1Q10 – $16.4/bbl. Lukoil is also quite sensitive to growth in transportation tariffs: apart from international crude oil sales, its business model envisages supplying Russian oil to Lukoil's own refineries overseas. TNK-BP Holding and Gazprom neft, which have lower refining leverage and are more exposed to crude oil exports, are also sensitive to growth of transportation tariffs.

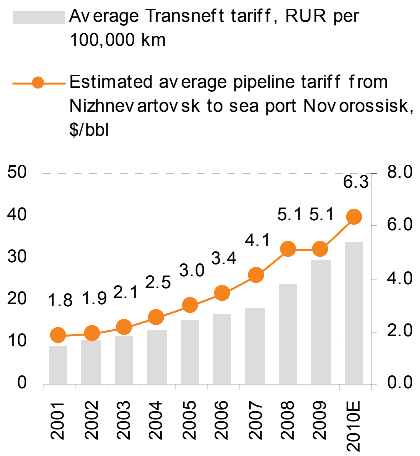
Figure 11. Number of revisions of Trasneft's pipeline tariffs



	2005	2006	2007	2008	2009
Transneft total debt, YE, $bn	0.6	2.7	6.6	8.7	18.4

Source: company data, Federal Tariff Services (FTS), TKB Capital estimates

Figure 12: Growth of Transneft pipeline tariffs



Source: Federal Tariff Services (FTS), TKB Capital estimates

Figure 13. Transportation costs of oil companies

	2005	2006	2007	2008	2009	1Q10
Total transportation costs, $ mn						
Lukoil*	3,967	4,286	5,305	6,532	5,785	1,617
as % of sales	*11%*	*10%*	*10%*	*9%*	*12%*	*11%*
Rosneft	2,231	3,226	4,226	5,673	5,414	1,764
as % of sales	*9%*	*10%*	*9%*	*8%*	*12%*	*12%*
TNK-BP Holding	2,296	1,903	2,239	2,614	2,658	n/a
as % of sales	*8%*	*6%*	*6%*	*6%*	*9%*	*-*
Gazprom neft	1,097	1,199	1,279	1,810	1,982	601
as % of sales	*8%*	*6%*	*6%*	*5%*	*8%*	*8%*
Tatneft	300	245	330	465	451	133
as % of sales	*3%*	*2%*	*2%*	*3%*	*4%*	*4%*
Estimated cost of transporting crude oil domestically, $/bbl						
Lukoil	1.2	1.7	2.1	2.4	1.9	2.2
Rosneft	2.1	2.0	2.3	4.0	3.8	4.7
TNK-BP Holding	1.7	1.6	1.9	3.2	3.4	n/a
Gazprom neft	2.8	2.9	3.1	3.2	2.5	2.7
Tatneft	-	-	-	-	-	-
Estimated cost of transporting crude oil for exports $/bbl						
Lukoil	2.2	1.2	2.4	5.1	4.9	6.8
Rosneft	2.5	2.4	2.7	6.1	5.6	6.9
TNK-BP Holding	2.5	2.4	2.7	4.8	5.0	n/a
Gazprom neft	5.6	5.8	6.2	6.4	5.0	6.8
Tatneft**	2.4	1.9	2.6	3.6	3.5	4.1

** Lukoil's estimated revenue, net of the re-sale value*

*** Assuming Tatneft exports 68% of produced crude oil and sells the remainder at the well head domestically*

Source: Company data, Federal Tariff Services (FTS), TKB Capital estimates

Model revisions

Rosneft's 2011E-2012E EBITDA revised down by roughly 20-30%. We have incorporated our new macroeconomic forecast, which raises Urals price by 3% to $76/bbl in 2010 and by 10% to $78/bbl in 2011 (see Figure 14), in our models for Rosneft and Lukoil. We have also adjusted our models for corporate 1Q10 results, new taxation for East Siberian greenfields and corresponding changes in production schedule (slower development pace), somewhat lower profitability of domestic sales of oil products, and other factors. As a result, we have revised down our forecast of Rosneft's 2011E EBITDA by 22% and 2012E EBITDA – by 31%, while our estimate of 2010E EBITDA practically did not change (see Figure 15). For Lukoil we have revised upwards our forecast of 2010E EBITDA – by 7%, 2011E EIBTDA – by 12% and 2012E EBITDA – by 6%.

New target price for Rosneft – $8.5/share, for Lukoil – $74/share, BUY. Following the revisions of our models, we have downgraded Rosneft's DCF-based 12-month target price by 15% from $10/share to $8.5/share. The new target price implies a 40% upside to Rosneft's current price ($6.1/share) and we retain Buy recommendation on the stock. We have upgraded Lukoil's DCF-based 12-month target price by 10% from $67/share to $74/share. The new target price implies a 45% upside to Lukoil's current price ($51/share) and we retain Buy recommendation on the stock. We apply WACC of 10.4% for Rosneft and 12.0% for Lukoil, assuming risk-free rate of 7%, equity risk premium of 6% and terminal growth rate of 3%.

Figure 14. Changes in the macroeconomic forecast

	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Old forecast											
Urals price, $/bbl	**74**	**71**	**85**	**83**	**80**	**83**	**87**	**90**	**94**	**97**	**101**
Avr. exchange rate, RUR/$	29	29	27	27	28	27	27	27	27	27	27
New forecast											
Urals price, $/bbl	**76**	**78**	**85**	**83**	**80**	**84**	**89**	**94**	**99**	**105**	**111**
Avr. exchange rate, RUR/$	30	28	28	30	31	30	29	28	28	27	27
change in Urals price, %	*3%*	*10%*	*0%*	*0%*	*0%*	*2%*	*2%*	*5%*	*6%*	*8%*	*10%*

Figure 15. Revisions in forecasts for Rosneft and Lukoil

	2010E	2011E	2012E
Rosneft			
Revenue			
Old	59,482	59,041	71,272
New	62,053	65,977	72,890
change, %	*4%*	*12%*	*2%*
EBITDA			
Old	17,451	17,566	20,870
New	17,551	13,768	14,495
change, %	*1%*	*-22%*	*-31%*
Net income			
Old	10,103	9,889	12,305
New	9,787	6,643	7,121
change, %	-3%	-33%	-42%
Lukoil			
Revenue			
Old	93,897	91,918	109,022
New	97,358	99,663	107,599
change, %	*4%*	*8%*	*-1%*
EBITDA			
Old	13,764	12,102	14,362
New	14,664	13,514	15,218
change, %	*7%*	*12%*	*6%*
Net income			
Old	7,929	6,772	8,583
New	8,433	7,747	9,310
change, %	*6%*	*14%*	*8%*

Source: Company data, TKB Capital estimates

Focusing on dividend plays and Gazprom in 2H10

Uncertainty with taxes calls for a conservative investment approach. Given the state's growing appetite for cash flows of the oil and gas companies, it becomes increasingly difficult to detect sound investment stories. Following the tax changes, Rosneft has lost its unique attractiveness. While at the current price levels Russian oil names look very appealing (trading, on average, at 2010E P/E of 5.8 vs. 9.0 for international super majors and 11.8 for emerging market peers (see Figure 2)), ongoing debates on further oil and gas tax hikes call us to focus on different investment ideas. In 2H10, we advise investors to focus on stocks, which deliver healthy dividend yields – ordinary and preferred shares of **TNK-BP Holding** (**TNBP**, **TNBPP**), preferred shares of **Bashneft** (**BANEP**) and preferred shares of **Tatneft** (**TANPP**). We also include **Gazprom** (**GAZP**) stock, currently the cheapest in our universe, as a top pick for 2H10.

TNK-BP Holding – ordinary and preferred shares (TNBP, TNBPP). Historically TNK-BP Holding has been one of the best local dividend plays. The company followed through conservative strategy, focusing mainly on brownfield redevelopment, refrained from M&A activity and paid out generous dividends (see Figure 16). This year TNK-BP Holding's cash flow is helped by tax savings from its East Siberian greenfield project Verkhnechonsk (discussed above). The market consensus suggests that the company's GAAP net income will increase by 17% y-o-y to $6,075 mn in 2010. Assuming payout ratio of 95%, TNK-BP Holding may increase annual dividend by 10% to RUR10.54/share ($0.35/share) that implies current yield of 18% for ordinary shares and 20% – for preferred.

Figure 16. TNK-BP Holding dividend history

	2005	9M06	4Q06	2006	1H07	2H07	2007	1H08	2H08	2008	9M09	4Q09	2009	2010E
Dividend, RUR/sh:														
Ordinary share	**8.06**	**5.95**	**1.37**	**7.32**	**1.33**	**1.71**	**3.04**	**2.94**	**2.12**	**5.06**	**7.41**	**2.18**	**9.59**	**10.54**
Preferred share	**8.06**	**5.95**	**1.37**	**7.32**	**1.33**	**1.71**	**3.04**	**2.94**	**2.12**	**5.06**	**7.41**	**2.18**	**9.59**	**10.54**
y-o-y growth				*-9%*			*-58%*			*66%*			*90%*	*10%*
Dividend payment, $ mn	4,642			4,390			1,937			3,315			4,918	5,772
GAAP net income, $ mn	**4,002**			**6,409**			**5,732**			**6,367**			**5,175**	**6,075**
GAAP payout ratio	*116%*			*68%*			*34%*			*52%*			*95%*	*95%*
Record date	May 12	Sep 29	Apr 27		Aug 14	May 14		Aug 21	May 15		Oct 30	May 14		

Current price, $/sh	
Ordinary share	1.98
Preferred share	1.74
Estimated 2010 dividend, $/sh	
Ordinary share	0.35
Preferred share	0.35
Implied dividend yield, %	
Ordinary share	18%
Preferred share	20%

Note: Consensus 2010 net income estimate

Source: SPARK, TKB Capital estimates

Bashneft – preferred shares (BANEP). Bashneft also has a history of generous dividends, particularly in 2008, when the company's ownership was challenged in courts (see Figure 17). Concerns that the Bashneft's new controlling shareholder – AFK Sistema – will change the dividend policy did not find the ground: Bashneft spent record high $700 mn as dividends for 2009. We suppose that now vertically integrated Bashneft will remain the profit-center for AFK Sistema and continue to pay out healthy dividends going forward. We estimate that the company's GAAP net income will increase more than three-fold to $1,200 mn in 2010. Assuming a payout ratio of 70%, Bashneft may increase annual dividend by 11% to RUR122 /share ($4.1/share) that implies current yield of 18% for preferred shares.

Figure 17. Bashneft dividend history

	2005	9M06	4Q06	2006	1H07	2H07	2007	9M08	4Q08	2008	2009	2010E
Dividend, RUR/sh												
Ordinary share	**1.1**	**25.8**	**0.0**	**25.8**	**16.3**	**0.0**	**16.3**	**34.2**	**14.6**	**48.8**	**109.7**	**122.1**
y-o-y growth				*nm*			*-37%*			*199%*	*125%*	*11%*
Preferred share	**5.7**	**25.8**	**0.0**	**25.8**	**16.3**	**0.0**	**16.3**	**34.2**	**14.6**	**48.8**	**109.7**	**122.1**
y-o-y growth				*nm*			*-37%*			*199%*	*125%*	*11%*
Dividend payment, $ mn	14	193	0	194	128	0	131	215	102	315	707	840
RAS net income, $ mn	**275**	**386**	**35**	**423**	**230**	**283**	**512**	**429**	**-106**	**341**	**510**	
RAS payout ratio	*5%*			*46%*			*26%*			*92%*	*139%*	
GAAP net income, $ mn											**320**	**1,200**
GAAP payout ratio											*221%*	*70%*
Record date	Mar 10	Sep 29	Mar 7		Aug 4	Mar 12		Nov 24	May 22		Mar 7	

Current share price, $/sh	
Ordinary share	35.3
Preferred share	23.0
Estimated 2010 dividend, $/sh	
Ordinary share	4.10
Preferred share	4.10
Implied dividend yield, %	
Ordinary share	12%
Preferred share	18%

Source: SPARK, TKB Capital estimates

Tatneft – preferred shares (TATNP). With Tatarstan government as a major shareholder (controlling around 36%), Tatneft has been under pressure to deliver large dividends, consistently paying out 30% of the RAS net income as dividends (see Figure 18). According to the market consensus, Tatneft's GAAP net income will decrease by 7% y-o-y to $1,691 mn in 2010. Assuming the company will reduce annual dividend accordingly – by 7% to RUR 6.07/share ($0.20/share), the implied dividend yield on Tatneft's preferred shares is currently 9%.

Figure 18. Tatneft dividend history

	2004	2005	2006	2007	2008	2009	2010E
Dividend, RUR/sh							
Ordinary share	**0.9**	**1.0**	**4.60**	**5.7**	**4.4**	**6. 6**	**6.1**
Preferred share	**1.0**	**1.0**	**4.60**	**5.7**	**4.4**	**6.6**	**6.1**
y-o-y growth		*11%*	*360%*	*23%*	*-22%*	*48%*	*-7%*
Dividend payment, $ mn	73	82	394	514	413	480	475
RAS net income, $ mn	**24,626**	**36,876**	**35,649**	**43,812**	**34,304**	**50,874**	**n/a**
RAS payout ratio	*9%*	*6%*	*30%*	*30%*	*30%*	*30%*	*30%*
GAAP net income, $ mn	813	998	1,096	1,692	338	1,711	1,691
GAAP payout ratio	*9%*	*8%*	*36%*	*30%*	*122%*	*28%*	*28%*
Record date	May 11	May 14	May 13	May 11	May 11	May 10	May 10

Current share price, $/sh	
Ordinary share	4.60
Preferred share	2.20
Estimated 2010 dividend, $/sh	
Ordinary share	0.20
Preferred share	0.20
Implied dividend yield, %	
Ordinary share	4%
Preferred share	9%

Note: Consensus 2010 net income estimate

Source: SPARK, TKB Capital estimates

Gazprom (GAZP) – cheapest stock in our universe. We have included Gazprom, currently the cheapest stock in our universe (see Figure 2), as a top pick for 2H10. On 2010E EV/EBITDA (consensus) Gazprom currently trades at roughly 30% discount to the international gas producers (3.6 vs. international peers' average of 5.4). On 2010E P/E (consensus) Gazprom is now the cheapest stock in our universe, trading at over 60% discount to the international gas producers (4.1 vs. international peers' average of 12.3), below the multiple of financially distressed BP (5.0). Also, Gazprom is one of the few stocks in our universe, trading substantially below its book value (P/BV of 0.6). Finally, Gazprom current price level ($4.8/share) suggests a 75% upside to the consensus 12-month DCF-based target price ($8.3/share).

Lukoil

BALANCE SHEET

$ mn	2009	2010E	2011E	2012E	2013E	2014E
TOTAL CURRENT ASSETS	**17,839**	**22,279**	**25,143**	**21,127**	**22,698**	**22,698**
PP&E, net	52,228	54,896	58,568	62,864	67,299	67,299
Other non-current assets	8,952	9,354	9,354	9,354	9,354	9,354
Total NON-CURRENT ASSETS	**61,180**	**64,250**	**67,922**	**72,218**	**76,653**	**76,653**
TOTAL ASSETS	**79,019**	**86,529**	**93,066**	**93,345**	**99,350**	**99,350**
Short-term borrowings	2,058	1,849	2,450	1,673	1,682	1,682
Other short-term liabilities	7,636	9,410	9,508	10,102	9,812	9,812
Total CURRENT LIABILITIES	9,694	11,259	11,958	11,774	11,494	11,494
Long-term borrowings	9,265	8,506	8,311	6,864	6,909	6,909
Other non-current liabilities	3,681	8,588	8,588	8,588	8,588	8,588
Total LONG-TERM LIABILITIES	**12,946**	**17,093**	**16,899**	**15,451**	**15,497**	**15,497**
Minority interest	388	385	385	385	385	385
Shareholders' equity	55,991	57,792	63,824	65,734	71,975	71,975
TOTAL EQUITY & LIABILITIES	**79,019**	**86,529**	**93,066**	**93,345**	**99,350**	**99,350**

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Revenue	**81,083**	**97,358**	**99,663**	**107,599**	**103,075**	**97,761**
Cost of production	(66,987)	(82,695)	(86,148)	(92,381)	(88,486)	(83,850)
EBITDA	**14,096**	**14,664**	**13,514**	**15,218**	**14,589**	**13,911**
DD&A	(4,318)	(4,008)	(4,021)	(4,013)	(3,944)	(3,916)
EBIT	**9,778**	**10,655**	**9,493**	**11,206**	**10,645**	**9,996**
Net interest income/(expenses)	(533)	(533)	(324)	(157)	(284)	(145)
Net other income/(expenses)	(182)	418	514	589	565	535
EBT	**9,063**	**10,540**	**9,684**	**11,637**	**10,925**	**10,386**
Income tax	(1,994)	(2,117)	(1,937)	(2,327)	(2,185)	(2,185)
Minority	(58)	10	-	-	-	-
Net income	**7,011**	**8,433**	**7,747**	**9,310**	**8,740**	**8,201**

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Net CF from operating activities	8,883	12,925	12,185	14,156	13,249	12,827
Net CF from investment activities	(8,923)	(6,866)	(7,809)	(8,424)	(8,495)	(8,237)
Net CF from financing activities	87	(2,845)	(1,549)	(9,867)	(2,688)	(2,690)
Net Debt	7,833	4,765	2,309	4,182	2,133	362

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	-25%	20%	2%	8%	-4%	-5%
EBITDA margin	17%	15%	14%	14%	14%	14%
Net margin	9%	9%	8%	9%	8%	8%
Net Debt/EBITDA	0.6	0.3	0.2	0.3	0.1	0.0

Source: company data, TKB Capital estimates

Lukoil	Common	GDR
Ticker	**LKOH**	**LKOD LI**
Recommendation	**Buy**	**Buy**
Price, $	**51.0**	**51.0**
Target price, $	**74.0**	**74.0**
Upside/downside, %	**45%**	**45%**

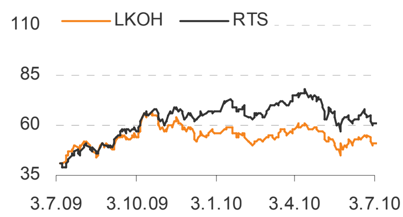
SHARE DATA	
Bloomberg	LKOHRX
Reuters	LKOH.MM
	Common
# of shares outstanding,	847
EV, $ mn	50,905
MC, $ mn	43,146
MIN 12 mnth., $	45
MAX 12 mnth., $	61
	Common
Shares per GDR	1

SUMMARY FINANCIALS, $ mn			
US GAAP	2009	2010E	2011E
Revenue	81,083	97,358	99,663
EBITDA	14,096	14,664	13,514
Net income	7,011	8,433	7,747
EPS, $	8.28	9.96	9.15
Rev. growth, %	-25	20	2
EPS growth, %	-24	20	-8
EBITDA margin, %	17	15	14
Net margin, %	9	9	8

SUMMARY VALUATIONS	2009	2010E	2011E
P/E	6.2	5.1	5.6
EV/EBITDA	3.6	3.5	3.8

SHAREHOLDER STRUCTURE	
ConocoPhillips	20.6%
Management	29.9%
Other	49.6%

PRICE DYNAMICS



Source: MICEX, RTS. TKB Capital estimates

TKB Capital

Rosneft

BALANCE SHEET

$ mn	2009	2010E	2011E	2012E	2013E	2014E
TOTAL CURRENT ASSETS	**15,169**	**16,347**	**14,686**	**16,970**	**17,439**	**21,452**
PP&E, net	57,704	61,322	64,331	69,528	75,003	80,183
Other non-current assets	10,359	10,313	10,313	10,313	10,313	10,313
Total NON-CURRENT ASSETS	**68,063**	**71,635**	**74,644**	**79,841**	**85,316**	**90,496**
TOTAL ASSETS	**83,232**	**87,982**	**89,330**	**96,810**	**102,755**	**111,948**
Short-term borrowings	7,838	5,500	3,500	3,500	2,634	2,773
Other short-term liabilities	5,605	7,207	7,519	8,052	8,014	7,910
Total CURRENT LIABILITIES	13,443	12,707	11,019	11,552	10,647	10,683
Long-term borrowings	15,669	12,774	9,669	7,669	5,669	6,367
Other non-current liabilities	8,583	8,718	8,718	8,718	8,718	8,718
Total LONG-TERM LIABILITIES	**24,252**	**21,492**	**18,387**	**16,387**	**14,387**	**15,085**
Minority interest	706	767	767	767	767	767
Shareholders' equity	44,831	53,016	59,157	68,104	76,954	85,414
TOTAL EQUITY & LIABILITIES	**83,232**	**87,982**	**89,330**	**96,810**	**102,755**	**111,948**

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Revenue	**46,826**	**62,053**	**65,977**	**72,890**	**72,201**	**70,893**
Cost of production	(33,261)	(44,501)	(52,209)	(58,395)	(57,742)	(56,501)
EBITDA	**13,565**	**17,551**	**13,768**	**14,495**	**14,459**	**14,392**
DD&A	(4,437)	(5,229)	(5,457)	(5,621)	(5,860)	(6,129)
EBIT	**9,128**	**12,323**	**8,310**	**8,874**	**8,599**	**8,263**
Net interest income/(expenses)	(89)	(112)	(87)	(63)	(53)	(40)
Net other income/(expenses)	(520)	129	85	90	87	84
EBT	**8,519**	**12,340**	**8,308**	**8,902**	**8,633**	**8,307**
Income tax	(2,000)	(2,492)	(1,662)	(1,780)	(1,727)	(1,661)
Minority	(5)	(61)	-	-	-	-
Net income	**6,514**	**9,787**	**6,646**	**7,121**	**6,906**	**6,646**

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Net CF from operating activities	10,319	15,571	12,101	12,531	13,079	13,141
Net CF from investment activities	(8,788)	(8,615)	(8,551)	(8,463)	(8,821)	(8,894)
Net CF from financing activities	(877)	(6,179)	(5,814)	(2,831)	(3,741)	(71)
Net Debt	19,002	13,449	10,574	7,303	3,887	515

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	-32%	33%	6%	10%	-1%	-2%
EBITDA margin	29%	28%	21%	20%	20%	20%
Net margin	14%	16%	10%	10%	10%	9%
Net Debt/EBITDA	1.4	0.8	0.8	0.5	0.3	0.1

Source: company data, TKB Capital estimates

Rosneft	Common	GDR
Ticker	**ROSN**	**ROSN LI**
Recommendation	**Buy**	**Buy**
Price, $	**6.1**	**6.1**
Target price, $	**8.5**	**8.5**
Upside/downside, %	**39%**	**39%**

SHARE DATA	
Bloomberg	ROSN RX
Reuters	ROSN.MM
	Common
# of shares outstanding,	9,598
EV, $ mn	77,098
MC, $ mn	58,286
MIN 12 mnth., $	5.9
MAX 12 mnth., $	9.3
	Common
Shares per GDR	1

SUMMARY FINANCIALS, $ mn

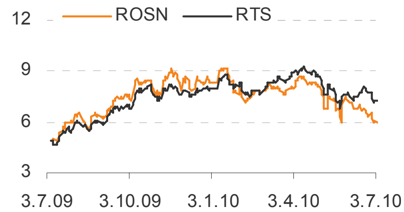
US GAAP	2009	2010E	2011E
Revenue	46,826	62,053	65,977
EBITDA	13,565	17,551	13,768
Net income	6,514	9,787	6,646
EPS, $	0.68	1.02	0.69
Rev. growth, %	-32	33	6
EPS growth, %	-41	50	-32
EBITDA margin, %	29	28	21
Net margin, %	14	16	10

SUMMARY VALUATIONS

	2009	2010E	2011E
P/E	9.0	6.0	8.8
EV/EBITDA	5.7	4.4	5.6

SHAREHOLDER STRUCTURE	
Rosneftegaz	75.2%
BP	1.2%
Petronas	1.1%
CNPC	0.1%
Treasury shares	9.4%
Other	13.1%

PRICE DYNAMICS



Source: MICEX, RTS. TKB Capital estimates

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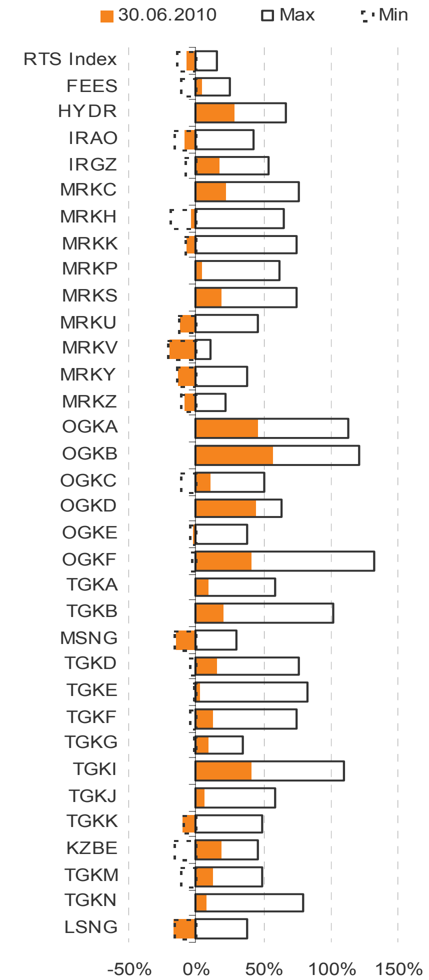
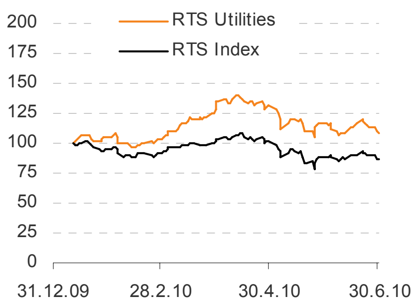
Power industry

More certainty, more distant investment appeal

YTD sector dynamic vs. RTS





Source: RTS, MICEX, TKB Capital estimates

The energy sector in the first half of 2010 remained on the radar screen of investors. Generation and grid companies were in demand, which was primarily due to the forthcoming liberalization of the industry. For most companies their strengths and weaknesses as well as specific risks have become clear. We believe that selective purchases will dominate in the power industry over the next six months, since the medium-term prospects for the sector are brightening and somewhat different from the investors' expectations.

Sector reform is in its final stage. 2011 will be the year of wholesale electricity market liberalization, the launch of a long-term capacity market and mass transfer of network companies to the RAB-regulation, and energy reform will enter the final straight.

Restoring growth of electricity consumption. Forecasts of energy consumption growth in Russia varies in the range of 1.7-2.7% for the next few years, but even such modest figures are able to support the growth of electricity prices, and as a consequence of the companies' financial performance of companies.

New rules and new regulatory mechanisms. Launch a long-term capacity market, the grid transition to five-year RAB-regulation and the wholesale market liberalization will change the shape of industry and lead to better financial performance of power companies.

The influence of the state sector will be decisive, even after liberalization. Despite the significant qualitative changes in the sector, direct (regulatory) and indirect (through state-controlled companies) state influence will remain, therefore, taking into account the strategy of social and economic development of Russia, power industry investment attractiveness will be further defined by state targets rather than market mechanisms. Apparently, curbing of tariff growth is the priority.

The debt burden and likelihood of SPO to increase. The necessity of investment program realization under limited tariff hikes will be translated into increased borrowings and likelihood of additional share issues.

Corporates risks. We estimate risks of minority shareholders, especially in large state holdings, as high. The need to raise funds in the industry over the next few years means there is no dividends and greater chance for additional share issue in favor of the state or strategic investors with possible dilution of minority stakes.

Key generation companies: RusHydro and OGK-4. In light of recent government initiatives to curb the growth of tariffs of natural monopolies in the generation sector, we recommend betting on the purchase of shares of companies with a predominance of hydro capacities, and above all **RusHydro**, because they are able to effectively capitalize on rising energy prices under full market liberalization, as well as betting on the most effective thermal companies, which can receive significant benefits thanks to established or newly-formed competitive advantages. In this segment, we prefer **OGK-4**.

In grid segment, we prefer FGC and MRSK Holding, even though growth rates of transmission tariffs for the next few years are limited. FGC, in our opinion, is the most stable in the grid segment in terms of financial performance, while investments into MRSK Holding are an alternative to buying basket of regional MRSKs and eliminate the risks of individual distribution companies. However, FGC and MRSK Holding are not the list of our sector top picks for the next six months, as the recent government initiatives to postpone RAB-regulation transition of regional distribution companies, whose parameters will be determined only towards the year-end, will put pressure on the quotes due to uncertainty.

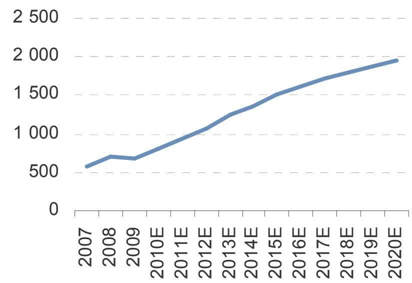
Risks of investing into Inter RAO are high because of the forthcoming additional share placement and unclear value of the assets included into payment settlements of the additional issue, since the most of them will be a swap tool.

Key industry trends

Selective approach. The energy sector has shown significant growth for 1H10. There are several waves of investors' demand in energy that has been observed in the thermal generation, hydro generation and grid companies. Investment attractiveness of shares was due to impending changes in the industry: declaration of development strategies, assets swap deals, corporate events, but the main catalyst was the liberalization of the market and change of the regulation rules. Over the past six months the situation in the industry has not changed dramatically. It became clear that 100% market liberalization of the sector will not come, and most of the market mechanisms retain state control circuits. We believe that the next six months actual and typical for investors would be a selective approach in assessing the investment attractiveness of the assets as a three-year horizon is practically predestined and there is a need for extrapolation of events in the industry for longer-term to understand its further development. Almost all companies have already cleared up their strengths and weaknesses, achievements and benefits they would receive from the full liberalization of the market. As a result, the trend of massive and roaring waves of demand in the sector would disappear and be replaced by selective purchases. In our view, the electricity sector retains its attractiveness for optimistic-minded long-term investors.

Contradictory rhetoric of the government. Recently, various representatives of the Russian government made a number of statements about limiting of the tariff hikes for natural monopolies. Currently, the prevailing view is the intention to limit growth in electricity tariffs by 10-15% over the next three years, due to the governmental target to control inflation. This should involve both generation and grid companies. This step may lead to a revision of investment programs at the expense of stretching the amount of investment in time in the case of grid companies and limiting the electricity tariff growth in case gencos. This is somewhat contrary to earlier statements made by governmental representatives, who have repeatedly stressed the need for greater investment in the sector in order to meet the coming post-crisis growth in electricity demand. And especially harsh criticism sounded against the owners of private generation companies. Strict requirements of the state to strategic investors were already reflected in the structure of Capacity Delivery Agreements (CDAs). It is clear that significant investment into generation can not be implemented against the backdrop of stagnation in the grid sector. This also contradicts the statements made by energy companies themselves, especially the state-owned, which have revised upwards their forecasts of necessary investments. We believe that the transition to RAB-regulation in grid segment is inevitable, but it is likely to take a little longer time than previously expected.

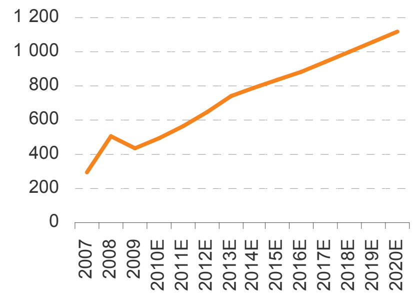
Forecast of deregulated electricity price, European price zone (RUB/MWh)



Source: TKB Capital Estimates

The state keeps influence the sector. The main current phenomenon is the dominance of industry consolidation solely on the basis of state-owned companies that in the context of tariff regulation will lead to the situation in the industry which will not be competitive and market-based.

Forecast of deregulated electricity price, Siberian price zone (RUB/MWh)



Source: TKB Capital Estimates

Debt burden to grow. Most power companies will face the need to raise funds for the implementation of investment programs and as a consequence will increase their debt loads. A significant number of companies, primarily gencos, have already announced plans to place bond issues. If over the next three years the mechanism of smoothing of tariffs for the grid companies will be applied, they will also be forced to increase debt burden.

The vertical and horizontal integration: a course to consolidation. Strategic investors in the industry entered the stage of vertical and horizontal structuring of their assets. For this purpose, many fruitful changes are being made: mergers of companies, fuel diversification, buying distribution companies and fuel assets. The main purpose is to diversify business and increase margins. In our view, the consolidation will not always provide synergy and create value for the shareholders. We believe that by the year-end, most of strategic investors would clarify the strategy of the asset development, and it will clarify the prospects of selected companies.

State support and state consolidaition increase risks for minorities. We expect the trend towards SPOs by most of state-owned energy companies to remain intact. RusHydro and Inter RAO have already announced on the forthcoming additional share issues, which can be placed under public subscription and in favor of strategic investors and we assume MRSK Holding companies to declare such plans in the foreseeable future. In our view, under the current environment prevailing trend for private companies will by increase in debt load, and SPO as a last resort measure.

M&A activities. Industry consolidation will lead to the increase in the number of M&A deals. Already now we observe resumption and intensification of negotiations on the assets swaps between the main players in the segment. According to our estimates, most of the negotiations will hit the active stage only in 2011, following the market liberalization. This activity implies new price tags of the assets for minorities, buy-out offers and new investment opportunities. According to our estimates, the majority of OGKs and TGKs will cease to exist as separate entities in the coming years because of market integration into the larger energy conglomerates. Thus, the development of domestic power industry is likely to follow the European way, where a few large corporations control most of the energy sectors. However, in Russia they would be state-owned. If the government confirms its commitment to creating a market environment and will implement a gradual privatization of state holdings, the creation of efficient market is only a matter of time. Meanwhile, we can expect new power blue chips to emerge on the Russian market.

Company	Installed Capacity, MW	Potential Consolidation Centre
RusHydro	25 337	
OGK-1	9 531	Inter RAO
OGK-2	8 695	GazpromEnergoHolding
OGK-3	8 357	
OGK-4	8 630	
Enel OGK-5	8 732	
OGK-6	9 052	GazpromEnergoHolding
TGK-1	6 279	RusHydro, Fortum
TGK-2	2 577	
Mosenergo	11 904	
Quadra (TGK-4)	3 348	
TGK-5	2 467	IES Holding
TGK-6	3 113	IES Holding
Volga TGK-7	6 879	IES Holding, GazpromEnergoHolding
TGK-9	3 280	IES Holding
Fortum	2 785	
TGK-11	2 026	Inter RAO
Kuzbassenergo	4 400	SUEK
Yenisei TGK-13	2 458	SUEK
TGK-14	633	
Inter Rao		
Bashkirenergo		AFK Systema
IrkutskEnergo		RusHydro, Inter RAO, EuroSibEnergo
NovosibirskEnergo		

Source: TKB Capital estimates

RAB-regulation is postponed. Making some conclusions about the investment attractiveness of grids companies, in our view, is justified only after clarifying the state's stance that is expected only towards the year-end. At the moment we do not rule out polar-scale decision on this matter, which can be very unpleasant for investors, because the issue is complicated and it is difficult to find the balance between the limiting in tariffs hike and attracting investments into energy sector. Therefore, the expectation of keeping announced parameters of RAB-regulation and their adoption as constants in such circumstances look overhastily. Compensation factor for decreased income during the future periods of regulation, stipulated by the RAB-mechanism, it is difficult to take into account for the moment.

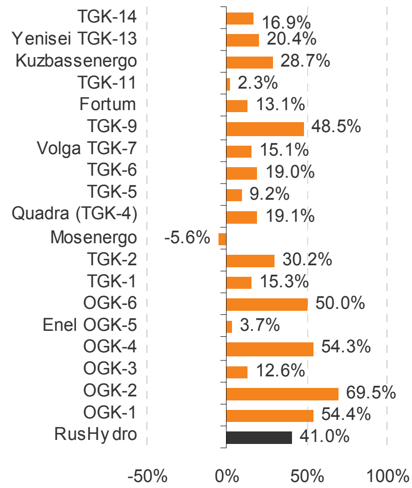
Gencos

The quality of the generation assets, their location and the rate of investment program implementation continue to shape the investment attractiveness of gencos.

In the run-up to 100% liberalization. In terms of profitability and the status quo of individual companies, the outcome of this year will be indicative for predicting the development in 2011 and going further. 2010 as a litmus paper will identify favorites and outsiders. This picture is unlikely to undergo significant changes in the future. Efficiency of the plants remains the main feature of investment attractiveness of gencos: the value of fuel rate per kW, capacity utilization factor in light of full market liberalization may be characterized as the main competitive advantages of companies. Possible restrictions imposed on capacity tariffs could reduce gencos' investment appeal, but is not a decisive factor.

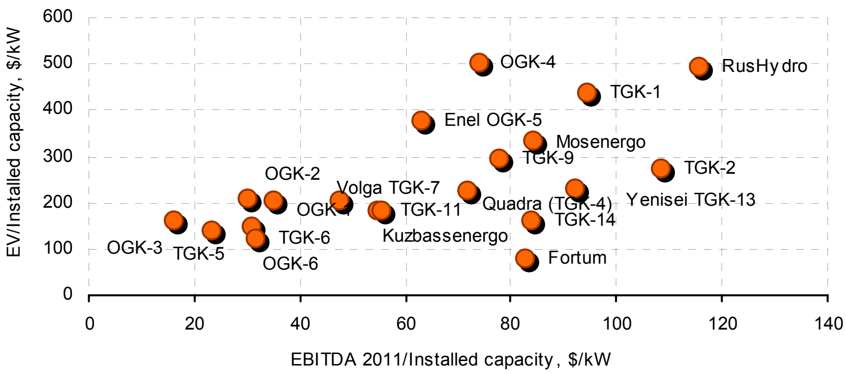
Thermal generation in 2010 will not bring any surprises. After successful 2009 it is unlikely that gencos will be able to surprise investors in 2010, certain conclusions can already be drawn from the first quarter results. The expected small increase in electricity demand, the inputs of new capacities and the need to increase the debt load for the implementation of investment programs in the background of simultaneous rather than quarterly as in 2009 gas price hikes will likely lead to a deterioration of key profitability indicators most thermal companies. It is worth noting that many companies have demonstrated strong results for 1Q10 and posted significant growth of operating profitability (TGK-1, OGK-5). However, the data for the first quarter is unlikely to be significant in annual terms.

Gencos' share dynamics YTD ($)



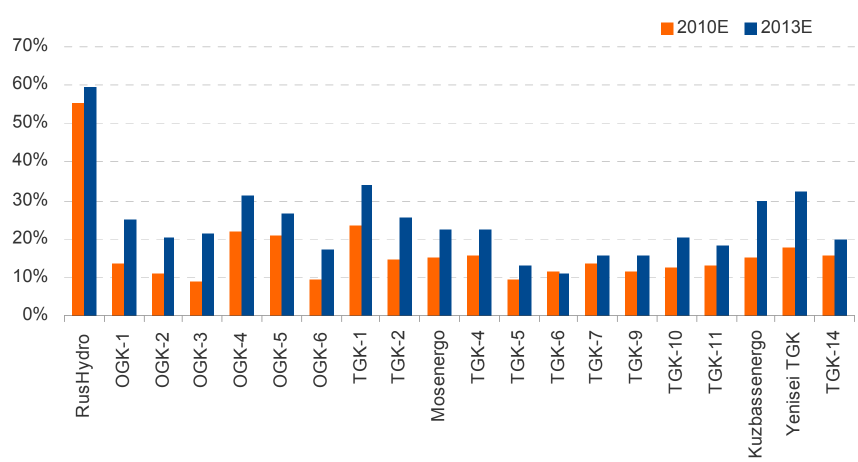
Source: RTS, MICEX, TKB Capital estimates

Russian Gencos: comparative valuation, 2011E



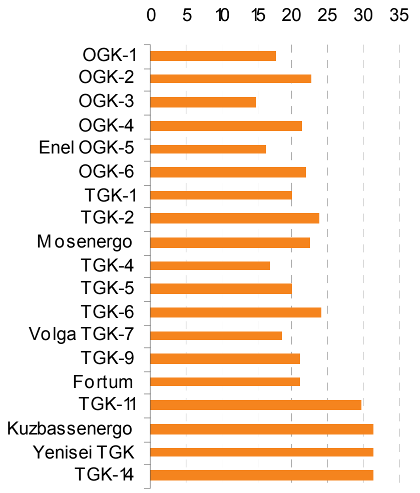
Source: RTS, MICEX, TKB Capital estimates

2010 vs 2013: EBITDA margins forecasts for Russian gencos



Source: TKB Capital Estimates

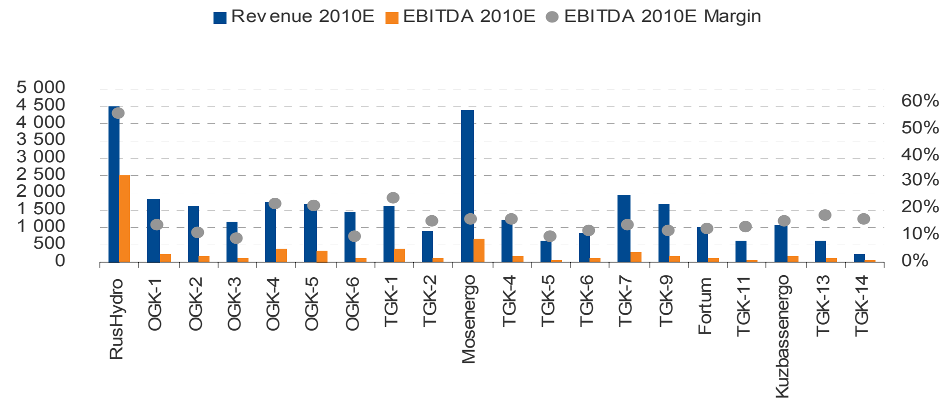
Capacity tariffs forecast for newly commissioned units (2011E), $/kW/per month



Source: TKB capital Estimates

Changing the driver of profit growth. In 2009, the main reason behind the growth of profitability was quarterly increase in gas tariffs with simultaneous increase in electricity tariffs. The second important component was the increase in capacity tariffs, which coupled with measures aiming at cost reduction, has led to significant improvement in financial performance. In 2010, this effect will not come: for most of the gencos, capacity tariffs were reduced, the tariffs for gas and electricity also were reviewed simultaneously. Thus, in annual terms the only possible driver may be activity of companies in a free segment of the wholesale market and their abilities to develop prudent tactics and reasonable use of competitive advantages and launch of new capacities.

