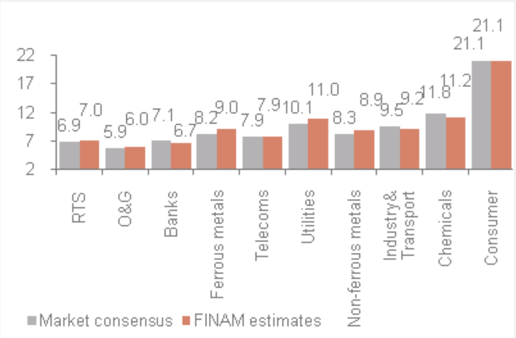
Tactics – March 2012

The market is not that cheap any more

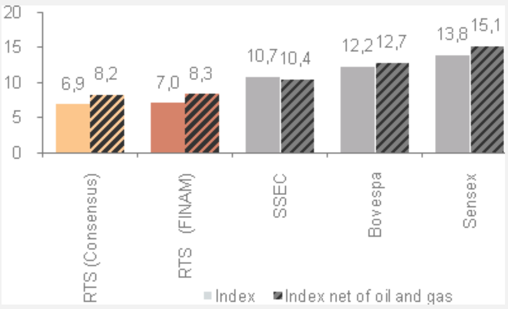
Macro factors and RTS year-end 2012 target

Scenario	worst-case	**base-case**	best-case
Brent crude	USD 70	**USD 95**	USD 120
GDP	1.0%	**3.5%**	4.5%
USD/RUB	35.0	**29.5**	28.0
RTS	1200	**1800**	2200

P/E 2012 for RTS and key economic sectors



P/E 2012 for BRIC equity benchmarks



Top picks

Moderate risk

Gazprom
Sberbank

Medium risk

Severstal
Nordgold
FGC
E.On Russia
M.video
Phosagro

High risk

TMK
Mechel local prefs
Nizhnekamskneftekhim
HMS Group

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The market has rallied 25% YTD. Russian equities continued to perform well in February, encouraged by a very favorable set of global and domestic factors, including the dream-come-true crude prices, strong US macro data, signs of improving sentiment in Europe and diminishing political risks in Russia. Fund flows also supported the growth, as Russia dedicated funds enjoyed the second straight monthly inflow in February. The benchmarks added-on roughly 25%, led by the high beta sectors, including Ferrous metals, Banks and Consumers.

Global and domestic sentiment continue to support the markets. Both the global and domestic environment has supported the stock market rally. (1) US macro data remained sustainably strong staying deaf to the numerous calls that world's largest economy could be out of steam. (2) Approval of the second bailout package for Greece and liquidity injections into the banking system helped to lower borrowing costs for debt laden nations and improve clarity on future developments. (3) Iran nuclear saga has spurred crude oil prices to post-crisis highs, which are very supportive for the Russian stock market. (4) With anti-authority protests losing steam and V. Putin close to winning the presidential campaign in the first round, political risks (which, in our view, initially were very exaggerated) diminished, giving the market another reason to head north.

However, Russian equities are not that cheap any more… Despite all of the driving forces mentioned above still being in place, we highlight that Russian stocks are already not that cheap any more. The RTS index is currently market valued at 7 weighted average forward looking earnings, a level not seen since Aug'11, while a number of sectors like M&M, Consumers, Chemicals are already priced in line with historical average multiples.

… and the recently powerful catalysts do not look absolutely sustainable going forward. It is also important to note that the major catalysts that drove Russian equities in the past two months don't look sustainable in the longer run. Liquidity injections from the ECB are only easing the pressure on debt-laden nations rather that solving the problem. Crude prices at above USD 120 bbl are creating a real risk to the economic recovery, especially considering the ongoing slowdown of emerging economies and the very vulnerable shape of the developed world. Investors who bet on Mr. Putin returning to the Kremlin are likely to be disappointed in the near future, as during his entire 12 year effective reign, the situation surrounding bureaucracy and state interventions into the economy has only become worse, and we don't see any reason that the situation could suddenly start changing for the better.

We believe the probability of a correction has increased substantially over the past month, and advise maintaining market-neutral positions. We continue to remain in the camp which believes that the upside opportunities and downside risks are more or less balanced in the near-term, at least for the upcoming month. High-Beta names have done very well YTD and could be at risk of becoming a subject for a painful correction, if the global sentiment worsens.

Stock-picking is becoming more and more important. Considering that top-tier names are already not that attractive, we advise investors to dig a little deeper in search for true value stories. However, considering the vulnerability of key market catalysts, it is obviously still not the time for the illiquid small-cap universe. We suggest betting on high-quality mid-cap names with strong corporate governance. Among our top favorites we point out: E.On Russia, Nordgold, M.Video, Phosagro and HMS Group.

Russian Equity Market

Russian equities extended the climb in Feb'12

RTS index led the February rally. Global equities continued to perform very well in February, encouraged by sustainably strong macro data from the US and in general, a considerable improvement in liquidity worldwide, and in Europe in particular. An increasing risk appetite continued to support demand for high-Beta emerging equities, resulting in an outstanding performance of Russian benchmarks for the second straight month. The RTS index has added 9% in February, outperforming all major EM and DM equity indexes.

Russian funds enjoyed second straight monthly inflow. In February, investors continued to favor emerging markets in general and Russia, in particular. Russia dedicated funds have enjoyed a USD 400 mn inflow over the past month, the best result in almost a year. The situation has also improved from a relative standpoint: the share of Russian funds in the total EM inflow rose from 2.3% in January to almost 6% in February, which is already very close to the historical average. However, we should note that the vast majority of capital inflow goes to ETFs, which clearly characterizes the speculative nature of the flows.

