

HMS Group

In the pumping heart of the Russian economy.
Initiating with a OW recommendation

- We initiate coverage of HMS Group with an OW recommendation and PT (end-2011) of \$12.2/ADR. HMS Group specializes in the design, manufacture and installation of pumps, modular equipment and Engineering, Procurement & Construction (EPC) services for oil and gas, water and power industries, mostly in Russia. HMS Group includes 3 design and research institutes, 6 production and 2 construction subsidiaries as well as maintenance facilities and marketing companies in Russia, Ukraine and Belarus. It employs c. 11,000 people.
- We forecast HMS' top line to increase from \$670mn in '10E to \$1,506 mn in '14E, mainly driven by infrastructure projects in Russia. HMS is the main pump supplier for the flagship ESPO pipeline, involved in the modernization of water utilities across Russia, a supplier of pumps for nuclear projects in Russia and abroad. Based on our estimates, infrastructure projects (primarily ESPO) and a move into integrated solutions should help drive the EBITDA margin up from an average of 12% in 2007-2009 to 13.5-17.3% in '10E-'14E.
- HMS Group was created by the management over almost a decade by consolidation of pump producing, modular equipment building and construction companies. HMS is one of largest players in the Russian pumps market, has solid presence in modular equipment market and a foothold in EPC segment, offering an entire package of products & services (integrated solutions) to clients. Extensive HMS-built installed base, competitive prices and well-established relationships with customers are key competitive advantages for HMS Group.
- Potential double-digit upside to PT (end-11): we valued the company based on a combination of target 11E multiples (EV/Sales, EV/EBIT and EV/EBITDA) and DCF (WACC = 13.4%, terminal growth rate of 4.5%). We note, however, that our PT (end-2011) of \$12.2/ADR assumes that HMS Group will sign a RUB20.5bn/\$680 mn follow-up contract with Transneft before end 2011. In the near term, we would watch the release of full year results and end-2010 backlog on April 26 and 1Q11 numbers on June 8.

Hydraulic Machines and Systems Group (HMSGq.L;HMSG LI)

FYE Dec	2009A	2010E	2011E	2012E	2013E
Adj. EPS FY (\$)	(0.01)	0.30	0.93	1.11	1.26
Revenue FY (\$ mn)	465	670	1,145	1,263	1,404
EBITDA FY (\$ mn)	60	90	194	219	243
Net Income FY (\$ mn)	(1)	36	109	130	148
EV/EBITDA FY	14.4	9.5	4.4	3.9	3.5
Adj P/E FY	NM	26.0	8.5	7.1	6.3
EBITDA margin FY	12.8%	13.4%	16.9%	17.3%	17.3%
DPS (Gross) FY (\$)			0.2	0.3	0.3

Source: Company data, Bloomberg, J.P. Morgan estimates.

Initiation Overweight

HMSGq.L, HMSG LI

Price: \$7.90

Price Target: \$12.20

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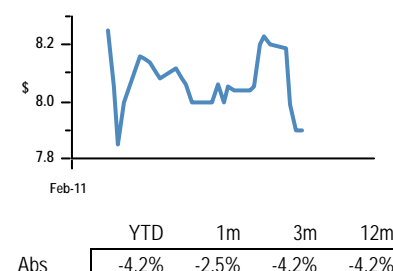
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Price Performance



Risks:

- (1) Lower oil prices might adversely affect HMS as many of their clients are in oil & gas
- (2) The Group relies on a limited number of key clients
- (3) RUB weakness might have a negative impact as operating profit is in rubles
- (4) HMS Group valuations and PT (end-11E) are heavily dependant on signing est. \$680 mn follow-up contract with Transneft

Company Data

Price (\$)	7.90
Date Of Price	17 Mar 11
Price Target (\$)	12.20
Price Target End Date	31 Dec 11
52-week Range (\$)	8.25 - 7.77
Mkt Cap (\$ bn)	0.9
Shares O/S (mn)	117

See page 73 for analyst certification and important disclosures, including non-US analyst disclosures.