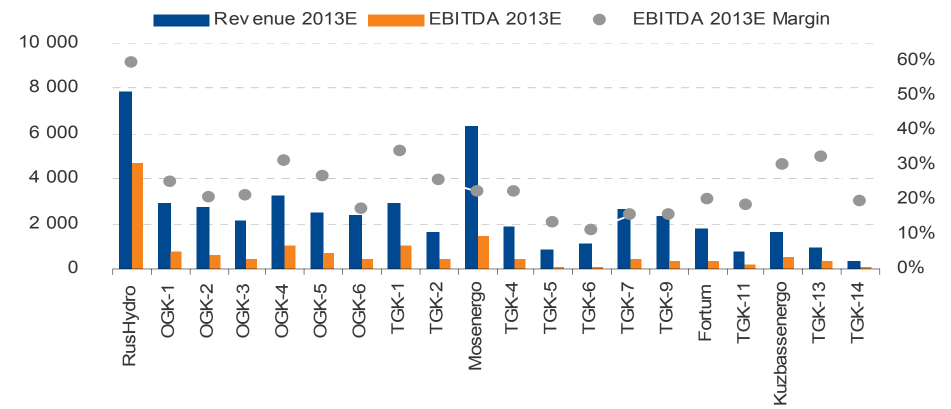
Russian Gencos:2010E financials



Source: Companies data, TKB Capital estimates

** Only gain from generation business of RusHydro are used in calculation*

Russian Gencos:2013E financials

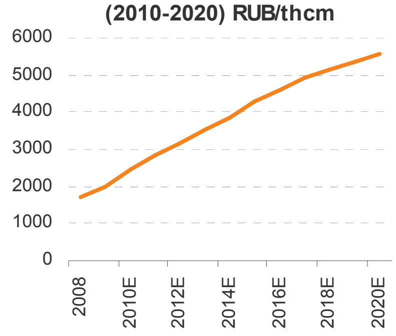


Source: Companies data, TKB Capital estimates

** Only gain from generation business of RusHydro are used in calculation*

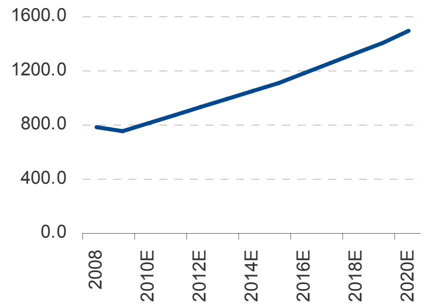
The price of gas is a clear and key determinant. According to the government forecast, price of gas will grow, on average, by 15% per annum over the next three years, which could lead to a proportional increase in electricity prices. Perhaps this fact will increase the attractiveness of coal generation, where the expected increase in prices should be relatively smaller, but certainly it can be argued only for companies that have signed long-term contract for the coal supply.

Average domestic price of natural gas in Russia, (2010-2020) RUB/thcm



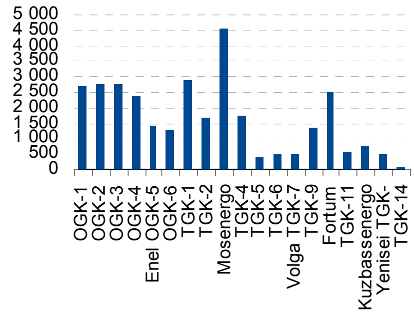
Source: TKB Capital Estimates

Average domestic price of thermal coal in Russia, (2010-2020) RUB/ton



Source: TKB Capital Estimates

New capacity commissioning forecasts until 2017, MW



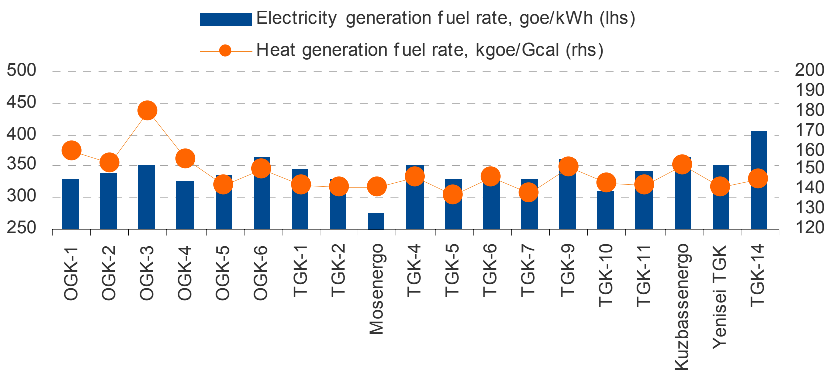
Source: Companies data, TKB Capital estimates

Higher debt burden and growing number of SPOs. To implement the investment program, most of gencos will acquire debt financing, so the total debt load for sector will grow. Placement of additional share issues in the current environment will be used by companies as a last resort tool.

New capacities are a new driver. Commission of effecient capacities and decommission of inefficient will gradually lead to an increase in the average efficiency of generation companies that will be reflected in their financials. Accordingly, companies that are actively realizing the investment programs create their long-term competitive advantage.

Transition to the RAB-regulation of heat business, stipulated by the law, can be a positive driver for the quotes of TGCs, in which approximately a half of the revenue accounts for the sale of heat, and may significantly increase the profitability of this business. However, taking into account the expertise of grid companies in transition to this mechanism of regulation, the process may be delayed for indefinite period of time, so it can become a catalyst only after clarifying all the details and the government's position.

Fuel efficiency for Russian thermal generation companies, 2010E



Source: Companies data, TKB Capital estimates

Gencos look cheap on multiples. At present, based on 2001E EV/EBITDA domestic companies trade at 4.4, which implies 25% discount to comparable foreign peers. Based on P/E, the whole sector of domestic thermal generation looks overvalued.

The average EV/Installed capacity for OGK is $260/kW, and for TGK is $220/kW, while foreign companies trade in line with their foreign peers at $1,000/kW.

RusHydro in terms of EV/Installed capacity ration trades at $480/kW as opposed to at least $1,200/kW for foreign hydro companies.

Bet on hydro generation (RusHydro) and fuel efficiency (OGC-4). We prefer betting on companies with a predominance of hydro power, as their profitability is the highest. Based on the value of a kW of installed capacity, these companies trade at a premium to the average for the Russian generation sector, and we believe this is justified, given their profitability and expected growth of financial indicators in the coming years. We favor OGK-4 as one of the most efficient thermal wholesale companies.

Russian Gencos: Comparative valuation

Company	Ticker	Market Cap, $ mn	Current EV, $m	EV/EBITDA 2009E	EV/EBITDA 2010E	EV/EBITDA 2011E	P/E 2009E	P/E 2010E	P/E 2011E	Installed capacity, MW	Mcap/ st.capacity, $/kW	EV/inst. capacity, $/kW	Capac. utiliza tion, %	EV/util. capacity, $/kW
RusHydro	HYDR	13,375	12,530	**7.7**	**5.6**	**4.3**	**13.5**	**8.9**	**7.4**	25,424	**526**	**493**	**37**	**1,356**
OGK-1	OGKA	1,590	1,914	10.7	7.8	5.7	12.8	18.4	12.5	9,531	167	201	52	326
OGK-2	OGKB	1,631	1,790	14.6	10.1	6.8	44.1	27.6	42.1	8,695	188	206	62	315
OGK-3	OGKC	2,671	1,338	10.1	12.6	10.0	33.0	16.4	22.9	8,357	320	160	41	346
OGK-4	OGKD	4,880	4,314	18.6	11.5	6.7	23.7	19.4	12.5	8,630	565	500	71	689
Enel OGK-5	OGKE	2,672	3,298	13.6	9.4	6.0	26.1	19.9	10.7	8,732	306	378	54	672
OGK-6	OGKF	1,148	1,263	7.4	9.5	5.9	13.2	neg.	neg.	9,052	127	140	37	285
OGKs average				**12.5**	**10.2**	**6.9**	**25.5**	**20.3**	**20.1**		**279**	**264**	**53**	**438**
TGK-1	TGKA	2,304	2,782	11.9	7.4	4.6	20.5	12.9	7.7	6,399	360	435	46	907
TGK-2	TGKB	378	698	9.0	5.2	2.5	9.6	neg.	neg.	2,577	147	271	45	605
Mosenergo	MSNG	3,789	3,968	7.9	5.8	4.0	34.1	27.3	13.4	11,904	318	333	59	541
Quadra (TGK-4)	TGKD	805	748	4.2	3.9	3.1	12.6	13.2	19.2	3,348	241	224	44	509
TGK-5	TGKE	486	357	8.0	6.2	4.7	9.2	13.2	15.6	2,467	197	145	51	285
TGK-6	TGKF	695	371	4.1	3.7	3.8	40.9	8.9	8.9	3,113	223	119	46	257
Volga TGK-7	TGKG	1,466	1,385	6.9	5.2	4.2	12.4	13.7	11.7	6,879	213	201	46	435
TGK-9	TGKI	1,108	963	5.3	5.0	3.8	8.1	11.6	11.0	3,280	338	294	53	556
Fortum	TGKJ	1,101	221	1.6	1.8	1.0	9.2	9.9	9.1	2,785	395	79	80	99
TGK-11	TGKK	264	364	4.6	4.5	3.3	8.5	7.3	5.5	2,026	130	180	48	376
Kuzbassenergo	KZBE	743	797	10.2	5.1	3.3	neg.	19.7	35.3	4,400	169	181	61	295
Yenisei TGK-13	TGKM	530	566	8.7	5.4	2.5	neg.	neg.	10.7	2,458	216	230	66	349
TGK-14	TGKN	166	100	6.0	2.7	1.9	neg.	6.1	4.5	633	262	159	45	352
TGKs Average				**6.8**	**4.8**	**3.3**	**16.5**	**13.1**	**12.7**		**247**	**219**	**53**	**428**
Average				**8.6**	**6.5**	**4.4**	**19.9**	**15.3**	**14.9**			**233**	**53**	**431**
EM hydro generation average				**7.0**	**6.0**	**5.6**	**10.3**	**11.2**	**10.0**			**1,148**		
Premium (discount), %				*11%*	*-6%*	*-24%*	*32%*	*-20%*	*-26%*			*-57%*		
DM hydro generation average				**15.3**	**11.2**	**10.5**	**12.9**	**17.1**	**16.4**			**2,724**		
Premium (discount), %				*-49%*	*-50%*	*-60%*	*5%*	*-48%*	*-55%*			*-82%*		
EM thermal generation average				**6.0**	**5.6**	**5.9**	**9.7**	**8.1**	**8.0**			**1,074**		
Premium (discount), %				*44%*	*16%*	*-25%*	*106%*	*89%*	*86%*			*-78%*		
DM thermal generation average				**9.4**	**8.1**	**7.5**	**19.6**	**14.6**	**13.5**			**1,018**		
Premium (discount), %				*-9%*	*-20%*	*-42%*	*2%*	*5%*	*11%*			*-77%*		

Source: RTS, MICEX, TKB Capital estimates

Grid companies

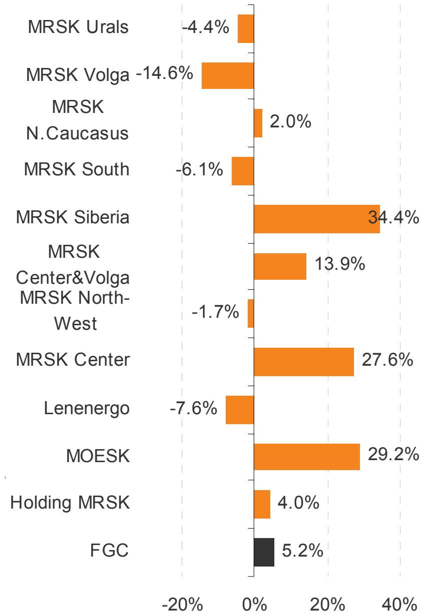
Investment appeal of the sector is under pressure from uncertainty over RAB-regulation parameters, the revision of which is highly likely because of the state's intention to restrain growth rate in coming years. There a whole bunch of modalities for the implementation of this decision – from revision of the RAB-parameters and the postponement of the introduction of regulations to transition to long-term indexation of tariffs. We focus on FGC and MRSK Holding as the most stable stocks in the sector.

Risks associated with RAB-transition increase. Based on approved RAB-regulation parameters, the tariff hikes for FGC in 2011 was expected to be 31%, for distribution companies – 15-40% depending on the region. The government wants to limit the growth by 15%. In our view, due to the postponement of the transition to RAB-regulation that was supposed to be finished by 1 July, 2010, we can expect the more conservative tariff decision-making, but the situation will become clear only towards the year-end. It should be noted that the mechanism for smoothing the growth rates during the first two or three years, with the compensation of decreased income in subsequent years is envisaged by the mechanisms of RAB-regulation. Smoothing rates in the first few years will reduce the attractiveness of the grid segment due to the switching of cash flows to later periods, but will not be decisive. Another possible solution might be a revision of RAB-regulation parameters for initial regulatory asset base (iRAB) and rates of return. We expect the government to decide on the methodology of determining the tariff rate in 4Q10, but we do not rule out somewhat higher growth rates than 15%.

Investment programs revision is the reality. Reduction of tariffs for power transmission may have an impact on investment programs of FGC, MRSK Holding and their sources of funding. This would increase the debt burden, and possibly lead to the SPOs by selected MRSKs in favor of a strategic investor or the state and will be accompanied by the governmental subsidies. In our view, if the introduction of RAB-mechanism continue, it is likely that stretching of investment programs over time in case of 70% depreciation of assets is hardly an adequate solution. If the tariff restrictions are approved and the volume of investment programs for grid companies remain intact, it will significantly reduce the investment attractiveness of the sector. A number of recent statements by representatives of state agencies suggests that the authorities understand the problem of a certain redundancy of investment programs and are ready to revise them downward, but we think that certainty in this matter can only come with understanding of the dynamics of tariff plans.

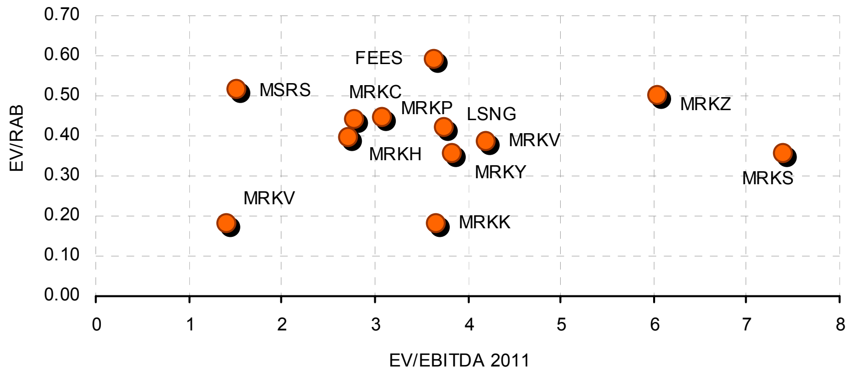
Indexation of tariffs as an alternative for RAB. It should be noted that for 70% of the region, estimates of RAB-base have not yet been approved. We believe that under the limited growth rate the state may undertake a last resort measures and reject the transfer of grid companies to RAB-regulation, replacing it with indexation of tariffs for the remaining companies. The possibility of such plans has already been announced. The final tariff decision is expected towards the end of this year, and we believe that a potential revoke of the RAB-regulation or postponement of its implementation in the future increases the risks for investing into grid segment.

Grids' share dynamics YTD ($)



Source: RTS, MICEX, TKB Capital estimates

Grid companies: comparative valuation (2011E)



Source: RTS, MICEX, TKB Capital estimates

Other things being equal, FGC is less risky. We prefer companies with a low debt burden, transparent strategy, governmental support and steady financials, which, in our view, reduce the risks of investments compared to MRSKs. The FGC intends to keep its investment programs unchanged for the next three years at RUR170 bn and foresees its modest increase in subsequent years (to RUR200 bn), which may translate into higher debt load. The company has completely switched to RAB, and revision of RAB-parameters is unlikely.

Holding MRSK – on the verge of changes. Currently several options for the development of MRSK Holding are considered: attraction of a strategic investor, privatization of MRSKs, transition to a single share, joining one of MRSKs to MRSK Holding. The company considers all these options, but the final decision is still pending. In our view, corporate risks of MRSK Holding are significantly lower than of the grid companies included into its structure.

Sector valuation. Currently, the average EV/RAB for the grid companies is 0.42. We believe this estimate is quite adequate, given the possibility of reducing the initial asset base (IRAB) and significant depreciation.

Comparative Valuation

Russian Grids Sector

Company	Ticker	Market Cap, $m	Current EV, $m	EV/EBITDA 2010E	EV/EBITDA 2011E	EV/EBITDA 2012E	P/S 2010E	P/S 2011E	P/S 2012E	P/E 2010E	P/E 2011E	P/E 2012E	EBITDA margin 2010E	EBITDA margin 2011E	EBITDA margin 2012E	EV/ Output, $/kW	EV/RAB
FGC	FEES	13,520	11,873	**5.97**	**3.65**	**2.53**	**3.39**	**2.48**	**1.90**	**16.59**	**8.88**	**5.80**	**50%**	**60%**	**66%**	**25**	**0.59**
MRSK of Center	MRKC	1,371	1,735	3.21	2.79	2.52	0.68	0.59	0.51	5.47	4.28	3.58	27%	27%	26%	28	0.44
MRSK of North West	MRKZ	650	806	6.20	6.04	3.15	0.70	0.63	0.50	63.37	32.83	5.24	14%	13%	20%	18	0.50
MRSK of Urals	MRKV	277	435	1.44	1.42	1.11	0.17	0.15	0.13	2.09	2.10	1.43	19%	17%	18%	5	0.18
MRSK of Siberia	MRKS	828	1,082	8.28	7.39	3.28	0.53	0.44	0.35	neg.	neg.	6.12	8%	8%	14%	10	0.35
MRSK of Center and Volga	MRKP	700	1,053	3.99	3.09	2.05	0.38	0.33	0.27	10.07	5.48	2.57	14%	16%	20%	17	0.44
MRSK of Volga	MRKV	565	727	4.49	4.21	2.60	0.52	0.45	0.36	12.80	10.26	4.01	15%	14%	18%	12	0.39
MRSK of South	MRKY	232	713	4.45	3.83	3.19	0.32	0.27	0.24	21.46	6.93	3.47	22%	22%	23%	14	0.36
MRSK of North Caucasus	MRKK	129	173	2.69	3.67	3.31	0.35	0.33	0.30	neg.	neg.	neg.	17%	12%	12%	*12*	0.18
Lenenergo	LSNG	742	1,222	2.50	3.75	5.99	0.65	0.70	0.70	3.64	31.10	neg.	43%	31%	19%	38	0.42
MOESK	MSRS	2,096	3,458	3.05	1.53	3.34	0.68	0.47	0.61	4.90	1.62	6.65	37%	51%	30%	42	0.52
Holding MRSK	MRKH	4,599	12,763	3.55	2.72	2.88	0.28	0.23	0.21	5.84	3.69	4.30	22%	24%	20%	18	0.40
MRSKs' Average				***3.85***	***3.17***	***3.06***	***0.47***	***0.39***	***0.38***	***8.89***	***6.76***	***4.30***	***24%***	***26%***	***22%***	***23***	***0.42***
International peers' average				***4.78***	***4.57***	***4.36***	***0.78***	***0.72***	***0.68***	***10.20***	***11.10***	***11.70***				***119***	***1.21***
Premium (discount), %				*-19%*	*-31%*	*-30%*	*-40%*	*-45%*	*-45%*	*-13%*	*-39%*	*-63%*				*-80%*	*-65%*

Source: Companies data, TKB Capital estimates

OGK-4
Efficiency means profitability

OGK-4 fuel efficiency is one of the main competitive advantages in light of the forthcoming liberalization of the wholesale electricity market. In our view, OGK-4 among other companies of wholesale thermal generation will benefit the most from the quality of its assets and will have a significant competitive advantage.

Strong operational performance. The utilization rate of OGK-4 installed capacity in 2009 exceeded 71%, the specific reference of fuel consumption was 322.18 g/kWh, which is the best indicator among the thermal wholesale generation companies. In our view, these facts are very positive in light of the upcoming liberalization of the electricity market, because they can be regarded as a strong competitive advantage. This is partly supported by the fact that the productive supply of electric power companies in 2009 amounted to 57.3 bn kWh that is only1.6% lower than in 2008, while most other companies' heat production decreased by 5-23%.

The most steady financials among other OGKs. Consolidated 2009 IFRS OGK-4 revenue grew by 12.8% and amounted RUR42.9 bn. EBITDA 2009 increased by 69% up to RUR8.9 bn. EBITDA margin is 20.7% vs. 13.8% a year earlier. We believe that the positive dynamics of indicators would continue even amid rising energy prices.

Lack of debt and availability of cash. Currently, the company has more than \$550 mn in cash on its balance sheet, which leaves a considerable room for maneuvers in implementing its investment program.

The investment program is close to completion. The investment program of OGK-4 stipulates the construction of several power and the increase in total installed capacity from 8.3 to 11 GW. The volume of investments is estimated at EUR2.3 bn. EUR1.5 bn of them were covered from the funds remaining from the placement of additional share issue within its sale to E.ON. Other funding will be provided through loans and profits. Until the end of 2010, OGK-4 is expected to launch a block of 400 MW at Shaturskaya GRES. Commission of two new units at Shaturskaya GRES-2, which is the flagship of the company and has the highest load factor among all the domestic power plants, is scheduled for 2011. The capacity of each unit is 400 MW. Their input will increase the total installed capacity of Shaturskaya GRES-2 up to 5.6 GW, which would significantly improve the financial performance of OGK-4.

On EV/Installed capacity OGK-4 trades at \$ 480/kW, well above the sector average, but in our opinion, it not fully reflects the fundamental value of the company, especially if we take into account the cost of kW of installed capacity of E.ON European stations. The closest to OGK-4 on profitability and cost per kW is Enel OGK-5, but its shares have lower liquidity.

OGK-4 is our top pick in the wholesale sector of thermal generation. We revised our financial model, taking into account the published results and incorporated WACC of 11.84%. We reiterate our BUY recommendation for OGK-4 with a new target price of \$0.118 per share, which implies 48% upside potential to the current market quotes.

OGK4	Common	Preferred
Ticker	**OGKD**	-
Recommendation	**BUY**	-
Price, $	**0.08**	-
Target price, $	**0.118**	-
Upside/downside, %	**48%**	-

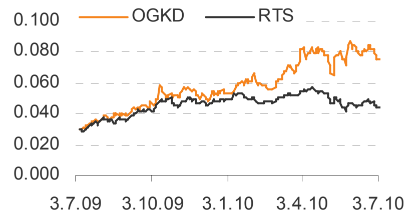
SHARE DATA		
Bloomberg	OGK4 RX	
Reuters	OGKD.MM	
	Common	Preferred
# of shares outstanding,mn	63 049	-
EV, $ mn	3 717	
MC, $ mn	4 897	
MIN 12 mnth., $	0.0295	
MAX 12 mnth., $	0.0876	
	Common	Preferred
Shares per GDR	-	-

SUMMARY FINANCIALS, $ mn			
IFRS	**2009**	**2010E**	**2011E**
Revenue	1 404	1 648	1 860
EBITDA	231	313	571
Net income	214	218	355
EPS, $	0.00	0.00	0.01
Rev. growth, %	-8.3	17.4	12.8
EPS growth, %	-12.6	1.9	62.6
EBITDA margin,%	16.5	19.0	30.7
Net margin, %	15.2	13.2	19.1

SUMMARY VALUATIONS	**2009**	**2010E**	**2011E**
P/E	22.88	22.45	13.81
EV/EBITDA	16.07	11.87	6.51

SHAREHOLDER STRUCTURE	
E.On Russia Power	76.6%
Free Float	23.4%

PRICE DYNAMICS



Source: MICEX, RTS. TKB Capital estimates

OGK-4

BALANCE SHEET

$ mn	2009	2010E	2011E	2012E	2013E	2014E
TOTAL CURRENT ASSETS	697	225	244	497	555	707
PP&E, net	2 210	3 050	3 610	3 896	3 631	3 866
Other non-current assets	6	6	6	6	6	6
Total NON-CURRENT ASSETS	2 231	3 072	3 631	3 917	3 651	3 888
TOTAL ASSETS	2 928	3 297	3 875	4 415	4 206	4 594
Short-term borrowings	-	-	34	34	31	33
Other short-term liabilities	87	114	152	189	205	256
Total CURRENT LIABILITIES	87	114	185	223	236	289
Long-term borrowings	-	-	168	168	157	167
Other non-current liabilities	128	133	131	130	122	129
Total LONG-TERM LIABILITIES	374	375	376	377	378	379
Minority interest						
Share and additional capital	2 155	2 223	2 190	2 189	2 040	2 172
Retained earnings	546	816	1 191	1 694	1 641	1 826
Total EQUITY	2 712	3 051	3 392	3 894	3 691	4 009
TOTAL EQUITY & LIABILITIES	2 928	3 297	3 875	4 415	4 206	4 594

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Revenue	1 268	1 726	2 324	2 877	3 232	3 891
Cost of production	(1 119)	(1 480)	(1 855)	(2 237)	(2 434)	(2 924)
EBITDA	232	374	642	845	1 012	1 190
Depreciation	77	121	161	193	200	206
EBIT	155	253	480	653	812	984
Net interest income/(expenses)	99	57	3	(27)	(8)	(3)
EBT	253	310	484	625	804	981
Income tax	(48)	(59)	(93)	(122)	(158)	(193)
Net income	206	251	390	504	646	788

CASH FLOW STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Net CF from operating activities	181	300	521	698	834	972
Net CF from/(used in) investment activities	(741)	(888)	(772)	(480)	(200)	(206)
Net CF from/(used in) financing activities	47	72	206	(27)	(603)	(699)
Net Debt	(551)	(35)	211	20	(24)	(79)

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	-17%	36%	35%	24%	12%	20%
EBITDA margin	18%	22%	28%	29%	31%	31%
Net margin	16%	15%	17%	18%	20%	20%
Net Debt/EBITDA	(2.4)	(0.1)	0.3	0.0	(0.0)	(0.1)

Source: company data, TKB Capital estimates

RusHydro
Buying future cash flows

RusHydro showed a considerable improvement in its profitability for the crisis year of 2009, during which decrease in power consumption and lower prices in the free segment of the wholesale market were observed. In our view, RusHydro will benefit the most from the liberalization of the electricity market among all other domestic generation companies.

RusHydro's low costs and high asset quality will enable the company to capitalize the growth of energy prices. As the growth of tariffs for gas and coal is crucial for pricing on the wholesale market, with low production costs RusHydro will monetize their increase that would directly affect the dynamics of financial performance and increase profitability. RusHydro's generation business EBITDA margin was 44% in 2009. We estimate the company's EBITDA margin for generation business to come close to 60% over the next few years and to exceed the respective figure of heat companies. According to our estimates, the company's EBITDA to more than double over the next three years.

Better operating performance. According to the management plans, in the coming years total production of electric power stations of RusHydro would increase to 113 bn kWh from the current 80 bn kWh.

Stronger supply business segment will increase revenue. The purchase of stakes in distribution companies throughout 2010 from RAO UES of East, according to our estimates, will be reflected in the company's financial results as early as in 2010 and enable the company to hedge the supplied to the wholesale market electricity volumes. We expect significant growth of the company's revenues up to 2010, primarily due to the consolidation of indicators of retail companies.

Plans to expand installed power capacities to 40 GW by 2015. RusHydro may be the major beneficiary of TGK-1's HPPs and the state's stake in Irkutskenergo (40%), and also has plans to acquire assets overseas. Restoration of Sayano-Shushenskaya HPP along with commission of Boguchanskaya HPP and the Cascade of Zaramagskie HPP's can become growth catalysts for RusHydro.

Undervalued on financial multiples. At the moment, based on EV/EBITDA RusHydro trades at 4.2 that assumes a 60% discount to hydro generation companies of developed markets. Based on EV/Installed capacity, RusHydro trades at around $480/kW that is almost twice lower than its peers of emerging markets.

Valuation. Our RusHydro's financial model is based on our current macroeconomic projections, estimates of price changes on the wholesale electricity market and current data on the investment program of the company. Our DCF-valuation model of RusHydro incorporates WACC of 12.8% and terminal growth rate of 2% that implies a target price of $0.0717 per share and a 41% upside potential. We rate the stock as BUY.

Risks. First, reduction of investment component in the tariff and uncertainty over payment rates for new capacity. Second, increase in investment program. Third, additional share issue in favor of the state or a new strategic investor. And finally risks associated with aggressive expansion to foreign markets and uncertainty over the asset swaps and payment options for them.

RusHydro	Common	GDR
Ticker	**HYDR**	**HYDR Li**
Recommendation	**BUY**	**BUY**
Price, $	**0.051**	**5.10**
Target price, $	**0.0717**	**7.2**
Upside/downside, %	**41%**	**41%**

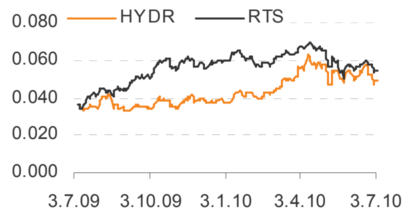
SHARE DATA	
Bloomberg	HYDR RX
Reuters	HYDR.MM
	Common
# of shares outstanding,mn	269 695
EV, $ mn	14 419
MC, $ mn	13 393
MIN 12 mnth., $	0.0328
MAX 12 mnth., $	0.0629
	Common
Shares per GDR	100

SUMMARY FINANCIALS, $ mn			
IFRS	**2009**	**2010E**	**2011E**
Revenue	3 649	13 131	15 650
EBITDA	1 621	2 233	2 942
Net income	987	1 495	1 811
EPS, $	0.004	0.0055	0.0067
Rev. growth, %	-15.9	259.9	19.2
EPS growth, %	19.0	51.4	21.2
EBITDA margin,%	44.4	17.0	18.8
Net margin, %	27.1	11.4	11.6

SUMMARY VALUATIONS	2009	2010E	2011E
P/E	13.6	9.0	7.4
EV/EBITDA	8.9	6.5	4.9

SHAREHOLDER STRUCTURE	
Government of Russia	60.4%
Free Float	39.6%

PRICE DYNAMICS



Source: MICEX, RTS. TKB Capital estimates

RusHydro

BALANCE SHEET

$ mn	2009	2010E	2011E	2012E	2013E	2014E
TOTAL CURRENT ASSETS	2 691	3 819	4 680	6 675	7 590	9 194
PP&E, net	11 734	15 344	16 505	17 167	16 433	17 885
Other non-current assets	1 555	1 605	1 580	1 580	1 472	1 568
Total NON-CURRENT ASSETS	13 290	16 949	18 085	18 746	17 905	19 453
TOTAL ASSETS	15 981	20 768	22 765	25 421	25 495	28 647
Short-term borrowings	85	341	336	336	313	333
Other short-term liabilities	746	2 572	3 031	3 502	3 680	4 362
Total CURRENT LIABILITIES	831	2 913	3 367	3 838	3 993	4 696
Long-term borrowings	640	717	706	705	657	700
Other non-current liabilities	1 173	1 210	1 192	1 191	1 110	1 182
Total LONG-TERM LIABILITIES	374	375	376	377	378	379
Minority interest						
Share and additional capital	9 315	10 260	10 105	10 100	9 413	10 023
Retained earnings	4 351	6 008	7 731	9 922	10 634	12 378
Total EQUITY	13 336	15 928	17 501	19 686	19 735	22 068
TOTAL EQUITY & LIABILITIES	15 981	20 768	22 765	25 421	25 495	28 647

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Revenue	3 649	13 131	15 650	17 953	19 521	22 356
Cost of production	(2 401)	(11 320)	(13 241)	(15 111)	(15 974)	(18 076)
EBITDA	1 621	2 233	2 942	3 420	4 128	4 893
Depreciation	373	423	533	578	580	613
EBIT	1 249	1 811	2 409	2 842	3 548	4 280
Net interest income/(expenses)	()	80	(122)	(99)	41	115
EBT	1 248	1 891	2 286	2 743	3 589	4 395
Income tax	(244)	(378)	(457)	(549)	(718)	(879)
Net income	987	1 495	1 811	2 177	2 854	3 498

CASH FLOW STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Net CF from operating activities	(1 007)	(3 381)	(1 938)	(1 248)	(1 029)	(1 000)
Net CF from/(used in) investment activities	10	308	-	-	-	-
Net CF from/(used in) financing activities	998	(1 562)	185	1 300	654	598
Net Debt	(867)	1 028	826	(475)	(1 199)	(1 734)

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	-16%	260%	19%	15%	9%	15%
EBITDA margin	44%	17%	19%	19%	21%	22%
Net margin	27%	11%	12%	12%	15%	16%
Net Debt/EBITDA	(0.5)	0.5	0.3	(0.1)	(0.3)	(0.4)

Source: company data, TKB Capital estimates

Metals and Mining
Stable in 2H10

Evgeny Ryabkov e.ryabkov@tkbc.ru

Steel market should stabilize in 2H10

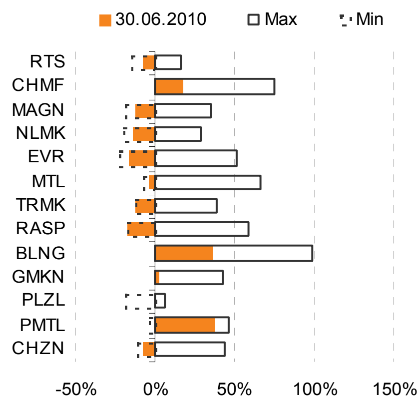
Rolled products demand stabilization. As we expected in our 2010 strategy "Run, Russia, Run", all the best for Russian steelmakers happened in 1H10. In particularly, principal demand and price growth occurred in the first half of the year. Average rolled product prices increased by 20-25% in 1H10, while we forecasted average annual growth at 20-22%. We expect stabilization of rolled products demand in 2H10 on the level of June, 2010.

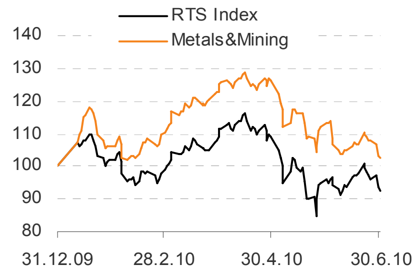
Steel prices are not expected to surpass 1H10 levels. We believe that 2010 price peak was in 1H10. At the end of 1H10 quite tangible price correction began due to lower consumption on export markets. Steel price could rebound by 10-12% this summer thanks to coking coal and iron ore high prices. We do not expect crucial changes till 4Q10 when seasonal decline of activity on the domestic steel market is likely.

Investment appeal of vertically integrated companies is on the rise. When iron ore and coking coal prices are climbing, investment appeal of vertically integrated companies may again increase.

Severstal is our top pick. We have chosen Severstal as our top pick in Russian steel sector. The company has progressive gold mining segment and effective steel business in Russia, which is fully integrated into coal and iron ore mining. The company's North American division now is not in its best condition but we believe that it has a huge potential. Severstal looks undervalued by multiples along with MMK. However, MMK is a laggard in covering its needs in raw materials.

YTD sector dynamic vs. RTS





Source: RTS, TKB Capital estimates

Will the government regulate steel sector?

Pricing regulation: the story continues. In 1H10 Russian government indicated its intention to pay close attention to uncontrolled steel price growth. As a result, the Federal Antimonopoly Service (FAS) initiated investigations against key steel producers. We suppose that this story should continue in 2H10. It would adversely impact the overall sector.

Coking coal prices remains high

In 2H10 coking coal concentrate price to consolidate at a high level. In 2H10 we expect coking coal prices to remain at the levels of the end of 1H10. We believe that risks of deficit caused by the accident on Raspadskaya mine and strong foreign market environment should support domestic prices.

Raspadskaya blasts: coal famine is unlikely. We do not expect coking coal deficit on the domestic market because of the accident on Raspadskaya. We believe that Russian coal producers should compensate for lack of the coking coal on the domestic market by export deliveries decrease.

Introduction of coking coal export duty is hardly probable. In our view, the Russian government may impose coking coal export duty only in case of severe coal deficit in the country. We believe this development is hardly likely. Russian coal companies should refocus a part of their exports to the domestic market in order not to complicate the state of affairs.

Raspadskaya: all risks are already priced in. We believe that Raspadskaya is the best investment theme in Russian coal sector. News concerning Raspadskaya mine restoration should boost the recovery of its capitalization. Raspadskaya trades in the line with its peers based on EV/EBITDA and P/E multiples. And this underlines all risks associated with accident have been already priced in.

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Comparative valuation

Steelmaking companies

	EV/EBITDA		P/E	
	2010E	2011E	2010E	2011E
NLMK	5.7	4.9	11.4	9.8
MMK	5.2	4.2	10.4	6.8
Severstal	4.6	3.9	10.6	6.9
Evraz Group	6.1	5.1	9.5	6.4
Median	**5.4**	**4.6**	**10.5**	**6.8**
Developed market				
ArcelorMittal	6.3	4.6	12.0	6.9
Nippon Steel	6.7	6.1	11.3	9.3
JFE Holdings	5.7	5.4	9.7	8.5
US Steel	5.6	3.4	17.5	6.0
Nucor	8.5	5.0	25.4	10.2
Voestalpine	5.5	4.8	9.4	6.6
Thyssen Krupp	6.3	4.4	30.6	11.4
Median	**6.3**	**4.8**	**12.0**	**8.5**
Developing markets				
Baoshan Iron&Steel	5.5	4.8	10.3	8.8
Angang Steel	6.3	5.2	12.0	9.6
Tata Steel	6.0	5.2	7.6	6.0
POSCO	5.2	4.8	7.8	7.6
China Steel	10.0	9.8	10.9	10.3
Gerdau	7.2	5.4	12.1	7.9
Median	**6.2**	**5.2**	**10.6**	**8.3**

Source: Company data, TKB Capital estimates

Coal companies

	EV/EBITDA		P/E	
	2010E	2011E	2010E	2011E
Mechel	6.3	5.2	11.5	8.0
Raspadskaya	7.6	6.5	11.7	10.6
Belon	6.3	6.1	10.3	9.5
Median	**6.3**	**6.1**	**11.5**	**9.5**
Massey Energy	4.5	2.7	12.9	5.5
Gloucester coal	14.4	6.8	23.2	10.3
Whiteheaven Coal	21.4	11.4	41.0	20.6
Consol Energy	4.4	3.2	12.3	8.0
Yanzhou Coal Mining	7.1	6.3	10.1	8.6
Alpha Natural Resources	4.3	3.4	10.1	6.6
Median	**5.8**	**4.9**	**12.6**	**8.3**

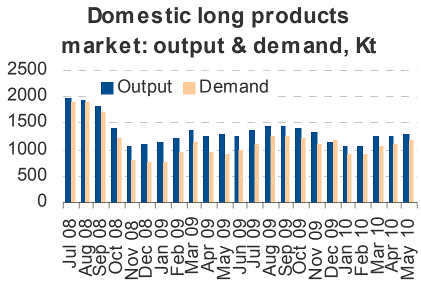
Source: Company data, TKB Capital estimates

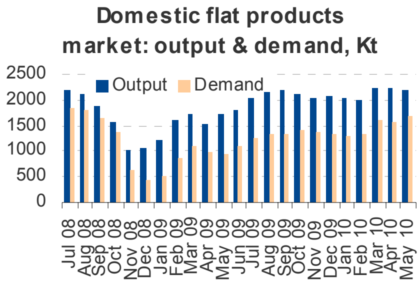
Steel

We believe that 2H10 would be weaker for Russian steelmaking companies than in 1H10. Steel price peak was in April-May and then prices began to weaken. In 2H10 steel demand should be sustainable and remain at the level of the end of 1H10. Meanwhile, we do not expect significant decline in steel prices due to support from high coking coal and iron ore prices. Thus, we believe that in 2H10 we would see quiet market without price rally and dramatic events. The expectations of lack of steel demand and price growth in 2H10 are already priced in. Severstal is our top pick in the Russian steel universe. The persisting threat of state regulation in the sector is the sole factor capable to put negative pressure on steel makers.

Without rally and shock

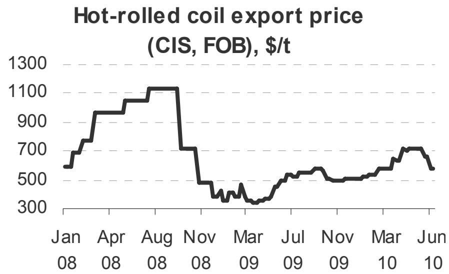
Steel rolled products demand stabilization. At the end of 1H10, demand for key types of rolled-steel finished products started to decrease due to consumption decline on export markets. One more reason was cautious operations of metal traders which do not hurry to pack their storehouses for 2H10. Demand in real sector of Russian sector, first of all in construction, recovers slowly. It illustrates poorly performing demand level for the long rolled-steel products. Thus, in mid-2008, 1.9 mn tons of long products were consumed domestically and 1.1 mn tons – for the first five months of 2010. However, flat products demand practically approached the pre-crisis level and made up 2.1 mn tons per month. We expect this tendency to continue in 2H10: long and flat products demand should remain at the current levels. As seen from the graph below, long products consumption has significant upside potential. However, it should be realized in a longer term outlook.

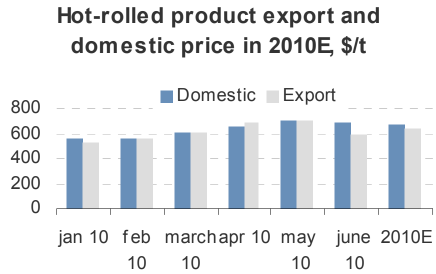




Source: Metal Expert, TKB Capital estimates

Steel prices: peak is in the past. We evidenced tangible export steel price decrease in June, 2010. Hot-rolled coil price (FOB, the Black Sea) dropped by 18% in mid-June in comparison with the beginning of May. Rebar price lost 24%. The key reasons are weaker demand and fears concerning Chinese economics slowdown. We think that price peak was in 1H10. We expect steel price rebound by 10-12% from the current levels in 2H10 and remain steady by the year-end. In our view, raw materials high prices should not enable steel prices to decrease further.