Global sentiment continued to support the market

Risk appetite increased. Global risk appetite continued to strengthen in February: USD Index sank, commodities extended the climb, VIX volatility index considerably fell below post-crisis averages, and EM equity benchmarks outperformed DMs. Russian country-related risks also moderated, mostly driven by skyrocketing crude prices and an increased clarity over the upcoming presidential elections: RUB extended gains and almost reached post-crisis peaks, 1-year sovereign CDS declined to the levels last seen in 1H11.

Crude prices approached post-crisis highs. Crude prices appreciated by 12% in February and touched the USD 125 bbl mark, moving very close to the post-crisis peaks set in 2Q11. Oil prices were driven by increasing geopolitical tensions in the middle-East, as the EU approved embargo against crude shipments from Iran is to become effective starting from 2H12, while Iran in response to the measure almost immediately halted shipments to a number of European states. An overall improvement in the global macro environment coupled with an easing debt crisis in Europe acted as another supporting factor for oil prices.

Political risks moderated. Diminishing political risks in Russian also backed the rally in equities. The anti-authority protests moderated further and evolved more into a form of flash-mob. The 1st round win for the current Prime Minister is becoming more and more obvious, without taking into account the fact that the Mr. Putin's 60% approval rating looks questionable. "No news is good news" - this proverb sounds irritating to the vast majority of the thinking population of Russia, but clearly represents the mood of equity investors, especially considering the fresh memories of the "Arab Spring".

Expectations and recommendations

The market is starting to look overbought. Russian equity benchmarks have rocketed 25% YTD and closed the gap to the Brazilian and Indian benchmarks, which began to show in January. The market doesn't look that cheap, both from the relative and absolute standpoint: the RTS index is currently market valued at 7 weighted average forward looking earnings, a level not seen since Aug'11, while a number of sectors like M&M, Consumers, Chemicals are already priced in line with historical average multiples. The lack of cheap investment opportunities in the top-tier universe is becoming more and more obvious, encouraging investors to dig deeper to find appealing names.

The catalysts that drove equities since early-2012, are likely to stay in place for a while… The three major catalysts that have driven Russian equities in the past two months could easily remain in place in the near-term. (1) Liquidity is likely to stay healthy, particularly in Europe where the ECB has just injected another half a trillion EUR into the banking system, (2) given the scale of geopolitical tensions, crude prices are unlikely to moderate substantially in the coming months, ensuring a very strong current account for Russia, (3) Mr. Putin being elected as a new-old president is likely to give extra impulse to Russian equities.

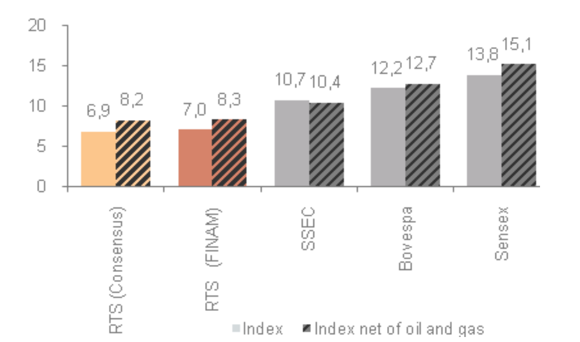
… but doesn't look sustainable in the longer term. However all three catalysts mentioned above don't look sustainable at all in the slightly longer-run. Liquidity injections from the ECB is only easing the pressure on debt-laden nations rather that solving the problem. Crude prices at above USD 120 bbl create a real risk for the economic recovery, especially considering the ongoing slowdown of emerging economies and the very vulnerable shape of the developed world. Investors who bet on Mr. Putin returning to the Kremlin are likely to be disappointed in the near future, as during his entire 12 year effective reign, the situation surrounding bureaucracy and state interventions into the economy only became worse, and we can't see any single reason for the situation to start changing for better.

Market-neutral position looks to be the optimum bet as of now. We continue to stay in the camp which believes that the upside opportunities and downside risks are more or less balanced in the near-term, at least for the coming month. High-Beta names have done very well YTD and could temporarily be out of steam, at the risk of becoming a subject for a painful correction if the global sentiment worsens. All in all, we suggest maintaining market neutral positions and sticking to a careful stock-picking approach.

Charts:

Figure 1-2. Estimated 2012 P/E for the RTS index and the main developed and emerging markets