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Investment thesis

HMS Group is one of the largest pump designers and producers for oil & gas, water utilities and power sectors in Russia. The group also manufactures and installs modules housing pumps, metering and other equipment. In addition, the company provides engineering, procurement and construction (EPC) services as part of package of services (integrated solutions) to many clients. HMS Group had 41% share in core segments of pump market, worth c. \$0.5 bn in '09, a sizable 35% share in \$0.3 bn core modular equipment market and a foothold – around 2% share - in core \$7.3 bn EPC segments. The company employed 11,029 people as of end Sep'10, with c. 60% in manufacturing.

Strong 9M10 performance after a steady 2009, mid-term visibility of revenues and margins. For 2009, HMS Group reported revenues of \$465 mn, EBITDA of \$59 mn and net income of \$3 mn. Over the 9 months of 2010, the company has already surpassed its 2009 results: revenues were \$532 mn, EBITDA \$74 mn and net income \$36 mn thanks to higher revenues/margins in pumps business on the back of the key Transneft contract and improved profitability in construction segment. HMS Group had c. \$676 mn backlog as of Sep 30, 2010, including the lucrative RUB12.4 bn/\$400 mn contract to supply pumping stations to Transneft's ESPO/Purpe-Samotlor pipelines. The follow-on contract with Transneft worth c. \$660 mn is to be tendered late 2011 and HMS Group has a very good chance of winning, in our view.

Key dates to watch: The company is to publish full year results on April 26th 2011 and 1Q11 numbers on June 8, 2011. The annual financials would be accompanied by backlog as of Dec 31, 2010, according to HMS Group.

Figure 1: HMS revenues by segment in 9M'10

\$ million

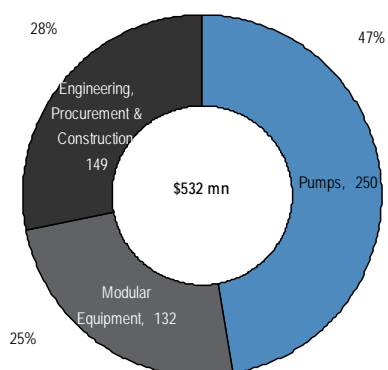
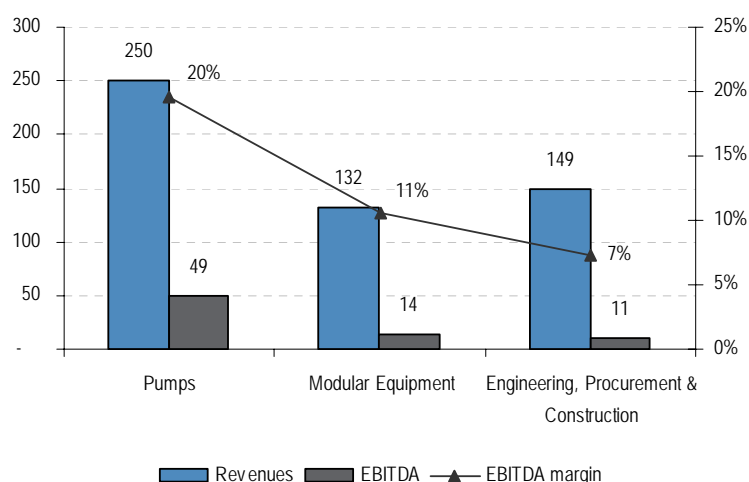


Figure 2: HMS key financials for 9M'10

\$ million

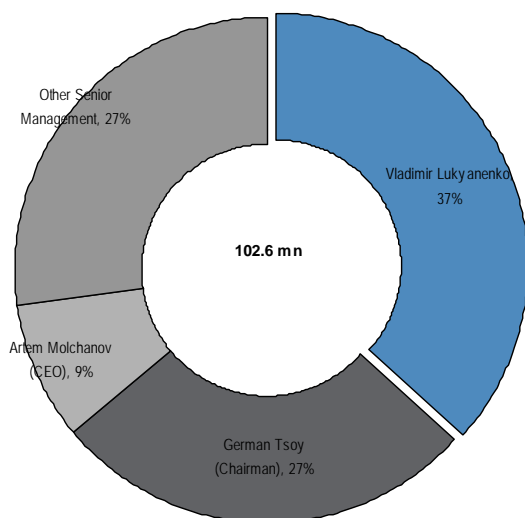


Source: Company 9M10 IFRS report, converted at average RUB:\$ exchange rate and J.P. Morgan estimates. Source: Company 2009 IFRS report, converted at average RUB:\$ exchange rate and J.P. Morgan estimates.