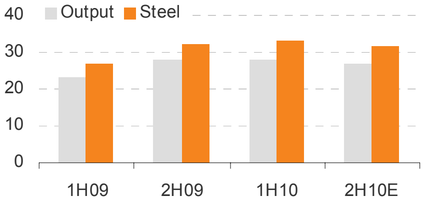
Source: Metal Bulletin, Chermet Corp., TKB Capital estimates

Steelmaking companies could decrease output in 2H10. We think that steel demand reduction and likelihood of coking coal deficit could force Russian steelmakers to decrease their outputs. Majority of domestic plants worked with capacities of nearly 95-100% in 1H10. In our view, they could reduce rolled products output in 2H10 due to lack of demand growth.

We expect Chinese steel production to stabilize in 2H10. China remains the key driver for the global steel sector. Over five months of 2010, the country raised crude steel output by 24% y-o-y to 270 mn tons. Also China increased steel export by 2.3 times y-o-y to 18 mn tons. We expect a slight decrease in steel output in 2H10 due to weaker demand. But it should not have a strong impact on the global steel market.

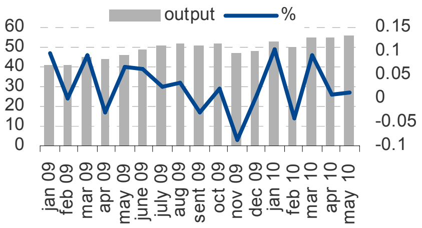
Investment appeal of vertically integrated companies is on the rise. In 2010, raw materials prices, in particular for coking coal and iron ore, increased considerably –.Coking coal concentrate domestic price grew by 41% to $141 per ton from the beginning of this year and pellets price added 116% to $132 per ton. Higher raw materials prices have improved investment appeal of vertically integrated companies. Among them we prefer Severstal, Mechel and Evraz Group. We believe that the raw materials prices should maintain at high levels in 2H10. Raspadskaya's output decrease caused by the accident should support domestic coking coal market, while continuous growth of iron ore consumption in China should have a positive impact on iron ore concentrate and pellet prices in Russia.

Domestic steel and finished products output, mn t



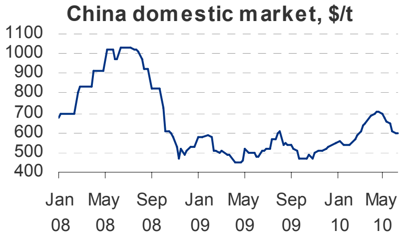
Source: Rosstat, TKB Capital estimates

Steel output in China, mn t



Source: World Steel Institute, TKB Capital estimates

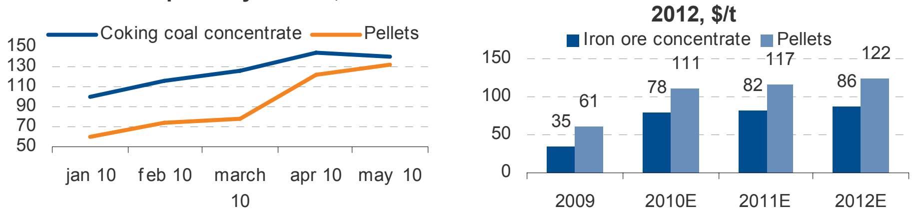
Hot-rolled product price in China domestic market, $/t



Source: World Steel Institute, TKB Capital estimates

Coking coal and pellets domestic price dymanics, $/t

Iron ore concentrate and pellets price forecast in 2010-2012, $/t



Source: Metal Expert, TKB Capital estimates

State regulation: is there a risk and how big is it?

Steel companies won the first round… Steel prices growth in 1H10 caused discontent of number of consumers, which addressed complaint to the Russian government. In May average domestic steel price increased by 25% from January's level. After that steel producers announced about another price hike by 20-25%. It made the cup run over. As a result, FAS investigates cases concerning steel price policy in 2010 in relation to Evraz Group, Severstal, MMK and Mechel. It should be noted that during some meetings of steelmakers and key consumers Russian officials refrained from tough wordings. It implies the desire to find a compromise. Apparently, memorable events of August, 2008 were taken into account. Meanwhile, steelmakers seemed to win this battle, as Severstal and AvtoVAZ have signed the agreement which envisages flat products price growth by 22% in June-August, 2010.

…but fight has not been finished yet. We believe the growth steel price is not over. Coking coal and iron ore prices growth would induce steelmakers to increase steel prices. In turn, the government, which is struggling against inflation, is unlikely to let them do it. We suppose steelmakers and key consumers (AvtoVAZ, KAMAZ, RZhD, defense industry companies) should conclude 2-3-month contracts with fixed steel prices, like Severstal and AvtoVAZ.

Coal

We expect in 2H10 the Russian coal companies to succeed backed by coking coal concentrate high prices. Constrained coal deliveries to the domestic market caused by Raspadskaya mine accident, as well as strong foreign environment should support coal prices. At the same time, because of lower steel prices metal companies may be dissatisfied by high coal prices. We do not rule out that in this case the Russian government may use its regulative functions with regard to coking coal producers, first of all, to Mechel. We see Raspadskaya as the most attractive play in coal sector. We believe that repercussions from its key mine accident are fully priced in.

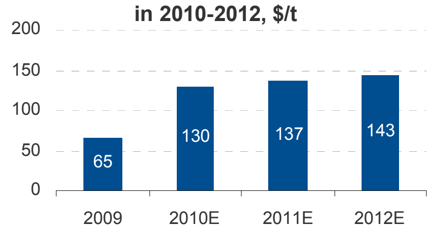
Steadily high prices in 2H10

In 2H10 high coking coal prices to remain. Domestic coking coal price environment remains strong. In our view, this tendency should continue in 2H10 due to scarce coal deliveries to the domestic market caused by Raspadskaya key mine accident and also as a result of high coal demand in China. Coking coal concentrate domestic prices increased by 40% YTD to $140 per ton. We estimate that prices should stay at about $140-145 per ton in 2H10. According to our forecast, average coking coal concentrate price should rose two-fold y-o-y to $130 per ton.

Raspadskaya accident: will coal deficit come in 2H10? According to our estimates, domestic market should receive about 3 mn tons of coking coal less, or nearly 8% of total Russian production due to explosions of Raspadskaya mine. Temporary stoppage of the mine production creates a coal deficit on the market and supports coal prices despite weaker steel price in May-June, 2010. We do not forecast a major coal shortage on the domestic market in 2H10 though. Russian coal companies could increase production and redirect a part of coal export flows to the domestic market. In April, 2010 Russian coking coal concentrate output made up 3.6 mn tons and consumption amounted 3.4 mn tons. Coal export accounted for 1.5 mn tons, so there is potential for domestic deliveries increase.

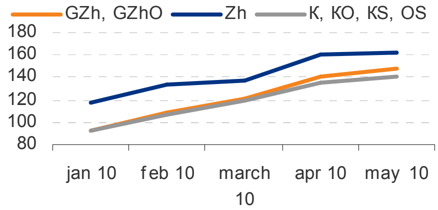
The impact from lifting of import coking coal duty is negligible. Russian government considers the possibility of revoking rich coking coal import duty, which accounts for 5%. Potential importer could be Kazakhstan. However, it is unlikely to help solving the problem with probable deficit of coking coal in Russia due to small import volumes. We believe that lack of coal could be compensated by export decline.

Coking coal concentrate price forecast in 2010-2012, $/t



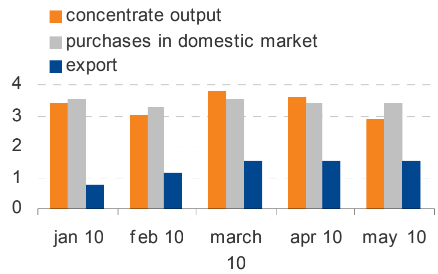
Source: Metal Expert, TKB Capital estimates

Domestic coal prices by grades, 2010



Source: Metal Expert, TKB Capital estimates

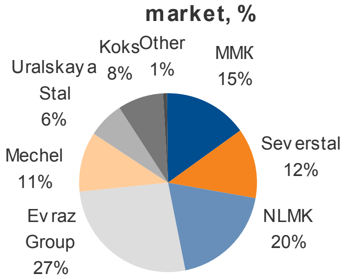
Russian coking coal market structure in 2010, mn t



Source: Metal Expert, TKB Capital estimates

Historical coking coal production in Russia, mn t

Coking concentrate key consumers on the domestic market, %



Source: Rosstat, Metal Expert, TKB Capital estimates

Government sees domestic market as priority

Will government introduce coal export duty? This spring media reported that the government could impose coking coal export duty in case of coking coal deficit on the domestic market. This scenario is probable because the market still has not felt in full Raspadskaya mine stoppage and deficit may emerge even with stable pig iron and steel production. At the same time, export duty introduction looks as extreme measure. We believe the authorities should employ it if key exporters reject to redirect export flows to the domestic market. In our view, it is hardly probable. In this case the strongest impact would be on Mechel, which exported around 3 mn tons or 40% of total volume of coking coal concentrate in 2009. Meanwhile, high coking coal prices and steel prices decrease could cause discontent of steelmaking companies. We do not rule the story of 2008 could reoccur. That time the government curbed coking coal price growth and forced its producers to conclude long-term agreements with steelmakers with fixed prices.

Copper price dynamics, $/t

Source: LME

Nickel price dynamics, $/t

Source: LME

Non-ferrous metals

Hope for the recovery

Stocks decrease points to real demand growth. In 1Q10, base metals prices showed good performance due to high demand in China and overwhelming optimism concerning overcoming of economic crisis. Thus, in 1Q10 average nickel price increased by 14% q-o-q and copper price rose by 9% q-o-q. Now metal prices slightly declined due to economic problems in EU and also due to fears concerning Chinese economics slowdown. Meanwhile, metal's stocks reduction indicates real demand growth. According to our estimates, in 2H10 nickel and copper prices could consolidate at the level of mid-May.

Norilsk Nickel is more attractive than peers. At present, Norilsk Nickel looks undervalued in comparison with its peers. The company trades at 2010 P/E of 7.8 that is 6% lower than the sector's median. Norilsk Nickel is likely to post strong 1H10 financials on the back of basic metal price increase. It may drive the company's share up.

Norilsk Nickel: comparison with its peers

	EV/EBITDA		P/E	
	2010E	2011E	2010E	2011E
Rio Tinto	5.1	4.5	7.7	6.5
BHP Billiton	7.0	4.6	12.5	7.8
Xstrata	4.5	3.8	6.7	5.3
Teck	4.8	4.1	8.1	6.6
Panoramic	2.6	2.9	7.0	7.4
Vedanta	7.4	3.3	16.0	5.7
Median	**4.9**	**3.9**	**7.9**	**6.5**
Norilsk Nickel	5.0	4.6	7.4	6.8

Source: Company data, TKB Capital estimates

Nickel and copper Bloomberg consensus forecast

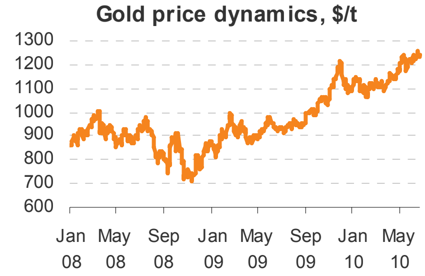
	2009	2010E	2011E	2012E	2013E
Nickel	14 758	18 989	20 976	23 028	18 739
% y-o-y	*-31%*	*29%*	*10%*	*10%*	*-19%*
Copper	5 186	7 035	7 600	7 743	6 668
% y-o-y	*-25%*	*36%*	*8%*	*2%*	*-14%*

Source: Bloomberg

Gold

The best hedge during turmoil

Gold price hit record high in 1H10. Gold offers the best bet for cash saving in time of stock market turbulence. The story with Greece debt and other EU issues proved it to be true. In 1H10 gold price reached its 20-year record high and exceeded $1,200 per ounce. We believe that gold price should continue edging up in 2H10. Investors' fears concerning global economics recovery and probable weakness of US dollar should support gold price. We expect gold price could to surpass $1,300 per ounce in 2H10.



Source: Bloomberg

Middle companies is a best bet

We single out Petropavlovsk and Highland Gold. Further gold price growth expectations are not the news for the market. Thereforeб we believe that these expectations are mainly priced in by large gold mining companies. Meanwhile, there are undervalued stories on the market, which could unfold in 2H10. We consider Petropavlovsk (POG LN) as the best investment play. The company has ambitious plans to increase its output within the next few years (by more than twice in 2013) due to new mines construction. Besides, Petropavlovsk is one of the most efficient gold mining companies in Russia. Highland Gold (HGM LN) looks undervalued too. However, whether investors believe in its outlooks depends on new projects development. Buryatzoloto is trading significantly cheaper than peers. The company extracts ore with high gold grade (8.3 g/ounce). Also Buryatzoloto has gold recovery rate higher than its competitors. Meanwhile, here risks connected with low company's reserves and resources should be taken into account, therefore Buryatzoloto practice supplementary exploration over last few years.

Gold mining companies: comparative valuation by multiples

	EV/EBITDA		P/E	
	2010E	2011E	2010E	2011E
International companies				
Barrick Gold	7.9	7.7	14.9	13.7
Newmont	6.6	6.2	16.0	13.7
GoldFields	6.1	3.9	16.8	11.1
AngloGold	8.6	6.6	18.6	13.6
Median	**7.2**	**6.4**	**16.4**	**13.7**
Companies, operating in Russia				
Polyus Gold	10.0	8.7	16.0	14.9
Polymetal	15.3	10.9	26.8	17.5
Petropavlovsk	7.4	6.8	12.1	11.9
Highland Gold	3.9	3.7	7.2	6.8
Buryatzoloto	1.5	-	5.3	-
Median	**7.4**	**7.8**	**12.1**	**13.4**

Source: Company data, TKB Capital estimates

Severstal		
	Common	GDR
Ticker	**CHMF**	**SVST LI**
Recommendation	**BUY**	**BUY**
Price, $	**10.11**	**10.25**
Target price, $	**15.5**	**15.5**
Upside/downside, %	**53%**	**53%**

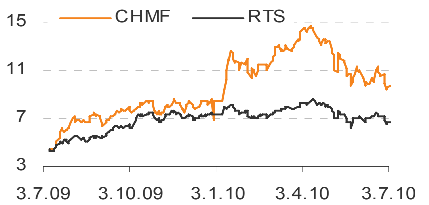
SHARE DATA	
Bloomberg	CHMF RX
Reuters	CHMF.MM
	Common
# of shares outstanding,mn	1 008
EV, $ mn	14 557
MC, $ mn	10 186
MIN 12 mnth., $	4.39
MAX 12 mnth., $	14.61
	Common
Shares per GDR	1

SUMMARY FINANCIALS, $ mn			
IFRS	2009	2010E	2011E
Revenue	13 054	16 365	18 756
EBITDA	812	3 110	3 640
Net income	-1 101	935	1 436
EPS, $	-1.09	0.93	1.43
Rev. growth, %	-41.7	25.4	14.6
EPS growth, %	-154.1	-184.9	53.6
EBITDA margin,%	6.2	19.0	19.4
Net margin, %	NM	5.7	7.7

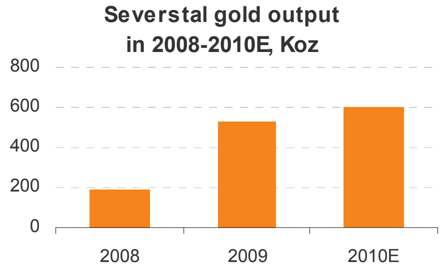
SUMMARY VALUATIONS			
	2009	2010E	2011E
P/E	neg.	10.90	7.09
EV/EBITDA	17.93	4.68	4.00

SHAREHOLDER STRUCTURE	
Alexey Mordashov	82.0%
Free-float	18.0%

PRICE DYNAMICS



Source: MICEX, RTS. TKB Capital estimates



Source: company data, TKB Capital estimates

Severstal

The most attractive play in steel sector

Severstal is one of the most interesting investments stories in Russian steel sector for 2H10. As positive triggers for Severstal we point to high vertically integration of the Russian steel business, growing gold mining segment, leverage risks decrease and hidden potential of its North American division. We recommend a BUY for Severstal with the target price of $15.5 per share.

Russian business: high level of vertically integration. Under growing iron ore prices, one of Severstal's advantages is a high level of integration into the iron ore production. The company covers Severstal Russia needs in iron ore and coking coal for 100%. We expect the raw division of Severstal to contribute 50% to total EBITDA margin in 2010 and its Russian steel division EBITDA margin to account for 26-27%.

Gold as a growth driver. We consider Severstal gold mining segment development as one of the positive triggers against the background of high gold prices. The division demonstrates high efficiency, which is in line with large global gold producers. Production potential of Severstal's existing gold mining assets is estimated at 20%. Moreover, the company intends to expand this business via new acquisitions. IPO of the gold mining segment, in our view, is likely within next few years and it should be one more favorable factor for Severstal.

Severstal North America is a hidden trigger. Severstal North America (SNA) continues to generate losses. We expect the segment to return to the profitable zone in 2011 with EBITDA of $170 mn. However, should Severstal manage to do this already in 2010, it would give a positive signal to the market.

Debt leverage risks wane. We regard Severstal's leverage risks as low, based on the company's 1Q10 financials. Short-term loans constitute $1,104 mn, while cash and equivalents, including short-term investments and deposits, amounted to nearly $2,500 mn. Net debt/EBITDA accounts for 1.4 and underpins the company's stable financial position.

TKB Capital

Severstal

BALANCE SHEET

$ mn	2009	2010E	2011E	2012E	2013E	2014E
TOTAL CURRENT ASSETS	8 185	12 696	12 306	15 111	15 390	18 206
PP&E, net	9 485	9 800	10 197	10 566	10 410	10 279
Other non-current assets	1 974	1 974	1 974	1 974	1 974	1 974
Total NON-CURRENT ASSETS	11 459	11 774	12 171	12 540	12 384	12 253
TOTAL ASSETS	19 644	24 470	24 477	27 651	27 774	30 459
Short-term borrow ings	1 478	3 793	2 283	2 903	2 028	2 653
Other short-term liabilities	2 350	2 447	2 644	2 869	2 991	3 053
Total CURRENT LIABILITIES	3 828	6 239	4 927	5 772	5 018	5 706
Long-term borrow ings	5 749	7 213	7 073	7 443	6 193	5 818
Other non-current liabilities	1 691	1 691	1 691	1 691	1 691	1 691
Total LONG-TERM LIABILITIES	7 440	8 904	8 764	9 134	7 884	7 509
Minority interest	498	514	538	569	604	642
Share and additional capital	4 451	4 451	4 451	4 451	4 451	4 451
Retained earnings	3 436	4 371	5 807	7 734	9 826	12 160
Total EQUITY	7 878	8 813	10 249	12 176	14 268	16 602
TOTAL EQUITY & LIABILITIES	19 644	24 470	24 477	27 651	27 774	30 459

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Revenue	13 054	16 365	18 756	21 491	22 705	23 786
Cost of production	(12 243)	(13 254)	(15 116)	(17 125)	(18 265)	(18 959)
EBITDA	812	3 110	3 640	4 366	4 440	4 827
Depreciation	(957)	(1 085)	(1 103)	(1 131)	(1 156)	(1 131)
EBIT	(145)	2 025	2 536	3 235	3 284	3 696
Net interest income/(expenses)	(497)	(837)	(712)	(787)	(625)	(644)
EBT	(1 101)	1 188	1 825	2 448	2 658	3 052
Income tax		(253)	(389)	(522)	(566)	(650)
Net income	(1 101)	935	1 436	1 927	2 092	2 402

CASH FLOW STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Net CF from operating activities	1 611	1 386	1 978	2 488	3 008	3 366
Net CF from/(used in) investment activities	(1 306)	(1 400)	(1 500)	(1 500)	(1 000)	(1 000)
Net CF from/(used in) financing activities	(429)	3 779	(1 650)	990	(2 125)	250
Net Debt	4 373	4 388	3 910	2 922	914	(1 452)

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue grow th	-42%	25%	15%	15%	6%	5%
EBITDA margin	6%	19%	19%	20%	20%	20%
Net margin	NM	6%	8%	9%	9%	10%
Net Debt/EBITDA	**5.4**	**1.4**	**1.1**	**0.7**	**0.2**	**(0.3)**

Source: company data, TKB Capital estimates

Raspadskaya		
	Common	Preferred
Ticker	RASP	-
Recommendation	BUY	-
Price, $	4.00	-
Target price, $	7.6	-
Upside/downside, %	90%	-

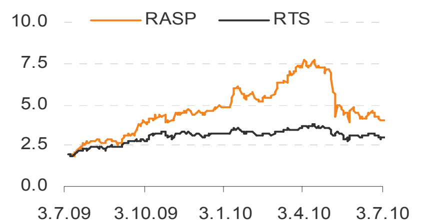
SHARE DATA		
Bloomberg	RASP RX	
Reuters	RASP.MM	
	Common	Preferred
# of shares outstanding,mn	781	-
EV, $ mn	3 427	
MC, $ mn	3 124	
MIN 12 mnth., $	1.89	
MAX 12 mnth., $	7.67	
	Common	Preferred
Shares per GDR	-	-

SUMMARY FINANCIALS, $ mn			
IFRS	2009	2010E	2011E
Revenue	497	748	900
EBITDA	259	453	524
Net income	117	266	294
EPS, $	0.15	0.34	0.38
Rev. growth, %	-58.6	50.4	20.5
EPS growth, %	-77.9	127.3	10.4
EBITDA margin,%	52.2	60.5	58.2
Net margin, %	23.6	35.6	32.6

SUMMARY VALUATIONS			
	2009	2010E	2011E
P/E	26.67	11.73	10.63
EV/EBITDA	13.22	7.57	6.54

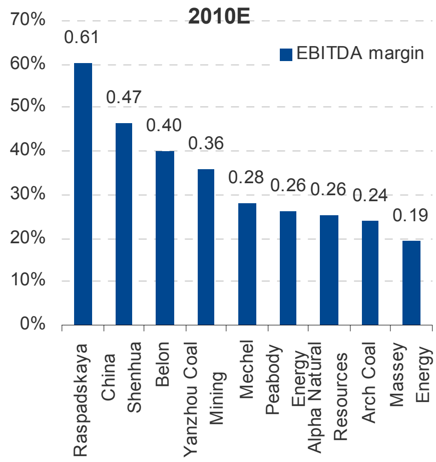
SHAREHOLDER STRUCTURE	
Evraz Group	40%
Management	40%
Free-float	20%

PRICE DYNAMICS



Source: MICEX, RTS. TKB Capital estimates

Raspadskaya EBITDA margin in comparison with its peers, 2010E



Source:; Company data, TKB Capital estimate

Raspadskaya

Benefits from long-term investments

We regard Raspadskaya as a good bet for long-term investments. We estimate Raspadskaya mine repairs, the key asset of the company, to take one and a half year and to cost $350 mn. We believe that adverse impact from accident is already priced in. The main risk is a full stoppage of the key mine but we think it is hardly likely. During the mine's main asset standstill and with high price for coking coal Raspadskaya remains one of the most profitable coal companies globally that underlines its resistance to force-majeur. We recommend a BUY for Raspadskaya with the target price of $7.6 per share.

Raspadskaya mine should resume operations in 3Q11. We estimate Raspadskaya to mine 7 mn tons of coking coal and produce 5.6 mn tons of coking coal concentrate in 2010 (down by 33% y-o-y). The main company's asset, Raspadskaya mine, produced nearly 3 mn tons of coal this year. According to our estimates, Raspadskaya mine should resume operations in 3Q11 that is in a year and half after the explosion, capex for recovery are estimated at around $350 mn. We forecast in 2011 Raspadskaya mine to produce around 3.8 mn tons of coking coal. At present, two mines of Raspadskaya are operating: Raspadsky Open Pit with capacities of 3 mn tons of coking coal and MUK-96 with capacities of 2 mn tons of coking coal. In 2012, Raspadskaya intends to launch Koksovaya mine, which was bought in 2010 from Evraz Group. Koksovaya capacities are estimated at 3 mn tons of coking coal K and KO grades.

Still the most profitable among its peers. Raspadskaya remains the most profitable among domestic and international peers despite the blasts. In 2010, we estimate EBITDA margin at 61% and it should be absolutely the best result in the coal mining sector. Meanwhile, in 2010 we forecast the company's coking coal concentrate cash costs to increase by 73% y-o-y to $37 per ton due to abrupt reduction of the coal output. For the comparison, Belon coking coal concentrate cash costs make up nearly $60 per ton.

Full stoppage of Raspadskaya mine is the key risk. We think that the main risk for Raspadskaya is associated with a full stoppage of Raspadskaya mine. According to our estimates, in that case the company's fair price would be about $3.8 per share which implies a discount to the current market value. Meanwhile, we view this scenario is hardly probable.

An attractive long-term play. We believe that Raspadskaya stock offers a good long-term investment bet. The company trades in line with its peers based on 2010E-2011E EV/EBITDA and P/E multiples. This valuation implies that negative developments caused by mine failure have been already priced in. We believe that positive outcome regarding the future of the key company's asset should improve Raspadskaya's investment appeal.

Raspadskaya

BALANCE SHEET

$ mn	2009	2010E	2011E	2012E	2013E	2014E
TOTAL CURRENT ASSETS	402	489	903	1 197	1 913	2 696
PP&E, net	1 410	1 563	1 750	1 739	1 729	1 720
Other non-current assets	38	38	38	38	38	38
Total NON-CURRENT ASSETS	1 448	1 601	1 788	1 777	1 767	1 758
TOTAL ASSETS	1 850	2 090	2 691	2 974	3 680	4 454
Short-term borrowings	28	2	302	2	2	2
Other short-term liabilities	82	72	80	101	104	108
Total CURRENT LIABILITIES	110	75	382	103	106	110
Long-term borrowings	303	313	313	263	263	263
Other non-current liabilities	162	162	162	162	162	162
Total LONG-TERM LIABILITIES	465	474	474	424	424	424
Minority interest	6	6	6	6	6	6
Share and additional capital	784	784	784	784	784	784
Retained earnings	663	929	1 223	1 835	2 537	3 307
Total EQUITY	1 275	1 541	1 835	2 447	3 149	3 919
TOTAL EQUITY & LIABILITIES	1 850	2 090	2 691	2 974	3 680	4 454

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Revenue	497	748	900	1 534	1 699	1 837
Cost of production	(238)	(295)	(377)	(619)	(673)	(726)
EBITDA	259	453	524	915	1 027	1 111
Depreciation	(79)	(97)	(112)	(131)	(130)	(129)
EBIT	180	355	411	784	897	981
Net interest income/(expenses)	(25)	(22)	(44)	(19)	(19)	(19)
EBT	150	333	368	765	878	963
Income tax	(12)	(37)	(47)	(56)	(77)	(193)
Net income	117	266	294	612	702	770

CASH FLOW STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Net CF from operating activities	212	420	439	718	840	909
Net CF from/(used in) investment activities	(152)	(250)	(300)	(120)	(120)	(120)
Net CF from/(used in) financing activities	(45)	(39)	256	(369)	(19)	(19)
Net Debt	303	156	61	(518)	(1 220)	(1 989)

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	-59%	50%	20%	70%	11%	8%
EBITDA margin	52%	61%	58%	60%	60%	60%
Net margin	24%	36%	33%	40%	41%	42%
Net Debt/EBITDA	1.2	0.3	0.1	(0.6)	(1.2)	(1.8)

Source: company data, TKB Capital estimates

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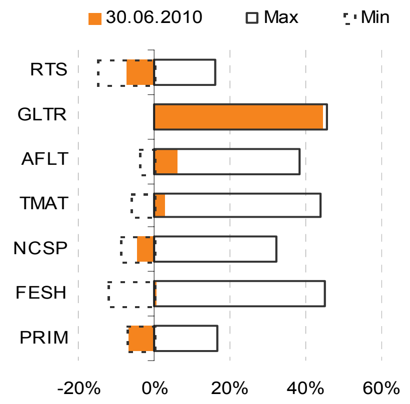
Transport

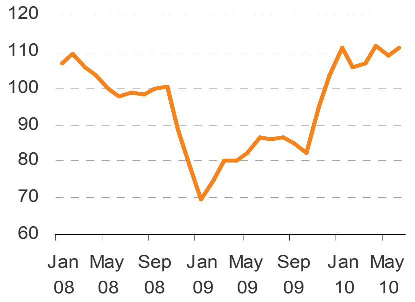
Mirroring economic recovery

YTD sector dynamic vs. RTS



Source: Bloomberg, MICEX, RTS

CargoIndex (represents the Russian railway cargo load performance on basic goods y-o-y)



Source: IA "Gudok"

Transportation was one of the Russian sectors most severely affected by the economic downturn in 1H09. Starting from 2H09 economic recovery determined improvement of operating results in transportation segment. This trend continued in 1H10 and turnover volume of freight transportation increased by 12.7% y-o-y. In spite of expected slower recovery of transportation sector in 2H10 due high basis effect, the cargo transportation would outperform the economy as a whole. Growth in turnover volume of freight transportation is estimated at 6% y-o-y in 2010 (vs. GDP growth of 3.1%). Already in 2010 Russian Railways plans to start selling its assets that coupled with the market recovery will boost investment interest to the segment. We have positive view on transportation segment in Russia as a part of infrastructure and choose Globaltrans as our top pick and the most attractive opportunity to benefit from transportation sector growth.

In 1H10 the turnover volume of freight transportation was gradually increasing… For 5M10 the total turnover volume increased by 12.7% y-o-y to 1958.5 bn t-km. All sectors staged growth, while rail and air freight transportation outperformed the market (up by 14.1% and 38.5%, respectively).

…but in 2H10 we expect slower growth rate with positive y-o-y trend. The high growth rate of freight turnover in 1H10 was mainly attributed to the low base in 2009 and we expect to see slower traffic growth in 2H10. According to Russian Railways (RZhD) forecast, freight rail transportation would grow by 5%, while we estimate total freight turnover to surge by 6% outperforming recovery of the Russian economy.

Slower growth of tariffs for rail transportation in 2011 will increase the influence of market factors. Tariffs for rail transportation will go up by 8% in 2011 (vs. earlier set at 9.2%). Lower tariff growth will help curb inflation and make pricing in the segment stronger dependent on the market conditions.

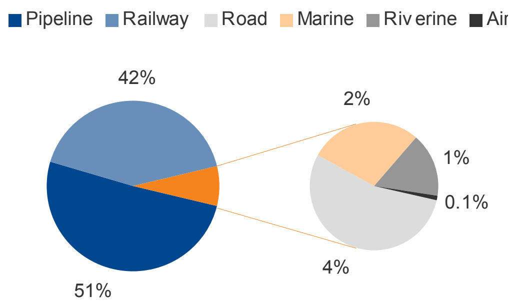
Russian Railway Reform and RZhD to create new investment opportunities. According to the Russian Railway Reform, the company will help finance its investment program through sales of its non-core assets and stakes in railway subsidiaries in 2010-2012. That together with recovery of transportation segment will provide great opportunities for investors.

Long-term targets – competitive carriage segment with efficient monopoly on infrastructure. In a long-term RZhD will keep monopoly on infrastructure and traffic control as well as locomotive component, while 100% of carriages will be operated by private companies (now 45%). Possible liberalization of locomotive segment will create new opportunities for private companies.

Globaltrans is the perfect play to invest into transportation segment. It is the largest privately held rail freight operator in Russia by a number of rolling stock in operation, moreover only this company has liquid stocks on international exchange. In 2009 the Group's total freight rail turnover over the year amounted to 80.9 bn t-km with 3% y-o-y outperforming RZhD results. In 2010 we expect further growth due to economic recovery as well as expansion of the fleet. Globaltrans looks attractive on fundamentals and multiples, so its GDRs trade with 29% and 8% discounts to its EM and DM peers, respectively. We have positive view on Globaltrans and plan to initiate the coverage of this stock shortly.

The turnover volume of freight transportation is gradually increasing, but recovery to pre-crisis levels is delayed. For 5M10 the total turnover volume of freight transportation rose 12.7% y-o-y to 1958.5 bn t-km (vs. 1737.5 bn t-km in 5M09). Air and rail transport demonstrated the most robust growth (38.5% and 14.1%, respectively). Motor cargo transportation, which increased by 8% y-o-y, also showed good performance. Based on the growth rate forecasts for different sectors of Russian freight transportation (road, rail, pipeline, etc.), we expect an increase in turnover volume of freight transportation at 6% in 2010. Taking into account the slow recovery in total freight turnover, we do not expect to see the full market recovery until 2012.

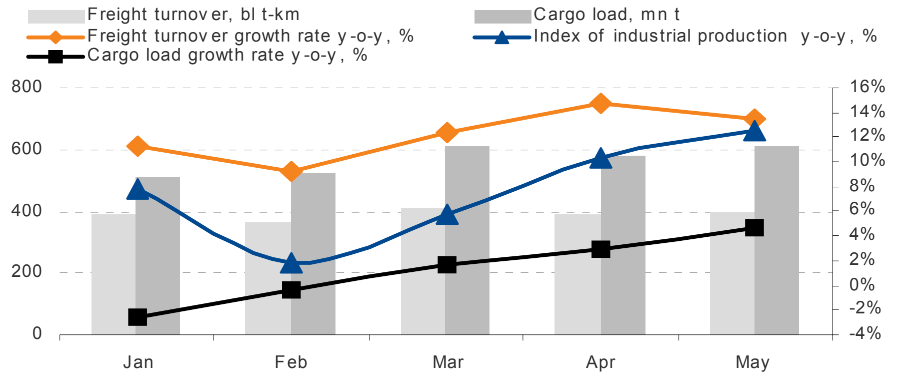
Russian freight turnover structure by type of transport in 2009,%



Source: Federal State Statistical Service

The growth rate of rail freight transportation outperforms the market in 1H10. Russian railway transportation volumes continue recovering in 1H10, so the rail freight turnover increased by 12.9% y-o-y to 977 bn t-km, meanwhile cargo load rose 12.2%. But the main contributors to this growth were increasing volumes in the metals and mining segment and stable numbers in oil sector, and this means that the recovery is still export-led. Activity remains subdued in the construction materials segment, where volumes were almost flat and still roughly a half of pre-crisis levels. We expect to see positive dynamics of freight rail transportation in 2H10 as a result of further economic recovery. This is confirmed by the expectations of RZhD, which in May, 2010 revised its growth forecast from 3.7% to 5% in 2010.

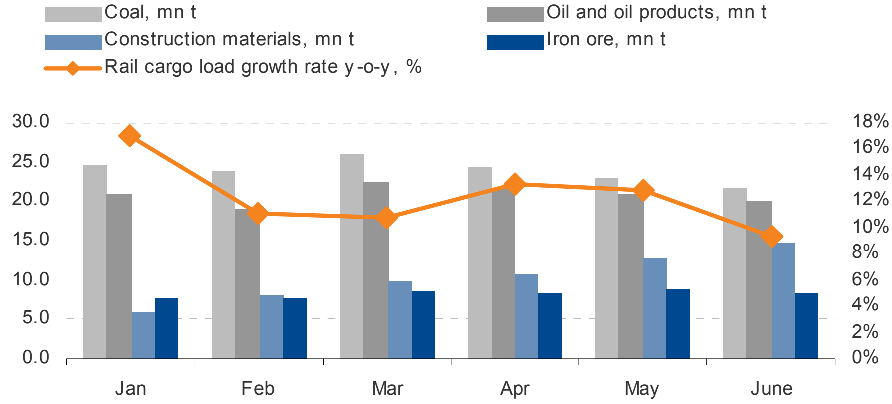
The main characteristics of freight transportation in Russia in 2010



Source:Federal State Statistical Service, TKB Capital

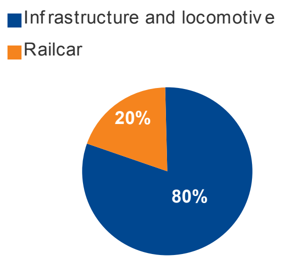
In 2H10 we expect positive y-o-y trend with slower growth rate. We believe the high rate of freight turnover growth in 1H10 was mainly due to the low base over the last year and we expect to see slower traffic growth in 2H10. Though we do not have official data on the turnover volume of total freight transportation in June 2010, data provided by Railways on the volume of cargo and loading over 6M2010 indirectly confirm this (growth at 12.9% and 12.2%, respectively vs. 14.1% and 12.9% over 5M2010). Though, in spite of the slowdown of growth rate, freight transportation will recover faster than other segments of the transport industry and the economy as a whole, we anticipate an increase in turnover volume of freight transportation of 6% y-o-y in 2010, so Russia's GDP growth is expected to reach 3.1%.

Volume and growrh rate of cargo load on the Russian railway in 2010



Source: RZhD, TKB Capital

Railway tariff structure, %



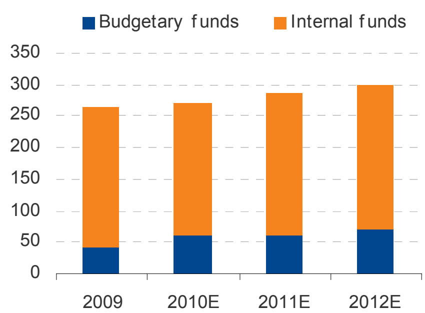
Source: RZhD

Tariff regulation in Russia. Railway transportation is a regulated industry in Russia with tariffs set every year that determines prices for Russian Railways' services and payment from private operators to RZhD. The main component of the overall price (around 80%) of freight rail services for end users – infrastructure and locomotive tariff for loaded trips – is established by the Federal Tariff Service (FTS) for all market participants. This charge applies to the services provided by Russian Railways and has a price-setting impact for the local market. The RZhD tariff depends on a number of factors, such as cargo weight, distance traveled, destination and cargo class. The second important part of rail transportation service tariff is the carriage component (around 20%), which is also regulated by FTS for Russian Railways, although private operators may independently set it with a premium or discount to RZhD's price. Private operators also have to pay an empty-run tariff for unloaded railcars. Although this charge is lower than the rail tariff for loaded trips, the share of empty-run trips is one of the key metrics which influences an operator's EBITDA margin.

Slower growth of tariffs for rail transportation in 2011 will increase the influence of market factors. As a result of policy aimed at reducing inflation to maintain economic growth, the government decided to decrease the growth rate of tariffs for rail transportation from 9.2% to 8% in 2011. Now owners of 65% of the railcar park compete for a carriage component in the tariff (private operators and Russian Railway subsidiaries). With lower tariffs this part of transportation price will be determined by the market conditions together with companies' ability to compete and to optimize their transportation routs. If the Russian economy shows faster recovery, prices on railway transportation will grow stronger on the back of increasing demand for freight operations.

State subsidies and asset sale will help finance investment program. Bearing in mind inflation targets and lower tariff growth, Prime Minister of Russia Vladimir Putin approved that the state will continue providing Russian Railways with subsidies to finance the company's investment program. Russian Railways was suffering from the underinvestment and now needs additional funds to finance its capex program. According to the Russian Railways Structural Reform Program, the company will start selling stakes in its core assets as well as non-core subsidiaries already this year that will provide additional financing.

RZhD's investment program in 2009-2012, bn rub



Source: RZhD

Russian Railways Reform to create new investment opportunities. Russian Railways investment program amounts to RUR270.5 bn in 2010 and will slightly grow in the following years. Capex will be financed by own company's funds and money assigned from the federal budget (approximately 20-25% of the total investments). Within the reformation process of Russian Railways, the company is planning to sell stakes in its railway subsidiaries and its non-core assets. RZhD expects to receive up to RUR150-200 bn during 2010-2012 from these sales through public and private offerings and auctions that will create more investment opportunities in the segment and attract new players. Further recovery and development of the Russian economy will boost development of transportation segment, which looks attractive for investors and paves the way for great investment opportunities.

Long-term targets – competitive carriage segment with efficient monopoly on infrastructure. According to the reform, the target model of the rail freight segment implies 100% of carriages will be operated by private companies (now 45%). That will create market model of pricing and equal conditions for all participants. Russian Railways will keep monopoly on infrastructure and traffic control as well as locomotive component. Later liberalization of locomotive segment will create additional opportunities for operators and increase competition, but at this stage RZhD is not planning to undertake any further step increasing share of private companies in locomotive business. Currently private operators own approximately 200 locomotives, which are able to operate at short distances and development of this segment will depend on the Russian Railways initiatives (RZhD owns 7,000 locomotives). Liberalization of locomotive segment will create new opportunities for the companies and investors.

Globaltrans		
	GDR	Preferred
Ticker	**GLTR**	-
Recommendation	**UR**	-
Price, $	**13.50**	-
Target price, $	-	-
Upside/downside, %	-	-

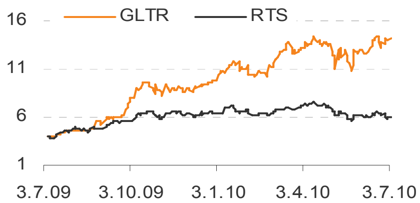
SHARE DATA		
Bloomberg	GLTR LI	
Reuters	GLTRq.L	
	GDR	Preferred
# of shares outstanding, mn	158	-
EV, $ mn	2 463	
MC, $ mn	2 135	
MIN 12 mnth., $	4.00	
MAX 12 mnth., $	14.40	
	Common	Preferred
Shares per GDR	1	-

SUMMARY FINANCIALS, $ mn			
IFRS	**2009**	**2010E**	**2011E**
Revenue	1 163	1 084	1 305
EBITDA	284	362	450
Net income	88	168	223
EPS, $	0.56	1.06	1.41
Rev. growth, %	-19.5	-6.8	20.3
EPS growth, %	-23.9	90.4	33.2
EBITDA margin, %	24.4	33.4	34.5
Net margin, %	7.6	15.5	17.1

SUMMARY VALUATIONS			
	2009	**2010E**	**2011E**
P/E	24.24	12.73	9.56
EV/EBITDA	8.67	6.81	5.48

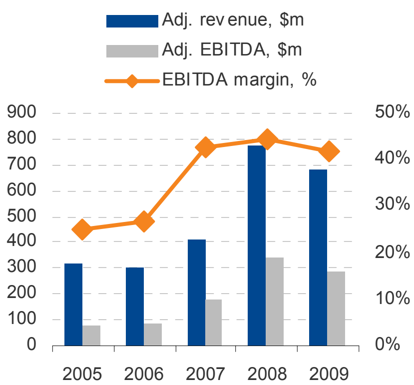
SHAREHOLDER STRUCTURE	
TIHL	50%
EIL	15%
Free-float	35%

PRICE DYNAMICS



Source: LSE, TKB Capital estimates

Key financials and EBITDA margin in 2005-2009



Source: company data

Globaltrans

Appealing infrastructure play

Globaltrans is a perfect theme to invest into transportation segment and for now the only opportunity to buy liquid stocks of a public rail company. Fast recovery of transportation segment together with strong operating and financial performance of the company determine our positive view on Globaltrans. Relatively new balanced rolling stock, advanced destination management and strong development with the key customers provide competitive advantages of the company. Globaltrans targets to increase its market share through M&A activity and optimization of its routs that makes the stock attractive for investors. We have a positive view on Globaltrans and plan to initiate the coverage in the offing.