Emerging markets



Developed markets

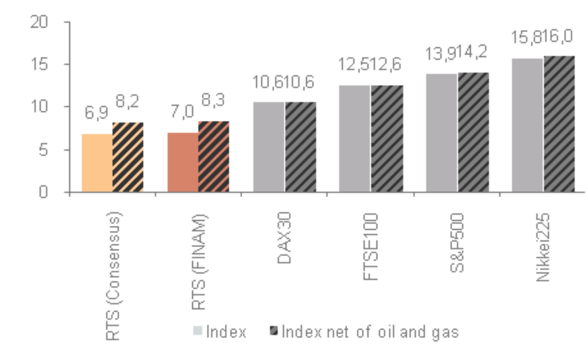


Figure 3. Russia and EM funds flows

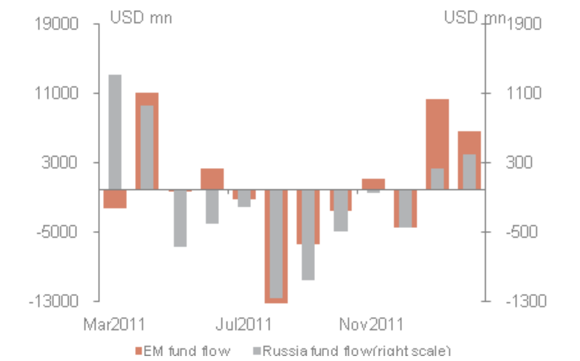


Figure 4. MSCI World index and VIX index performance

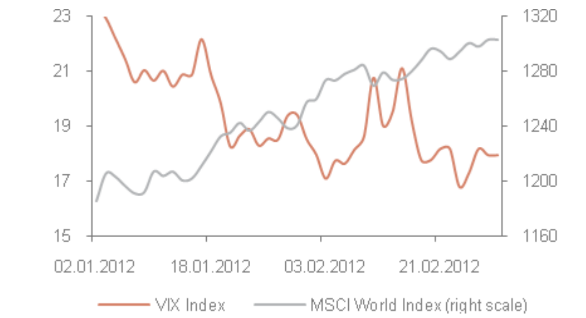


Figure 5. Russia 1-year CDS and Brent crude price dynamics

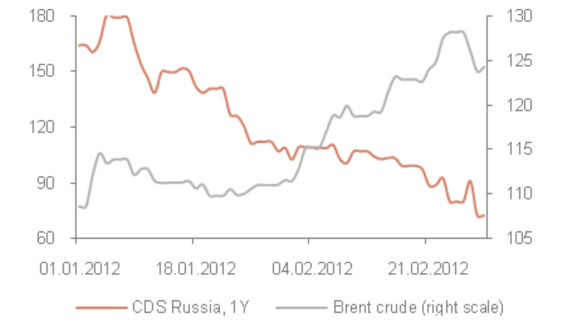


Figure 6. RTS, developed and emerging market equity benchmarks' performance

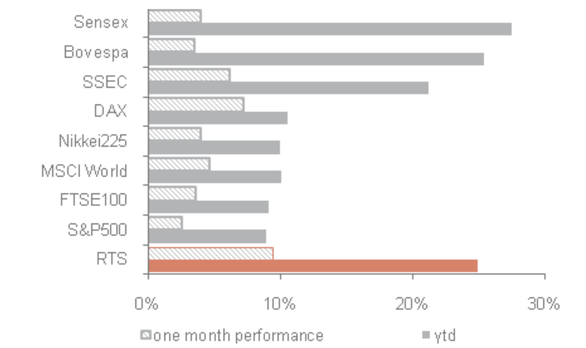


Figure 7. Gold prices and base metals price index

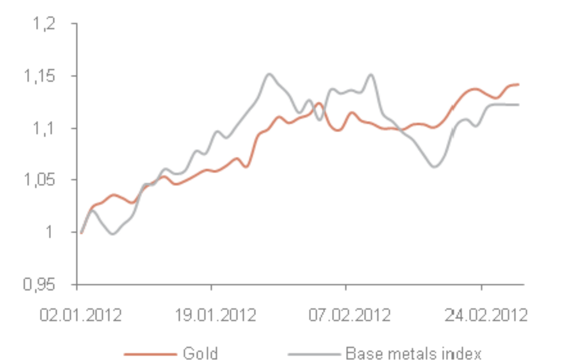
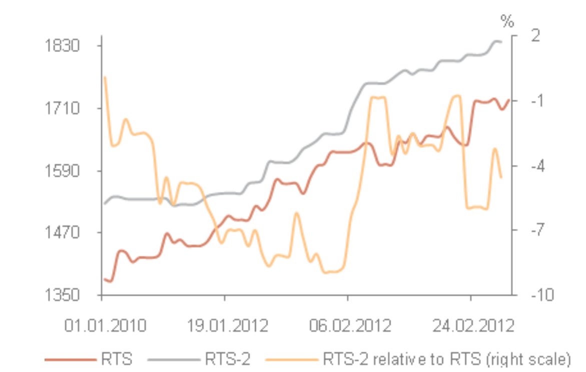


Figure 8. RTS vs RTS-2 performance



Source: Bloomberg, FINAM

Economy

Global economy

USA

Macro stats released in Feb'12 generally pointed to the accelerating recovery of the world's largest economy. Industrial production and capacity utilization remained healthy, retail sales advanced, 4Q11 GDP growth was revised from 2.8% to 3.0%, and leading indicators pointed to the gradual improvement of the economic climate. The Labor market delivered the most encouraging news, as unemployment rates substantially declined to 8.3%, and initial jobless claims moderated to the levels not seen since 1H08. Inflation picked up a bit. However, despite the obvious improvements in the economic activity, the construction sector continued to show few signs of recovery.

The US economy extended its recovery, effectively resisting external negative factors, however, we still do not see this trend as absolutely sustainable in the longer ran. The EU debt issues are expected to remain on the table for some time to come, high crude prices could damage the economic growth world-wide, and geopolitical tensions in the Middle-East also bear substantial risks for the world economy. All in all, despite the very substantial improvement of US macro data during recent months, we refrain from taking QE3 off of the table, and still believe it has a reasonable chance to be launched before the end of 2012.

Europe

It was not at all surprising that EU and Greece in particular remained the major global newsmaker in February. After a very tough negotiating process, the Greek parliament approved additional budget cutting measures and negotiated the terms of debt restructuring with private creditors, effectively opening the door for a second EUR 130 bn rescue package, which was approved by EU finance chiefs. Additional budget cuts triggered another wave of anti-authority protests all around Greece.

The ECB held another loan auction (the first one was held in mid-Dec'11) and provided roughly EUR 0.53 trln loans to European banks at a 1% interest rate. Initially, the measure was aimed at increasing liquidity in the European banking system and worked well: the borrowing costs for debt-laden nations declined substantially, allowing the ECB to bring the government bond secondary market purchase program to a close, which was re-launched in Aug'11.