Corporate history stretching over a decade. Majority owned by the management post IPO. HMS Group was formed through a series of acquisitions by the group of managers who started their careers back in 1993 as traders in pumps and supplies. Between 2003 and 2010, HMS Group consolidated a numbers of leading pumps and equipment manufacturers in former Soviet Union, including many flagship companies such as the Ukrainian NasosEnergoMash – the main supplier of pumps for Transneft and leading designer and manufacturer of non-MCP pumps for nuclear industry. The net result of the M&A activity was formation of a leading industrial group, which can offer full integrated solutions (from design to manufacturing to engineering & construction and repairs & maintenance) to its clients across oil & gas, water and power utilities industries.

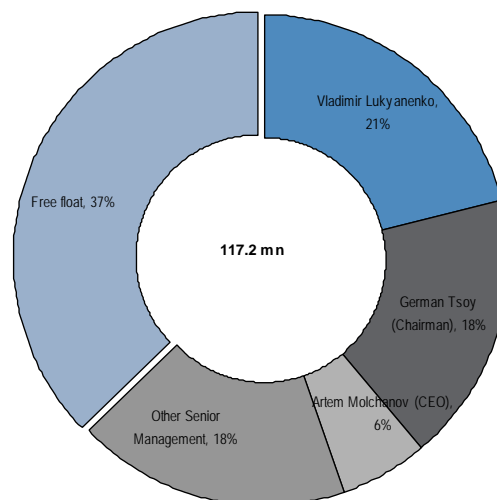
Prior to IPO in February 2011, the management owned 64% of HMS Group with 37% owned by Vladimir Lukyanenko, a private investor and member of the Board of Directors. There were 29 mn of shares existing and issuance of 14.5 mn of new shares to outside investors at IPO, HMS Group remains under management control. Key shareholders have 63% interest in the company including Mr. Lukyanenko's stake of 21%. Free float is estimated at 37%.

Figure 3: Shareholder structure and number of shares prior to IPO



Source: J.P. Morgan estimates.

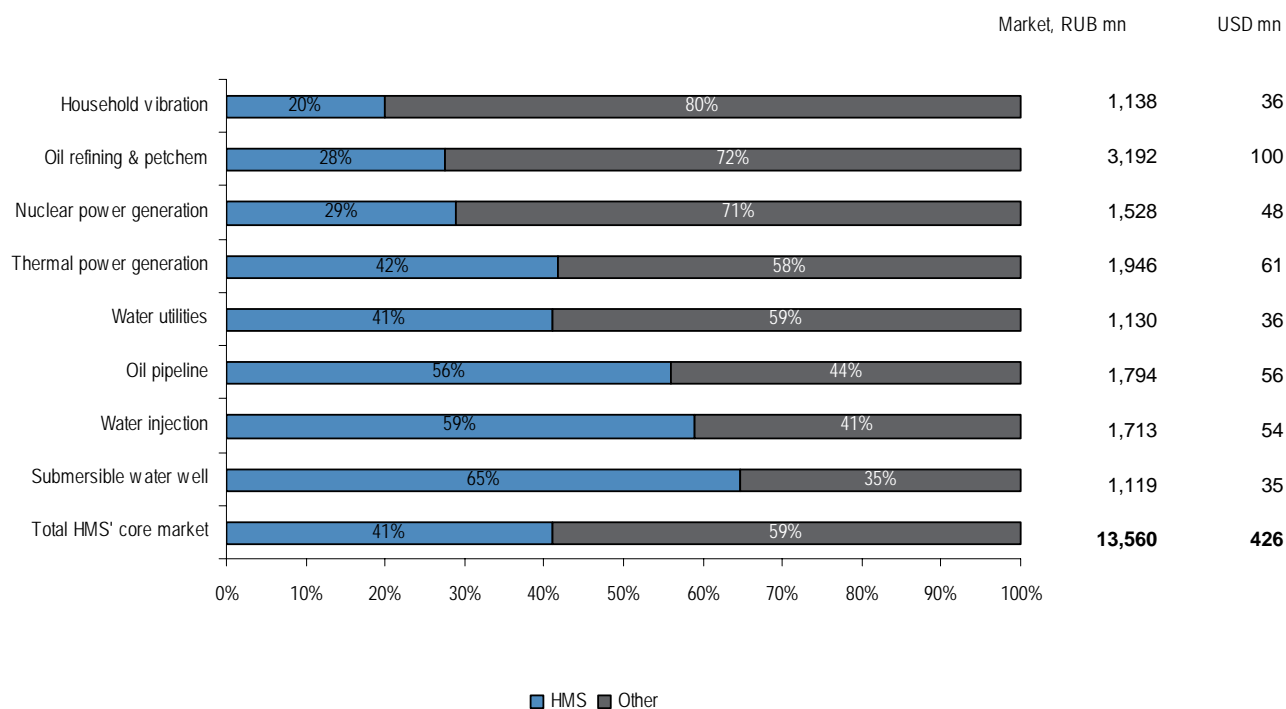
Figure 4: Shareholder structure and number of shares post IPO *