Globaltrans is the largest privately owned railway operator by the number of owned fleet. The primary business of the Group is freight rail transportation or operation of rolling stock. The company's business is well balanced and diversified. Traditionally the main share of the company's freight rail turnover was in metallurgical segment. With acquisition of BaltTransService in 2009 Globaltrans gained foothold in oil and oil products transportation. According to the company's 2009 consolidated financials, metallurgical segment amounted to 48% of the freight rail turnover, oil and oil products to 38%, while the rest was in coal and construction segment.

Balanced rolling stock and optimal routing increase return. Exposure to the transportation of oil and oil products, as well as to freight of cyclical goods (metals) make Globaltrans less vulnerable to the economic downturn and enable to gain on the back of economic recovery. In 2009 Globaltrans increased its share of the total freight rail turnover in Russia from 3.9% to 4.8%. The Group's total freight rail turnover over the year amounted to 80.9 bn t-km with 3% y-o-y growth outperforming RZhD results. In 2010 we expect further growth due to economic recovery as well as expansion of the fleet.

Revenue to grow at CAGR of 14% in 2010-2014. We expect net adjusted revenue to grow at CAGR of 14% thanks to transportation price hike, optimization of the cargo mix and routing. Average price per trip will increase by 18% during the period, while average number of trips per year will go up by 40%. Empty run costs will decline comparing to 2009 driven by dispatch optimization and economic recovery.

Globaltrans shareholder structure. The core shareholder (50%) of the Group is Transportation Investment Holding Limited (TIHL), which is one of the largest privately-owned transportation groups in Russia. The holding is owned by Nikita Mishin, Konstantin Nikolaev and Andrey Filatov. Another core shareholder is Envesta Investment Limited (15%), which is beneficially owned by the management of Globaltrans – Sergey Maltsev (51%) and Alexander Eliseev, (49%).

M&A deals to be a strong driver. Globaltrans is active in M&A deals aiming at expansion of its fleet and transportation routs. The company is constantly watching market and we expect to see more deals in the coming future. Acquisition of BTS helped Globaltrans to diversify its business structure and expand presence in attractive oil transportation segment. Liberalization of locomotive segment will add value to the company's business.

Attractive on fundamentals and multiples. Globaltrans GDRs are traded at a 29% discount to its EM peers and at a 8% discount to its DM peers. In 2009 EBITDA margin amounted to 41.2% and we expect it at healthy 42-44% in 2010-2014 that together with strong prospects of business development make the stock attractive as a mid and long-term investment. M&A deals may become a driver in a close future.

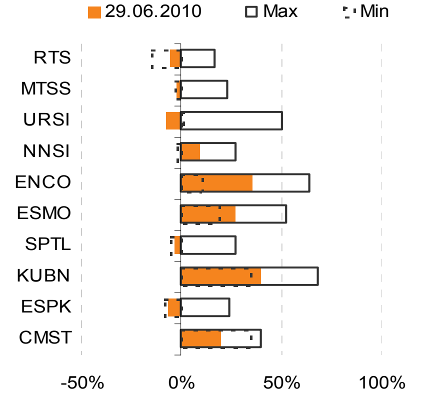
TKB Capital

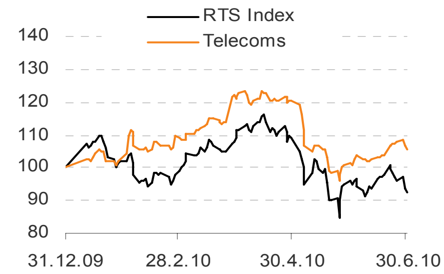
Telecoms
Safe Haven

Daniel Zatologin

For the Russian telecom segment efficiency and reorganization become increasingly important. Operating and investment efficiency is crucial for wireless operators given the global trend in strategic development. Svyazinvest reorganization is at the finish line, and already in early 2011 on the Russian stock market we will see another blue chip – consolidated Rostelecom. In the medium term investors should focus on companies with the best profitability and return on invested capital among mobile operators. Shares of consolidated Rostelecom will be in demand on the Russian stock market because of their liquidity.

YTD sector dynamic vs. RTS





Source: RTS, TKB Capital estimates

Wireless segment – in search of ideas

Operating and investment efficiency is the key priority for wireless operators. Today, the global paradigm of strategy of telecom companies is undergoing qualitative transformation. Thus, in the medium term the focus will be performance-oriented on business and investments.

Local trend: broadband and VAS development. The penetration rate of broadband in Russia for the households is 20%, which implies a two-fold upside potential for the next 2-5 years. The development of additional services, including mobile data, SMS/MMS and different content, will continue.

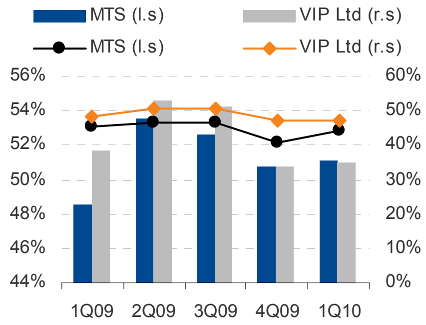
Fixed-line segment – in expectation of consolidated Rostelecom

Emerging of a new blue chip. Early in 2011 the procedure of a transfer to a single share will be completed. The shares of the company will become the most liquid stock in local telecom segment

In broadband pressure is growing from other players. Consolidated Rostelecom retains a significant share of the Russian broadband market. But pressure from competitors increases and this trend will only be gaining speed. In the wireless segment the company shifts its development strategy to universal data operator.

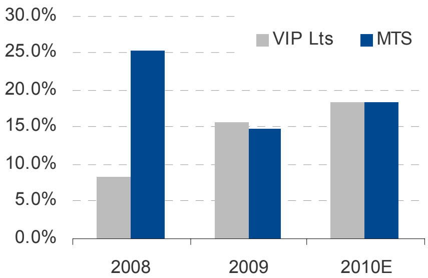
We recommend a BUY for the Russian telecom companies. Given the trend towards efficiency, we recommend a BUY for wireless operators – VimpelCom Ltd (VIP) and MTS (MBT). They look attractive in comparison with their peers both from developed and emerging markets. Also we bring investors' attention to consolidated Rostelecom, which definitely will be in demand.

OIBDA margin
(cons& Rus mob)



Source: company data

ROIC

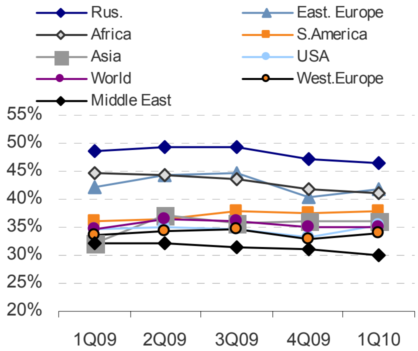


Source: company data

Wireless segment – in search of ideas

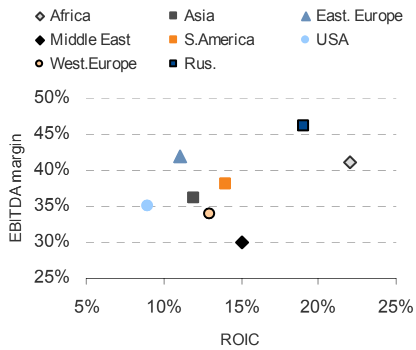
Operational and investment efficiency as the key priority for cellular operators. Growth of mobile broadband in recent years forced the mobile operators think about changing the strategy of further development. As a result, in the medium term investor focus will shift towards more effective wireless operators. The upcoming changes of the telecom market would radically change the composition of the participants of global wireless segment and their business models. And in the end only the most efficient companies will survive. MTS and Vimpelcom Ltd retain a comparable level of return on invested capital (ROIC, estimated at 18.4% in 2011). EBITDA margin of both companies over the last two quarters has surpassed 50%. EBITDA margin of the Russian operators look significantly better than that of cellular companies from developed and emerging markets. Based on 2010E EV/EBITDA, VimpelCom ADRs are traded at a discount of 15% to its peers of emerging markets and of 20% to its peers of developed markets, and while MTS ADRs are traded at a discount of 8% and 12%, respectively.

EBITDA margin region
performance



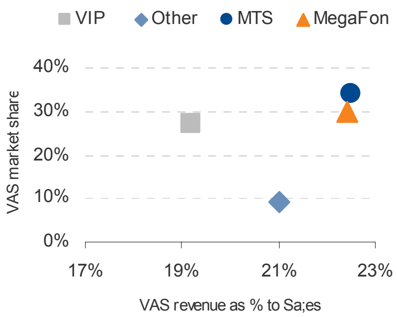
Source: Ovum, Wireless Intelligence, TKB Capital estimates

EBITDA margin vs ROIC
(1H'10)



Source: Bloomberg, Wireless Intelligence, TKB Capital estimates

VAS, 4Q09 Russia



Источник: AC&M Consulting, TKB Capital estimates

Broadband segment: local story number one. Among local themes perhaps broadband will be the most relevant for the next two-four years. The broadband penetration in Russia is around 20%, while global penetration of 45% is the limit for the rapid organic growth. VimpelCom Ltd intends to continue its active expansion in the regions, because that is where the most intense struggle will unfold in the near future. MTS is also considering this segment as one of the highest priority for the further development.

VAS continues to gain speed. According to AC&M Consulting, in 2009 this segment (including SMS/MMS, content, mobile data) in Russia reached $3.9 bn, an increase of 27% y-o-y. The portion of VAS revenue in total incomes of "Big Three" added 3.9 ppt and amounted to 18.8%. It should be noted that the most impressive dynamics in the VAS income mix showed the segment of mobile data. Total revenues from this segment for the "Big Three" increased by 58%, while the market reached RUR36.4 bn.

We recommend a BUY for Vimpelcom Ltd and MTS. We recommend investors to buy ADRs of the Russian wireless operators. These companies are among the most effective. Based on 2010E EV/EBITDA, VimpelCom ADRs are traded at a discount of 15% to emerging markets and of 20% to the developed ones, and MTS ADRs are traded at a discount of 8% and 12%, respectively.

Fixed-line segment – in expectation of consolidated Rostelecom

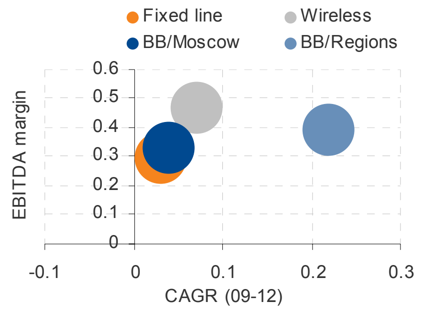
Consolidated Rostelecom is an emerging blue chip. Consolidated Rostelecom will become another blue chip of the Russian stock market. We suppose that the demand for its shares from investors will be supported by the fact that actually it will be the most liquid chip among Russian traded telecom companies. The business model of consolidated Rostelecom will incorporate fixed and mobile segments, as well as broadband.

In broadband the pressure from other players is growing. The market share of consolidated Rostelecom in broadband segment remains significant and amounts to 44.7% in Russia. In future, the main growth driver for the broadband segment in Russia will be regional markets. At the same time, taking into account the plans for the development of alternative operators and of the "Big Three", in the medium term we expect increasing competition especially in the Volga and the Ural regions. In addition, M&A activity on the part of consolidated Rostelecom is likely in Moscow and St. Petersburg.

Wireless segment: focus shifts to the data transfer. According to AC&M Consulting, as of May, 2010, the market share of consolidated Rostelecom in the wireless segment was 6.8% (14.5 mn SIM-cards). More than 70% of cellular subscriber base accounts for Ural region and Siberia, and about 25% of it – for the Volga region. The market position of consolidated Rostelecom seems to us weak in the mobile sector of Russia. Along with market forces the company's position is undermined by the fragmentation of companies (18 operators), the lack of a unified brand and unified billing and ERP-systems. Currently, the company intends to adjust the strategy of mobile business development and shift the focus from the creation of a fourth GSM-operator to the creation of a universal data operator (based on Sky Link). At the same time, the segment of mobile data is already under scrutiny of "Big Three" operators, which since 2008 have carried out an expansion of 3G networks in the regions.

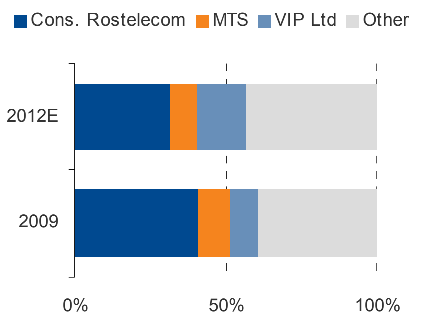
The shares of consolidated Rostelecom will be in demand. We believe that the shares of the consolidated operator will have be in the scope of investors' interest taking into consideration their liquidity. In the current conjuncture the stock would trade at a premium of 3% to the local shares of MTS (MTSS) and at a discount of 15% to MTS and Vimpelcom Ltd ADRs.

Growth opportunities of different TMT segments in Russia (09-12)



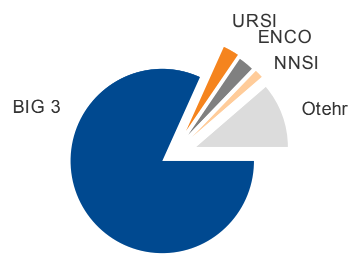
Source: Constanta Advisory

BB market forecast in Russia (until 2012E)



Source: company data, TKB Capital estimates

Mobile market share in Russia SIM cards (Dec'09)



Source: AC&M Consulting

Vimpelcom Ltd (VIP) and MTS (MBT)

Efficiency is paramount, local history in mind

Vimpelcom			
	ADR		
Ticker	**VIP**		
Recommendation	**BUY**		
Price, $	**15.41**		
Target price, $	**40.87**		
Upside/downside, %	**165%**		

SHARE DATA			
Bloomberg	VIP US		
Reuters	VIP.N		
	ADR		
# of ADR outstanding, mn	1 302		
EV, $ mn	25 182		
MC, $ mn	20 064		
	Common		
Shares per ADR	0.05		

SUMMARY FINANCIALS, $ mn			
GAAP	2009	2010E	2011E
Revenue	8 703	12 917	14 111
EBITDA	4 273	6 518	6 905
Net income	1 117	2 779	2 540
EPS, $	0.86	2.13	1.95
Rev. growth, %	-14.0	48.4	9.2
EPS growth, %	113.1	148.7	-8.6
EBITDA margin,%	49.1	50.5	48.9
Net margin, %	12.8	21.5	18.0

SUMMARY VALUATIONS			
	2009	2010E	2011E
P/E	18.0	7.2	7.9
EV/EBITDA	5.9	3.9	3.6

MTS			
	ADR	OS	
Ticker	**MBT**	**MTSS**	
Recommendation	**BUY**	**BUY**	
Price, $	**19.25**	**7.59**	
Target price, $	**28.00**	**14.00**	
Upside/downside, %	**45%**	**84%**	

SHARE DATA			
Bloomberg	MBT US		
Reuters	MBT.N		
	ADR	OS	
# of ADR outstanding, mn	997		
EV, $ mn	24 137		
MC, $ mn	19 186		
MIN 12 mnth., $	13.35	4.49	
MAX 12 mnth., $	23.55	9.54	
	Common		
Shares per ADR	2		

SUMMARY FINANCIALS, $ mn			
GAAP	2009	2010E	2011E
Revenue	8 584	9 780	11 413
EBITDA	4 036	4 931	5 674
Net income	1 150	2 068	2 511
EPS, $	1.15	2.07	2.52
Rev. growth, %	-16.2	13.9	16.7
EPS growth, %	-40.4	79.8	21.5
EBITDA margin,%	47.0	50.4	49.7
Net margin, %	13.4	21.1	22.0

SUMMARY VALUATIONS			
	2009	2010E	2011E
P/E	16.7	9.3	7.6
EV/EBITDA	6.0	4.9	4.3

We regard MTS (MBT) as well as Vimpelcom Ltd (VIP) as excellent investment plays. The russian operators in comparison with their peers from developed and emerging markets are attractive given the efficiency and market multiples. In addition, local history may also help increase the value of Vimpelcom Ltd and MTS.

The efficiency is the major trend for mobile operators in the long term. Tremendous growth of mobile traffic over the past years on the one hand and the inability of cellular operators to fully capitalize it on the other hand gave impetus for rethinking the development strategy. It is obviously that this may dramatically change the composition of the participants in the global wireless segment, and their business models. In this regard, the most successful companies should be more effective, and the other is ready for the development of strategic alliances. From the perspective of both ROIC and EBITDA margin, both operators seem comparable and, moreover, appear more attractive by multiples than their peers from developed and emerging markets.

Local history number one – broadband. The local broadband market remains attractive. Given the penetration in Moscow and St. Petersburg at 60%, the key battle for subscribers will unfold in the regions, mainly in the European part of Russia. We remind that since 2010 Vimpelcom Ltd has resumed investments into the deployment of regional fiber optic channels and expects to increase revenues from fixed broadband to 50-60% in 2010 (which may surpass $ 200 mn, about 2% of consolidated sales). MTS due to the merger with Comstar-UTS also plans to participate in the struggle for regional broadband market. By the end of 2009, the regional base of broadband subscribers of VimpelCom Ltd according to AC&M Consulting grew by 88.5% (526,000 households) in Russia, as a consequence, the company's share amounted to 4.5%. MTS subscribers base increased by 41% (the market increased by 43%), and amounted to 403,000 households, and the share of the company at region market reached 3.4%.

Additional services –moderate growth. The traditional part of a business model of wireless operators is VAS, which in 2009 grew by 27%, while market capacity increased to $3.9 bn. VAS share increased to 18.8% of total revenues of mobile operators. In 2009, operators' stakes mix remained almost unchanged y-o-y: MTS accounted for 34%, MegaFon –30%, while VimpelCom – for 27%. In addition, according to AC&M, in the medium term VAS segment will keep moderate growth rate and by 2012 may advance to 30% of the total cellular companies'.

We recommend a BUY for ADR of Vimpelcom Ltd (VIP) and MTS (MBT). We rate Vimpelcom Ltd as well as MTS ADRs as BUY. In the short run, traditionally strong financials for the second and third quarters may contribute to an increase in demand for shares. In the longer term, we believe that the shares of both companies are great investment bets because of their performance indicators and cheap valuation in comparison with peers. Our end-2010 target price for Vimpelcom is $29.1 per ADR and implies a 89% upside, while our end-2010 price for MTS is $28 per ADR with upside potential of 45% (RUR378.4 per a local share, upside potential of 61%).

Vimpelcom Ltd

BALANCE SHEET

$ mn	2009	2010E	2011E	2012E	2013E	2014E
TOTAL CURRENT ASSETS	2 967	3 700	3 108	4 274	3 655	4 090
PP&E, net	5 562	11 913	13 078	14 617	15 890	16 491
Other non-current assets	6 204	-	-	-	-	-
Total NON-CURRENT ASSETS	11 766	11 913	13 078	14 617	15 890	16 491
TOTAL ASSETS	14 733	15 613	16 186	18 891	19 545	20 581
Short-term borrow ings	1 813	1 745	1 045	2 003	1 617	859
Other short-term liabilities	1 601	2 427	2 248	3 070	2 792	3 392
Total CURRENT LIABILITIES	3 414	4 172	3 293	5 072	4 409	4 251
Long-term borrow ings	5 540	4 901	5 620	7 096	6 296	6 001
Other non-current liabilities	4 175	5 124	4 601	5 144	6 096	6 096
Total LONG-TERM LIABILITIES	9 715	10 025	10 221	12 240	12 392	12 097
Minority interest	509	541	572	572	572	572
Total EQUITY	4 509	5 047	5 393	6 079	6 581	7 912
TOTAL EQUITY & LIABILITIES	14 733	15 613	16 186	18 891	19 545	20 581

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Revenue	8 703	10 996	12 186	13 779	15 186	16 101
Cost of production	(6 125)	(7 662)	(9 230)	(10 687)	(11 800)	(12 315)
EBITDA	4 272	5 440	5 985	6 606	7 276	7 903
Depreciation	(1 694)	(2 106)	(3 029)	(3 514)	(3 890)	(4 117)
EBIT	2 578	3 334	2 956	3 092	3 386	3 786
Net interest income/(expenses)	(359)	(423)	(227)	(221)	(214)	(202)
EBT	1 552	3 515	2 695	3 243	3 207	3 401
Income tax	(435)	(2 117)	(1 549)	(1 652)	(1 345)	(1 484)
Net income	1 117	1 398	1 146	1 592	1 862	1 917

CASH FLOW STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Net CF from operating activities	3 513	4 199	4 209	5 211	6 108	7 002
Net CF from/(used in) investment activities	(1 433)	(2 878)	(2 747)	(3 774)	(4 483)	(5 117)
Net CF from/(used in) financing activities	(1 545)	(559)	(951)	1 445	(1 671)	(1 014)
Net Debt	5 906	5 049	4 839	7 253	5 972	4 919

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue grow th	-14%	26%	11%	13%	10%	6%
EBITDA margin	49%	49%	49%	48%	48%	49%
Net margin	13%	13%	9%	12%	12%	12%
Net Debt/EBITDA	1.4	0.9	0.8	1.1	0.8	0.6

Source: Vimpelcom Ltd, TKB Capital estimates

MTS

BALANCE SHEET

$ mn	2009	2010E	2011E	2012E	2013E	2014E
TOTAL CURRENT ASSETS	4 395	3 159	3 011	3 418	3 611	3 900
PP&E, net	7 745	7 816	9 342	10 234	11 590	12 079
Other non-current assets	3 640	3 532	3 746	4 047	4 471	4 843
Total NON-CURRENT ASSETS	11 385	11 348	13 088	14 281	16 061	16 922
TOTAL ASSETS	15 780	14 507	16 099	17 699	19 672	20 822
Short-term borrowings	2 002	1 631	1 949	1 572	1 617	237
Other short-term liabilities	2 256	2 074	1 793	2 318	2 201	2 588
Total CURRENT LIABILITIES	4 258	3 705	3 742	3 890	3 818	2 826
Long-term borrowings	6 327	6 703	5 598	4 628	3 437	4 431
Other non-current liabilities	711	205	148	147	75	-
Total LONG-TERM LIABILITIES	7 038	6 908	5 746	4 775	3 512	4 431
Total EQUITY	4 484	3 894	6 612	9 033	12 342	13 565
TOTAL EQUITY & LIABILITIES	15 780	14 508	16 099	17 698	19 672	20 822

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Revenue	9 824	10 780	11 413	12 305	13 534	14 486
Cost of production	(7 276)	(7 609)	(8 093)	(8 941)	(9 996)	(11 119)
EBITDA	4 388	5 131	5 374	5 759	6 334	6 694
Depreciation	(1 840)	(1 960)	(2 054)	(2 395)	(2 796)	(3 327)
EBIT	2 802	3 171	3 620	4 259	5 088	6 367
Net interest income/(expenses)	(464)	(566)	(407)	(419)	(375)	(304)
EBT	1 495	2 495	3 016	3 723	4 519	5 589
Income tax	(491)	(1 227)	(1 407)	(1 865)	(1 919)	(2 254)
Net income	1 004	1 268	1 609	1 858	2 600	3 335

CASH FLOW STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Net CF from operating activities	3 596	4 677	5 204	6 571	7 382	9 606
Net CF from/(used in) investment activities	(2 385)	(2 834)	(3 331)	(4 033)	(4 713)	(6 097)
Net CF from/(used in) financing activities	148	(1 809)	(2 289)	(2 279)	(2 791)	(4 307)
Net Debt	5 806	6 036	5 890	5 593	4 460	4 734

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	-17%	10%	6%	8%	10%	7%
EBITDA margin	45%	48%	47%	47%	47%	46%
Net margin	10%	12%	14%	15%	19%	23%
Net Debt/EBITDA	1.3	1.2	1.1	1.0	0.7	0.7

Source: MTS, TKB Capital estimates

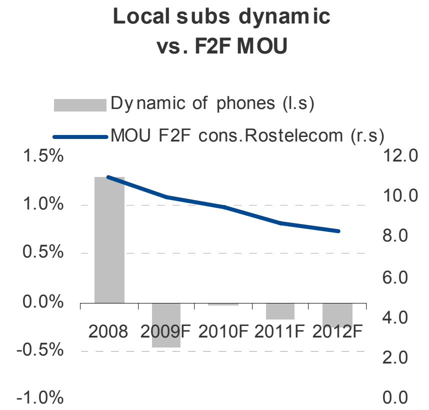
Consolidated Rostelecom
Solid performer

Shares of consolidated Rostelecom will become one of the blue chips of the Russian market. Demand for the shares from investors will be supported by their high liquidity as compared to the rest of the Russian telecom names.

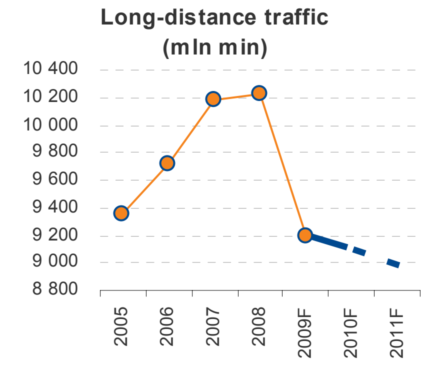
60% of Rostelecom's consolidated revenue comes from traditional segment. The business model of consolidated Rostelecom includes fixed-line and mobile segments, as well as broadband. For 1Q10 more than 60% of income comes from fixed-line segment, only about 15% – from broadband and about 13% – from wireless services. Local calls are supported by tariffs indexation. The total number of subscribers of local calls of consolidated Rostelecom is about 30 mn. At the same time, around 30% of income of fixed lined segment comes from local calls. The dynamics of local calls revenues was supported by indexing of tariffs and in the long run is expected to grow at the inflation rate As a result of falling average price per minute (APPM) from mobile operators and taking into account the dynamics of local tariffs, subscribers shift their preferences towards cellular operators. Taking into consideration 2009 results, the income from DLD and outgoing ILD in the total fixed revenue of consolidated Rostelecom amounted to 15%. At the same time, revenues from DLD and outgoing ILD for the year decreased by 12% and 6%, respectively. In addition, the crisis conjecture, increased competition in this segment, along with the migration of traffic to wireless operators have negatively impact the segment's earnings. We suppose that stagnation of revenue in these segments can be reversed due to the development of services to operators and improvement of market positions in the corporate segment. Strengthening market positions of the operator in the corporate segment may improve due to development of a single brand with the ability to provide services under one-stop solution.

Broadband segment: the pressure from the other players increases. The penetration of the broadband segment in Russia is lower than at developed and some emerging markets (Russia – 26%, the EU – 44%). In the medium term, this segment will demonstrate the highest growth rates. We believe that up to 2012-2013 players will mostly evolve organically by focusing on growth of their subscriber bases in the regions. The regional market in 2009 grew by 43%, while the subscriber base of consolidated Rostelecom as a whole showed a weaker dynamic and added only 41%. Yet, the company still dominates, and according to AC&M Consulting, for February, 2010 its market share was about 42%. At the same time, taking into account the plans for the development of alternative operators, together with the companies of "The Big Three", in the medium term we expect increasing competition especially in the Volga and the Ural regions

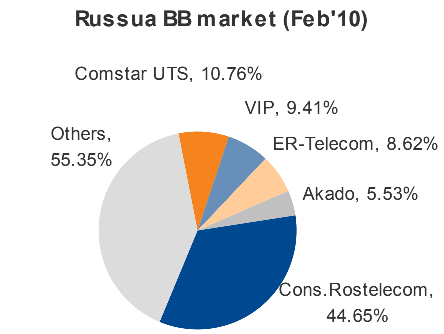
Further development of voice mobile in Russia is limited. According to AC&M Consulting, the density by SIM-cards in May, 2010 in Russia amounted to 146.5% or 212 mn subscribers. For the same period the number of SIM-cards of consolidated Rostelecom reached 14.5 mn (6.8% market share). 36% of it account for the Ural and Siberia, and about 25% – for the Volga region. The market position of consolidated Rostelecom in this segment appears to be weak. Creation of a single GSM-operator on the basis of existing wireless assets (18 separate operators) requires substantial investments into billing, ERP-systems as well as promoting the brand. We believe that all such investments can be viewed as an instrument of protection of voice segment, thus we do not expect substantial growth of income from these services. However, the development of mobile data seems more justified. Sky Link has already experience in this segment, moreover, in future frequencies in addition to existing LTE–frequencies are likely to be allocated. Currently Svyazinvest with consultants finalize the strategy of mobile segment development, which will be announced within the 5-year strategy of consolidated Rostelecom at the end of this year.



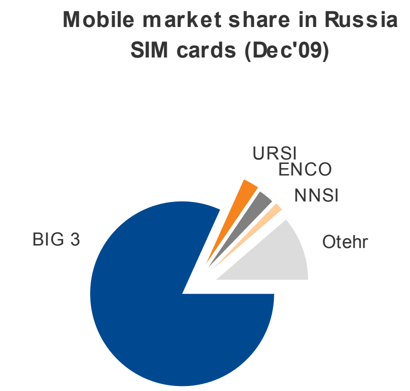
Source: company data, TKB Capital estimates



Source: company data, TKB Capital estimates



Source: AC&M Consulting



Source: AC&M Consulting

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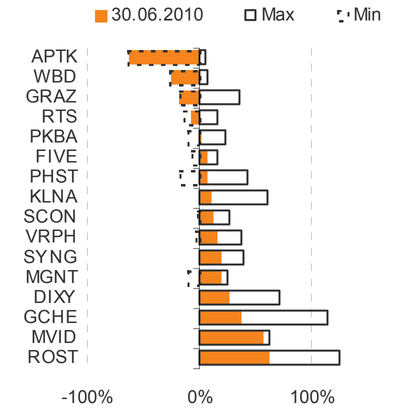
Consumer and retail

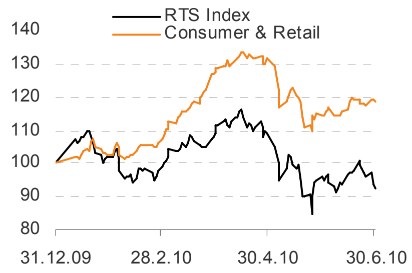
Seasonally stronger quarters are coming!

We maintain our positive view on consumer and retail sector in 2H10, which is now supported by ongoing consumption recovery in both food and non-food segments and remarkable improvement in companies' operating efficiency. In 2H10 we expect the main sector growth driver to be strong financials as seasonally weak 1Q10 has already passed. We also expect M&A activity and new SPOs in 2H10 to fuel investors' interest. At the same time, sector risks remain in force, particularly in relation to the government regulation, which may hurt the companies' gross margins and development plans. However, they appeared to be ready to mitigate detrimental effect from such regulation. Our BUY top picks 2H10 are food retailers – Magnit and X5 Retail Group, pharma producers – Pharmstandard and Veropharm and dairy and beverage producer Wimm-Bill-Dann.

Sector performance in 1H10

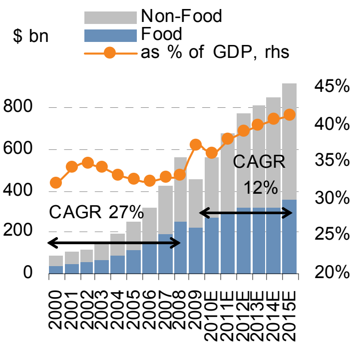


Source: RTS, TKB Capital estimates

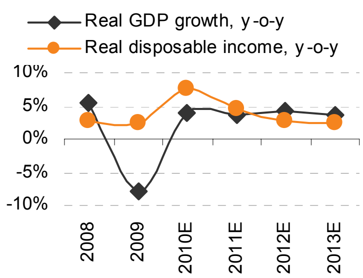


Source: RTS, TKB Capital estimates

Russia's retail sales dynamics



Source: Federal Statistics Service, TKB Capital estimates



Source: MEDT, TKB Capital estimates

Consumer demand is recovering

Consumer demand is on the uptrend. Looking forward in 2H10, we expect consumer demand to continue strengthening on further income growth due to lower unemployment rate along with stable inflation and gradual consumer credit growth.

New macro assumptions imply more optimism. Our updated macro forecasts assume full-year real disposable income growth of 7.5%, supported by 38% y-o-y real growth in pensions, which should improve consumer purchasing power going forward. At the same time, we expect ruble to remain relatively strong at 29.5 and RUR28.2/$ for 2010 and 2011, respectively, which would support companies' US-dollar based top line growth.

In expectation of strong financial performance… Seasonally weak 1Q10 is already behind and it delivered generally positive results to the market. We believe that seasonally stronger 2Q10 and 3Q10 quarters and optimistic management guidance will come and drive the companies' quotes growth.

…and corporate events. In 2H10 the market will keep an eye on M&A deal by Danone and Unimilk. We also expect Wimm-Bill-Dann to announce several deals to guarantee its leading position on the Russian market. In retail segment further speculation on possible M&A targets for Wall-Mart is very likely. A series of new IPOs and SPOs may be launched.

Attractive but risks along for the ride

Comparative valuation. The key investment theme in the sector remains the affluent long-term growth prospects for the Russian companies, which look more attractive than developed market peers and even the majority of emerging market analogues (particularly based on PEG ratio). The comparative valuation of the Russian consumer sector stocks based on 2011E EV/EBITDA show potential upside of 30-50%, on average.

Our top picks for 2H10. We continue to highlight food retailers and pharma producers with PEG ratio at 0.6 on average vs. 1.3 and 1.2 for emerging market peers, respectively. For 2H10 we recommend to BUY Magnit, X5 Retail Group, Pharmstandard, Veropharm and Wimm-Bill-Dann.

Key sector risks are well-known – macro conditions and government regulation. Investors should take into account the risk of weaker than forecasted macroeconomic conditions, which may directly affect the consumer power, and possible negative outcomes of stricter government regulation in the sector.

Consumer demand is recovering

Consumer demand is on the uptrend. As we expected, since the beginning of the year consumer demand has been on the uptrend geared by the real disposable income growth (by 6.2% y-o-y for 5M10) supported by the increased pensions, which account for about 15% of gross personal income and were forecasted to rise by 38% this year (in real terms). At the same time, 5M10 wages growth appeared to be slightly moderate at 4.4% y-o-y, which means that companies are successful in optimizing personnel costs. Looking forward in 2H10, we expect consumer demand to continue strengthening on further income growth due to lower unemployment rate (almost 7% in May vs. more than 9% in January) along with stable inflation and gradual consumer credit growth.

New macro assumptions imply more optimism. Our updated macro forecasts assume full-year real disposable income growth of 7.5% y-o-y on 38% y-o-y real growth in pensions and 4.2% y-o-y recovery in real wages, which should improve consumer purchasing power. However, taking into account an increasing level of savings we have downgraded our full-year retail sales growth forecast to 6.6% y-o-y in 2010 from 7.2%, but increased it in 2011 from 4.9% to 6.4%. At the same time, we expect ruble to remain relatively strong at 29.5 and 28.2 RUR/$ for 2010 and 2011, respectively, which should support companies' dollar-based top line growth. All in all, we now see more evidence for our optimism regarding the sector growth prospects.

Key macro parametrs

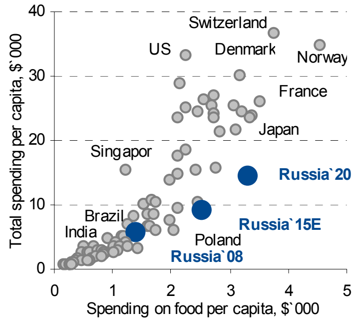
	2000-08	2009	2010E	2011-15E
Real GDP grow th, % CAGR	6.9%	-7.9%	4.1%	3.6%
CPI, % (avg)	13.7%	8.9%	7.0%	5.8%
Real w ages, %	14.7%	-2.8%	4.2%	3.5%
Real disposable income grow th, % CAGR	10.7%	2.3%	7.5%	3.5%
Retail trade, % CAGR	11.9%	-5.5%	6.6%	3.9%
Retail trade as % to GDP (avg)	33.3%	37.2%	36.1%	40.0%
Unemployment rate, % (avg)	7.8%	8.4%	7.0%	7.0%

Source: Federal Statistics Service, TKB Capital estimates

In expectation of strong financial performance… Seasonally weak 1Q10 is already behind and it delivered generally positive results to the market. We believe that seasonally stronger 2Q10 and 3Q10 quarters and optimistic management guidance will come and drive the companies' quotes growth.

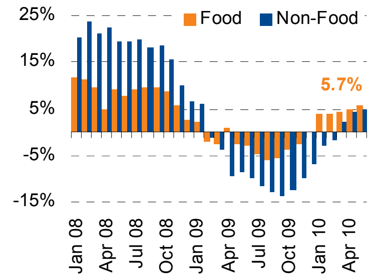
…and corporate events. We also expect 2H10 to be full with corporate news. The market will keep an eye on M&A deal of Danone and Unimilk, which plan to merge their dairy assets in CIS area. We also see Wimm-Bill-Dann (WBD) to announce several deals to guarantee its leading position on the market. In retail segment we are likely to see further speculation on possible M&A targets for Wall-Mart, which is still at the crossroads. And recently adopted the Trade Law is likely to act in favor of domestic players rather than aggressive foreign competitors. Besides, we may see new IPOs (in particularly, O'key announced its plans to go public this autumn), and a series of SPOs.

On the long way to DM…



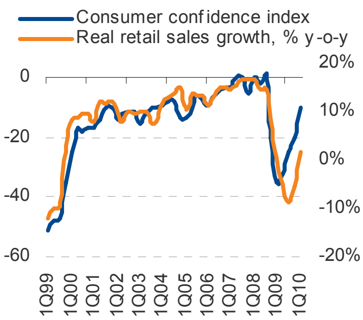
Source: USDA, TKB Capital estimates

Retail sales dynamics, % y-o-y

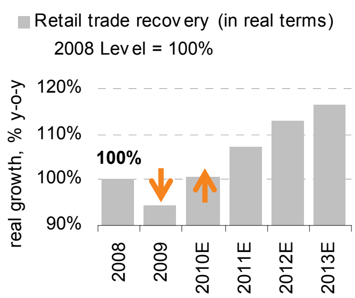


Source: Federal Statistics Service

Consumer confidence index and retail sales dynamics



Source: Federal Statistics Service



Source: TKB Capital estimates

Attractive but risks along for the ride

Comparative valuation. The key investment theme in the sector remains the affluent long-term growth prospects for the Russian companies, which look more attractive than DM and even the majority of EM (particularly based on PEG ratio). The grounds for such growth are still low level of per capita consumption of main goods vs. European levels in line with upbeat expectations of steady growth in disposable income per capita toward European benchmarks in the long run (to above $15,000 by 2020 from $5,300 in 2009). The comparative valuation of the Russian consumer sector stocks vs. EM peers on the basis of 2011E EV/EBITDA shows potential upside of 30-50%. We continue to highlight food retailers and pharma producers with PEG ratio at 0.6 on average vs. 1.3 and 1.2 for EM, respectively. For 2H10 we recommend to BUY Magnit, X5 Retail Group, Pharmstandard, Veropharm and Wimm-Bill-Dann.

Key sector risks are well-known: macro conditions and government regulation. Investors should take into account the risk of weaker than forecasted macro conditions (in particular real wages growth and unemployment), which may directly affect the consumer power, and possible negative outcomes of strengthening government regulation in the sector.

Food retail in 2H10

Growing companies and growing stocks

Recovery in food is apparent; non-food remains a laggard. As we expected, since the beginning of the year, food retail sales have continued demonstrating sizable recovery, while non-food segment remains a laggard. Retail sales statistics for 5M10 showed 2.9% y-o-y growth with 4.6% y-o-y growth in food and 1.3% y-o-y growth in non-food. We attribute it to the fact that real disposable income growth in 1H10 was mainly due to increase in pensions. These have supported food retail companies' sales (discounters and hypermarkets), which remain our favorites for 2H10, as pensioners and other low-budget consumers, who focus on staples goods consumption (in particular, food and drugs), are the target audience of discounters and to some extent of hypermarkets.

Discounters and hypermarkets continue to win traffic. In 1Q10 we saw that food discounters and hypermarkets continued to outperform the market in LFL sales growth and we expect them to remain on the front line through 2010. As earlier, we consider supermarkets and non-food segment to be a longer term bets on consumption recovery. However, we see retailers, even in non-food segment, expressing optimism and ambitious expansion plans (particularly in such segments as apparel, consumer electronics, cosmetics, sporting goods, etc. and even luxury goods).

Store openings and efficiency gains drive value. We expect that in 2H10 retail companies will speed up its store openings to meet their full-year targets and will continue to control costs effectively to compensate for further investments of gross margins into consumer loyalty. In general, we feel comfortable with companies' store openings since the beginning of the year (except of Dixy): Magnit guided to open 450-550 convenience stores and up to 35 hypermarkets, X5 Retail Group planned to add 200-250 stores, while Dixy said it will open up to 100 stores (with only 28 opened in 5M10). Besides, seasonally stronger 2H10 may provide for more positive surprises in company operating margins.