The ECB left the benchmark interest rate unchanged at its monthly policy meeting. Talking about macro conditions, the ECB chairman admitted that economic growth was disappointing and the downside risks for the regional economy were not going anywhere. However, Mr. Dragi also noted that inflation should moderate in a couple of months and that the positive effect from the liquidity injections haven't fully materialized so far.

Macro data remained predominantly discouraging as unemployment rates remained at 10.4% - the highest level in almost 15 years, inflation was substantially above the ECB 2% target rate, and the Eurocommision significantly lowered its GDP forecast for 2012 – predicting a recession in the Euro zone.

G20 financial chiefs discussed the potential supporting measures for EU but agreed that Euro countries should increase their own crisis-fighting efforts first, before external bailouts should be involved.

We believe the heavy liquidity injections into the EU banking system should ease borrowing costs for debt laden states and ease the pressure, however considering the very poor shape of a number of EU members, we expect the overall economic environment to remain challenging with some extra monetary easing possible closer to mid-2012.

Japan

Macro data released in Fed'12 showed some signs of upcoming economic improvement, but the general economic indicators remained weak: 4Q11 GDP declined both on q-o-q and y-o-y basis, the trade deficit in January was at a record high. Among positive signs, we highlight capacity utilization and industrial production growth y-o-y, as well as an improvement in consumer confidence.

The BoJ left the benchmark rate unchanged in Feb'12, but increased the asset purchase program by USD 131 bn (+18%). Considering that the policy move came as a surprise for the market, it resulted in substantial depreciation of the Yen which considerably weakened to the USD, effectively returning to mid-2011 levels.

We maintain our mid-term view that the rebuilding effect could start adding steam to the economy in the mid-term, however, the relatively weak demand for exports expected to considerably damage the recovery pace. We expect to see slow positive economic growth in upcoming quarters and won't be surprised with new APP increase.

China

From the statistical point of view, the Chinese economy continued to show few signs of weakness in February. Industrial production and retail sales held firm, manufacturing expended in February for the third straight month, current account surplus widened to the highest level since Jul'11. Inflation unexpectedly picked up, with CPI jumping from 4.1 to 4.5% after 5 straight months of moderation. Despite increased inflationary pressure, PBoC lowered reserve requirements for banking system for the first time in 2012.

Considering the strong macro data, we expect China to maintain the healthy growth rates in the coming quarters, and continue to regard the hard-lending scenario as very unlikely. We also forecast that the PBoC is to make some extra accommodative policy moves in order to support growth, which could be restrained by a challenging global environment, however if the inflationary pick up is not a one-off effect, the regulator will defiantly refrain from employing the full ammunition available.

Expectations

Recently, we received some encouraging signs from US and China, and the tension in the EU softened a bit. All of this could be called supportive for the global economic recovery, if we saw the trends mentioned above as absolutely sustainable, which actually, we do not. We believe that the recovery across all of the major regions remains very vulnerable, especially considering the skyrocketing energy costs driven by geopolitical tensions. As we see it now, Europe over the next 1-2 quarters has little chance of escaping the recession, while the US is likely to remain on the recovery track and China is forecasted to slowdown modestly.

As for potential monetary policy actions, we still expect the world's major central banks to refrain from any decisive steps in the coming months. Inflation in China and EU leaves little room for immediate rate reductions, while the BoJ and US already have almost zero interest rates. Asset purchase program increases are also seen as unlikely, at least before 2H12.

Russian economy

Russian economic growth moderated in Jan'12. Real GDP y-o-y growth rate in Jan'12 amounted to 3.9%, which is slightly below the FY11 figure of 4.2%. On a m-o-m basis, the growth was even negative as the real GDP declined 0.1% compared to Dec'11. The major contributors to the slowdown were weak retail sales and depressing investments in WC. On the flip-side of the coin, the industry did fairly well during the first month of 2012: industrial production rose 1.0% on a m-o-m basis.

Unemployment rises to 6.6%. Unemployment rates in Russia increased substantially through January and reached 6.6% by the end of the first month of 2012 (6.2% at the beginning of the year). At first glance, the increase looks very substantial, but we would suggest reading this figure as a slip of Russian statistics rather than as a considerable worsening of labor market conditions. During the previous three years, the unemployment rate produced a sizeable 0.6-1.0% jump in January, paying no attention to whether the economic environment had been worsening or improving.

The Ruble strengthened further in Feb'12. The Ruble continued to appreciate through February, being backed by skyrocketing crude prices. By the end of February, Brent crude was approaching post crisis peaks by surpassing the USD 125 bbl levels, allowing the Russian currency to strengthen in relation to the EUR-USD basket by another 3.1%, the YTD appreciation has amounted to 8%. The Basket currently is standing at only 1.5% above post crisis lows against the RUB. Considering the very strong current account surplus, moderating capital outflow and diminishing political risks, we see a reasonable chance for the RUB to set a new post crisis peak against EUR-USD basket already in March.

Inflation remains subdued, 12M trailing CPI declined to an unprecedented low. By February 27, the YTD inflation amounted only 0.9% vs. 3.2% in the same period of 2011. The major reason for such a significant decline was the pre-election capping of the tariffs' increase. The average weekly inflation remained stable at 0.1% rate through Feb'12. The 12M trailing inflation declined to an unprecedented level of 3.7%. We regard this level of inflation as artificial (held in place by pre-election government initiatives), and expect the CPI to undergo a sizeable increase in 2H12, partly driven by tariffs growth. Central bank officials also recently admitted that the current low inflation rate shouldn't be thought of as sufficient grounds for adjusting the mid and long-term inflationary expectations.