Risks are on the radar screen: the Trade Law implications. Since the beginning of the year, food retailers have been adjusting their operations to comply with the Trade Law, which created new reality for food retailers and suppliers. From 1 August, food retailers should set supplier bonuses (which suppliers pay to retailers) at not more than 10% with no any bonuses allowed for socially important goods (the list of products, which is still not approved, includes chicken, milk, rye bread, wheat bread, wheat rolls and buns) and comply with maximum payment period for food products (10, 45 and 90 days), depending on their shelf life. The government will also have the right to introduce price caps for socially important food for not more than 90 days in the case of more than 30% price increase during one month.

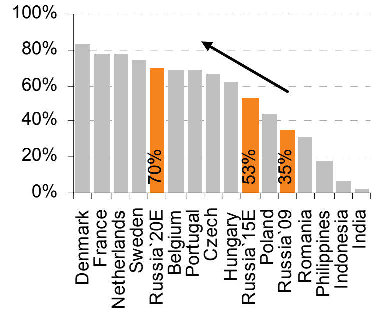
In expectation of market share regulation... At the same time, the most thrilling clause of the law – regarding food retailers' market share regulation has come into effect since 1 July, 2010. Now food retailers are prohibited from new store openings or acquisition of stores if its retail sales exceed 25% of the total retail turnover of a particular urban district (or municipal region, in particular, Moscow and St. Petersburg). At the moment the market exactly knows only about X5 Retail Group's more than 35% market share in St. Petersburg in 2009. Thus, we expect to receive details on companies' market shares in coming months.

Food retail: market shares of key players, %

	2010E	2015E	2020E
X5 Retail Group	5%	8%	12%
Magnit	3%	6%	8%
Auchan	3%	4%	5%
Metro Cash & Carry	2%	2%	2%
Dixy	1%	2%	2%
O`Key	1%	2%	2%
Lenta	1%	2%	2%
Seventh Continent	1%	1%	1%
Share of top 5 players	13%	21%	30%

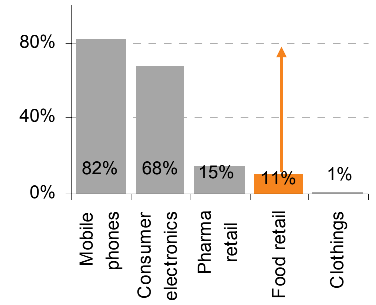
Source: TKB Capital estimates

Modern format penetration in food retail, %



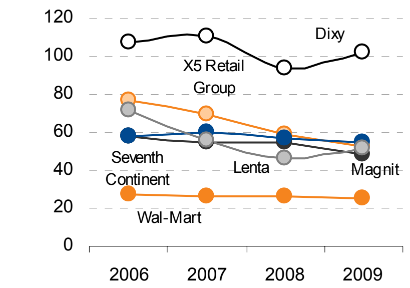
Source: Eurostat, Minpromtorg, TKB Capital estimate

Market share of Top5 players, %



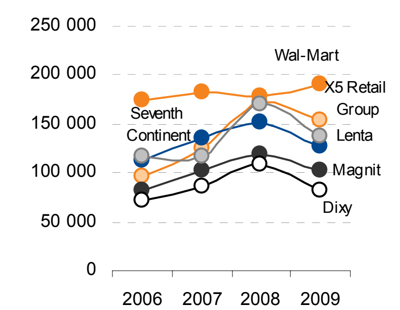
Source: TKB Capital estimates

Employees per `000 sq m of selling space



Source: TKB Capital estimates

Revenue per employee, $

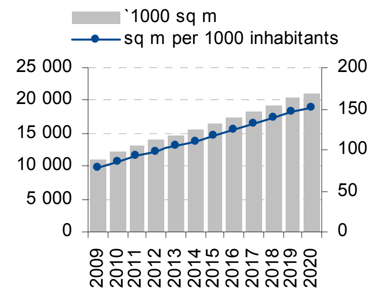


Source: TKB Capital estimates

…with still a lack of clarity. The Trade Law clauses have already been criticized by retailers and even some food producers, which also suffer from increased paperwork and need to control the compliance of contracts with the law. The penalties on the possible violation of the law are not clear at the moment and should be considered by the government only this autumn. Besides, the government authorities propose to expand the incidence of the Trade Law from food retail to non-food segment.

Our top picks are Magnit and X5 Retail Group. Russian food retailers trade with 2010E EV/EBITDA at 8-12 on average vs. EM peers median at 12. However, we believe Russian retailers deserve a premium in its multiples valuation due to the expected rapid growth of consumer spending, which may be translated into companies EPS growth outpacing EM peers. We recommend to BUY both Magnit (end-2010 target price is $122 per share and $24.4 per GDR) and X5 Retail Group (end-2010 target price is $50 per GDR).

Russia food stores roll-out prospects



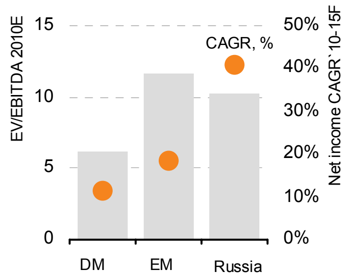
Source: Minpromtorg, TKB Capital estimate

Relative valuation

Company	P/E			EV/EBITDA			EV/S			PEG
	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	
Russian peers										
X 5 Retail Group (GDR)	57.1	28.0	16.5	14.9	11.6	8.3	1.3	0.9	0.7	0.5
Magnit (GDR)	29.9	23.6	16.3	16.2	12.2	8.4	1.5	1.1	0.8	0.8
Magnit	26.9	21.3	14.7	14.6	11.0	7.5	1.4	1.0	0.7	0.5
Seventh Continent	48.9	26.0	14.3	9.4	8.3	6.9	0.8	0.6	0.5	0.5
Dixy Group	neg.	21.6	11.6	11.0	7.9	5.8	0.6	0.4	0.3	0.5
Median	**39.4**	**23.6**	**14.7**	**14.6**	**11.0**	**7.5**	**1.3**	**0.9**	**0.7**	**0.5**
Average	**40.7**	**24.1**	**14.7**	**13.2**	**10.2**	**7.4**	**1.1**	**0.8**	**0.6**	**0.6**
Developed markets peers										
Median	12.9	12.8	11.7	5.9	6.2	5.8	0.4	0.4	0.4	1.2
Average	15.5	13.6	12.1	6.8	6.6	6.1	0.5	0.4	0.4	1.2
Emerging markets peers										
Median	25.9	21.5	18.6	16.1	11.6	10.5	0.8	0.9	0.8	1.2
Average	24.8	20.9	18.1	17.9	12.1	10.5	1.0	0.9	0.8	1.3

Source: Bloomberg, TKB Capital estimate

Relative valuation



Source: Bloomberg, TKB Capital estimate

Pharma producers in 2H10

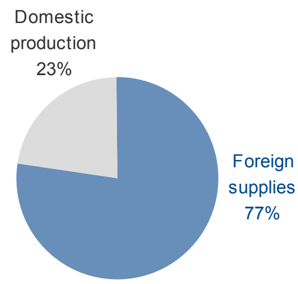
Growth under the government support

Foreign players announced plans to enter Russia. Foreign producers seek opportunities to establish local production in Russia and thus bet on the Russian pharma market growth prospects, which remains second largest in terms of long-term growth rates after China. The matter is the new government strategy for the long-term development of the Russian pharmacy industry targeting a considerable increase in the domestic drugs production, which should reach up to 50% of the market by 2020 (in value terms) vs. current share of less than 25%. Moreover, the government aims to stimulate domestic R&D and production of original drugs and substances in Russia, modernize production capacities to GMP standard, support import substitution in budget tenders and promote export.

Pharmstandard and Veropharm expressed ambitious plans. We maintain our positive view on domestic leaders, such as Pharmstandard and Veropharm, and consider them to be able to benefit from the projected Russian pharma market growth and government call for import substitution due to their high quality production capacities and a successful track record of launching new drugs production. Besides, both companies have expressed their ambitions to continue to strengthen their leading positions via both organic growth and M&As.

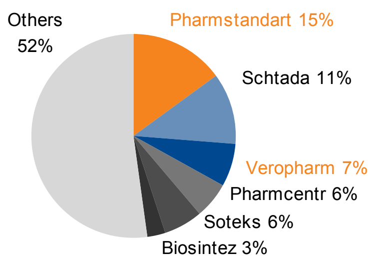
2H10 triggers: strong financials… We expect both companies to demonstrate solid 1H10 financials (expected in late-August – mid-September, 2010) and provide the market with optimistic guidance for 2H10, which should trigger companies' stocks growth. These pharma names still lack of investors' interest. In particular, Pharmstandard shares have not fully recovered from the weakness due to the recent exclusion from the MSCI Russia Index. Both Pharmstandard and Veropharm remain our top picks for 2H10. Our end-2010 target price for Pharmstandard is $33.5 per GDR and $134 per local share. Our end-2010 target price for Veropharm is $47 per share.

Russian pharmacy market



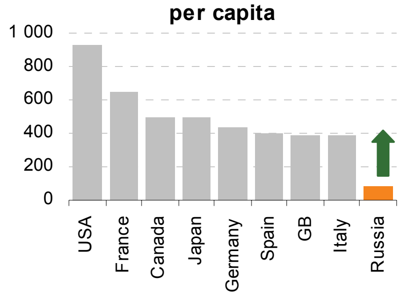
Source: Company data

Russian producers breakdown (23% of the market)



Source: Company data

Pharmacies, consumption, $ per capita



Source: Company data

Relative valuation

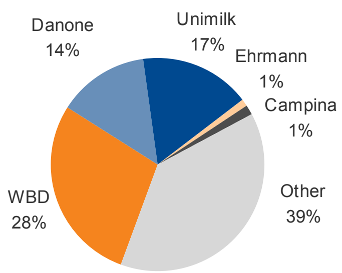
Company	P/E			EV/EBITDA			EV/S			PEG
	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	
Russian peers										
Pharmstandard (GDR)	17.4	13.7	11.0	12.0	10.0	8.2	4.6	4.9	4.0	0.6
Pharmstandard	13.8	10.9	8.7	9.5	7.9	6.5	3.6	3.9	3.2	0.4
Veropharm	9.6	8.5	6.7	8.1	6.2	5.0	2.6	1.9	1.6	0.9
Median	**13.8**	**10.9**	**8.7**	**9.5**	**7.9**	**6.5**	**3.6**	**3.9**	**3.2**	**0.6**
Average	**13.6**	**11.0**	**8.8**	**9.9**	**8.1**	**6.6**	**3.6**	**3.6**	**2.9**	**0.6**
Developed markets peers										
Median	**14.1**	**10.2**	**9.0**	**6.1**	**5.8**	**5.6**	**2.7**	**2.2**	**2.2**	**1.9**
Average	**14.2**	**9.6**	**8.7**	**7.6**	**6.3**	**6.1**	**2.8**	**2.4**	**2.3**	**3.0**
Emerging markets peers										
Median	**14.1**	**15.1**	**17.0**	**13.3**	**11.7**	**10.5**	**2.5**	**2.5**	**2.3**	**1.4**
Average	**25.1**	**18.7**	**17.7**	**16.3**	**14.1**	**12.8**	**4.0**	**3.5**	**3.1**	**1.2**

Source: Bloomberg, TKB Capital estimate

Dairy in 2H10

Catalysts on the part of M&As

Russian dairy market (value)



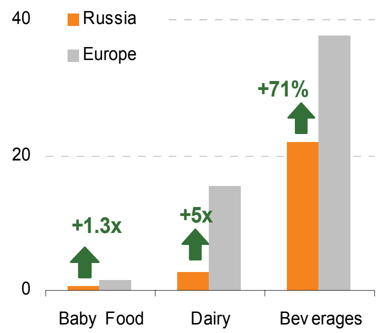
Source: Company data

Focus on Danone-Unimilk CIS assets merger and WBD's response. By the end of the year we would see the successful completion of the deal between Danone and Unimilk, which announced the merger of their diary business in CIS area to approach WBD's leading position (around 30%) on the market. This confirms high attractiveness of the Russian dairy market in terms of both volumes and value growth prospects in the medium term.

Wimm-Bill-Dann is ready to compete. We expect Wimm-Bill-Dann to announce M&A deals in response to this and the company has already confirmed that it is ready to accomplish several acquisitions on the dairy and baby food market before the year-end (in Russia, Ukraine or Belorussia).

2H10 triggers: strong financials… The company is set to disclose 2Q10 financials, which are expected to be solid (in September, 2010), while the following management comments on the market outlook may positively surprise investors and give more clarity regarding the company's valuation as a bet on economic recovery.

Consumption per capita, liters



Source: Company data

WBD may buy Danone's stake. Danone said that it will rethink its investments into a 18.4% stake of WBD. Commenting this, the latter announced it will be ready to buy this stake and will be particularly interested in local shares (about a half of Danone's stake) to improve the liquidity on the local market. We expect this to lead to narrowing spreads between ADR's price and local stock price (the current spread is up to 40%). Hence we believe WBD's local shares are good investment opportunity and maintain our BUY recommendation for the stock with end-2010 target price of $108 per share. We also have a BUY recommendation for the company's ADRs with end-2010 target price of $27 per ADR.

Relative valuation

Company	P/E			EV/EBITDA			EV/S			PEG
	2009	2010E	2011E	2009	2010E	2011E	2009	2010E	2011E	
Russian peers										
Wimm-Bill-Dann (ADR-based)	28.8	20.2	15.2	11.8	9.2	7.5	1.7	1.3	1.1	0.8
Wimm-Bill-Dann	17.2	12.1	9.1	7.4	5.8	4.7	1.0	0.8	0.7	0.5
Developed markets peers										
Median	**18.2**	**11.8**	**12.5**	**7.1**	**5.8**	**5.8**	**0.4**	**0.4**	**0.4**	**1.4**
Average	**18.6**	**15.6**	**14.1**	**7.9**	**7.4**	**6.8**	**0.8**	**0.8**	**0.7**	**1.8**
Emerging markets peers										
Median	**34.1**	**25.5**	**20.7**	**16.8**	**13.0**	**10.8**	**1.2**	**0.8**	**0.7**	**1.1**
Average	**27.1**	**20.6**	**17.0**	**13.3**	**12.0**	**10.0**	**4.3**	**1.0**	**0.9**	**1.0**

Source: Bloomberg, TKB Capital estimate

Magnit

Bet on aggressive growth and focus on efficiency

We believe Magnit remains highly attractive despite the impressive performance in 1H10. The company's value growth drivers in 2H10 will be strong financial numbers from discounters and hypermarkets and continued aggressive store openings. Investors will keep an eye on the state statistics on food retailers' market shares, which we expect to be disclosed in coming months, and whether any limitations under the Trade Law will be imposed. However, Magnit store openings plans look quite safe. The recent inclusion of the company into the MSCI Russia Index will support investors' interest to the stock.

BUY with still attractive upside. Our end-2010 target price for Magnit is $122 per share ($24.4 per GDR) based on DCF-model (WACC of 11.2%, terminal growth of 3%), which justifies our BUY recommendation on the stock. Our company valuation assumes fair 2011E P/E and EV/EBITDA to be at 21 and 11, respectively, which imply about 15% and 4% premiums to its EM peers multiples respectively, but is justified by the expected company's financials growth in the medium term. We also expect that the recent inclusion of Magnit into the MSCI Index should support investors' interest towards the stock.

New stores to fuel growth. We see growth triggers for the company value in 2H10 to be strong 1H10 financial results (expected in late-August) and continued aggressive store openings. This year Magnit targeted to spend a record sum of about $1 bn and open 450-550 convenience stores and up to 30-35 hypermarkets, considering to retain such store openings pace in 2011. Thus, Magnit continues an aggressive growth strategy with a focus on increased efficiency through optimizing business processes and further logistics development, which should enable the company to retain its EBITDA margin at 8-9% this year. Moreover, the company estimates its 2010E Net Debt/EBITDA to stay at not more than 1.0.

Government regulation and macro risks. Investors should take into account the risk of weaker than forecasted macro conditions (in particular, real wages growth and unemployment rate), which may adversely affect the consumer power. Besides, the Trade Law clause on retailers' market share regulation within particular urban districts came into effect on 1 July, 2010. We expect that in the coming months the authorities will disclose food retailers' market shares and which limitations on store openings will be imposed. However, we regard Magnit store openings plans as quite consistent with the law.

Magnit	Common	GDR
Ticker	**MGNT**	**MGNT LI**
Recommendation	**BUY**	**BUY**
Price, $	**83.2**	**18.5**
Target price, $	**122.0**	**24.4**
Upside/downside, %	**47%**	**32%**

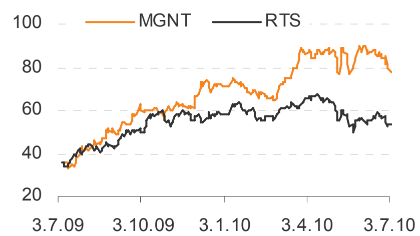
SHARE DATA	
Bloomberg	MGNT RX
Reuters	MGNT.MM
	Common
# of shares outstanding,mn	89.0
EV, $ mn	7 448
MC, $ mn	7 407
MIN 12 mnth., $	33.3
MAX 12 mnth., $	90.0
	Common
Shares per GDR	1/5

SUMMARY FINANCIALS, $ mn			
IFRS	**2009**	**2010E**	**2011E**
Revenue	5 354	7 648	10 673
EBITDA	509	676	990
Net income	275	348	504
EPS, $	3.09	3.92	5.67
Rev. growth, %	0.1	42.8	39.6
EPS growth, %	46.4	26.7	44.7
EBITDA margin, %	9.5	8.8	9.3
Net margin, %	5.1	4.6	4.7

SUMMARY VALUATIONS	2009	2010E	2011E
P/E	26.9	21.3	14.7
EV/EBITDA	14.6	11.0	7.5

SHAREHOLDER STRUCTURE	
Sergey Galitskiy, CEO	44%
Labini Investments Ltd.	4%
Management & BoD	5%
Other	46%

PRICE DYNAMICS



Source: MICEX, RTS. TKB Capital estimates

Magnit

BALANCE SHEET

IFRS, $ mn	2009	2010E	2011E	2012E	2013E	2014E
CASH	378	452	615	746	871	973
ACCOUNTS RECEIVABLE		2	2	3	3	4
INVENTORIES	415	468	656	816	947	1 065
OTHER CURRENT ASSETS	68	295	252	192	161	181
TOTAL CURRENT ASSETS	**862**	**1 217**	**1 525**	**1 757**	**1 983**	**2 223**
PPE	1 638	2 524	3 296	4 094	4 834	5 514
INTANGIBLE ASSETS	4	10	14	16	16	13
OTHER NON-CURRENT ASSETS	25	()		()	()	
TOTAL NON-CURRENT ASSETS	**1 667**	**2 534**	**3 310**	**4 110**	**4 850**	**5 527**
TOTAL ASSETS	**2 529**	**3 751**	**4 835**	**5 867**	**6 832**	**7 749**
ST BORROWINGS	267	676	924	1 113	1 212	1 217
OTHER CURRENT LIABILITIES	658	812	1 138	1 415	1 691	2 003
TOTAL CURRENT LIABILITIES	**924**	**1 489**	**2 062**	**2 529**	**2 902**	**3 220**
LT BORROWINGS	152	377	511	613	666	669
OTHER NON-CURRENT LIABILITIES	27	29	43	53	62	69
TOTAL NON-CURRENT LIABILITIES	**180**	**407**	**553**	**666**	**728**	**738**
MINORITY INTEREST	-	-	-	-	-	-
SHARE AND APIC	1 008	1 008	1 008	1 008	1 008	1 008
OTHER EQUITY ITEMS	(179)	-	-	-	-	-
RETAINED EARNINGS	596	848	1 212	1 664	2 194	2 783
TOTAL EQUITY	1 425	1 856	2 220	2 672	3 202	3 791
TOTAL LIABILITIES AND EQUITY	**2 529**	**3 751**	**4 835**	**5 867**	**6 832**	**7 749**

PROFIT & LOSS STATEMENT

IFRS, $ mn	2009	2010E	2011E	2012E	2013E	2014E
REVENUES	**5 354**	**7 648**	**10 673**	**13 261**	**15 386**	**17 282**
OPERATING EXPENSES LESS DD&A	(4 845)	(6 972)	(9 682)	(12 007)	(13 891)	(15 596)
EBITDA	**509**	**676**	**990**	**1 253**	**1 494**	**1 686**
DD&A	103	135	209	280	357	436
EBIT	**406**	**541**	**782**	**974**	**1 137**	**1 250**
INTEREST INCOME	2	2	2	2	2	2
INTEREST EXPENSES	(54)	(96)	(137)	(174)	(198)	(207)
MINORITY INTEREST	-	-	-	-	-	-
OTHER NON-OPERATING INCOME (EXPENSES)	12	-	-	-	-	-
EXTRAORDINARY INCOME (LOSS)	-	-	-	-	-	-
PRE-TAX PROFIT	**355**	**447**	**646**	**802**	**941**	**1 045**
TOTAL INCOME TAX EXPENSE	(80)	(98)	(142)	(176)	(207)	(230)
NET INCOME	**275**	**348**	**504**	**625**	**734**	**815**

CASH FLOW STATEMENT

IFRS, $ mn	2009	2010E	2011E	2012E	2013E	2014E
Operating CF	**376**	**572**	**819**	**995**	**1 165**	**1 316**
CF from investments	**(448)**	**(1 035)**	**(985)**	**(1 079)**	**(1 097)**	**(1 113)**
CF from financing activities	**339**	**538**	**328**	**216**	**57**	**(101)**
Net Debt	**41**	**602**	**820**	**980**	**1 006**	**913**

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	0%	43%	40%	24%	16%	12%
EBITDA margin	10%	9%	9%	9%	10%	10%
Net margin	5%	5%	5%	5%	5%	5%
Net Debt/EBITDA	0.1	0.9	0.8	0.8	0.7	0.5

Source: company data, TKB Capital estimates

X5 Retail Group
Largest and ambitious, looking for M&As

Our end-2010 target price for X5 Retail Group is $50 per GDR, which justifies our BUY recommendation. Solid financials and potential M&A deals will trigger the company's growth in 2H10. In the short term the market will focus on the state statistics, which is expected to be released in the coming months, and possible limitations on retail chain expansion to be imposed under the Trade Law. However, we consider that company's store openings ambitions look quite safe.

Attractive upside on impressive growth prospects. Our company DCF-based end-2010 target price (WACC of 11.3%, terminal growth of 3%) is $50 per GDR, which justifies our BUY recommendation. We estimate X5's fair 2011 P/E and EV/EBITDA to be at 24 and 11, respectively, which assume 27% and 8% premiums to its EM peers multiples. However, we see this to be justified by the forecasted revenue and EPS CAGR for 2010-2013 to be at 30% and 52%, respectively.

Coming growth triggers: 1H10 financials and management forecasts. We expect that coming 1H10 financials disclosure (expected on 26 August) and the following management guidance on the company store openings and full-year results may provide positive surprises to investors and give more visibility of the company attractive valuation as a bet on further company success in Russian food retail market consolidation. X5 Retail Group 2010-2011 organic capex implies more than 200 new stores opened annually. Besides, we expect X5 to continue playing an active role in market consolidation through M&As.

Government regulation and macro risks. The overall consumer & retail sector risk is weaker than forecasted macro conditions (in particular real wages growth and unemployment), which may negatively affect the consumer power. Besides, food retail in Russia is now exposed to certain government regulation risks. We would like to remind you that from July 1 the Trade Law clause on retailers' market share regulation within particular urban districts has came into effect. We expect that in coming months the government authorities will disclose food retailers market shares and whether any limitations on store openings will be imposed. However, now we estimate that company store openings plans look quite safe.

X5 RETAIL GROUP	
	GDR
Ticker	**FIVE**
Recommendation	**BUY**
Price, $	**34.8**
Target price, $	**50.0**
Upside/downside, %	**44%**

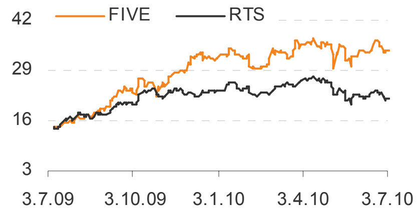
SHARE DATA	
Bloomberg	FIVE LI
Reuters	PJPq.L
	GDR
# of GDR outstanding, mn	271.6
EV, $ mn	10 984
MC, $ mn	9 445
MIN 12 mnth., $	33.3
MAX 12 mnth., $	90.0
	Common
Shares per GDR	1/4

SUMMARY FINANCIALS, $ mn			
IFRS	**2009**	**2010E**	**2011E**
Revenue	8 717	12 337	16 347
EBITDA	736	950	1 323
Net income	165	337	573
EPS, $	0.61	1.24	2.11
Rev. growth, %	4.4	41.5	32.5
EPS growth, %	-107.7	104.0	70.0
EBITDA margin,%	8.4	7.7	8.1
Net margin, %	1.9	2.7	3.5

SUMMARY VALUATIONS			
	2009	**2010E**	**2011E**
P/E	57.1	28.0	16.5
EV/EBITDA	14.9	11.6	8.3

SHAREHOLDER STRUCTURE	
Alfa Group	48%
Founders of Pyaterochka	23%
Management	2%
Other	27%

PRICE DYNAMICS



Source: LSE, RTS, TKB Capital estimates

X5 Retail Group

BALANCE SHEET

IFRS, $ mn	2009	2010E	2011E	2012E	2013E	2014E
CASH	412	485	539	653	1 092	1 757
ACCOUNTS RECEIVABLE	310	304	403	493	555	616
INVENTORIES	613	669	887	1 085	1 223	1 359
OTHER CURRENT ASSETS	210	381	524	703	859	1 020
TOTAL CURRENT ASSETS	**1 544**	**1 839**	**2 353**	**2 934**	**3 728**	**4 753**
PPE	2 995	3 328	3 560	3 816	3 976	4 113
INTANGIBLE ASSETS	496	480	461	444	421	397
OTHER NON-CURRENT ASSETS	1 144	1 166	1 202	1 239	1 269	1 301
TOTAL NON-CURRENT ASSETS	**4 636**	**4 974**	**5 223**	**5 499**	**5 666**	**5 812**
TOTAL ASSETS	**6 180**	**6 813**	**7 576**	**8 433**	**9 394**	**10 564**
ST BORROWINGS	1 659	790	565	325	187	108
OTHER CURRENT LIABILITIES	2 221	2 616	3 332	3 987	4 392	4 771
TOTAL CURRENT LIABILITIES	**3 880**	**3 406**	**3 897**	**4 311**	**4 579**	**4 879**
LT BORROWINGS	292	1 063	760	438	253	147
OTHER NON-CURRENT LIABILITIES	236	236	236	236	236	236
TOTAL NON-CURRENT LIABILITIES	**527**	**1 298**	**996**	**673**	**488**	**382**
MINORITY INTEREST	**-**	**-**	**-**	**-**	**-**	**-**
SHARE AND APIC	2 143	2 143	2 143	2 143	2 143	2 143
OTHER EQUITY ITEMS	(570)	(570)	(570)	(570)	(570)	(570)
RETAINED EARNINGS	199	537	1 110	1 875	2 753	3 730
TOTAL EQUITY	1 772	2 110	2 683	3 448	4 327	5 303
TOTAL LIABILITIES AND EQUITY	**6 180**	**6 813**	**7 576**	**8 433**	**9 394**	**10 564**

PROFIT & LOSS STATEMENT

IFRS, $ mn	2009	2010E	2011E	2012E	2013E	2014E
REVENUES	**8 717**	**12 337**	**16 347**	**19 982**	**22 501**	**24 993**
OPERATING EXPENSES LESS DD&A	(7 981)	(11 387)	(15 024)	(18 372)	(20 715)	(23 042)
EBITDA	**736**	**950**	**1 323**	**1 610**	**1 786**	**1 951**
DD&A	268	279	314	349	387	421
EBIT	**468**	**671**	**1 009**	**1 261**	**1 399**	**1 530**
INTEREST INCOME	-	-	-	-	-	-
INTEREST EXPENSES	(154)	(152)	(127)	(84)	(48)	(28)
MINORITY INTEREST	4	-	-	-	-	-
OTHER NON-OPERATING INCOME (EXPENSES)	50	-	-	-	-	-
EXTRAORDINARY INCOME (LOSS)	-	-	-	-	-	-
PRE-TAX PROFIT	**264**	**519**	**882**	**1 178**	**1 351**	**1 502**
TOTAL INCOME TAX EXPENSE	(99)	(182)	(309)	(412)	(473)	(526)
NET INCOME	**165**	**337**	**573**	**765**	**878**	**976**

CASH FLOW STATEMENT

IFRS, $ mn	2009	2010E	2011E	2012E	2013E	2014E
Operating CF	**734**	**789**	**1 193**	**1 356**	**1 387**	**1 496**
CF from investments	**(434)**	**(611)**	**(611)**	**(679)**	**(626)**	**(646)**
CF from financing activities	**(194)**	**(104)**	**(527)**	**(563)**	**(323)**	**(185)**
Net Debt	**1 539**	**1 368**	**786**	**109**	**(652)**	**(1 502)**

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	4%	42%	33%	22%	13%	11%
EBITDA margin	8%	8%	8%	8%	8%	8%
Net margin	2%	3%	4%	4%	4%	4%
Net Debt/EBITDA	2.1	1.4	0.6	0.1	(0.4)	(0.8)

Source: company data, TKB Capital estimates

Wimm-Bill-Dann

Struggling to prove its leadership

Wimm-Bill-Dann shares, in our view, will be well-supported by the investment triggers in 2H10 – in particular, by M&As on dairy and baby food market, expected strong 1H10 financials and potential acquisition of Danone's 18.4% stake in the company, which may enable Wimm-Bill-Dann to improve the liquidity of its shares on the Russian market. The company remains undervalued to its emerging markets peers on 2010E EV/EBITDA, which is consistent with our DCF-based valuation. We recommend to BUY local shares and ADRs.

Wimm-Bill-Dann is well positioned to benefit. Our target price for the company is $108 per share and $27 per ADR based on DCF-model (WACC of 11.2%, terminal growth of 3%), which justifies our BUY recommendation. The company trades with almost 30% and 55% discount on 2010E EV/EBITDA to its peers from EM (based on the prices for ADRs and local shares, respectively), which do not reflect the expected company's financials' growth in the medium-term.

Future triggers: M&As, 1H10 financials and management forecasts. WBD confirmed its plans to accomplish several M&As on the dairy market before the end of this year (Russia, Ukraine or Belorussia) to respond to the recent announcement of Danone-Unimilk merger, which should strengthen the company's market position. WBD also said it will be ready to buy Danone's 18.4% stake and will be particularly interested in local shares (about a half of Danone's stake) to improve the liquidity on the local market. This would result in narrowing spreads between ADR's price and local share's price (the current spread is up to 40%). Besides, we expect that coming 1H10 financials (scheduled for September) and the following management comments on the market outlook may bring positive surprises to investors and clarify the company's valuation.

Key risks are in macro sphere. We consider possibly weaker than forecasted macroeconomic conditions, slower pace in dairy and beverage consumption revival and outpacing increase in operating expenses as the key risks to our valuation model. However, we consider these factors as upside risks to our valuation in the case of more optimistic scenario.

Wimm-Bill-Dann	Common	ADR
Ticker	**WBDF**	**WBD US**
Recommendation	**BUY**	**HOLD**
Price, $	**45.6**	**19.1**
Target price, $	**108.0**	**27.0**
Upside/downside, %	**137%**	**42%**

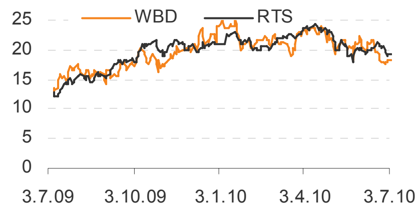
SHARE DATA	
Bloomberg	WBD US
Reuters	WBD.N
	ADR
# of ADR outstanding, mn	44.0
EV, $ mn	2 258
MC, $ mn	2 008
MIN 12 mnth., $	13.0
MAX 12 mnth., $	25.4
	ADR
Shares per ADR	1/4

SUMMARY FINANCIALS, $ mn			
IFRS	**2009**	**2010E**	**2011E**
Revenue	2 181	2 731	3 276
EBITDA	307	390	479
Net income	117	166	220
EPS, $	2.6	3.8	5.0
Rev. growth, %	-22.8	25.2	19.9
EPS growth, %	14.6	42.5	32.4
EBITDA margin, %	14.1	14.3	14.6
Net margin, %	5.3	6.1	6.7

SUMMARY VALUATIONS	**2009**	**2010E**	**2011E**
P/E	17.2	12.1	9.1
EV/EBITDA	7.4	5.8	4.7

SHAREHOLDER STRUCTURE	
WBD founding shareholders	45%
Danone	18%
Other	36%

PRICE DYNAMICS



Source: NYSE, RTS. TKB Capital estimates

Wimm-Bill-Dann

BALANCE SHEET

US GAAP, $ mn	2009	2010E	2011E	2012E	2013E	2014E
CASH	249	288	342	412	556	833
ACCOUNTS RECEIVABLE	112	149	178	206	221	237
INVENTORIES	191	239	285	328	351	374
OTHER CURRENT ASSETS	90	114	136	158	169	181
TOTAL CURRENT ASSETS	**641**	**790**	**941**	**1 104**	**1 297**	**1 625**
PPE	700	822	869	916	953	951
INTANGIBLE ASSETS	39	35	35	35	35	35
OTHER NON-CURRENT ASSETS	109	429	467	509	552	590
TOTAL NON-CURRENT ASSETS	**847**	**1 286**	**1 371**	**1 460**	**1 540**	**1 576**
TOTAL ASSETS	**1 489**	**2 076**	**2 312**	**2 564**	**2 837**	**3 200**
ST BORROWINGS	213	217	186	133	79	46
OTHER CURRENT LIABILITIES	243	605	738	886	992	1 090
TOTAL CURRENT LIABILITIES	**456**	**822**	**925**	**1 019**	**1 070**	**1 137**
LT BORROWINGS	286	314	269	192	113	67
OTHER NON-CURRENT LIABILITIES	43	30	40	53	61	68
TOTAL NON-CURRENT LIABILITIES	**329**	**344**	**310**	**245**	**174**	**135**
MINORITY INTEREST	**9**	**12**	**14**	**17**	**21**	**26**
SHARE AND APIC	194	194	194	194	194	194
OTHER EQUITY ITEMS	(78)	12	14	17	21	26
RETAINED EARNINGS	587	704	870	1 090	1 377	1 709
TOTAL EQUITY	703	909	1 078	1 301	1 592	1 928
TOTAL LIABILITIES AND EQUITY	**1 489**	**2 076**	**2 312**	**2 564**	**2 837**	**3 200**

PROFIT & LOSS STATEMENT

US GAAP, $ mn	2009	2010E	2011E	2012E	2013E	2014E
REVENUES	**2 181**	**2 731**	**3 276**	**3 790**	**4 066**	**4 350**
OPERATING EXPENSES LESS DD&A	(1 874)	(2 341)	(2 797)	(3 215)	(3 430)	(3 652)
EBITDA	**307**	**390**	**479**	**575**	**636**	**697**
DD&A	105	125	140	156	173	187
EBIT	**202**	**266**	**339**	**419**	**463**	**510**
INTEREST INCOME	5	5	5	5	5	5
INTEREST EXPENSES	(34)	(58)	(50)	(36)	(21)	(12)
MINORITY INTEREST	1	2	2	3	3	4
OTHER NON-OPERATING INCOME (EXPENSES)	(14)	12	2	-	-	-
EXTRAORDINARY INCOME (LOSS)	-	-	-	-	-	-
PRE-TAX PROFIT	**158**	**224**	**296**	**388**	**447**	**502**
TOTAL INCOME TAX EXPENSE	(41)	(56)	(74)	(97)	(112)	(125)
NET INCOME	**117**	**166**	**220**	**288**	**332**	**373**

CASH FLOW STATEMENT

US GAAP, $ mn	2009	2010E	2011E	2012E	2013E	2014E
Operating CF	**312**	**190**	**315**	**405**	**485**	**541**
CF from investments	**(125)**	**(161)**	**(186)**	**(204)**	**(209)**	**(185)**
CF from financing activities	**(187)**	**11**	**(75)**	**(131)**	**(133)**	**(79)**
Net Debt	**250**	**243**	**114**	**(88)**	**(364)**	**(720)**

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	-23%	25%	20%	16%	7%	7%
EBITDA margin	14%	14%	15%	15%	16%	16%
Net margin	5%	6%	7%	8%	8%	9%
Net Debt/EBITDA	0.8	0.6	0.2	(0.2)	(0.6)	(1.0)

Source: company data, TKB Capital estimates

TKB Capital

Pharmstandard
Healthy financials and solid growth

Pharmstandard is set to demonstrate strong performance in 2H10 having been technically suppressed due to the recent exclusion from the MSCI Russia Index. However, the company fundamentally remains a wise bet on the Russian pharma market growth, fueled by the government call for import substitution. Demonstrating its high financial stability, Pharmstandard maintains its ability to generate positive cash flows for shareholders and finance development via organic growth and M&As. We have set a BUY recommendation on shares and GDRs.

Undervalued exposure to the Russian pharma market. Our target price for the company is $134 per share ($33.5 per GDR) based on DCF-model (WACC of 12.1%, terminal growth of 3%), which justifies our BUY recommendation on the stock. The company shares are now traded with about 50% discount to its EM peers on the basis of 2010E EV/EBITDA, which doesn't reflect the expected company financials' growth in the medium-term.

2H10 growth triggers: 1H10 financials, M&A ambitions. We expect that coming 1H10 financials release (expected in mid-September) and the management guidance on the company's growth plans to trigger investors' interest towards the stock. Pharmstandard's performance was technically suppressed following the exclusion from the MSCI Russia Index and we expect the stock to be again in the scope of investors' interest in 2H10. Besides, with sufficient liquidity, the company is able to continue M&As in the next few years. Acquiring successful brands could become an additional catalyst for its financials.

Government regulation and macro risks. We see downside risks to our valuation model in the case of worsening macro conditions in 2H10, which may undermine consumer purchasing power, though medicines consumption is less sensitive to changes in prices. We also see the risk of increasing government regulation in the sector, which in particular may limit direct promotion of new drugs to physicians. Starting from September, 2009, the government introduced the law on circulation of vital and essential medicines, which sets mandatory registration of producer prices for these drugs and implies limits for distributors' and pharmacy chains' trading margins. However, we believe it will be less damaging for domestic producers than importers, distributors and retailers, taking into account the government call for import substitution and increase of domestic production.

Pharmstandard	Common	GDR
Ticker	**PHST**	**PHST LI**
Recommendation	**BUY**	**BUY**
Price, $	**72.7**	**23.0**
Target price, $	**134.0**	**33.5**
Upside/downside, %	**84%**	**46%**

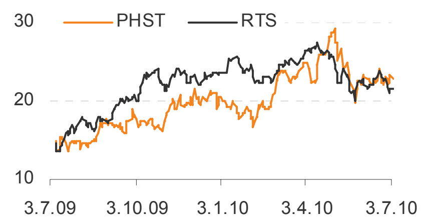
SHARE DATA	
Bloomberg	PHST LI
Reuters	PHSTq.L
	GDR
# of GDR outstanding, mn	151.2
EV, $ mn	2 645
MC, $ mn	2 749
MIN 12 mnth., $	13.5
MAX 12 mnth., $	29.2
	GDR
Shares per GDR	1/4

SUMMARY FINANCIALS, $ mn			
IFRS	**2009**	**2010E**	**2011E**
Revenue	759	711	863
EBITDA	293	360	441
Net income	216	265	329
EPS, $	1.4	1.8	2.2
Rev. growth, %	31.6	-6.4	21.4
EPS growth, %	53.0	22.7	24.4
EBITDA margin, %	38.6	50.7	51.2
Net margin, %	28.4	37.3	38.2

SUMMARY VALUATIONS			
	2009	**2010E**	**2011E**
P/E	12.7	10.4	8.3
EV/EBITDA	9.0	7.3	6.0

SHAREHOLDER STRUCTURE	
Augement Investments Limited	54.3%
GDRs	27.6%
Local shares	18.1%

PRICE DYNAMICS



Source: LSE, RTS. TKB Capital estimates

Pharmstandard

BALANCE SHEET

IFRS, $ mn	2009	2010E	2011E	2012E	2013E	2014E
CASH	130	336	600	937	1 334	1 762
ACCOUNTS RECEIVABLE	307	338	411	471	503	534
INVENTORIES	91	72	85	96	102	107
OTHER CURRENT ASSETS	13	16	19	21	23	24
TOTAL CURRENT ASSETS	**541**	**762**	**1 115**	**1 525**	**1 961**	**2 428**
PPE	122	112	101	89	75	62
INTANGIBLE ASSETS	204	202	198	193	188	183
OTHER NON-CURRENT ASSETS	-	-	-	-	-	-
TOTAL NON-CURRENT ASSETS	**326**	**314**	**299**	**282**	**263**	**245**
TOTAL ASSETS	**867**	**1 076**	**1 414**	**1 808**	**2 225**	**2 672**
ST BORROWINGS	13	6	3	2	1	
OTHER CURRENT LIABILITIES	161	158	261	364	449	539
TOTAL CURRENT LIABILITIES	**174**	**164**	**264**	**366**	**450**	**540**
LT BORROWINGS	13	6	3	2	1	
OTHER NON-CURRENT LIABILITIES	29	70	87	101	108	116
TOTAL NON-CURRENT LIABILITIES	**42**	**77**	**90**	**102**	**109**	**116**
MINORITY INTEREST	**14**	**14**	**14**	**14**	**14**	**14**
SHARE AND APIC	1	1	1	1	1	1
OTHER EQUITY ITEMS	()					
RETAINED EARNINGS	636	820	1 045	1 325	1 651	2 002
TOTAL EQUITY	638	821	1 046	1 326	1 652	2 003
TOTAL LIABILITIES AND EQUITY	**867**	**1 076**	**1 414**	**1 808**	**2 225**	**2 672**

PROFIT & LOSS STATEMENT

IFRS, $ mn	2009	2010E	2011E	2012E	2013E	2014E
REVENUES	**759**	**711**	**863**	**990**	**1 056**	**1 122**
OPERATING EXPENSES LESS DD&A	(466)	(351)	(421)	(480)	(509)	(538)
EBITDA	**293**	**360**	**441**	**510**	**547**	**584**
DD&A	24	24	25	25	26	26
EBIT	**269**	**336**	**417**	**485**	**521**	**558**
INTEREST INCOME	4	-	-	-	-	-
INTEREST EXPENSES	(5)	(2)	(1)	()	()	()
MINORITY INTEREST	1	1	1	1	1	1
OTHER NON-OPERATING INCOME (EXPENSES)	3	(3)	(4)	(5)	(5)	(6)
EXTRAORDINARY INCOME (LOSS)	-	-	-	-	-	-
PRE-TAX PROFIT	**272**	**331**	**412**	**480**	**516**	**552**
TOTAL INCOME TAX EXPENSE	(56)	(66)	(82)	(96)	(103)	(110)
NET INCOME	**216**	**265**	**329**	**384**	**413**	**442**

CASH FLOW STATEMENT

IFRS, $ mn	2009	2010E	2011E	2012E	2013E	2014E
Operating CF	**193**	**234**	**282**	**350**	**408**	**438**
CF from investments	**28**	**(14)**	**(12)**	**(10)**	**(9)**	**(9)**
CF from financing activities	**(53)**	**(13)**	**(6)**	**(3)**	**(2)**	**(1)**
Net Debt	**(104)**	**(324)**	**(594)**	**(933)**	**(1 333)**	**(1 761)**

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	32%	-6%	21%	15%	7%	6%
EBITDA margin	39%	51%	51%	52%	52%	52%
Net margin	28%	37%	38%	39%	39%	39%
Net Debt/EBITDA	(0.4)	(0.9)	(1.3)	(1.8)	(2.4)	(3.0)

Source: company data, TKB Capital estimates

Veropharm
Import substitution on a niche market

We recommend investors to BUY Veropharm, which is a play on the Russian pharma market growth and a proxy of government call for import substitution. In 2H10 the value growth drivers will be expected recovery in 1H10 financials, which should revive investors' interest towards the stock.

Attractive valuation with more than 40% upside potential. Our target price for the company is $47 per share, which is derived from our DCF-model (WACC of 12.7%, terminal growth of 3%). Such valuation implies more than 40% of upside potential and thus justifies our BUY recommendation. Veropharm relative valuation in comparison with its EM peers implies almost 50% discount on the basis of 2010E EV/EBITDA.

Strong financials with a favorable growth outlook. We expect the company to report strong 1H10 financials (should be released in late-August). This year the company intends to outperform market by growth rates (which are expected at 20% y-o-y in retail segment in ruble terms), which are likely to meet our forecast of the company's 24% y-o-y top line growth (in ruble terms). Veropharm plans to reach gross margin of 70% (vs. our current forecast of 68%) and EBITDA margin of up to 40% (vs. our forecast of 32%). Hence, the company projections are more ambitious than our forecasts and overall market expectations. It implies that investors may revive their interest towards the stock in 2H10.

Government regulation and macro risks. The overall sector risk is weaker than expected macro conditions in 2H10, which may lead to worsening of consumer power, though consumer demand on medicines looks the most resistant to price changes. Another point of concern is increasing government regulation in the sector, which assumes mandatory registration of producer prices for vital and essential drugs and implies limits for distributors' and pharmacy chains' trading margins. However, we believe domestic producers will be less vulnerable than importers, distributors and retailers, taking into account the government call for import substitution and increase of domestic production.

Veropharm	
	Common
Ticker	**VRPH**
Recommendation	**BUY**
Price, $	**33.4**
Target price, $	**47.0**
Upside/downside, %	**41%**

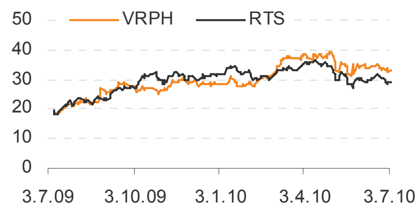
SHARE DATA	
Bloomberg	VFRM RX
Reuters	VFRM.MM
	Common
# of shares outstanding,mn	10.0
EV, $ mn	356
MC, $ mn	334
MIN 12 mnth., $	18.1
MAX 12 mnth., $	39.1
	Common
Shares per GDR	-

SUMMARY FINANCIALS, $ mn			
IFRS	**2009**	**2010E**	**2011E**
Revenue	138	183	223
EBITDA	44	57	71
Net income	35	39	50
EPS, $	3.5	3.9	5.0
Rev. growth, %	-20.0	32.4	21.5
EPS growth, %	-5.4	12.6	27.7
EBITDA margin, %	31.6	31.4	31.9
Net margin, %	25.2	21.5	22.6

SUMMARY VALUATIONS			
	2009	**2010E**	**2011E**
P/E	9.6	8.5	6.7
EV/EBITDA	8.1	6.2	5.0

SHAREHOLDER STRUCTURE	
Leget Invetments Limited	26.9%
Glazar Limited	24.9%
Other	48.2%

PRICE DYNAMICS



Source: MICEX, RTS, TKB Capital estimates

Veropharm

BALANCE SHEET

IFRS, $ mn	2009	2010E	2011E	2012E	2013E	2014E
CASH	10	7	17	37	71	112
ACCOUNTS RECEIVABLE	138	176	201	228	242	255
INVENTORIES	35	33	39	45	47	50
OTHER CURRENT ASSETS	-	-	-	-	-	-
TOTAL CURRENT ASSETS	**183**	**215**	**258**	**309**	**360**	**418**
PPE	26	34	41	48	54	59
INTANGIBLE ASSETS	11	12	13	13	14	14
OTHER NON-CURRENT ASSETS	-	-	-	-	-	-
TOTAL NON-CURRENT ASSETS	**38**	**46**	**53**	**61**	**67**	**73**
TOTAL ASSETS	**221**	**261**	**312**	**370**	**427**	**491**
ST BORROWINGS	29	26	13	12	9	7
OTHER CURRENT LIABILITIES	19	20	35	47	53	59
TOTAL CURRENT LIABILITIES	**49**	**46**	**49**	**59**	**62**	**66**
LT BORROWINGS	3	11	20	18	13	11
OTHER NON-CURRENT LIABILITIES	2	2	2	2	2	2
TOTAL NON-CURRENT LIABILITIES	**6**	**13**	**22**	**20**	**16**	**13**
MINORITY INTEREST	**-**	**-**	**-**	**-**	**-**	**-**
SHARE AND APIC						
OTHER EQUITY ITEMS				()	()	()
RETAINED EARNINGS	166	201	240	291	349	412
TOTAL EQUITY	167	202	241	291	349	412
TOTAL LIABILITIES AND EQUITY	**221**	**261**	**312**	**370**	**427**	**491**

PROFIT & LOSS STATEMENT

IFRS, $ mn	2009	2010E	2011E	2012E	2013E	2014E
REVENUES	**138**	**183**	**223**	**252**	**267**	**283**
OPERATING EXPENSES LESS DD&A	(95)	(126)	(152)	(171)	(181)	(192)
EBITDA	**44**	**57**	**71**	**81**	**86**	**91**
DD&A	4	3	4	4	5	5
EBIT	**40**	**54**	**67**	**76**	**81**	**86**
INTEREST INCOME	-	-	-	-	-	-
INTEREST EXPENSES	(2)	(5)	(4)	(3)	(2)	(2)
MINORITY INTEREST	-	-	-	-	-	-
OTHER NON-OPERATING INCOME (EXPENSES)	-	-	-	-	-	-
EXTRAORDINARY INCOME (LOSS)	(1)	-	-	-	-	-
PRE-TAX PROFIT	**37**	**49**	**63**	**73**	**79**	**84**
TOTAL INCOME TAX EXPENSE	(2)	(10)	(13)	(15)	(16)	(17)
NET INCOME	**35**	**39**	**50**	**58**	**63**	**67**

CASH FLOW STATEMENT

IFRS, $ mn	2009	2010E	2011E	2012E	2013E	2014E
Operating CF	**(1)**	**13**	**27**	**35**	**53**	**58**
CF from investments	**(7)**	**(12)**	**(12)**	**(12)**	**(12)**	**(12)**
CF from financing activities	**7**	**4**	**(4)**	**(4)**	**(7)**	**(4)**
Net Debt	**22**	**30**	**16**	**(7)**	**(48)**	**(94)**

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	-20%	32%	22%	13%	6%	6%
EBITDA margin	32%	31%	32%	32%	32%	32%
Net margin	25%	21%	23%	23%	24%	24%
Net Debt/EBITDA	0.5	0.5	0.2	(0.1)	(0.6)	(1.0)

Source: company data, TKB Capital estimates

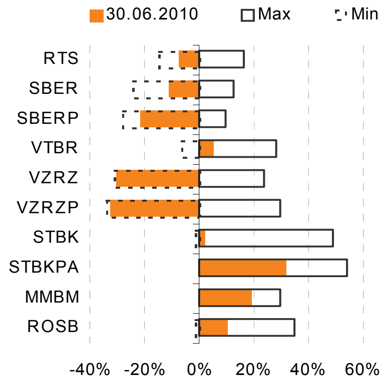
Banking sector

On the way to recovery

Maria Kalvarskaia m.kalvarskaia@tkbc.ru

Stabilization of the credit quality helped the banks to improve their financial results. On the contrary, lower interest rates led to margin compression, while activity on the credit market remained low. We believe that interest rate cycle reached its bottom in May-June and the rates will stabilize at these levels. Demand for loans will start growing in 2H10 supported by increasing economic activity, but 2010 growth rates are revised downward due to slower recovery. Sberbank remains our top pick in Russian banking universe, while dynamics of less liquid stocks of Bank Vozrozhdenie and Bank St. Petersburg will depend on the banks' performance with a lag to the market trend. We reiterate a BUY for Sberbank and Bank St. Petersburg and a HOLD for VTB, shares of which look more risky comparing to the largest bank in Russia – Sberbank.

YTD sector dynamic vs. RTS

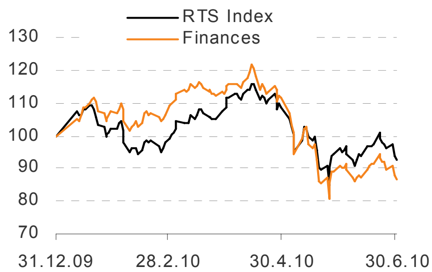


Source: RTS, MICEX, TKB Capital estimates

With assets growth and ample liquidity... Assets of the Russian banks grew by 1% since the beginning of 2010 due to clients' funds inflow, boosting securities portfolio.

…demand for loans remained weak. As we expected, 1H10 was weak in terms of loan portfolio growth, which grew by 0.5-1% YTD. Large volumes of repayment and a small number of new loans determined negative growth rate.

Lower interest rates put pressure on margins. Excess liquidity and stabilization of the economic situation led to interest rates reduction from 13.6% to 11.4% in rubles for corporate clients that determined margin compression for the banks. Under these conditions, those with higher cost efficiency will outperform.



Source: RTS, TKB Capital estimates

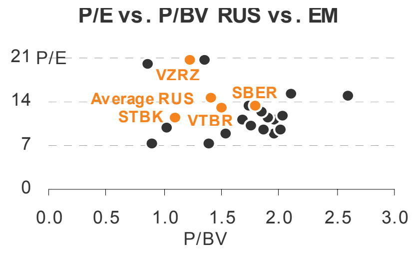
Stabilization of credit quality supported bottom line. Beginning of 2010 was successful for the banks due to low basis of 1Q09. Significant reduction of loan loss provisions helped to improve results.

The market rather than the state will weigh on future development. In 2010 the state role subsided with less support required for the banks and weaker pressure from authorities. Interest rate policy, aimed to limit inflation, put pressure on the market interest rates, but does not determine the rates directly.

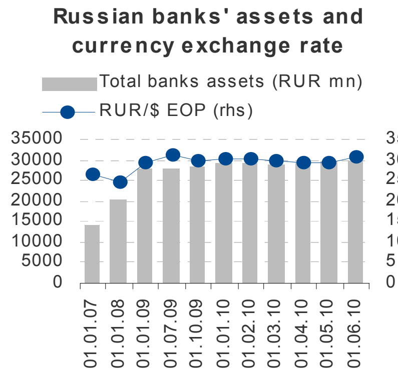
2010 growth will be limited. We forecast total banking assets' growth in 2010 at 10-12% with acceleration of the growth rates in 2H10. Over 5M10 assets increased just 1%. Low business activity and weak demand for loans are the reasons behind slower recovery.

Sberbank is our top pick. Among the banking shares, we see Sberbank as the most interesting play. Strong funding base, high cost efficiency, stable loan quality and healthy margins determine solid financial results, while recovery of lending will drive assets growth. Launching of DRs program will support the shares. We upgrade our TP for Sberbank to \$3.5 per ordinary share and to \$2.9 per pref (previous targets are \$3.05 and \$2.30, correspondingly).

BUY for Bank Vozrozhdenie and Bank St. Petersburg and HOLD for VTB reiterated, but performance will depend on the market environment. Beginning of 2010 was quite challenging for Vozrozhdenie and St. Petersburg banks on the back of margin compression, existing credit risks and growing competition. Financial results of VTB were determined by trading operations to a high degree that also increases risks for future financial performance. Further economic recovery will boost loan portfolio and stabilize profit, but existing risks will restrain growth of the stock.



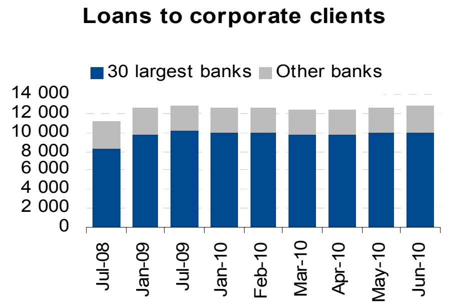
Source: Bloomberg, TKB Capital estimates



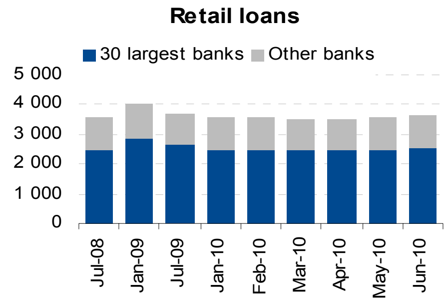
Source: CBR, TKB Capital estimates

Rebalancing assets, but no growth signs. Russian banks' assets were almost flat since the beginning of 2010 adding 0.5% over 4M10. Loan repayment and weak demand for new loans caused the reduction of the total loan portfolio. At the same time, a part of funds went to securities portfolio, which increased 18.5% since the year beginning. Banks also grew their liquid funds that will be used to expand their credit activity, when demand recovers.

Demand for loans remained weak. As we expected, 1H10 was weak in terms of loan portfolio growth, which grew just 0.5-1% over the first five months. Large volumes of repayment and a small number of new loans determined negative growth rate. The largest banks reported on improvement of the situation in May, which is a positive sign, but not a start of a stable trend. We expect to see stronger numbers in 2H10, when stabilization of economic situation will drive demand for new loans supported by low interest rates.

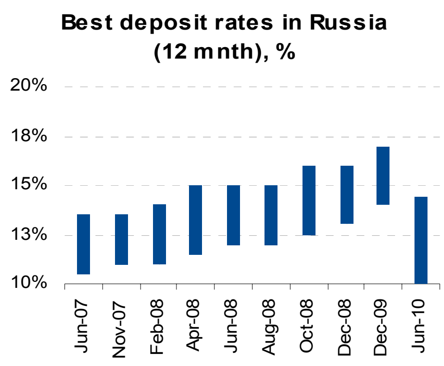


Source: CBR, TKB Capital

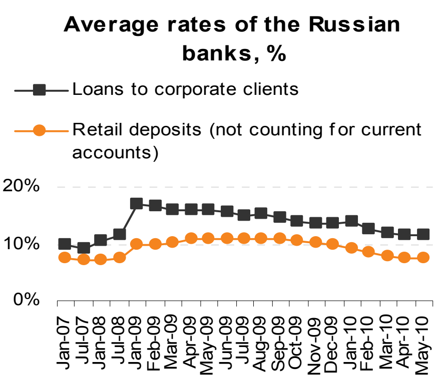


Source: CBR, TKB Capital

Sufficient and cheaper funding. Inflow of clients' funds was stable in 4M10. Corporate and retail clients' funds grew by 5.8% since the beginning of 2010. The banks were constantly reducing a share of the CBR funds, which became an expensive resource on the back of excess liquidity on the market. The share of CBR funds declined to 1.5% of the total liabilities comparing to 4-12% in 2009. Thus, most of Russian banks are approaching 2H10 with sufficient funding and liquidity that will be used to finance their active operations.



Source: RBC Rating (top 100 banks), TKB Capital estimates



Source: CBR, TKB Capital estimates

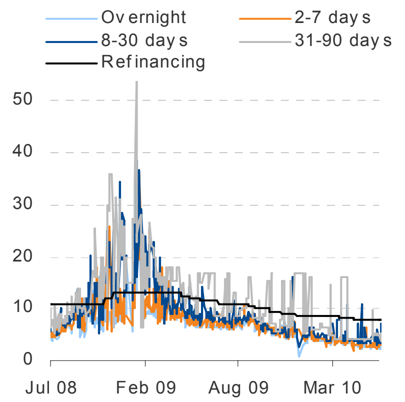
Lower interest rates put pressure on margins. Excess liquidity and stabilization of the economic situation led to interest rates reduction in ruble terms for corporate clients that determined margins compression for the banks. Interest rates for retail clients went down from 9.7% to 7.6%. The largest bank reported net interest margin compression by 50-100 bps comparing to 4Q09. At the same time, the numbers were stronger than in 1Q09 due to improving situation on the money market.

CBR cut rates setting the trend. In 2010 CBR cut its refinancing rate 3 times that brought the benchmark from 8.5% to 7.75%. These changes reflect the market environment (excess liquidity and lower financial risks) as well as necessary conditions for the economic recovery. In addition, CBR and the government agreed to cut rates on subordinated loans issued in 2009. The interest rates will be cut by 1.5-2 ppt to 6.5-7.5%. Cheaper financing will help the banks to expand its credit activity, but effect on financials will be quite moderate though.

Banks with higher cost efficiency will outperform. Cost reduction during the crisis period determined higher efficiency ratios. The banks continue keeping costs under control showing healthy cost-to-income ratios at 20-40%. At the same time, we would pay attention to operating costs to assets ratio, serving as a benchmark for efficiency of banks' operations. We believe that the trend on margin contraction will continue going forward with development of financial system and costs efficiency determining the banks' ability to generate stable profits.

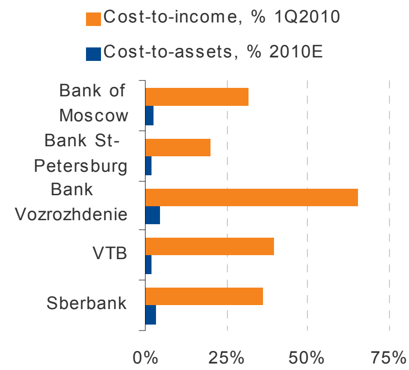
Stabilization of credit quality supported bottom line. The main challenge for the banks in 2009 was deteriorating credit quality that required additional provisions. In 1H10 situation stabilized, while overdue loans grew from 5.1% at the beginning of 2010 to 5.6% in June. Lower credit risks led to provisioning reduction that helped to increase profit. Earlier the banks expected to see pick of provisioning in 1H10, but now expectations are slightly changed and the bottom line is likely to be touched in 2H10. Risks still exist that requires additional provisions, and the latest numbers prove that. Slow growth of loan portfolio also determine larger share of NPL despite stabilization of the credit quality.

Interest Rates CBR



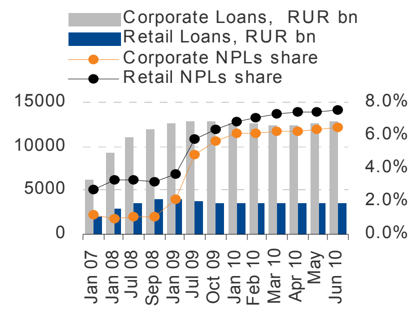
Source: CBR, TKB Capital estimates

Operating costs to assets and income, 2010E



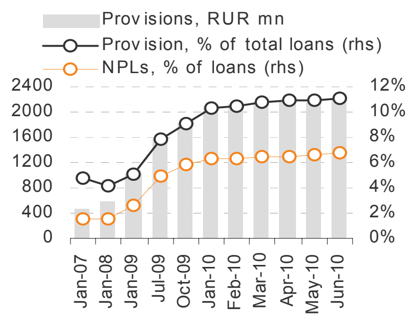
Source: banks' data, TKB Capital estimates

Overdue Loans



Source: CBR data, TKB Capital estimates

NPL Provisions



Source: CBR, TKB Capital estimates

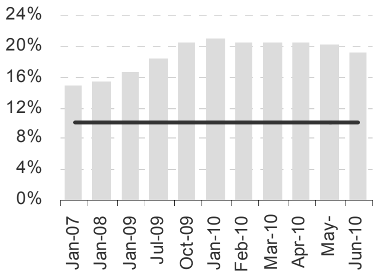
Positive prospects, in 2010 growth will be limited. We forecast total banking assets' growth in 2010 at 10-12% with acceleration of the growth rates in 2H10. Over 5M10 assets increased just 1%. Low business activity and weak demand for new loans determine slow recovery. At the same time dynamics in May-June were better than in the first months 2010. Significant part of expensive loans issued in 2009 has been refinanced that will help to increase volumes of new loans in 2H2010. Revision of interest rate policy by some banks aimed at deposit rates growth also reflect growing demand for loans that requires additional funding. Thus, banks met 2H2010 ready for further growth with strong liquidity position, sufficient capital and lower risks.

BN RUR	2009	2010E	2011E
Total Assets	29430	32962	37906
Equity Capital	3766	4143	4764
Loans	19847	22819	27090
Retail Loans	3574	4217	4976
Corporate Loans	12542	14423	17308
Clients Funds	17131	19701	23641
Retail Clients Funds	7485	9356	11228
Corporate Deposits	5467	6014	6916

Growth rates	2009	2010E	2011E
Total Assets	5.0%	12.0%	15.0%
Equity Capital	21.1%	10.0%	15.0%
Loans	-0.2%	15.0%	18.7%
Retail Loans	-7.0%	18.0%	18.0%
Corporate Loans	0.3%	15.0%	20.0%
Clients Funds	16.2%	15.0%	20.0%
Retail Clients Funds	26.7%	25.0%	20.0%
Corporate Deposits	10.6%	10.0%	15.0%

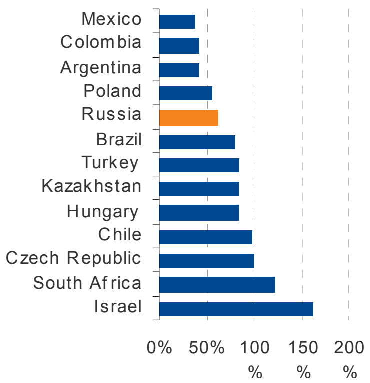
Source: CBR, TKB Capital estimates

CAR of the Russian banks



Source: CBR, TKB Capital estimates

Assets/GDP



Source: CBR, WB, TKB Capital estimates

Long-term prospects. In a long-term development of the Russian banking system is determined by low penetration of banking services that creates bright opportunities in the future especially in the retail business. Another aspect of Russian financial system development is consolidation process in the sector, which is aimed to reduce the number of banks that will improve the quality of provided services and reduce competition among small banks. We keep our positive view on the banking industry as it reflects economic recovery and growing consumption, and we expect banking shares and especially liquid ones to outperform the market in 2H2010.

Banking shares – the same leader. In our strategy for 1H2010 we recommended buying Sberbank as well as Bank Vozrozhdenie and Bank St-Petersburg shares. Despite high volatility Sberbank justified our expectations showing strong results and providing forecasts for the future. At the same time smaller banks showed weaker financial performance reflecting existing risks that put pressure on the stocks. VTB share are traded with discount to Sberbank and we do not expect to see stronger performance without substantial support. So, during 1H2010 were reduced our target prices on the stocks of Bank St-Petersburg and Bank Vozrozhdenie reflecting the market situation. Recovery of the banking sector in 2H2010 will support the shares, while we consider Sberbank our top pick in the universe.

Comparative valuation

Bank	P/E			P/BV		
	2009	2010E	2011E	2009	2010E	2011E
Sberbank	61.5	12.7	6.9	2.1	1.7	1.4
VTB	отр	12.3	9.1	1.4	1.4	1.2
Bank St-Petersburg	47	10.8	6.1	1.1	1	0.8
Bank Vozrozhdenie	20.4	18.7	6	1.2	1.1	0.9
Median	**47**	**12.5**	**6.5**	**1.3**	**1.2**	**1.0**
Average	**40.9**	**12.5**	**8**	**1.7**	**1.5**	**1.3**
Developed Markets						
Median	15.40	8.72	6.58	0.88	0.76	0.71
Average	15.65	9.76	6.85	0.88	0.82	0.76
Emerging Markets						
Median	12.93	11.25	9.43	2.01	1.86	1.62
Average	177.94	12.08	9.63	1.96	1.81	1.61

Source: Bloomberg, TKB Capital estimate

TKB Capital

Sberbank
In the rank of leader

We upgraded our target price for Sberbank shares from $3.05 to $3.50 and keep our BUY recommendation. Strong operating results over 2009 and 1Q10, forecasts for 2010 coupled with sound cost efficiency and better loan portfolio quality will support the bank's performance. Conservative forecasts for 2010 reflect the current market conditions, while the published numbers (IFRS FY2009 and 1Q10) allow expecting for substantial improvement already in 2010.

Loan portfolio growth will be restrained in 2010, quality will stabilize. According to the management forecast, loan portfolio will grow at 10-15%. We expect average growth rate in 2010-2014 at 16% with faster expansion of the retail loans on the back of growing consumption and higher activity in mortgage segment. At the end of 1Q10 non-performing loans amounted to 8.9% of the total loans, while provisions were created at 11.7% of the total portfolio. In 2010 the bank expects provisions to grow to 12-14%. We foresee reserves at the end of 2010 to amount to 13% with decline in coming years due to credit quality improvement and loan portfolio expansion.

Security portfolio – substitute for loans and liquid funds. In 2009 the bank increased its loan portfolio buying corporate bonds as a substitute for corporate loans, whereas in 1Q10 higher volume of securities was attributable mainly to purchase of CBR bonds and federal loan bonds (OFZs), while a share of corporate bonds came down from 28% to 21%. We believe that a part of these funds will be used for expansion of credit activity as soon as demand recovers or for repayment of its subordinated loans.

Strong funding base. Clients' funds amount to 85% of the total liabilities of the bank and grew slightly in 1Q10. In 1Q10 loan to deposit ratio was at 86% vs. approximately 100% before crisis. In 2Q10 Sberank paid back RUR200 bn of RUR500 bn subordinated loan, which was an expensive source of funding for the bank. In 2H10 CBR and the state agreed to cut rates on subordinated loans that will reduce costs, but Sberbank still may pay back the remaining part of loan. In 2010 the bank is also considering Eurobond issue to diversify its liabilities, which are relatively cheaper than of the other players.

Contracting margins, lower provisions and high cost efficiency will determine bottom-line. In 2010 net interest margin is expected to decline by 100-150 bps comparing to 2009 giving still healthy 6.1-6.3%. Total provisions over the period would decline by more than 50% delivering stronger profit. Cost-to-income ratio will be close to 40%, while operating costs to the total assets ratio will be at about 3%. We expect Sberbank's net profit over 2010 at RUR120 bn vs. guideline from the bank at RUR100 bn.

Market recovery as well as DRs' and option programs to be the core drivers. We believe that in 2H10 activity on the credit market will increase substantially taking into account accumulated demand for loans. Now Sberbank does not have any legal obstacles to launch its DRs program. But the current market conditions do not look favorable for the bank, and it will come back to the listing in 2H10. According to the management, it will take 4-5 weeks from the final decision regarding the listing is done until DRs start trading on the market. Option program is still under discussion and may be approved already this year that will also support the stock.

Our TP for Sberbank ords is $3.5, for prefs $3 and BUY recommendation reiterated. We used excess return on capital model to estimate fair value of Sberbank shares. Price revision was determined by changes in financials' forecasts and lower country risk premium used in the model. We applied 18% discount for preferred shares to ordinary shares as for now rumors regarding possible conversion do not seem to be sound. Risks to our valuation are weaker macroeconomic environment and lower interest rates on loans that would put pressure on margins. Sberbank is traded at P/BV for 2010E of 1.7 and 2011E of 1.4 vs. average level of 1.8 and 1.6 for its peers from emerging countries. In developed countries these ratios are 0.8 and 0.6. According to our valuation, 2011E P/BV gives 2.1.

Sberbank	Common	Preferred
Ticker	**SBER**	**SBERP**
Recommendation	**BUY**	**BUY**
Price, $	**2.33**	**1.70**
Fair price, 2008 $	**3.50**	**2.90**
Upside/downside potential	**50%**	**71%**

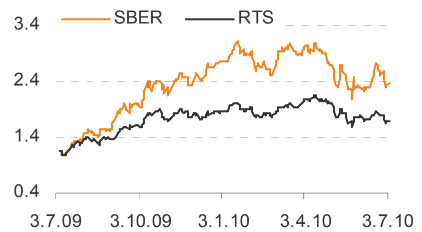
SHARE DATA		
Bloomberg	SBER RU	
Reuters	SBER.RTS	
# of shares outstanding, mn	Common	Preferred
	21 588	1 001
MC, $ mn	52 002	-
MIN 12 mnth, $	1.05	0.65
MAX 12 mnth, $	3.06	2.05

SUMMARY FINANCIALS, RUR mn	2009	2010E	2011E
Interest incomes	814 962	802 597	884 897
Net Interest	502 717	461 958	509 964
Net Income	24 396	119 816	220 446
Equity	779 111	870 363	1 062 343
EPS, RUR	1.13	0.94	4.96
Interest income growth, %	32	-2	10
EPS growth, %	-75	390	84
ROAE	3%	14%	21%

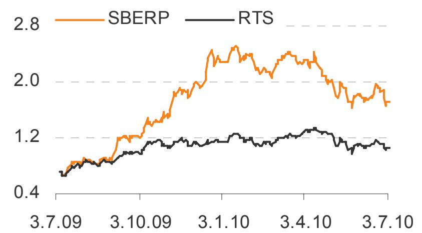
SUMMARY VALUATIONS	2009	2010E	2011E
P/BV	2.1	1.7	1.4
P/E	61.5	12.7	6.8
Loans/Deposits	85%		
P/B trailing	1.7		

SHAREHOLDER STRUCTURE	
Central Bank of	58%
Others	42%

PRICE DYNAMICS



Source: Bloomberg, TKB Capital estimates



Source: Bloomberg, TKB Capital estimates

Sberbank

BALANCE

RUR mn	2009	2010E	2011E	2012E	2013E	2014E
Loans and advances to customers	4 864 031	5 392 336	6 660 342	8 034 721	9 487 674	10 895 815
Securities	1 061 436	1 128 623	1 160 124	1 195 895	1 236 531	1 282 713
Due from other banks	10 219	12 263	14 715	17 658	21 190	25 428
Other	1 169 380	1 211 301	1 303 355	1 261 042	1 235 225	1 334 146
TOTAL ASSETS	**7 105 066**	**7 744 522**	**9 138 536**	**10 509 316**	**11 980 621**	**13 538 101**
Customer accounts and deposits	5 438 871	5 911 777	6 945 526	7 930 982	8 936 893	10 004 591
Issued securities	124 599	206 225	323 048	414 993	519 587	581 662
Due to other banks	53 947	68 742	96 914	138 331	155 876	174 499
Other liabilities	709 547	687 416	710 705	737 766	779 380	872 493
TOTAL LIABILITIES	**6 326 964**	**6 874 159**	**8 076 193**	**9 222 073**	**10 391 736**	**11 633 245**
Share capital	87 742	87 742	87 742	87 742	87 742	87 742
Share premium	232 493	232 493	232 493	232 493	232 493	232 493
Revaluation Reserves	54 942	55 540	55 540	55 540	55 540	55 540
Retained Earnings	403 934	494 588	686 568	911 469	1 213 110	1 529 081
TOTAL EQUITY	779 111	870 363	1 062 343	1 287 244	1 588 885	1 904 856
TOTAL EQUITY & LIABILITIES	**7 106 075**	**7 744 522**	**9 138 536**	**10 509 316**	**11 980 621**	**13 538 101**

ASSET QUALITY

RUR mn	2009	2010E	2011E	2012E	2013E	2014E
NPLs	462 727	611 964	590 050	522 739	504 475	459 838
NPL Reserves	579 814	727 307	715 278	677 592	601 820	600 125
NPLs/Gross Loans	**8.5%**	**10.0%**	**8.0%**	**6.0%**	**5.0%**	**4.0%**
Reserves/NPLs	**1.3**	**1.2**	**1.2**	**1.3**	**1.2**	**1.3**

PROFIT & LOSS STATEMENT

RUR mn	2009	2010E	2011E	2012E	2013E	2014E
Interest income	814 962	802 597	884 897	1 007 001	1 128 699	1 244 593
Interest expenses	312 245	340 639	374 933	417 372	483 639	520 073
Net interest income	502 717	461 958	509 964	589 629	645 060	724 520
Provision for loan impairment	(388 932)	(174 454)	(74 556)	(18 558)	28 334	(14 648)
Net income from security operations	36 463	10 000	5 000	5 000	5 000	5 000
Net comission fee	101 089	101 737	122 453	143 691	165 821	188 104
Other net income	7 804	7 258	1 622	(4 986)	12 409	13 138
Administrative and other operating expenses	(229 277)	(256 729)	(288 926)	(336 430)	(392 084)	(442 368)
Profit before tax	29 864	149 770	275 557	378 346	464 540	473 746
Income tax	(5 468)	(29 954)	(55 111)	(75 669)	(92 908)	(94 749)
Net profit	24 396	119 816	220 446	302 677	371 632	378 997

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Net interest income growth	33%	-8%	10%	16%	9%	12%
Net comission fee growth	17%	1%	20%	17%	15%	13%
Net interest margin	7%	6%	6%	6%	6%	6%
Cost/income ratio	35%	44%	45%	46%	47%	48%
ROE	3%	14%	21%	24%	23%	20%
Loan/Assets	68%	70%	73%	76%	79%	80%
Deposits/Liabilities	86%	86%	86%	86%	86%	86%
Loans/Deposits	89%	91%	96%	101%	106%	109%
Equity/Assets	11%	11%	12%	12%	13%	14%

Source: company data, TKB Capital estimates

VTB
Is on the way to achieve strategic goals

We keep our HOLD recommendation for VTB shares with a target price of $0.0026 per stock ($5.2 per GDR). In May VTB announced its new strategy aimed at increasing its market share and doubling loan portfolio by 2013, which sounds quite ambitious. Pressure on interest margins, weak growth of loans in 1H10 and revenue structure limit upside potential for this year. As the situation on the financial market improves, we expect to see stronger demand for the stock.

Loans to grow by 10-15% in 2010, but expansion is postponed for 2H10. The bank expects loans to grow at 10-15% in 2010. We believe that the numbers will be close to the lower end of the range. The bank reported stronger demand for new loans just in May, which is a positive sign, but does not indicate a secular trend on the market. More aggressive development in the future may put pressure on margins taking into account high competition on the market and cost of funds.

High margin products and cheaper financing will support profit… NIM was almost flat in 1Q10 q-o-q at 5.2%. We expect lower numbers for the whole 2010 (at 4.8-5%). According to the bank's expectations, interest rates will stabilize at the level of 2Q10, but we think that reprising of loans and liabilities may put pressure on margins. At the same time, the bank is promoting new high margin products to increase return and support efficiency. Thus, NII will grow just slightly y-o-y mainly due to new loans, high margin products and cheaper financing comparing to 2009.

Declining provisions and cost efficiency to boost bottom-line. Stabilization of the loan portfolio quality determines lower provisions. The bank expects to reduce cost of risk to pre-crisis level. We forecast total provisions at 10-10.5% of the total loans, while the share will be achieved due to expansion of the loan portfolio. Cost control is still one of the key priorities of VTB. Thus, cost-to-income ratio is forecasted at approximately 43% in 2010 (vs. bank's expectations at 40%). The bank is planning to expand substantially the number of its branches keeping costs at low level, which will require substantial increase in revenues. We do not foresee effect of this growth to come already this year, while valuation will depend on recovery of the loan market or the bank's ability to deliver return on its assets.

Investment business is expected to generate sustainable income, and trading gains is a part of it. More than 50% of income related to the investment business activities is coming from the clients' operations and is not directly related to the market operations. We keep quite conservative forecast of related income in 2010 taking into account volatility on the market and mixed nature of this profit.

Targeted return to be achieved in later years. We expect net income in 2010 at RUR53 bn vs. losses a year ago. That corresponds to ROAE of 10% vs. targeted 15-20% for the next years. We believe that VTB has all chances to achieve the goals, but now the stock looks less attractive comparing to Sberbank.

Option program and market recovery as the drivers, while risks are still there. News regarding option program for the bank's management as well as stable positive trend on the credit market may boost the share price. Now VTB is traded below its peers on P/BV (1.4 vs. 1.6 on average), while on P/E ratio the stock is fairly valued by the market comparing to the competitors. We keep a HOLD recommendation and consider loan portfolio quality, revenue structure and weak demand for loans as the main risks.

VTB	Common	GDR
Ticker	**VTBR**	**VTBR LI**
Recommendation	**HOLD**	**HOLD**
Price, $	**0.0023**	**4.71**
Target price, $	**0.0026**	**5.20**
Upside/downside, %	**13%**	**10%**

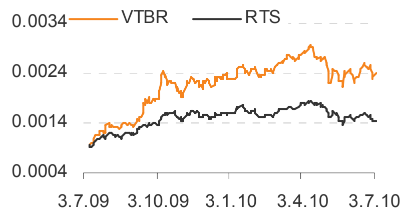
SHARE DATA		
Bloomberg	VTBR RU	
Reuters	VTBR.MM	
# of shares outstanding, bn	Common	GDR
	10 461	
MC, $ mn	24 059	
MIN 12 mnth, $	0.0010	
MAX 12 mnth, $	0.0027	
Shares per GDR	2000	

SUMMARY FINANCIALS, RUR mn	2009	2010E	2011E
Interest incomes	373 700	370 283	409 680
Net Interest	152 200	165 701	177 981
Net Income	-59 600	52 833	93 161
Equity	502 223	536 798	587 183
EPS, RUR	neg.	0.0051	0.009
Interest income growth, %	41	0	11
EPS growth, %		-	-2
ROAE	neg.	10%	17%

SUMMARY VALUATIONS	2009	2010E	2011E
P/BV	1.4	1.4	1.2
P/E	отр.	12.3	9.1
Loans/Deposits	147%		
P/B cur.	1.4		

SHAREHOLDER STRUCTURE	
State property	85.50%
Others	14.50%

PRICE DYNAMICS



Source: Bloomberg, TKB Capital estimates

VTB

BALANCE SHEET

RUR mn	2009	2010E	2011E	2012E	2013E	2014E
Loans and advances to customers	2 309 900	2 636 178	3 177 788	3 553 321	4 034 869	4 591 534
Securities	400 700	426 205	476 247	520 673	558 675	582 024
Due from other banks	345 600	276 480	276 480	276 480	276 480	248 832
Other	554 600	560 801	476 106	540 874	559 372	549 947
TOTAL ASSETS	**3 610 800**	**3 899 664**	**4 406 620**	**4 891 349**	**5 429 397**	**5 972 337**
Customer accounts and deposits	1 568 800	1 744 065	2 010 922	2 344 617	2 777 700	3 257 399
Issued securities	485 700	496 252	528 886	557 290	562 800	571 980
Due to other banks	287 000	301 350	316 418	332 238	348 850	366 293
Other liabilities	756 777	810 900	952 912	974 128	961 462	875 196
TOTAL LIABILITIES	**3 098 277**	**3 352 566**	**3 809 138**	**4 208 273**	**4 650 812**	**5 070 868**
Share capital	113 064	113 064	113 064	113 064	113 064	113 064
Share premium	358 500	358 500	358 500	358 500	358 500	358 500
Treasury stocks	(441)	(441)	(441)	(441)	(441)	(441)
Non-realized gains	3 400	3 400	3 400	3 400	3 400	3 400
Revaluation Reserves	25 000	25 200	18 200	18 200	18 200	18 200
Retained Earnings	2 700	37 074	94 459	180 052	275 561	398 445
TOTAL EQUITY	**502 223**	**536 798**	**587 183**	**672 775**	**768 285**	**891 168**
Minority share	**10 300**	**10 300**	10 300	10 300	10 300	10 300
TOTAL EQUITY & LIABILITIES	**3 610 800**	**3 899 664**	**4 406 620**	**4 891 349**	**5 429 397**	**5 972 337**

ASSET QUALITY

RUR mn	2009	2010E	2011E	2012E	2013E	2014E
NPLs	**249 390**	**292 652**	**276 687**	**268 179**	**258 466**	**217 111**
NPL Reserves	**234 900**	**290 342**	**280 799**	**277 801**	**272 898**	**233 165**
NPLs/Gross Loans	**9.8%**	**10.0%**	**8.0%**	**7.0%**	**6.0%**	**4.5%**
Reserves/NPLs	**0.9**	**1.0**	**1.0**	**1.0**	**1.1**	**1.1**

PROFIT & LOSS STATEMENT

RUR mn	2009	2010E	2011E	2012E	2013E	2014E
Interest income	373 700	370 283	409 680	436 879	474 328	505 042
Interest expenses	(221 500)	(204 582)	(231 700)	(233 433)	(256 915)	(269 035)
Net interest income	152 200	165 701	177 981	203 445	217 413	236 007
Provision for loan impairment	(154 700)	(57 752)	(3 638)	(6 535)	(2 204)	31 663
Net income from security operations	(39 900)	10 000	4 000	15 000	14 000	12 500
Net comission fee	21 000	21 901	28 538	32 439	40 875	47 094
Other net income	33 300	8 281	3 157	4 438	11 259	11 611
Administrative and other operating expenses	(80 200)	(82 089)	(93 586)	(105 184)	(118 543)	(134 604)
Profit before tax	(68 300)	66 041	116 451	143 603	162 801	204 271
Income tax	8 700	(13 208)	(23 290)	(28 721)	(32 560)	(40 854)
Net profit	**(59 600)**	**52 833**	**93 161**	**114 882**	**130 240**	**163 417**

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Net interest income growth	23%	9%	7%	14%	7%	9%
Net comission fee growth	9%	4%	30%	14%	26%	15%
Net interest margin	5%	5%	5%	5%	4%	4%
Cost/income ratio	43%	45%	44%	45%	47%	0%
ROAE	neg	10%	17%	18%	18%	20%
Loan/Assets	64%	68%	72%	73%	74%	77%
Deposits/Liabilities	51%	52%	53%	56%	60%	64%
Loans/Deposits	147%	151%	158%	152%	145%	141%
Equity/Assets	14%	14%	13%	14%	14%	15%

Source: company data, TKB Capital estimates

Bank St. Petersburg
Efficiency vs. risks

Bank St. Petersburg remains the most efficient bank on the market considering operating costs, while its exposure to SME and regional clientele determine relatively high credit risks comparing to its peers. Strong loan portfolio growth in 2009 gave place to weaker numbers due to tough competition from the federal players aiming at market share expansion. Lower interest rates put pressure on margins, while substantial provisions diminish financial results of the bank. The released numbers over 1Q10 and more conservative forecasts from the management do not provide downside risks to our long-term valuation (with a BUY recommendation and a $4.2 target price), while in the medium term the financials will limit upside potential of the stock. Preferred shares of the bank look less attractive comparing to ords, which are traded with 60% discount.