Expectations

We expect economic growth to remain around 4% in the coming months. Considering that the very strong commodity prices will directly have a positive impact on net exports and an indirect but still significant influence on three other components of GDP, we do not see any major reasons for the

Russian economy to slowdown in the coming months. We believe the economic growth could settle at around 4% in the coming months, which exceeds our FY forecast of 3.5%. However, we do not regard the current commodity market environment as sustainable, and believe there is a real risk of crude prices considerably moderating in 2H12, and in turn, putting substantial pressure on the energy export-oriented economy.

Ruble could approach post-crisis high. Both the global and domestic environment are likely to continue favoring the RUB in the near-term, creating the necessary conditions for further appreciation. (1) Considering the existing geopolitical tensions, crude prices are likely to stay high, which are very supportive for the Russian current account; (2) political uncertainty is likely to diminish further following the presidential elections in early-March; (3) CBR officials recently stated that they expect capital outflows to moderate in coming months, which should be another supporting factor for the Ruble. The combination of these factors could drive the price of the EUR-USD basket to below its post-crisis lows of 33.08 RUB.

Inflation to start picking up a bit. Given that the usual annual increase in natural monopolies' tariffs was capped in light of the upcoming presidential elections, we still expect inflation to remain way below 2011 levels. However, considering the accelerated money supply expansion, there is a reasonable chance to see a pick up in inflation in the coming quarters. Despite the fact that 12M trailing inflation moderated to 3.7%, we still stick to the view that CPI will be between 6% and 7% in 2012.

Charts:

Figure 9. US, Eurozone and China industrial production, y-o-y

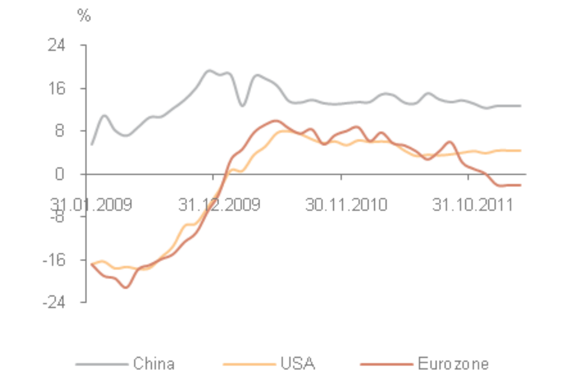


Figure 10. US, Eurozone and China CPI, y-o-y

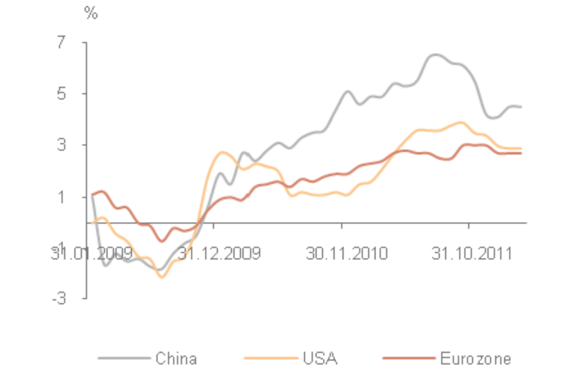


Figure 11. Oil prices and CRB Commodity Index

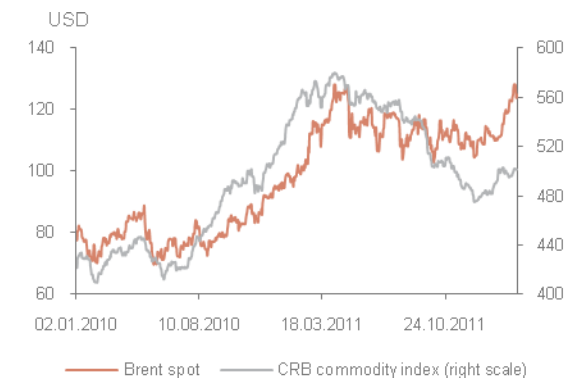


Figure 12. EUR-USD basket and dollar index

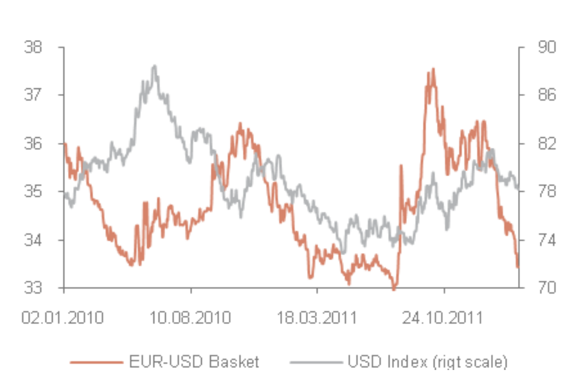


Figure 13. Russian GDP and industrial production, y-o-y

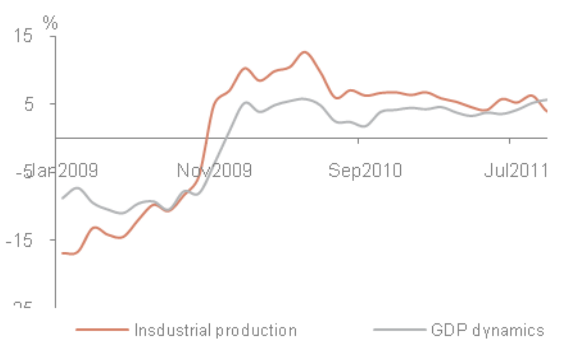


Figure 14. Russian unemployment rate

Figure 15. Russian inflation and money supply

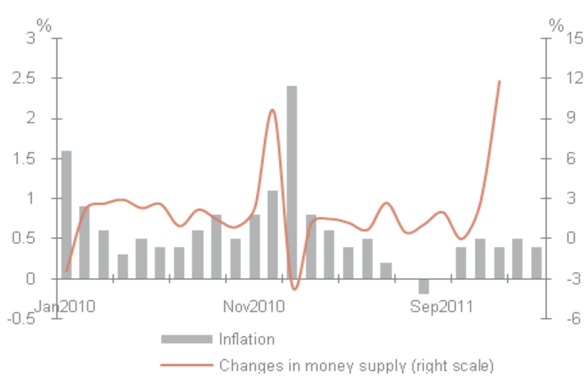
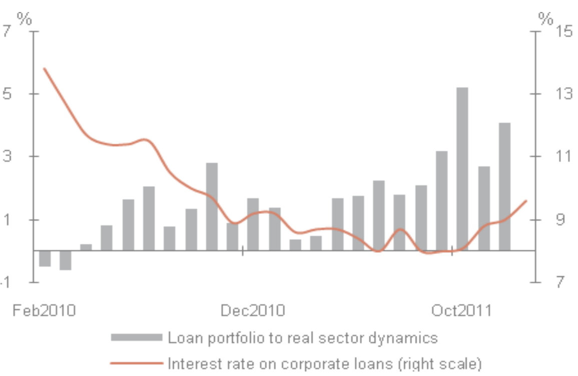


Figure 16. Russian banking sector gross loan portfolio growth and interest rates



Source: Bank of Russia, Economic Development Ministry, Bloomberg

Top picks by industry sector

O&G

Gazprom (12M TP USD 10.2; upside 55%)

MCap – USD 157 bn; EV – USD 186 bn; P/E 2012 – 4.1; EV/EBITDA 2012 – 3.1; Free float - 40%

Gazprom remains our fundamental top-pick within the Russian O&G universe due to its high long-term growth potential and absolutely distressed market ratios. Despite appreciating 23% YTD (in line with the market), the company is still trading at the lowest multiples among the Russian and international oil and gas majors – P/E'12 – 4.1. An improvement in risk appetite, triggered by diminishing political risks in Russia, should encourage capital inflow into Russian equities (which remain heavily underinvested) and Gazprom, being top weighted in the MSCI Russia, is well positioned to benefit in the near term.

Ferrous Metals

Severstal GDRs (12M TP USD 17.8; upside 20%)

MCap – USD 12.1 bn; EV – USD 16.2 bn; P/E 2012 – 7.8; EV/EBITDA 2012 – 5.1; Free float - 18%

Severstal is a leader in terms of EBITDA margin among Russian steel majors, and its domination is unlikely to be challenged by anyone in the mid-term. The company is fully self sufficient in raw materials (both coking coal and iron ore) which makes it virtually immune to any fluctuation of coking coal and iron ore prices. Despite producing very strong margins and being well positioned to deliver production growth across all major segments going forward, the company is priced with a 10% discount to Russian peers, which we believe is not justified, and demonstrates a reasonable chance that Severstal could outperform peers in the near-term.

Mechel local prefs (12M TP USD 12.4; upside 52%)

MCap – USD 5.4 bn; EV – USD 13.9 bn; P/E 2012 – 7.3; EV/EBITDA 2012 – 6.1; Free float - 35%

We continue to anticipate a robust demand for dividend stories during the upcoming months as record dates draws closer. Within the M&M universe, Mechel prefs look to become the unchallenged leaders in terms of dividend yield, as the name is likely to return up to 12.5% of the current share price.

TMK GDRs (12M TP USD 22.9; upside 60%)

MCap – USD 3.4 bn; EV – USD 6.9 bn; P/E 2012 – 9.1; EV/EBITDA 2012 – 6.3; Free float - 23%

If crude prices remain strong and the EU debt crisis does not significantly infect the real sector, TMK is well positioned to benefit from the current market conditions: raw material prices (scrap & HRC) have strongly declined from 2011 peaks, while the demand from O&G majors is expected to increase through 2012. TMK also looks attractive from a valuation standpoint: the company is currently market priced with 40% discount to post-crisis highs, effectively being valued at 6 EBITDA'12, which is considerably below the last 3-year average.

Non-Ferrous Metals

Nordgold (NR)

MCap – USD 2.4 bn; EV – USD 2.2 bn; P/E 2012 – 8.0; EV/EBITDA 2012 – 3.1; Free float - 11%

We highlight Nordgold, the nearly listed gold mining company, as an appealing near term bet for equity investors. Nordgold is well positioned to deliver a healthy production growth in the coming years, the company is absolutely competitive is terms of cash costs and enjoys the highest EBITDA margin among Russian gold mining majors. But the most attractive thing about Nordgold is the valuation: the company is market priced at only 3.1 EBITDA'12, more than 2x lower than the average ratio for gold mining majors. We believe the huge discount is first and foremost driven by the low liquidity of the name, which should improve going forward, considering management's recent statement that a number of free-float increasing initiatives are currently on the table.