NIM will stay at 5-6%. The bank foresees NIM in 2010 at 5-6%, while the level of 5.6%, which it achieved in 1Q10, does not look sustainable taking into account the current market conditions. These numbers are slightly less optimistic than the management expected earlier. Meanwhile, we estimate NIM at 5.5% in 2010.

The bank will continue provisioning in consecutive quarters. According to the management comments, higher than expected provisions over 1Q10 are explained by existing risks and considered as additional cushion in case of worsening situation. The bank will continue provisioning in 1-2 more quarters, while it expects the NPLs to peak in 2H10. According to the bank expectations, it will write off 6-7% in coming years and expects situation to improve in 2011. Provisions were at 10.4% of the total portfolio, covering overdue loans 1.2 times. Reserves will pick up in 2H10 and may reach 12-13% of the total loans.

Cost control will be strict. The bank expects operating costs to grow approximately by 10% y-o-y in 2010, which reflects strong efficiency ratios. Cost-to-income ratio was at 19.9% and in 2010 we expect this number at 22-25%. This is the lowest ratio among its market peers, which is one of the core competitive advantages of the bank.

Expansion of loan portfolio is limited. Loan portfolio is expected to grow by 12% in 2010, which is slightly below previous forecasts. 1Q10 numbers were quite strong, but in 2Q10 growth slowed down due to large repayment of loans and still low demand for new ones. Thus, future growth numbers will depend on the market conditions.

Conservative forecasts postpone growth. The shares of the bank are traded at a discount to its peers on the Russian market (based on P/BV of 1.0 vs. 1.6 on average) that reflects existing risks, but the bank shows stable performance and development. More conservative forecasts from the bank's management will limit upside potential of the stock in a short-term period. At the same time, we keep our long-term positive view with a BUY recommendation. For now convertible preferred shares of Bank St. Petersburg with fixed dividend look as more protective play.

Bank St. Petersburg	Common	Preferred
Ticker	**STBK**	**STBKP**
Recommendation	**BUY**	**UR**
Price, $	**2.60**	**3.80**
Target price, $	**4.20**	**-**
Upside/downside, %	**62%**	**-**

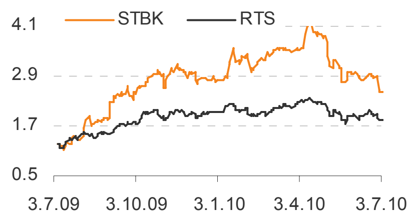
SHARE DATA		
Bloomberg	SRBK RU	
Reuters	STBK.MM	
	Common	Preferred
# of shares outstanding, mı	282	74
MC, $ mn	1 015	-
MIN 12 mnth, $	1.19	3.20
MAX 12 mnth, $	4.15	4.60

SUMMARY FINANCIALS, RUR mn	2009	2010E	2011E
Interest incomes	25 597	26 964	29 381
Net Interest incomes	10 420	12 507	11 479
Net Income	641	2 150	4 861
Equity	25 252	27 478	32 532
EPS, RUR	2.27	7.62	17.23
Interest income gı	34	5	9
EPS growth, %	-77	235	126
ROAE	3%	8%	16%

SUMMARY VALUATIONS	2009	2010E	2011E
P/BV	1.1	1.0	0.8
P/E	47.0	10.8	6.1
Loans/Deposits	90%		
P/B тек.	1.0		

SHAREHOLDER STRUCTURE	
Savelyev A.V.	29.91%
Other nanagers	29.48%
Others	40.61%

PRICE DYNAMICS



Source: Bloomberg, TKB Capital estimates

Bank St. Petersburg

BALANCE SHEET

RUR mn	2009	2010E	2011E	2012E	2013E	2014E
Loans and advances to customers	158 200	172 708	200 406	230 591	262 080	296 278
Securities	29 717	32 689	35 958	39 553	43 466	47 768
Due from other banks	5 867	5 867	6 454	7 099	7 099	6 389
Other	41 822	52 615	52 727	53 766	51 465	50 086
TOTAL ASSETS	**235 606**	**263 879**	**295 544**	**331 009**	**364 110**	**400 521**
Customer accounts and deposits	175 990	196 535	221 561	247 988	277 698	307 592
Issued securities	5 151	5 408	5 678	5 962	6 260	6 572
Due to other banks	16 002	17 730	15 781	17 495	15 878	10 376
Other liabilities	13 179	16 727	19 992	20 141	17 719	21 332
TOTAL LIABILITIES	**210 322**	**236 400**	**263 012**	**291 586**	**317 554**	**345 873**
Share capital	3 630	3 630	3 630	3 630	3 630	3 630
Share premium	15 744	15 744	15 744	15 744	15 744	15 744
Revaluation Reserves	1 966	2 064	2 168	2 276	1 600	1 400
Retained Earnings	3 912	6 040	10 990	17 773	25 582	33 874
TOTAL EQUITY	**25 252**	**27 478**	**32 532**	**39 423**	**46 556**	**54 648**
TOTAL EQUITY & LIABILITIES	**235 574**	**263 879**	**295 544**	**331 009**	**364 110**	**400 521**

INCOME STATEMENT

RUR mn	2009	2010E	2011E	2012E	2013E	2014E
NPLs	12 884	19 471	17 913	12 670	12 819	12 812
NPL Reserves	15 910	22 002	23 511	22 806	22 790	24 023
NPLs/Gross Loans	7.4%	10.0%	8.0%	5.0%	4.5%	4.0%
Reserves/NPLs	1.2	1.1	1.3	1.8	1.8	1.9

CASH FLOW STATEMENT

RUR mn	2009	2010E	2011E	2012E	2013E	2014E
Interest income	25 597	26 964	29 381	32 961	35 684	40 014
Interest expenses	(15 177)	(14 458)	(17 902)	(19 576)	(19 663)	(21 144)
Net interest income	10 420	12 507	11 479	13 385	16 022	18 870
Provision for loan impairment	(10 512)	(7 066)	(2 629)	(55)	(554)	(1 874)
Net income from security operations	1 714	200	50	50	50	50
Net comission fee	1 490	1 392	1 839	2 144	2 577	2 980
Other net income	1 422	(123)	270	295	295	295
Administrative and other operating expenses	(3 773)	(4 222)	(4 934)	(5 443)	(6 142)	(6 794)
Profit before tax	761	2 687	6 076	10 376	12 248	13 527
Income tax	(120)	(537)	(1 215)	(2 075)	(2 450)	(2 705)
Net profit	**641**	**2 150**	**4 861**	**8 301**	**9 798**	**10 822**

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Net interest income growth	10%	20%	-8%	17%	20%	18%
Net comission fee growth	108%	93%	132%	117%	120%	116%
Net interest margin	5%	5%	4%	5%	5%	5%
Cost/income ratio	25%	30%	36%	34%	32%	31%
ROAE	3%	8%	16%	23%	23%	21%
Loan/Assets	67%	65%	68%	70%	72%	74%
Deposits/Liabilities	84%	83%	84%	85%	87%	89%
Loans/Deposits	90%	88%	90%	93%	94%	96%
Equity/Assets	11%	10%	11%	12%	13%	14%

Source: company data, TKB Capital estimates

TKB Capital

Bank Vozrozhdenie
No drivers – no growth

Bank Vozrozhdenie confirmed its conservative forecasts for 2010, which were proved by 1Q10 financials. Interest margin contraction and substantial loan loss provisions as well as relatively high operating costs determined weak numbers on bottom-line and the situation is unlikely to change through 2010 due to low demand for new loans and relatively expensive funding. The stock dropped 35% from this year highs underperforming its peers. We see a limited upside for the name in 2010, which will be realized only in case of faster credit market recovery.

High margins are in the past. Stagnation of loan portfolio and lower interest income resulted in net interest income decline and NIM contraction to 4% in 1Q10, while interest spread was at 7.4% (vs. 9.2% in 4Q09). Lower interest income was the crucial reason for downgrading financial forecast for 2010. We expect NIM at 4.2% in 2010 vs. 5.9% in 2009 mainly due to lower prices on loans and significant share of retail funding in liabilities.

Loan portfolio is flat, quality of loans became worse. We forecast low growth of loans in 2010 at 6%, while in 1Q10 volume of loans was flat. At the same time, the quality of loan portfolio continues worsening. Overdue loans increased to 11.1% in 1Q10 vs. 10% at the beginning of 2010 due to higher portion of 1-30 days overdue loans. The bank expected a significant part of those loans to recover in a short period and 1H10 numbers will show if this happens. We expect provisions to grow to 11.5% in 2010 that may be lower than the total volume of overdue loans as the bank believes that 1-30 overdue loans will return to the working assets.

Relatively high costs as another challenge. Lower core income and relatively high operating costs due to existing business model reduce efficiency of the bank. Thus, cost-to-income ratio jumped to 65.3% that is the highest number among the Russian traded financial names. We expect cost-to-income at 65-67% in 2010 that will also put pressure on bottom line. The bank forecasts net profit in 2010 at RUR500 mn vs. RUR1.2 bn in 2009.

Limited upside under the current market conditions. Now the shares of bank Vozrozhdenie are traded with 2010 P/BV of 1.3 vs. 1.7 for Sberbank, which was earlier a kind of benchmark for Vozrozhdenie taking into account its business model with large branch network and a significant share of retail operations. Stronger competition and existing credit risks limit upside of the shares and we recommend considering them as long-term investment bet.

Bank Vozrozhdenie	Common	Preferred
Ticker	**VZRZ**	**VZRZP**
Recommendation	**BUY**	**BUY**
Price, $	**26.60**	**10.00**
Target price, $	**45.90**	**17.20**
Upside/downside potential	**73%**	**72%**

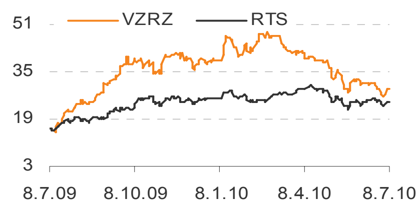
SHARE DATA		
Bloomberg	VZRZ RU	
Reuters	VZRZ.RTS	
# of shares outstanding, mı	Common	Preferred
	24	1
MC, $ mn	645	-
MIN 12 mnth, $	17.25	11.00
MAX 12 mnth, $	47.20	18.75

SUMMARY FINANCIALS, RUR mn	2009E	2010E	2011E
Interest incomes	16 954	14 600	15 602
Net Interest	8 326	6 331	8 168
Net Income	1 217	677	2 534
Equity	16 286	16 931	19 450
EPS, RUR	51.24	28.51	106.70
Interest income gr	17	-14	7
EPS growth, %	-61	-44	274
ROAE	8%	4%	14%

SUMMARY VALUATIONS	2009E	2010E	2011E
P/BV	1.2	1.1	0.9
P/E	20.4	18.7	6.0
Loans/Deposits	75%		
P/B trailing	1.1		

SHAREHOLDER STRUCTURE	
Orlov D.L.	30.70%
BURLINGTON TRADING	13.82%
Brysam Global Partners	9.37%
Others	46.11%

PRICE DYNAMICS



Source: Bloomberg, TKB Capital estimates

Bank Vozrozhdenie

BALANCE SHEET

RUR mn	2009	2010E	2011E	2012E	2013E	2014E
Loans and advances to customers	85 205	88 650	107 860	132 035	161 465	197 271
Securities	11 068	12 175	13 392	14 732	16 205	17 825
Due from other banks	6 363	7 317	8 196	9 179	10 280	11 514
Other	42 967	50 565	45 130	43 074	38 932	36 573
TOTAL ASSETS	**145 603**	**158 707**	**174 578**	**199 019**	**226 882**	**263 183**
Customer accounts and deposits	113 129	130 098	144 409	163 182	184 396	212 055
Issued securities	6 364	3 612	3 951	5 598	6 751	7 913
Due to other banks	4 368	1 747	1 660	1 577	1 498	1 423
Other liabilities	5 570	6 319	5 107	5 015	5 130	5 859
TOTAL LIABILITIES	**129 431**	**141 777**	**155 128**	**175 372**	**197 776**	**227 250**
Share capital	250	250	250	250	250	250
Share premium	7 306	7 306	7 306	7 306	7 306	7 306
Revaluation Reserves	70	52	52	52	52	52
Retained Earnings	8 660	9 323	11 842	16 039	21 498	28 324
TOTAL EQUITY	**16 286**	**16 931**	**19 450**	**23 647**	**29 106**	**35 932**
TOTAL EQUITY & LIABILITIES	**145 717**	**158 707**	**174 578**	**199 019**	**226 882**	**263 183**

INCOME STATEMENT

RUR mn	2009	2010E	2011E	2012E	2013E	2014E
NPLs	9 370	11 537	12 039	11 557	10 401	10 401
NPL Reserves	9 439	11 672	12 527	12 430	11 893	10 758
NPLs/Gross Loans	9.9%	11.5%	10.0%	8.0%	6.0%	5.0%
Reserves/NPLs	1.0	1.0	1.0	1.1	1.1	1.0

CASH FLOW STATEMENT

RUR mn	2009	2010E	2011E	2012E	2013E	2014E
Interest income	16 954	14 600	15 602	17 762	19 998	22 956
Interest expenses	(8 628)	(8 269)	(7 434)	(8 045)	(8 422)	(9 533)
Net interest income	8 326	6 331	8 168	9 717	11 576	13 423
Provision for loan impairment	(4 752)	(2 428)	(1 075)	(168)	219	753
Net income from security operations	204	20	50	50	50	50
Net comission fee	3 729	3 874	4 279	4 834	5 455	6 274
Other net income	737	222	10	10	10	10
Administrative and other operating expenses	(6 325)	(6 977)	(7 812)	(8 849)	(10 031)	(11 408)
Profit before tax	1 919	1 042	3 620	5 595	7 279	9 102
Income tax	(702)	(365)	(1 086)	(1 399)	(1 820)	(2 275)
Net profit	**1 217**	**677**	**2 534**	**4 196**	**5 459**	**6 826**

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Net interest income growth	-2%	-24%	29%	19%	19%	16%
Net comission fee growth	-10%	4%	10%	13%	13%	15%
Net interest margin	6%	4%	5%	5%	6%	6%
Cost/income ratio	49%	67%	62%	61%	59%	58%
ROAE	8%	4%	14%	19%	21%	21%
Loan/Assets	59%	56%	62%	66%	71%	75%
Deposits/Liabilities	87%	92%	93%	93%	93%	93%
Loans/Deposits	75%	68%	75%	81%	88%	93%
Equity/Assets	11%	11%	11%	12%	13%	14%

Source: company data, TKB Capital estimates

TKB Capital

Machinery

State is the engine for progress

Artem Lavrischev a.lavrischev@tkbc.ru

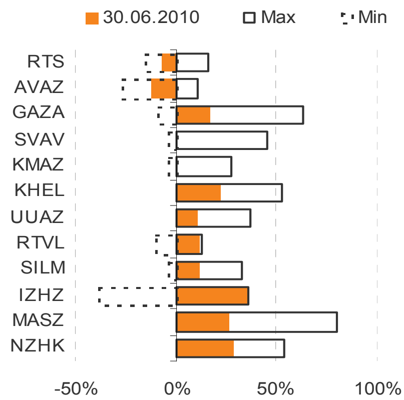
Auto makers – premium for scrap

Cash for clunkers program drives fast. The Russian government plans to increase budget by RUR10 bn for additional 200,000 scrappage certificates. We expect the domestic car and LCV market to boost 20% y-o-y to 1.75 mn vehicles in 2010.

Auto loans – hidden potential. The state could provide subsidized auto loans for 120,000 vehicles per annum (increase of 68% y-o-y). Further decline of interest rates during 2H10 may bring new impulse for customer demand recovery.

Sollers and AVTOVAZ are key performers. We believe these two companies to reach the best financial improvements due to strong vehicle sales – AVTOVAZ gets 80% of scrappage certificates, Sollers has well-positioned product portfolio.

YTD sector dynamic vs. RTS

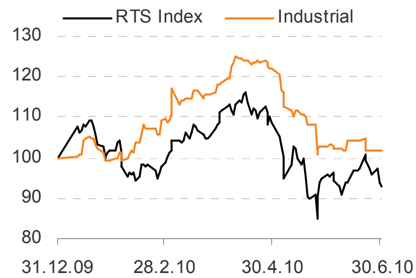


Helicopter producers – confident flight

2H10 will be strong. We expect Russian helicopter makers to increase vehicle output by 20% y-o-y to 220 units in 2010. Most of deliveries will fall on 2H10, which will be reflected on the companies' financials.

IPO of state holding – 2011 is not so far away. Russian Technologies plans to make an IPO of Helicopter Holding in 2011, which we believe is strongly interested both in domestic and foreign investors due to great industry growth prospects.

Bet on Kazan Helicopters and Ulan-Ude Aviation Plant. According to our estimates, KVZ and U-UAZ may be the most performers in the industry on a base of their high efficiency and civil aviation direction.



Source: RTS, TKB Capital estimates

Power equipment producers – orders flow to come soon

Huge capex into power generation. Updated Minenergo general scheme, which envisages investments over $300 bn into new capacity installations of 173.4 GW by 2030. This scenario is based on electricity output CAGR of 2.2%.

It is time to sign contracts. In mid-summer the Russian utility companies will start to sign capacity delivery agreements. It gives them a free hand to place orders for power equipment needed for execution their investment programs.

Power Machines and Izhorskiye Zavody are the main winners. These two companies are expected to benefit the most from stipulated orders due to the government support for domestic producers and their monopolies in several positions.

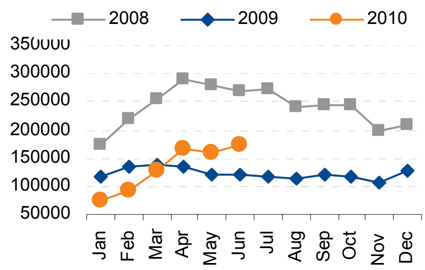
Nuclear fuel producers – atomic era

Key emerging markets bet on nuclear industry. Electricity output by nuclear power stations in Russia is expected to achieve 25% in total balance by 2030 vs. 16.5% in 2009. China and India also plan to make huge investments into nuclear industry.

Duopoly of MSZ and NCCP on domestic market. The state controlled TVEL Corporation is a monopoly provider of fuel for domestic nuclear power plants fabricated by its subsidiaries – MSZ and NCCP.

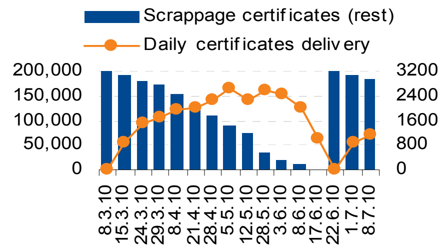
Joint ventures are key risk. Rosatom expansion to foreign markets may bring new orders for fuel fabrication especially from India and China. However, these countries are expected to establish joint ventures in its territory to localize production.

Russian automarket volume, units



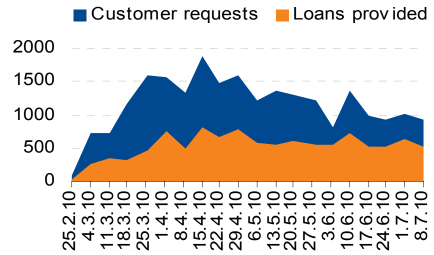
Source: AEB, TKB Capital estimates

Scrappage certificates delivery dynamics



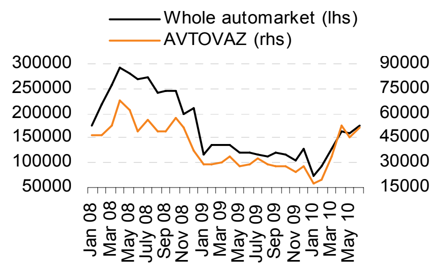
Source: Minpromtorg, TKB Capital estimates

State subsidized car loans provided (daily)



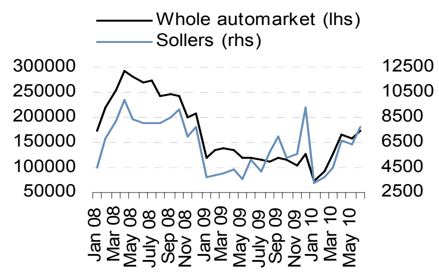
Source: Minpromtorg, TKB Capital estimates

AVTOVAZ vs. Russian automarket, units



Source: AEB, TKB Capital estimates

Sollers vs. Russian automarket, units



Source: AEB, TKB Capital estimates

Auto makers – premium for scrap

Cash for clunkers program drives fast. Since March, 2010 the Russian government has run cash for clunkers program to support domestic auto makers. The state suggests to deliver certificates of RUR50,000 ($1,600) for old (at least 10 years) cars going to scrap. Government allocated budget of RUR10 bn ($320 mn) for 2010, which could provide sales of 200,000 vehicles on the domestic market. Scrappage certificate could be used by customer for purchasing Russian made car under the threshold of RUR600,000 ($19,200) with a respective discount. The program is gaining speed: from the very beginning Minpromtorg provided less than 1,000 certificates daily, however already in May this figure went up to 2,500. All stipulated 200,000 scrappage certificates were allocated already by mid-June vs. November, as it was initially expected. As a result, the Russian car and LCV market showed y-o-y recovery from its drop of 37% in January to increase of 45% in June. Total vehicle sales for 1H10 advanced by 3% y-o-y to 790,517 units. The Russian government inspired by success of the program decided to boost its budget by RUR10 bn for additional 200,000 scrappage certificates. Based on the state support, we expect the domestic car and LCV market to increase by 20% y-o-y to 1.75 mn vehicles in 2010.

Auto loans – hidden potential. State-subsidized auto loans program is the second key supportive measure for domestic producers. Government compensates 2/3 of CBR refinancing rate for 3-year auto loans if a customer purchases Russian made car below RUR600,000 and pays 15% downpayment. During August–December 2009 banks provided 71,486 state-subsidized loans or 5% of the domestic auto market. Delay of the credit program from January to end-February in 2010 due to bureaucratic procedures had an additional negative impact on the domestic auto market at the beginning of the year. Thus, January and February car and LCV sales have declined since 2008 to less than 100,000 units per month. Banks issued state-subsidized auto loans for 470 vehicles daily in March and already 660 vehicles in April (growth of 40% m-o-m). According to our estimates, the total amount of provided state-subsidized auto loans this year to increase by 68% y-o-y and reach threshold of 120,000 loans or 7% auto market share.

Sollers and AVTOVAZ are key performers. 1H10 results maintained our positive outlook on AVTOVAZ and Sollers, which increased their vehicle sales by 23% y-o-y and 29% y-o-y, respectively vs. whole market growth of 3% y-o-y. The state cash for clunkers program had the largest impact on AVTOVAZ car sales recovery – 80% of customers prefer to use their scrappage certificate to buy LADA models. As a result, the car maker sold 52,449 vehicles in April (up by 54% y-o-y) vs. 17,308 units in January (down by 41% y-o-y). The company's management inspired by spike in demand for its cars boosted 2010 target for sales on the domestic market to 542,000 vehicles (55% y-o-y increase). It means that AVTOVAZ is likely to achieve 31% market share in 2010 vs. 24% in 2009. The company's management forecasts that AVTOVAZ will meet positive operating income over 2010. Sollers received requests for about 10,000 vehicles or 5% in cash for clunkers program mostly for UAZ models. However, the company managed to raise its market share to 4.1% in 1H10 from 3.2% in 1H09 mostly due to outperformed sales of UAZ (up by 41% y-o-y), SsangYong (up by 33% y-o-y) and Fiat LCV (up by 115% y-o-y). Sollers plans to reach EBITDA of $100-120 mn this year vs. $8 mn in 2009. The Russian government keeps an eye on relations of auto makers and steel companies as the latter increased metal prices by 17-22% due to commodity market conditions. It is likely no further changes to happen this year, which will help auto makers to control costs. We believe that AVTOVAZ and Sollers to be top performers among Russian auto makers and to show the best financial improvements due to strong vehicle sales recovery.

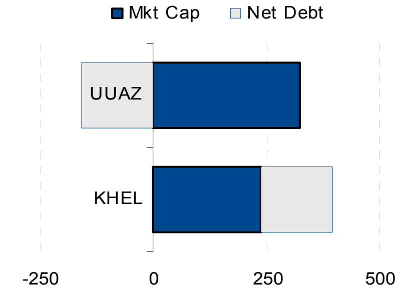
Helicopter producers – confident flight

2H10 will be strong. Russian helicopter makers' export share is traditionally exceeds 50% level. Contracts with foreign partners are signed through the state-controlled company – Rosoboronexport. According to Russian Helicopters guidance – the managing company of domestic helicopter makers – total vehicle output in 2010 may increase by 20% y-o-y to 220 units. We estimate that most of deliveries will fall on 2H10, which will be reflected in the companies' financials.

State holding IPO – 2011 is not far away. Russian Technologies' subsidiary – UIC Oboronprom – plans to make a public placement of Russian Helicopters already next year, which could have positive impact on the whole industry transparency. Furthermore, we believe that both domestic and foreign investors are strongly interested in such an IPO. We consider market capitalization of the state holding company could be valued of \$1.0–\$1.5 bn.

Kazan Helicopters and Ulan-Ude Aviation Plant – a bet on civil aviation. We believe that Kazan Helicopters and Ulan-Ude Aviation Plant may be top performers in the industry on a base of their civil aviation direction, high efficiency and an entry ticket to Russian Helicopters. Both our top picks have a 62% discount to foreign peers on the basis 2010E of EV/EBITDA.

Enterprise Value breakdown, $ mn



Source: TKB Capital estimates

Key financial multiples of companies for 2010

	P/E	EV/EBITDA	EV/S
Ulan-Ude Aviaplant	4.2	1.4	0.35
Kazan Helicopters	4.9	5.2	0.72
Russian companies average	4.6	3.3	0.54
Premium/(discount)	*-75%*	*-62%*	*-51%*
Foreign peers average	18.3	8.6	1.1

Source: Bloomberg, TKB Capital estimates

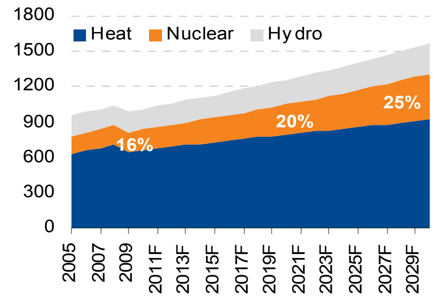
Power equipment producers – orders flow to come soon

Huge capex into power generation. Minenergo recently approved updated general scheme, which envisaged investments over \$300 bn into new capacity installations of 173.4GW and decommissioning of 67GW by 2030. Current installed capacities in Russia amounted to 216.3 GW. Minenergo scenario is based on electricity output CAGR of 2.2% and average cost of \$1,500 per KW. We also note that improvements should fall mainly on nuclear segment, which share in total balance is expected to achieve 25% by 2030 vs. 16.5% in 2009.

It is time to sign contracts. Russian power companies' investment program delay period is going over. In mid-summer key domestic utility players will start to sign capacity delivery agreements. It gives them a free hand to place orders for power equipment needed for execution their investment programs.

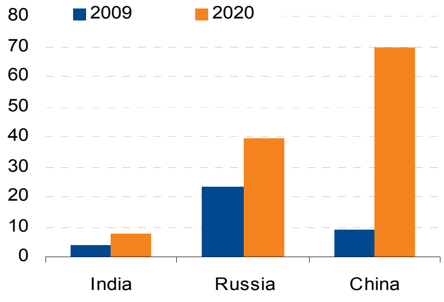
Power Machines and Izhorskiye Zavody are main winners. We believe these two companies are expected to receive the significant part of stipulated orders due to the government support to domestic producers and their monopolies in several positions. Power Machines and Izhorskiye Zavody order portfolio amounted to \$3.65 bn and \$700 mn, respectively for 2010-2013. Furthermore, both companies trade at a 55% discount to foreign peers on 2010E EV/EBITDA basis.

Electricity output in Russia (KWh bn)



Source: Rosstat, APBE, TKB Capital estimates

NPP installed capacities, GW



Source: Rosatom, OECD, WNA, TKB Capital estimates

Nuclear fuel producers – atomic era

Key emerging markets bet on nuclear industry. Russia is expected to launch new 18 nuclear power units by 2020, which will increase installed capacities of domestic NPPs by 70% to 39.4 GW from 23.2 GW in 2009. Key Russian partners in nuclear industry on emerging markets – India, China, Vietnam and Venezuela – also have substantial plans for NPP establishment. Thus, India plans to double its capacities to 8 GW by 2017, China is expected to expand its nuclear power generation capacity to 70 GW by 2020 from the current 9.1 GW. Russia traditionally has good partnership relations with these countries and we believe it will be continued.

Duopoly of MSZ and NCCP on domestic market. State controlled TVEL Corporation is a monopoly provider of fuel for domestic nuclear power plants fabricated by its subsidiaries – Mashinostroitelny Zavod (MSZ) and Novosibirsk Chemical Concentrates Plant (NCCP). Furthermore, every sixth reactor in the world is working on TVEL nuclear fuel. We believe the state company has all the chances to increase its market share due to Rosatom expansion to foreign markets. TVEL signed $400 mn contract with Slovakia, according to which MSZ will deliver 1,500 fuel assemblies for new power units of NPP Mohovce during 2012-2017.

Joint ventures are key risk. Atomic era on emerging markets is great chance for Russian nuclear industry taking into account the country's experience in this sphere. Rosatom relations with foreign partners may bring new orders for fuel fabrication especially from India and China, which have the most ambitious plans in new capacity installations. However, recent tendency indicates that both partners are willing to establish joint ventures with TVEL in its territory targeting fuel production localization. This is a key risk for MSZ and NCCP growth potential. At the same time, we both companies trade at a 80% discount to foreign peers on 2010E EV/EBITDA basis.

Ulan-Ude Aviation Plant
Effective leader

We believe Ulan-Ude Aviation Plant (U-UAZ) to keep its leading position as the most efficient company among public helicopter producers in Russia with 2010E EBITDA margin of 26%. Furthermore, U-UAZ shares could be an interesting entry ticket to Russian Helicopters, which IPO is expected to happen in 2011. U-UAZ is one and the only among domestic helicopter producers, which has net cash position of $162 mn. Our positive outlook on the company is also supported by 70% discount to foreign peers on a basis of EV/EBITDA and P/E multiples. We recommend a BUY for Ulan-Ude Aviation Plant shares with a 2010 target price of $1.8/share.

2009 figures came in line with our estimates. According to U-UAZ RAS financials for 2009, the company's revenue increased by 27% y-o-y to $389 mn, EBITDA grew by 61% y-o-y to $111 mn. Net Income advanced by 38% y-o-y to $79.5 mn. These figures came only 1-3% below our estimates. We note that U-UAZ strong financial performance was mostly due to increase of helicopter delivery, positive impact from Russian ruble depreciation over the last year (28% y-o-y) and high export share (above 60%).

U-UAZ had net cash position of $162 mn by the end of March. The company's 1Q10 RAS financials showed revenue decline of 17% y-o-y to $82.3 mn, operating income reduction of 29% y-o-y to $24.1 mn, net income decrease of 37% y-o-y to $18.5 mn. We view these results as neutral, given the large share of U-UAZ revenue should fall on 2H10 due to the helicopter maker delivery schedule. Our view is proved by the company's net cash position of $162 mn allocated by the end of March mostly due to customers' prepayments, which hit its record over the last few years.

Attractive prospects are confirmed. United Industrial Corporation Oboronprom plans to make an IPO of its subsidiary Russian Helicopters (a managing company for all domestic helicopter producers) in 2011. We believe that U-UAZ shares could become a promising entry ticket to the state holding company. Oboronprom owns a 75.1% stake in U-UAZ. The company is expected to increase vehicle output by 42% to 85 helicopters by 2012 from 60 helicopters in 2009. U-UAZ traditionally keeps export share above 50%, which will have positive impact on the company's margins.

Our U-UAZ 2010 target price is $1.8/share. We estimate that in 2010 the company's revenue will increase by 16% y-o-y to $454 mn mostly owing to helicopter delivery growth, EBITDA will advance by 5.7% y-o-y to $117.6 mn. Net income is expected to fall by 4.1% y-o-y to $76.2 mn. Slower dynamic of incomes vs. expenses are mainly due to forex changes, increase in costs for steel and fuel purchases. We use WACC and terminal growth rate of 14.6% and 2.0%, respectively in our DCF-model. We confirm our BUY recommendation for U-UAZ with a 2010 target price of $1.8/share, which has a 70% discount to foreign peers on 2010E P/E basis.

Ulan-Ude Aviation Plant	Common	Preferred
Ticker	**UUAZ**	-
Recommendation	**BUY**	-
Price, $	**1.20**	-
Target price, $	**1.80**	-
Upside/downside, %	**49%**	-

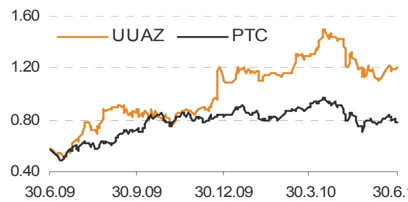
SHARE DATA		
Bloomberg	UUAZ RX	
Reuters	UUAZ.MM	
	Common	Preferred
# of shares outstanding,mr	267	-
EV, $ mn	160	
MC, $ mn	322	
MIN 12 mnth., $	0.50	
MAX 12 mnth., $	1.50	

SUMMARY FINANCIALS, $ mn			
RAS	**2009**	**2010E**	**2011E**
Revenue	389	454	503
EBITDA	111	118	115
Net income	79	76	72
EPS, $	0.30	0.29	0.27
Rev. growth, %	27.1	16.5	10.9
EPS growth, %	38.1	-4.1	-5.0
EBITDA margin,%	28.6	25.9	22.9
Net margin, %	20.4	16.8	14.4

SUMMARY VALUATIONS	**2009**	**2010E**	**2011E**
P/E	4.05	4.23	4.45
EV/EBITDA	1.44	1.36	1.39

SHAREHOLDER STRUCTURE	
Oboronprom	75.1%
ZAO Lider (Gazfond)	6.2%
Others	18.7%

PRICE DYNAMICS



Source: MICEX, RTS, TKB Capital estimates

Ulan-Ude Aviation Plant

BALANCE SHEET

$ mn	2009	2010E	2011E	2012E	2013E	2014E
TOTAL CURRENT ASSETS	381	394	376	381	405	424
PP&E, net	27	34	37	39	42	44
Other non-current assets	25	26	30	37	39	40
Total NON-CURRENT ASSETS	52	61	67	76	81	85
TOTAL ASSETS	433	455	444	457	486	508
Short-term borrowings	13	(10)	(32)	(54)	(77)	(101)
Other short-term liabilities	222	196	134	97	73	38
Total CURRENT LIABILITIES	235	187	103	43	(4)	(63)
Long-term borrowings	-	-	-	-	-	-
Other non-current liabilities	6	-	-	-	-	-
Total LONG-TERM LIABILITIES	6	-	-	-	-	-
Minority interest	-	-	-	-	-	-
Share and additional capital	18	19	19	20	18	18
Retained earnings	173	249	321	394	472	553
Total EQUITY	192	268	341	414	490	571
TOTAL EQUITY & LIABILITIES	433	455	444	457	486	508

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Revenue	389	454	503	570	606	634
Cost of production	(274)	(327)	(372)	(433)	(460)	(482)
EBITDA	111	118	115	119	126	132
Depreciation	3	4	4	5	5	5
EBIT	108	113	111	114	121	127
Net interest income/(expenses)	(1)	-	-	-	-	-
EBT	104	95	91	91	97	101
Income tax	(25)	(19)	(18)	(18)	(19)	(20)
Net income	79	76	72	73	78	81

CASH FLOW STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Net CF from operating activities	(54)	(18)	(49)	31	52	48
Net CF from/(used in) investment activities	(18)	(9)	(7)	(9)	(5)	(4)
Net CF from/(used in) financing activities	12	(23)	(22)	(22)	(23)	(24)
Net Debt	(83)	(106)	(128)	(149)	(173)	(197)

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	27%	16%	11%	13%	6%	5%
EBITDA margin	29%	26%	23%	21%	21%	21%
Net margin	20%	17%	14%	13%	13%	13%
Net Debt/EBITDA	(0.7)	(0.9)	(1.1)	(1.3)	(1.4)	(1.5)

Source: U-UAZ, TKB Capital estimates

TKB Capital

Kazan Helicopters
Keeps rising

Kazan Helicopters is the biggest Russian helicopter producer in terms of vehicle output. We expect the company to outperform the whole industry growth due to helicopter producer develops small and midsize vehicles in civil aviation segment which is mostly demanded by domestic and external markets. Furthermore, Kazan Helicopters exports abroad more than 70% of vehicles that positively impacts its margins. The company trades with 2010E EV/EBITDA and P/E financial multiples at a discount of 40–70% to its foreign peers. We recommend a BUY for Kazan Helicopters and our target price is $2.2 per share.

2009 financials: margins improved as we expected. Kazan Helicopters RAS revenue advanced by 6% y-o-y to $475 mn in 2009, EBITDA increased by 4% y-o-y to $66 mn, net income skyrocketed by 178% y-o-y to $48.6 mn. These figures came 0-12% below our estimates due to the fact that a part of helicopter producer's vehicle deliveries was delayed to 1Q10. Thus, the company produced 85 helicopters in 2009 (up by 31% y-o-y), while customers received only 65 vehicles (up by 12% y-o-y). At the same time, positive impact came from last year Russian ruble depreciation (28% y-o-y) and high export share in revenue (above 70%), which boosted net margin to 10.2%.

Strong 1Q10 brings optimism to the whole 2010. The company increased vehicle deliveries by 125% y-o-y to 18 helicopters In January-March. As a result, the producer's revenue for the same period doubled y-o-y to $164.5 mn, operating income amounted to $47.1 mn vs. operating loss for 1Q09 of $4.7 mn, net income soared by 4 times y-o-y to $34.9 mn. It is worth noting that Kazan Helicopters contracted cash on its balance almost by 2 times to $102 mn during 1Q10, while its borrowings stayed almost unchanged – $259 mn. We consider this happened mostly due to the company makes investments into launch of new models production in coming years.

High capacity utilization and favorable IPO prospects. According to Russian Helicopters (the management company owned by Oboronprom), Kazan Helicopters is fully loaded for 2010–2011. Furthermore, the company's export deliveries bring more than 70% of revenue, which positively impacts the margins. We note that Oboronprom (owns a 54.7% stake in Kazan Helicopters) plans to make an IPO of Russian Helicopters in 2011 and we believe that Kazan Helicopters' shares could be one of the most promising entry to the state holding company.

Our Kazan Helicopters 2010 target price is $2.2 per share. We expect the company's revenue to advance by 16% y-o-y to $549 mn mostly due to helicopter delivery growth in 2010. We forecast EBITDA to increase by 14% y-o-y to $76 mn. Net Income is expected to lose 1% y-o-y to $48 mn mainly due to forex changes as well as to increase in steel and fuel expenses. We keep using WACC and terminal growth rate of 14.6% and 2.0%, respectively. Our end-2010 target price for Kazan Helicopters is $2.2 per share with a BUY recommendation.

Kazan Helicopters	Common	Preferred
Ticker	**KHEL**	**KHELP**
Recommendation	**BUY**	-
Price, $	**1.54**	-
Target price, $	**2.20**	-
Upside/downside, %	**43%**	-

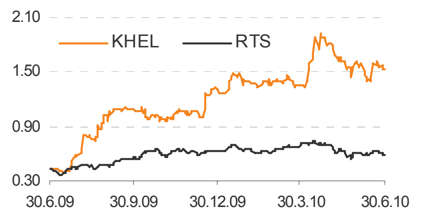
SHARE DATA		
Bloomberg	KHEL RX	
Reuters	KHEL.MM	
	Common	Preferred
# of shares outstanding, mn	154.1	0.6
EV, $ mn	394	
MC, $ mn	237	
MIN 12 mnth., $	0.39	
MAX 12 mnth., $	1.92	

SUMMARY FINANCIALS, $ mn			
RAS	**2009**	**2010E**	**2011E**
Revenue	475	549	602
EBITDA	66	76	83
Net income	49	48	53
EPS, $	0.32	0.31	0.34
Rev. growth, %	5.7	15.6	9.6
EPS growth, %	177.8	-0.6	9.6
EBITDA margin, %	13.9	13.8	13.7
Net margin, %	10.2	8.8	8.8

SUMMARY VALUATIONS			
	2009	**2010E**	**2011E**
P/E	4.9	4.9	4.5
EV/EBITDA	6.0	5.2	4.8

SHAREHOLDER STRUCTURE	
Oboronprom	54.7%
TFK	11.5%
Others	33.9%

PRICE DYNAMICS



Source: MICEX, RTS, TKB Capital estimates

Kazan Helicopters

BALANCE SHEET

$ mn	2009	2010E	2011E	2012E	2013E	2014E
TOTAL CURRENT ASSETS	847	959	1 050	1 092	1 121	1 189
PP&E, net	56	58	61	63	66	68
Other non-current assets	25	35	41	47	53	58
Total NON-CURRENT ASSETS	81	93	102	111	119	126
TOTAL ASSETS	928	1 052	1 152	1 203	1 240	1 316
Short-term borrowings	261	247	231	214	197	179
Other short-term liabilities	498	586	649	660	664	700
Total CURRENT LIABILITIES	759	833	880	875	862	880
Long-term borrowings	-	-	-	-	-	-
Other non-current liabilities	-	-	-	-	-	-
Total LONG-TERM LIABILITIES	-	-	-	-	-	-
Minority interest	-	-	-	-	-	-
Share and additional capital	69	72	73	74	68	66
Retained earnings	99	147	200	255	311	370
Total EQUITY	168	219	273	328	379	436
TOTAL EQUITY & LIABILITIES	928	1 052	1 152	1 203	1 240	1 316

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Revenue	475	549	602	653	702	744
Cost of production	(326)	(384)	(433)	(483)	(533)	(566)
EBITDA	66	76	83	86	89	94
Depreciation	3	4	4	5	5	5
EBIT	63	71	78	82	84	89
Net interest income/(expenses)	(17)	(11)	(12)	(13)	(14)	(15)
EBT	49	60	66	69	70	74
Income tax	-	(12)	(13)	(14)	(14)	(15)
Net income	49	48	53	55	56	60

CASH FLOW STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Net CF from operating activities	34	141	118	117	108	150
Net CF from/(used in) investment activities	(18)	(13)	(9)	(9)	(8)	(7)
Net CF from/(used in) financing activities	82	(15)	(16)	(16)	(17)	(18)
Net Debt	73	58	42	26	9	(9)

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	6%	16%	10%	9%	7%	6%
EBITDA margin	14%	14%	14%	13%	13%	13%
Net margin	10%	9%	9%	8%	8%	8%
Net Debt/EBITDA	1.1	0.8	0.5	0.3	0.1	(0.1)

Source: Belon, TKB Capital estimates

Real estate sector

Restoring demand

We continue to be moderately positive on the Russian real estate sector. However, we expect slower growth of prices throughout 2H10. Instability on financial and currency markets, volatility of oil prices and limited domestic consumer demand are impediments to the sector recovery after crisis. We still consider state support in form of investments into mortgage lending development and purchases of residential real estate for social needs as main triggers of successful sector recovery.

Key bet on residential real estate

Demand for housing to remain. In the conditions of the lowest saturation of residential in Russia demand for mass market residential remains high. The limited offer is one of major growth drivers for the real estate prices in the long-term prospect.

Mortgage lending relived. The favorable factor triggering stronger demand for residential real estate is a development of mortgage lending market. The state intends to spend RUR250 bn within 2010 for encouraging growth of mortgage purchases thank to reduction of credit rates.

The state will continue to buy residential. The program of attraction of private construction companies like PIK Group and LSR Group for building residential real estate remains, in our view, one of the best ways for additional load their capacities while market demand is insufficient.

Correction in prices is likely by the year-end

Average price performance may slide down. From the beginning of the year the average price of a square meter of Moscow residential real estate increased by 16% in rubles and by 11% in dollars. Considering current macroeconomic background, we do not exclude correction of prices – within 10% in rubles.

Commercial real estate under pressure

The prices stabilized, but growth is still far away. Rebound of commercial real estate in the first half of the year occurred thanks to growth of business and consumer activity. However, launch of new areas which were "frozen" during the crisis, dilutes demand and constrains price rise.

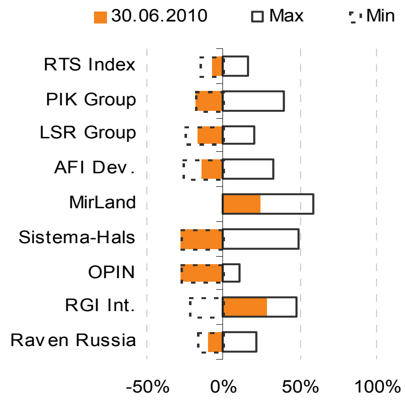
Our top pick – LSR Group

Comfortable liquidity and growing project portfolio. Additional placement of shares for $385 mn provided financial stability to LSR Group. The growing project portfolio and expansion to perspective Moscow region raises investment appeal of the company.

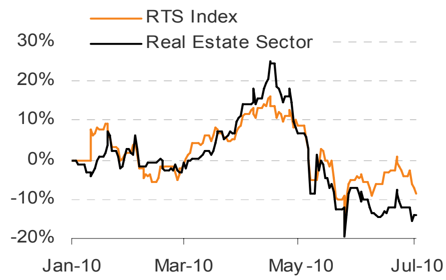
Attractive valuation based on multiples. LSR Group trades with an average EV/EBITDA 2010-2011E equaling 9.4 and 8.2 accordingly, that assumes average discount of 25% to its foreign peers.

Fundamental value is above the market. We recommend to buy shares of the market leader of construction sector – LSR Group. Our end-2010 target price is $11.4 per GDR and $57 per share.

YTD sector dynamic vs. RTS

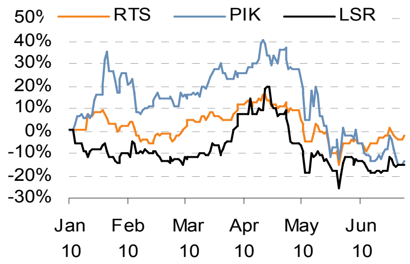


Sources: Bloomberg, TKB Capital estimates



Sources: Bloomberg, RTS, TKB Capital estimates

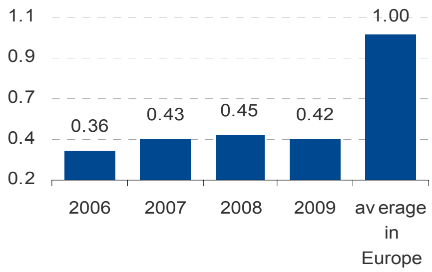
Price dynamics of LSR Group, PIK Group and RTS Index



Sources: Bloomberg, TKB Capital estimates

Russia has a long way to go to EU countries' levels

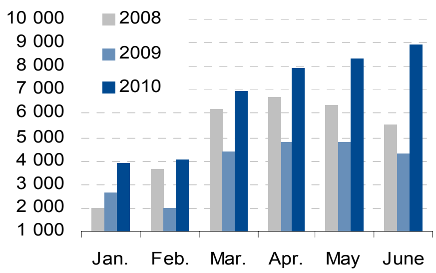
Volume of residential construction per capita, sqm



Sources: Rosstat, TKB Capital estimates

Transactions are on the rise

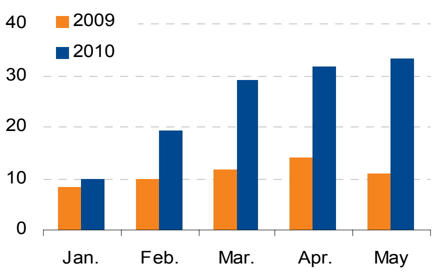
CData on the number of purchases and sales transactions registered in Moscow



Source: Federal Registration Service

Mortgage lending is growing steadily…

Mortgage credits issued



Sources: Rosstat, TKB Capital estimates

Our forecasts for 1H10 came true and even turned out to be better that the reality. Early in 2010, housing sector showed confident rebound in demand, and price per a square meter reversed a part of its losses in 2009 having increased by 16% YTD in ruble terms in the absence of strong growth drivers. PIK Group and LSR Group managed to restructure the major part of their debts and obtained credit lines for the development of new projects. Against this backdrop, PIK Group and LSR Group staged rally in January-April this year. However, they did not finish 1H10 on a positive note. Aggravated in 2Q10 problems on financial and currency markets uncovered sector risks and resulted in correction of construction names.

Key bet – on residential real estate

Demand for residential to remain. In 1H10 steady revival was observed not only on building sites of Moscow and St. Petersburg, but also in regions of Russia. Building of many projects "frozen" during crisis renewed, new projects were started. This was triggered by low prices for building materials and strong demand recovery. The needs for residential in Russia remains high, and they can be satisfied over next few years the given its deficit. Volumes of annual construction (including pre-crisis period) account only for 40% of average European level. Housing per capita in Europe more than twice exceeds the respective indicator in Russia.

New offer of housing will be limited. Despite the financial state of construction companies improved over last year and many of them restructured their debts, yet they have not found sufficient stability. Debt load remains high. Access to foreign investment capital for the majority of the companies is still closed and the key source of financing of developers' projects is bank credits. Thus, banks though express desire to finance developers, submit stricter requirements and prefer to provide financing only to large companies (such as PIK Group and LSR Group) that finally leads to reduced volumes of building in Russia and, as a consequence, to limited offer.

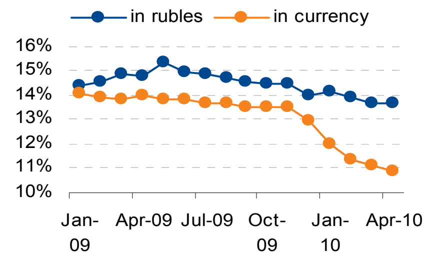
Volumes of purchases confirm pent-up demand. The demand accumulated in crisis surpassed our expectations. The buyers who have postponed purchases of apartments because of crisis 2008-2009, have started to enter the market in 2010. In first half of 2010 the number of transactions of residential real estate in Moscow exceeded not only level of 2009 (up by 76%), but also pre-crisis level of 2008 (up by 32%). We believe, such spike in activity of buyers is caused, first, by growing level of disposable incomes and expected recovery of Russian economy; secondly, by stable prices for residential real estate which despite increased number of purchases, raise by moderate rates; and thirdly, by revival of mortgage lending market.

Mortgage lending is coming back to life. The additional favorable factor for market demand is the reviving market of mortgage lending. The volume of issued credits for first five months of 2010 exceeded level of 2009 by 124%. However, we are not overwhelmingly optimistic regarding this way of purchase of residential. First, despite solid growth of volumes y-o-y, basically thanks to effect of low base, current number of purchases accounts for about 40% of pre-crisis level; secondly, in Russia the volume of purchases of mortgage apartments is less than 2% of GDP in many respects because of high credit rates. Thus, for example, in Poland and Czech Republic the respective indicator constitutes about 10%, in France – 34%, in Germany – 48% and in the USA – more than 50%, and the average credit rate varies within the range of 2.5-4.8%.

The state promotes lower credit rates... This year the state plans to invest totally RUR250 bn into the mortgage lending market. RUR50 bn will be allocated by VEB, RUR160 bn – by funds of pension savings and RUR40 bn – by National Prosperity Fund. The main goal is to reduce interest rates for mortgage loans to 10-11%, in 2010. In May Prime Minister of Russia Vladimir Putin stated that VEB launched the program aimed at encouraging mortgage lending. From the beginning of this year the average credit rate for mortgage decreased by 0.5 ppt to 13.7% in rubles and by 2.1 ppt to 10.9% in dollars. We positively view on the state initiatives, however given instability of financial and currency markets, we do not expect significant decrease in mortgage rates from current levels till the end of 2010.

...against the backdrop of lower credit rates

Average mortgage credit rates in Russia



Sources: Rosstat, TKB Capital estimates

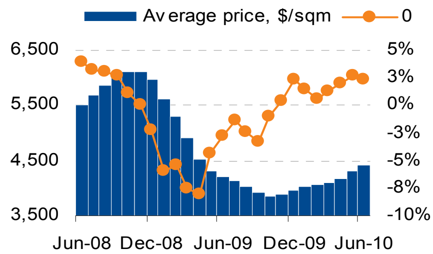
...and also continues to purchase residential real estate for social needs. The program to attract private construction companies for building of social residential remains the effective way to offset lower market demand. In spite of the fact that builders' operational profitability does not exceed 5-7%, the companies which participate in state orders, first, have an opportunity to load free (in the absence of market demand) capacities and secondly, improve their short-term liquidity. For example, the largest customer of social housing – Defense Ministry of Russia, which plans to spend for residential purchase RUR110 bn ($3.5 bn) only in 2010-2011, makes advance payments for construction.

Correction in prices is likely

Average price performance may slide down. Confident growth of price of a square meter of real estate in Moscow was observed throughout first half of the year. From the beginning of 2010, the average price of a square meter of Moscow real estate grew by 16% in rubles and by 11% in dollars. Thus, recently increased instability of financial and currency markets may lead to correction of prices in 2H10. The real estate market is characterized by high lentitude and the time of its reaction on economic events can vary from a month to a half of a year. Therefore, we predict that 2H10 for real estate market will be quite volatile, but at the same time, we do not see any reasons both for sharp growth or falling price of a square meter. According to our forecasts, a possible correction of ruble prices will not exceed 10% from current levels.

Price performance approached a positive zone

Average price per sqm in Moscow



Sources: Bloomberg, TKB Capital estimates

Commercial real estate is under pressure of new spaces

The prices stabilized, but growth is still far away. We have a moderately positive outlook on this segment of real estate market. In 1H10 thanks to growth of business and consumer activity average rental rates for office and retail spaces consolidated, and insignificant growth of average rates (within 2-3%) is observed in some areas with favorable locations. However, considering volumes of new offer on the market and declared volume of commercial spaces to be commissioned during next two years, rebound in demand for commercial real estate would require longer time than for residential. We expect that the market of commercial real estate will be under pressure of new spaces and we expect positive dynamics of rental rates not earlier than in 2011. The current portion of unoccupied office areas is 17-19% and that of trading spaces is 13-14%. We believe that more confident growth of rental rates will come as soon as the share of unoccupied areas falls below 10% that is expected not earlier than in 2012.

LSR GROUP		
	Common	GDR
Ticker	LSRG RU	LSRG LI
Recommendation	**BUY**	**BUY**
Price per GDR, $	**26.9**	**7.0**
Fair price, $	**57.0**	**11.4**
Upside/downside potential	**112%**	**63%**

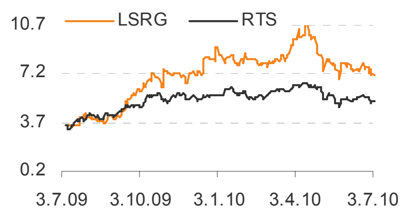
SHARE DATA	
Bloomberg	LSRG LI
Reuters	-
	GDR
# of GDRs outstanding, mn	468.3
EV, $mn	4 433
MC, $ mn	3 278
MIN 12 mnth., $	0.5
MAX 12 mnth., $	11.0
	Common
GDR per 1 share	5

SUMMARY FINANCIALS, $ mn			
	2009	2010E	2011E
Revenue	1 608	1 751	2 161
EBITDA	464	473	540
Net income	145	205	262
EPS ($)	0	0	1
Rev. growth (%)	-20	9	23
EPS growth (%)	-145	42	28
EBITDA Margin (%	28.9	27.0	25.0
Net Margin (%)	9.0	11.7	12.1

SUMMARY VALUATIONS			
	2009	2010E	2011E
EV/EBITDA	9.5	9.4	8.2
EV/S	2.8	2.5	2.1

SHAREHOLDER STRUCTURE	
Streetlink Limited	48%
A. Molchanov	10%
Management	12%
Free Float	30%

PRICE DYNAMICS



Source: Bloomberg, TKB Capital estimates

LSR Group
Heading to Moscow

LSR Group remains our top pick in real estate sector. We believe that its flexible business model, comfortable debt leverage and beneficial project portfolio are capable to provide the company competitive advantage over other large builders. Rapid expansion into Moscow region, which is able to recover fast, will widen sale scope and improve LSR Group profitability thanks to high margin of Moscow residential real estate market in comparison with other regions of Russia.

SPO improved liquidity. In April this year, LSR Group successfully made secondary placement of shares and raised $385 mn. From them $179 mn were spent for debt repayment, while LSR intends to invest the remaining part into development of real estate business segment and expansion of capacities. According to 2009 financials, net debt of LSR Group stood at $1.2 bn and net debt to EBITDA ratio was 2.6 that is one of the lowest indicators in sector. Among perspective directions of LSR Group development we underline expansion into Moscow market where the company already owns factories which produce concrete and reinforced concrete products, and this year the company has started to develop several residential real estate projects with a total area of 440,000 sqm.

LSR Group is gaining its foothold on Moscow market. In March, 2010 the company entered Moscow market with $100 mn mass-market residential project, located in 13 km from Moscow with 79,000 sqm of net selling area. In April LSR continued to strengthen its positions, having announced $600 mn business-class residential project in the southwest of Moscow with 170,000 sqm of net selling area and $260 mn mass-market residential project in 16 km from Moscow with 190,000 sqm of net selling area. According to our estimates, operating margin of the projects located in Moscow region will amount about 25%, projects in Moscow – 35%. Business expansion into Moscow and region will positively affect LSR Group profitability. According to Builders Association of Russia, gross margin in Moscow by 13-15 ppt exceeds the respective figure in St. Petersburg.

The portfolio of state orders keeps growing. We positively view on LSR Group liaison with the state agencies on building of social residential. In 2010, the company completed $60 mn state contract and additionally received $180 mn contracts. Based on our calculations, the order portfolio for social housing is valued at $830 mn for next two years. In our view, participation in such projects ensures maximum loading of capacities of LSR Group and offsets market risks.

Attractive by multiplies. Valuation based on multiplies indicates good upside potential. LSR Group trades at an average 2010-2011E EV/EBITDA of 9.4 and 8.2 accordingly, that implies average 25% discount to its foreign peers.

Fundamental value is above the market. We recommend to buy LSR Group which is the market leader of construction sector. Based on our DCF-model, end-2010 target price of LSR Group is $11.4 per GDR and $57 per share.

LSR Group

BALANCE SHEET

$ mn	2009	2010E	2011E	2012E	2013E	2014E
TOTAL CURRENT ASSETS	2 240	2 721	3 291	4 053	4 757	5 458
PP&E, net	1 053	1 124	1 121	1 082	1 043	1 005
Other non-current assets	354	356	390	420	442	457
Total NON-CURRENT ASSETS	1 407	1 480	1 510	1 502	1 486	1 462
TOTAL ASSETS	3 647	4 201	4 801	5 556	6 243	6 921
Short-term borrowings	500	400	400	400	400	400
Other short-term liabilities	972	1 092	1 480	1 933	2 238	2 475
Total CURRENT LIABILITIES	1 471	1 492	1 880	2 333	2 638	2 875
Long-term borrowings	808	750	700	650	600	550
Other non-current liabilities	58	58	58	58	58	58
Total LONG-TERM LIABILITIES	866	808	758	708	658	608
Minority interest	12	12	12	12	12	12
Share and additional capital	1 039	1 424	1 424	1 424	1 424	1 424
Retained earnings	259	464	726	1 078	1 511	2 001
Total EQUITY	1 298	1 888	2 150	2 502	2 935	3 425
TOTAL EQUITY & LIABILITIES	3 647	4 201	4 801	5 556	6 243	6 921

INCOME STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Revenue	1 608	1 751	2 161	2 669	3 025	3 277
Cost of production	(1 018)	(1 067)	(1 384)	(1 728)	(1 957)	(2 117)
EBITDA	462	473	540	657	755	821
Depreciation	76	83	92	100	100	98
EBIT	331	390	448	557	655	723
Net interest income/(expenses)	(144)	(126)	(110)	(104)	(98)	(92)
EBT	187	264	338	453	557	631
Income tax	(42)	(59)	(75)	(101)	(124)	(141)
Net income	145	205	262	352	433	490

CASH FLOW STATEMENT

$ mn	2009	2010E	2011E	2012E	2013E	2014E
Net CF from operating activities	109	380	517	656	653	642
Net CF from/(used in) investment activities	(182)	(184)	(114)	(82)	(76)	(69)
Net CF from/(used in) financing activities	63	228	(50)	(50)	(50)	(50)
Net Debt	1 212	631	228	(346)	(923)	(1 495)

RATIOS

%	2009	2010E	2011E	2012E	2013E	2014E
Revenue growth	-20%	9%	23%	24%	13%	8%
EBITDA margin	29%	27%	25%	25%	25%	25%
Net margin	9%	12%	12%	13%	14%	15%
Net Debt/EBITDA	2.6	1.3	0.4	(0.5)	(1.2)	(1.8)

Sources: company data, TKB Capital estimates

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Small Caps

Slavneft's subsidiaries: waiting for the split of assets

No final decision on Slavneft's subsidiaries has been made yet. The talks about Slavneft's division have been in progress for a few years. Nevertheless, the agreement between main shareholders – Gazprom neft and TNK-BP International (a holding company of TNK-BP Holding) – has not been achieved yet. But Gazprom neft CEO Alexander Dyukov touched upon Slavneft's theme on St. Petersburg's economic forum and said that possibility of division is being considering. At the same time, rumors have recently circulated on the market about the agreed division scheme, and allegedly the split is likely in 2011-2012. 1Q11 was named as another term for the split.

News flow on acceleration of the split may drive subsidiaries' share price up. In 2H10 we expect the news about the division to come out, in case of which the minorities of Slavneft and its subsidiaries may receive a mandatory buy-out offer.

The split will be made at the level of stand-alone companies. The process started three years ago from Yaroslavnefteproduct's reorganization. The company was reorganized through the separation of Gazpromneft-Yaroslavl and TNK-Yaroslavl, in which Gazprom neft and TNK-BP Holding gained controlling stakes, respectively. Yaroslavnefteproduct's minorities, which voted against the reorganization or abstained from voting, received an offer from the company, which was higher than market price by 93% for ordinary shares and by 9% – for preferred ones. This scheme is not applicable for the split of other Slavneft's subsidiaries due to technological and legislative restrictions. We expect that control over each subsidiary will be transfered to one of the existing Slavneft's main shareholders.

Free floats of subsidiaries

Company	Tiker	MCap $ mn	Free float		Ordinary shares free float	
			%	$ mn	%	$ mn
Slavneft	SLAV	4,588	1.0	45	1.0	45
Megionneftegaz	MFGS MFGSP	2,498	5.2	130	3.4	66
Obneftegazgeologiya	obne obnep	273	20.3	56	8.3	17
Megionneftegazgeologiya	slme slmep	219	5.9	13	2.5	5
Yaroslavnefteorgsintez	JNOS JNOSP	609	5.9	36	3.0	15

Source: Company data, TKB Capital estimates

Some of Slavneft's subsidiaries look attractive. We valued the companies, shares of which are traded on stock exchange, based on 2010E EV/Production (Throughput) multiple of $30/bbl. This corresponds to the sector average adjusted for the size of valued companies. For Slavneft's stand-alone valuation we factored its own production and its portions in the subsidiaries' production and refining. In our view, Slavneft, Megionneftegaz (MNG) and Megionneftegazgeologiya (MNGG) look more expensive comparing to other Slavneft's subsidiaries. MNG has showed negative production dynamics over last years. In 2009 the company produced 12 mn t that is 8% lower y-o-y. Over 5M10 this indicator fell 9% y-o-y to 4.6 mn t. MNGG has also posted negative dynamics – its production was 20% down y-o-y in 2009 to 1.2 mn t and 19% y-o-y down over 5M10 to 0.4 mn t. On a stand-alone basis, Slavneft's production accounts for only 10% of the holding's production. The company increased production by 17% y-o-y to 1.3 mn t in 2009, but over 5M10 it declined by 5% y-o-y to 0.5 mn t.

MFGS	Common	Preferred
Ticker	**MFGS**	**MFGSP**
Recommendation	**SELL**	**SELL**
Price, $	**20**	**17**
Target price, $	**14**	**12**
Upside/downside, %	**-30%**	**-30%**
SHARE DATA		
Bloomberg	MFGS RU	MFGSP RU
Reuters	MFGS.MM	MFGS_p.MM
# of shares	99	33
EV, $ mn	3 133	
MC, $ mn	2 498	
MIN 12 mnth., $	6.6	3.6
MAX 12 mnth., $	26	19

obne	Common	Preferred
Ticker	**obne**	**obnep**
Recommendation	**BUY**	**BUY**
Price, $	**83**	**76**
Target price, $	**196**	**178**
Upside/downside, %	**136%**	**136%**
SHARE DATA		
Bloomberg	OBNE RU	OBNEP RU
Reuters	OBNEI.RTS	-
# of shares	2.5	0.8
EV, $ mn	272	
MC, $ mn	273	
MIN 12 mnth., $	35	16
MAX 12 mnth., $	110	113

slme	Common	Preferred
Ticker	**slme**	**slmep**
Recommendation	**SELL**	**SELL**
Price, $	**1.2**	**1.3**
Target price, $	**1.2**	**1.2**
Upside/downside, %	**-6%**	**-6%**
SHARE DATA		
Bloomberg	SLME RU	-
Reuters	SLMEI.RTS	-
# of shares	172	6.3
EV, $ mn	218	
MC, $ mn	219	
MIN 12 mnth., $	0.6	0.4
MAX 12 mnth., $	1.7	1.6

JNOS	Common	Preferred
Ticker	**JNOS**	**JNOSP**
Recommendation	**BUY**	**BUY**
Price, $	**0.5**	**0.4**
Target price, $	**2.2**	**1.6**
Upside/downside, %	**314%**	**314%**
SHARE DATA		
Bloomberg	JNOS RU	JNOSP RU
Reuters	JNOS.RTS	JNOS_p.RTS
# of shares	933	311
EV, $ mn	1 148	
MC, $ mn	609	
MIN 12 mnth., $	0.2	0.1
MAX 12 mnth., $	0.8	0.5

We see Obneftegazgeologiya (ONGG) and Yaroslavnefteorgsintez (YaNOS) as the most undervalued stocks. ONGG develops Taylakovskoye oil field with estimated reserves of 111 mn t. Production CAGR stood at 31% over last three years The production increased by 66% y-o-y to 1.2 mn t over 5M10. YaNOS's installed refining capacities are 15 mn t pa. Over 5M10 the plant refined 5.4 mn t that is 2% higher y-o-y. Refining depth amounted 66% in 2009. Currently, YaNOS is being upgraded, which will increase its refining depth to 88%. The plant carries out processing now, but this scheme may undergo some changes with transitioning under control of a sole shareholder.

Subsidiaries' valuation

Company	Tiker	MC, $ mn	EV, $ mn	EV/Production (Throughpput) 2010П, $/bbl	Target price, $	Upside potential, %
MNG	MFGS	2,498	3,133	39	14	-30
ONGG	oObne	273	272	13	196	136
MNGG	sSlme	219	218	32	1.2	-6
YaNOS	JNOS	609	1,148	11	2.2	314

Source: Companies data, Oil trade magazine, TKB Capital estimates

RUSSIAN ADRS & GDRS ON WESTERN EXCHANGES

Bloomberg Code	Issuer	Stock Exchange	Shares per ADR/GDR	30.06.2010 Price per ADR/GDR, $	31.12.2009 Price per ADR/GDR, $	Change, %	1H10 high	1H10 low
OGZD LI	Gazprom	LSE	4	19.09	25.50	-25.14%	26.64	18.06
ROSN LI	Rosneft	LSE	1	6.18	8.60	-28.14%	9.30	6.18
LKOD LI	LUKOIL	LSE	1	51.90	57.30	-9.42%	60.80	44.70
SGGD LI	Surgutneftegas, Common	LSE	10	8.83	8.90	-0.79%	10.20	7.76
ATAD LI	Tatneft, Common	LSE	6	28.20	29.14	-3.23%	33.10	22.66
GAZ LI	Gazprom Neft	LSE	5	18.90	27.40	-31.02%	29.40	16.95
NVTK LI	NOVATEK	LSE	10	72.30	66.00	9.55%	80.50	63.40
AOIL SS	Alliance Oil	OMXS	1	11.28	14.31	-21.15%	17.28	11.04
EDCL LI	Eurasia Drilling	LSE	1	19.30	16.04	20.29%	21.28	13.02
INTE LI	Integra	LSE	0.05	2.25	3.00	-25.00%	3.47	2.20
O2C GR	CAT Oil	XETRA	1	8.46	7.02	20.47%	8.53	6.22
VGAS LN	Volga Gas	LSE	1	3.01	3.39	-11.31%	4.59	2.91
SSA LI	Sistema	LSE	20	23.72	21.00	12.95%	30.99	21.00
MBT US	Mobile TeleSystems	NYSE	2	19.16	19.56	-2.02%	23.55	17.84
VIP US	VimpelCom	NYSE	0.05	16.18	n/a	n/a	19.01	14.34
CMST LI	Comstar-UTS	LSE	1	6.10	5.50	10.91%	7.01	5.45
RKMD LI	Rostelecom, Common	LSE	6	21.16	28.00	-24.43%	31.89	18.20
CTCM US	CTC Media	NASDAQ	1	14.44	14.77	-2.27%	19.63	12.68
SITR LI	SITRONICS	LSE	50	1.00	1.55	-35.48%	1.55	0.80
VTBR LI	VTB Bank	LSE	2000	22.00	26.50	-16.98%	35.68	22.00
VZY GR	Vozrozhdenie Bank, Common	XETRA	0.75	4.87	4.72	3.18%	5.93	4.20
FIVE LI	X5 Retail Group	LSE	0.25	33.90	31.90	6.27%	37.10	29.35
MGNT LI	Magnit	LSE	0.20	17.29	15.85	9.09%	19.60	14.35
PHST LI	Pharmstandard	LSE	0.25	22.00	20.49	7.37%	29.15	16.75
WBD US	Wimm-Bill-Dann Foods	NYSE	0.25	17.80	23.83	-25.30%	25.35	17.62
CHE LI	Cherkizovo Group	LSE	2/3	14.36	10.50	36.76%	22.50	10.50
URKA LI	Uralkali	LSE	5	18.02	21.00	-14.19%	25.20	15.00
RUSAL FP	RUSAL	Euronext	20	18.39	24.92	-26.23%	25.70	17.43
MNOD LI	Norilsk Nickel	LSE	0.1	14.52	14.35	1.18%	20.00	14.15
SVST LI	Severstal	LSE	1	9.80	9.50	3.16%	15.72	9.20
NLMK LI	NLMK	LSE	10	26.00	30.70	-15.31%	39.40	25.04
MMK LI	MMK	LSE	13	9.29	11.30	-17.79%	14.30	9.10
MTL US	Mechel, Common	NYSE	1	18.14	18.82	-3.61%	31.18	18.14
EVR LI	Evraz Group	LSE	1/3	23.63	28.25	-16.35%	42.72	22.82
PLZL LI	Polyus Gold	LSE	0.5	27.50	27.75	-0.90%	29.90	22.75
PMTL LI	Polymetal	LSE	1	12.55	9.17	36.86%	13.55	8.90
HGM LN	Highland Gold	LSE	1	2.02	1.46	37.97%	2.44	1.34
HRG CN	High River Gold	TSX	1	0.73	0.55	30.73%	0.87	0.59
TMKS LI	TMK	LSE	4	15.00	17.93	-16.34%	23.50	15.00
CHZN LI	Chelyabinsk Zinc Plant	LSE	1	3.10	3.35	-7.46%	5.11	3.10
LSRG LI	LSR Group	LSE	0.2	7.60	9.10	-16.48%	10.90	6.75
PIK LI	PIK Group	LSE	1	3.40	4.15	-18.07%	5.81	3.40
AFID LI	AFI Development	LSE	1	1.63	1.90	-14.21%	2.51	1.39
MLD LN	MirLand Development	LSE	1	2.99	2.58	15.54%	3.91	2.71
HALS LI	Sistema Hals	LSE	0.05	1.05	1.45	-27.59%	2.17	1.05
RUS LN	Raven Russia	LSE	1	0.61	0.73	-16.60%	0.89	0.55
RGI LN	RGI International	LSE	1	2.04	1.58	29.11%	2.33	1.23
GLTR LI	Globaltrans	LSE	1	14.29	9.90	44.34%	14.40	10.20
NCSP LI	NCSP	LSE	75	11.00	11.51	-4.43%	15.20	10.50

Source: Bloomberg

TKB Capital

WORLD EQUITY INDICES

Index	Country	30.06.2010	31.12.2009	Change, %	1H10 high	1H10 low
Asia						
Nikkei 225	Japan	9 382.64	10 546.44	-11.04%	11 339.30	9 382.64
Hang Seng	Hong Kong	20 128.99	21 872.50	-7.97%	22 416.67	18 985.50
Straits Times	Singapore	2 835.51	2 897.62	-2.14%	3 019.74	2 650.61
Seoul Composite	South Korea	1 698.29	1 682.77	0.92%	1 752.20	1 552.79
Shanghai Composite	China	2 398.37	3 277.14	-26.82%	3 282.18	2 398.37
Taiwan Weighted	Taiwan	7 329.37	8 188.11	-10.49%	8 356.89	7 071.67
SENSEX	India	17 700.90	17 464.81	1.35%	17 970.02	15 790.93
Europe						
FTSE 100	Great Britain	4 916.87	5 412.88	-9.16%	5 825.01	4 914.22
DAX	Germany	5 965.52	5 957.43	0.14%	6 332.10	5 434.34
CAC 40	France	3 442.89	3 936.33	-12.54%	4 065.65	3 331.29
Budapest SE Index	Hungary	21 050.43	21 227.01	-0.83%	25 322.96	20 224.74
PX50	Czech Republic	1 103.90	1 117.30	-1.20%	1 314.60	1 092.80
WIG 20 TR	Poland	2 271.03	2 388.72	-4.93%	2 604.76	2 173.25
ISE 100	Turkey	54 839.46	52 825.02	3.81%	59 330.34	48 739.43
RTS	Russia	1 339.35	1 444.61	-7.29%	1 676.27	1 226.57
MICEX	Russia	1 309.31	1 370.01	-4.43%	1 530.93	1 197.39
Africa						
FTSE/JSE Top 40	South Africa	23 294.83	24 996.97	-6.81%	26 547.87	23 093.24
Egypt CMA GENL	Egypt	561.07	573.44	-2.16%	695.44	545.94
America						
DJIA	USA	9 774.02	10 428.05	-6.27%	11 205.03	9 774.02
S&P 500	USA	1 030.71	1 115.10	-7.57%	1 217.28	1 030.71
NASDAQ	USA	2 109.24	2 269.15	-7.05%	2 530.15	2 109.24
Bovespa	Brazil	60 935.90	68 588.41	-11.16%	71 784.78	58 192.08
BUSE MERVAL	Argentina	2 185.01	2 320.73	-5.85%	2 487.76	2 061.07
IBC	Venezuela	65 158.40	55 075.68	18.31%	65 264.84	54 368.95
Emerging markets indexes						
MSCI BRIC		300.20	332.29	-9.66%	347.68	277.12
FTSE Russia IOB Index		769.59	879.03	-12.45%	984.11	705.18
MSCI Russia		707.47	795.32	-11.05%	909.21	656.44

Source: Bloomberg

COMMODITY MARKETS

Bloomberg code	Commodity	30.06.2010	31.12.2009	Change, %	1H10 high	1H10 low
Spot-market						
EUCRBRDT	Brent	73.87	77.20	-4.31%	88.45	69.60
EUCRURMD	Urals	72.85	76.73	-5.06%	85.18	67.31
USCRWTIC	WTI	75.63	79.36	-4.70%	86.84	65.96
GOLDLNPM	Gold	1 244.00	1 087.50	14.39%	1 261.00	1 058.00
SLVRLN	Silver	18.74	16.99	10.30%	19.64	15.14
PLAT	Platinum	1 533.50	1 465.50	4.64%	1 745.00	1 445.85
PALL	Palladium	442.25	407.80	8.45%	566.25	394.00
LMAHDY	Aluminium	1 951.25	2 197.00	-11.19%	2 439.85	1 834.75
LMCADY	Copper	6 483.50	7 342.00	-11.69%	7 960.25	6 067.75
LMNIDY	Nickel	19 679.00	18 452.00	6.65%	27 227.00	16 976.00
LMZSDY	Zinc	1 759.50	2 529.00	-30.43%	2 686.25	1 596.50
MBSTCIHR	Steel HRC (FOB Black Sea)	580.00	507.50	14.29%	715.00	507.50
MBSTUSHR	Steel HRC (USA)	625.00	505.00	23.76%	645.00	505.00
LMSNDY	Tin	17 380.00	16 869.00	3.03%	19 127.00	15 139.00
LMPBDY	Lead	1 725.75	2 402.00	-28.15%	2 652.75	1 529.00
Futures						
CO1	Brent	75.01	77.93	-3.75%	88.94	69.55
CL1	WTI	75.63	79.36	-4.70%	86.84	68.01
HO1	Heating Oil	198.17	211.88	-6.47%	234.51	187.17
PG1	Gasoline	206.04	205.29	0.37%	243.51	188.64
NG1	Natural Gas	4.62	5.57	-17.16%	6.01	3.84
GC1	Gold	1 245.90	1 096.20	13.66%	1 257.20	1 052.20
SI1	Silver	18.67	16.82	10.99%	19.64	14.83
PL1	Platinum	1 530.90	1 460.00	4.86%	1 747.30	1 452.30
PA1	Palladium	444.40	407.25	9.12%	567.45	394.50
LY1	Aluminium	1 887.25	1 934.50	-2.44%	2 304.00	1 777.50
LP1	Copper	6 492.75	7 351.50	-11.68%	7 967.25	6 069.50
LN1	Nickel	19 693.00	18 467.00	6.64%	27 245.00	16 984.00
LX1	Zinc	1 767.00	2 534.75	-30.29%	2 691.25	1 598.00
LT1	Tin	17 385.00	16 893.00	2.91%	19 149.00	15 145.00
LL1	Lead	1 731.75	2 409.00	-28.11%	2 657.75	1 529.75
API21MON	Steam Coal	94.75	83.19	13.90%	98.15	72.75
CCKPTAIY Index	Coking Coal	1 680.00	1 700.00	-1.18%	1 830.00	1 680.00
MBFOFO01 Index	Iron Ore	148.50	111.50	33.18%	189.50	126.00
SB1	Sugar	18.03	26.95	-33.10%	29.90	13.67
CC1	Cocoa	2 894.00	3 289.00	-12.01%	3 461.00	2 787.00
KC1	Coffee	164.20	135.95	20.78%	167.00	127.70
C 1	Corn	354.25	414.50	-14.54%	423.00	325.00
W 1	Wheat	464.75	541.50	-14.17%	572.50	428.00
S 1	Soybean	948.50	1 039.75	-8.78%	1 052.25	908.00
CT1	Cotton	82.60	75.60	9.26%	84.72	66.62

Source: Bloomberg

TKB Capital

MONEY MARKET

FOREX

Bloomberg code	Currency	30.06.2010	31.12.2009	Change, %	1H10 high	1H10 low
RUB Curncy	Dollar USD (rubles per $1)	30.67	30.04	2.12%	31.52	28.93
RREU Curncy	Euro (rubles per 1 euro)	38.29	43.07	-11.10%	43.47	37.58
RUBBASK Curncy	Basket $0.55/0.45€ (rubles)	34.41	35.96	-4.31%	36.19	33.46
EUR Curncy	Euro ($ per 1 euro)	1.226	1.433	-14.47%	1.451	1.195
GBP Curncy	British Pound Sterling ($ per 1 pound)	1.496	1.615	-7.34%	1.638	1.432
JPY Curncy	Japanese Yen (yen per $1)	88.58	93.14	-4.90%	94.72	88.40
CHF Curncy	Swiss Franc (francs per $1)	1.078	1.035	4.16%	1.162	1.017
CNY Curncy	Chinese Yuan (yuan per $1)	6.781	6.827	-0.67%	6.835	6.781
BRL Curncy	Brazilian Real (reals per $1)	1.797	1.742	3.13%	1.895	1.720
MXN Curncy	Mexican Peso (pesos per $1)	12.87	13.08	-1.65%	13.18	12.15
TRY Curncy	Turkish Lira (liras per $1)	1.579	1.493	5.76%	1.604	1.452
INR Curncy	Indian Rupee (rupee per $1)	46.45	46.53	-0.16%	47.71	44.29
KRW Curncy	S.Korean Won (won per $1)	1 221.4	1 158.1	5.47%	1 262.9	1 103.3

Interest rates

Bloomberg code	Indicator	30.06.2010	31.12.2009	Change, p.p.	1H10 high	1H10 low
BP00O/N Index	LIBOR Overnight	0.31	0.17	0.14	0.32	0.17
BP0001M Index	LIBOR 1Month	0.35	0.23	0.12	0.35	0.23
BP0003M Index	LIBOR 3Months	0.53	0.25	0.28	0.54	0.25
EUR001M Index	EURIBOR 1Month	0.49	0.45	0.03	0.49	0.40
EUR003M Index	EURIBOR 3Months	0.77	0.70	0.07	0.77	0.63
MOSKON Index	MosPrime Overnight	2.84	4.45	-1.61	5.95	2.50
MOSK1W Index	MosPrime 1Week	2.96	4.60	-1.64	5.45	2.91
MOSK2W Index	MosPrime 2Weeks	3.12	4.95	-1.83	5.50	3.09
MOSKP1 Index	MosPrime 1Month	3.42	6.32	-2.90	6.35	3.41
MOSKP3 Index	MosPrime 3Months	3.94	7.05	-3.11	7.11	3.91

NDF RUR

Bloomberg code	Maturity	30.06.2010	31.12.2009	Change, p.p.	1H10 high	1H10 low
RRNI1M Curncy	1 Month	4.58	5.74	-1.16	5.86	4.35
RRNI3M Curncy	3 Months	2.98	7.52	-4.54	7.57	2.66
RRNI6M Curncy	6 Months	3.68	6.05	-2.37	6.08	2.92
RRNI12M Curncy	1 Year	4.14	6.46	-2.32	6.46	4.04

Government Bonds

Bloomberg code	Bond	30.06.2010	31.12.2009	Change, p.p.	1H10 high	1H10 low
GT2 Govt	UST 2Y	0.61	1.14	-0.53	1.17	0.60
GT5 Govt	UST 5Y	1.78	2.68	-0.91	2.74	1.77
GT10 Govt	UST 10Y	2.93	3.84	-0.91	3.99	2.93
GT30 Govt	UST 30Y	3.89	4.64	-0.75	4.84	3.89
EC228830 Corp	RUS 30Y	5.29	5.40	-0.12	5.95	4.79
	Spread RF30/US10	2.35	1.56	0.79		

Source: Bloomberg

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