Banking sector

Sberbank (12M TP USD 4.83; upside 41%)

MCap – USD 76.5 bn; P/E 2012 – 6.5; P/BV 2012 – 1.4; Free float – 43%

We highlight Sberbank as an optimal risk-return bet in the Russian banking sector. The bank has put forth a tremendous effort over the past 3 years to become more client-friendly, which has already resulted in a very healthy loan growth and a substantial improvement in earnings generating skills and is expected to support revenue going forward. Despite a huge scale, the bank looks beneficial compared to peers, and in addition to the asset quality standpoint, Sberbank has become the only Russian traded bank to post a net provision release for 9M11. The bank seems to be postponing the privatization of the government stake, which is positive, in terms of eliminating the risk of the oversupply of shares (at least for a while). Despite a healthy appreciation (35% YTD), Sberbank still looks very attractive from the valuation standpoint.

Utilities

Federal Grid Company (12M TP USD 0.015; upside 27%)

MCap – USD 14.4 bn; EV – USD 15.5 bn; P/E 2012 – 17.2; EV/EBITDA 2012 – 5.2; Free float - 21%

By April, the regulator (the Federal Tariff Service) is to announce the FGC's revised tariffs for 2012-2014, which we believe should significantly decrease the regulatory risk surrounding the stock. Although the FGC is certain to see a more moderate tariff dynamic in the next three years than was previously approved (an average 26% annual tariff growth), we have not ruled out that the company will eventually see more favorable figures than the market expectations. We believe that the regulator will take into account the company's importance in the implementation of national infrastructure projects as well as its relatively low impact on the electricity price level for end consumers. In addition, we see an upside risk for the company, if the government revises its CAPEX downwards.

E.On Russia (12M TP USD 0.15; upside 80%)

MCap – USD 4.2 bn; EV – USD 3.6 bn; P/E 2012 – 6.1; EV/EBITDA 2012 – 3.3; Free float - 21%

In March, the German-based E.On is to publish 2011 IFRS results, including numbers for its Russian division – E.On Russia (formerly OGK-4). In 2011, E.On Russia strongly benefitted from the ongoing liberalization of the wholesale electricity market, effective cost control and growth in electricity production numbers mainly due to new capacities being commissioned (in July-August, the company put into operation 3 new energy units at Surgutskaya GRES-2 and Yajvinskaya GRES). Another positive consequence of the investment program being implemented is that the new capacity being supplied within capacity supply contracts will be a key driver for solid earnings growth, since it will bring income from new volumes sold and receive considerably higher capacity payments than the old (existing) capacity. We expect the company to see a further improvement on EBITDA level in 4Q11. In terms of zero y-o-y tariff growth in 1H12, we recommend betting on E.On Russia as the most effective generator.

Consumer

M.Video (NR)

MCap – USD 1.5 bn; EV – USD 1.25; P/E 2012 – 12.9; EV/EBITDA 2012 – 5.3; Free float – 26%

We believe that M.Video refers to one of those high quality names which haven't realized their rebound potential yet. Considering that the company remains a top quality asset with strong management, good growth momentum, a sizeable cash position and a healthy market share, we expect that the still fairly distressed valuation at about 5.5 EBITDA'12 could continue driving the stock price in the near-term. In addition, the company guides an efficiency breakthrough in 2012, which if achieved, should become another strong fundamental catalyst for the name.

Chemicals

Phosagro (NR)

MCap - USD 4.3 bn; EV - USD 4.9 bn; P/E 2012 – 5.2; EV/EBITDA 2012 – 3.9; Free-float – 10.4%.

We believe that PhosAgro (PHOR) is still substantially undervalued in comparison with both its Russian and global peers. PHOR is currently trading at P/E'12-5.2 and 3.9 EV/EBITDA'12- versus a respective P/E'12 -9.5 and 6.3 -EV/EBITDA'12 within its peer group. Acron, which cannot boast of such a vertically integrated business model, (at least before it launches the Oleniy Ruchey phosphate mine), as Phosagro, is currently trading at 6.1 EV/EBITDA'12.

We believe that PHOR, which outperformed the market in February despite a negative news flow on phosphate fertilizers prices, is to continue the climb, once the negative trend is overcome in the upcoming months.

Nizhnekamskneftekhim (12M TP USD 1.37; upside 46%)

MCap - USD 1.3 bn; EV – USD 1.6 bn; P/E 2012 – 3.1; EV/EBITDA 2011 – 2.0; Free-float – 20.6%.

We note that most probably in March, there will be a dividend cut-off for NKNC and NKNCP: the company traditionally pays out around 30% of its net income in the form of dividends. Despite the unfavorable global macroeconomic environment, the demand for NKNC's core product (synthetic rubber) is high and prices continue to rebound. We believe that the company has an outstanding fundamental potential and expect the stock price to continue to grow in March. The company is still very cheap in comparison with its peers: it is currently trading at 3.1 P/E'12 and 2.0 EV/EBITDA'12 versus 12.7 and 7.5 within its peer group, respectively.

Common shares for the name are to have a 9% dividend yield, while at the current price levels, prefs are to yield 13%.

Industry, Transport & Infrastructure

HMS Group (NR)

MCap – USD 580 mn; EV – USD 671 mn; P/E 2012 – 5.1; EV/EBITDA 2012 – 3.6; Free float - 37%

We highlight the major Russian pump producer HMS Group as an attractive bet within the infrastructure sector, especially considering a recent underperformance to the market and infrastructure peers. The company continues to operate in a fairly healthy environment when its key customers, O&G companies, are flush with cash thanks to high crude prices and are looking forward to increasing their investments. Despite, however, no material damage done to the industry environment by global financial markets' turmoil since August, the company's share price continues to trade 40% below the IPO price. We believe that the current valuation of the company at 3.6 EV/EBITDA'12 is a promising opportunity for fundamental investors.

Charts:

Figure 17. Estimated P/E 2012 for the RTS index and key sectors of the Russian economy

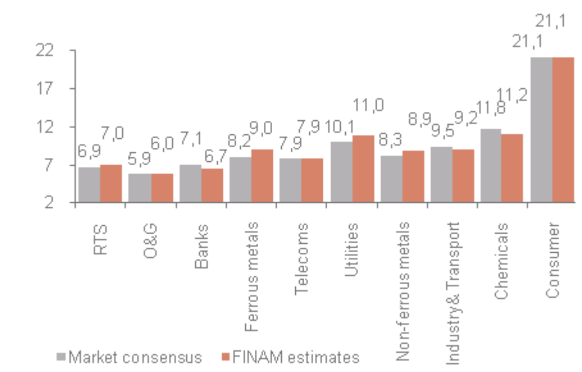


Figure 18. P/E 2012 and YTD performance for Russian economic sectors

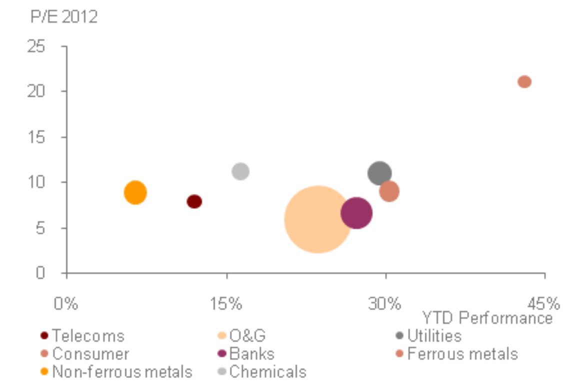


Figure 19. Russian RTS Index and key sector performances YTD

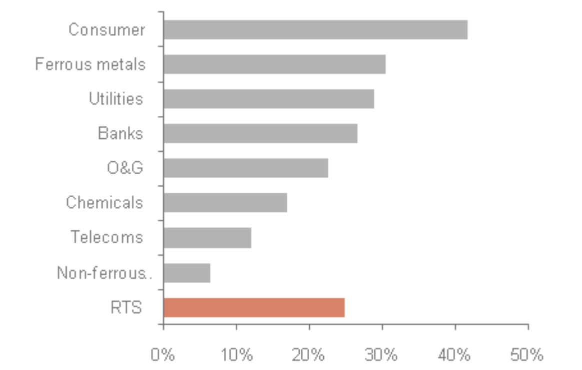


Figure 20. Estimated 2012 NI growth of RTS Index companies and key economy sector

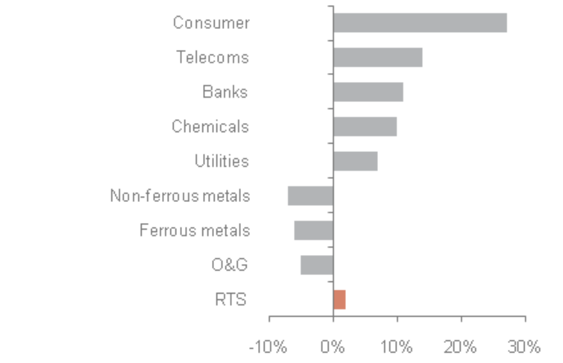
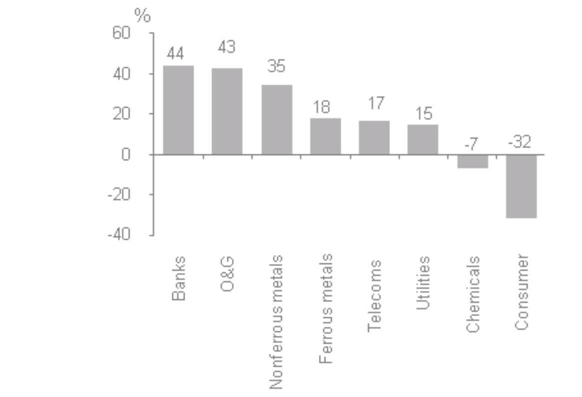
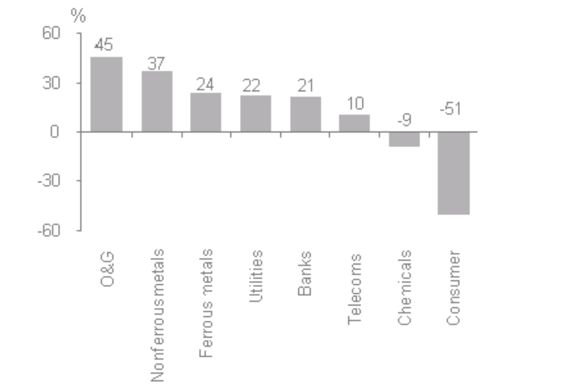


Figure 21-22. Discount/premium of Russian economic sectors to foreign peers on a P/E 2012 ratio

Discount to emerging market peers



Discount to developed market peers



Source: Bloomberg, FINAM

Top picks by risk

We offer all our top picks mentioned above, split into three groups, according to their risk-return profile:

Moderate risk

Mostly blue-chips, with minimal market risk, strong industry positions, and healthy financials:

- Gazprom
- Sberbank

Medium risk

Typically, mid-caps with stable business models, fairly high liquidity and strong corporate governance standards:

- Severstal
- Nordgold
- FGC
- E.On Russia
- M.Video
- Phosagro

High risk

This category is traditionally for extreme Bata companies or less liquid names that do not always meet even Russian corporate governance standards. However, triple-digit returns are quite possible within 1-2 years:

- TMK
- Mechel local prefs
- Nizhnekamskneftekhim
- HMS Group

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