Source: J.P. Morgan estimates. Note: * = excluding over-allotment shares

Competitive edge in pumps: R&D capability, full product cycle service, competitive price and client relationship. Pump design and manufacturing is the core activity for the HMS Group – 47% of total revenues and 64% of EBITDA (9M10). It was also the most profitable with EBITDA margin of 18%. **HMS is a leader in the Russian market** for (1) pumps used for oil transportation; (2) water injection pumps for oil fields, (3) submersible water well pumps for water utilities and has solid market share across other products such as pumps for thermal and nuclear power plants.

Figure 5: HMS market share in Russian pumps market* in 2009



Source: Frost & Sullivan. Note = * pumps, solutions and after-market

In our view, HMS Group is likely to maintain its market position in pumps on the back of the following:

- For tailor-made or specially designed pumps and modular equipment (such as pump stations or associated gas gathering stations), HMS is *often the only company which can provide design with required specifications, manufacture and test the product at own premises and then follow up with turn-key assembly/installation* with less glitches often caused by multiple companies involved in various stages of the project. HMS designed, manufactured and installed pumping modules at Rosneft's Vankor field. The company won \$400 mn contracts to manufacture and project managed installation of pumping stations for ESPO/Purp—Samotlor pipelines in 2010-2011 (the remaining backlog for the contracts is \$341 mn as of Sep 30, 2010) and is a front runner for a larger follow-up contract.
- For many projects, *track record (references) and obligatory state certification* of the equipment is a must, which rules out many foreign producers. HMS is delivering \$36 mln worth of non-MCP (non-main circulation) pumps to nuclear power stations in Russia (backlog as of Sep 30, 2010). Company's pumps manufacturing facility in Sumy has quality outpost of RosAtom - the Russian Nuclear Agency. GTNG - company's Research & Design Institute is leading facility, directly involved in preparing technical documentation and certification for infrastructure projects in Russia – Rosneft and Gazprom Neft are exclusive customers for upstream project design.

- For **mass-produced pumps**, such as water submersibles and household ones, HMS **offers very competitive prices**, close to that of local producers but many times lower than that for similar foreign-manufactured analogues. Livny Nasos subsidiary had 65% share in submersible water well pumps market in '09, offering products at least 3.5x cheaper than foreign competition.
- The fact that **the installed base** across core segments of the pump market is **predominantly HMS-manufactured** makes customers familiar with company's equipment and opens doors for modernization (upgrade) and replacement contracts. In water injection pumps for oil industry, HMS had 59% market share in new pumps with 87% share of installed base. TNK-BP, SurgutNG, Rosneft and other oil majors are key clients.
- **Maintenance & repairs, manufacturing and construction facilities are geographically close** to customers - it is an advantage. HMS' Group employs over 3,000 people in construction and repair & maintenance divisions in W. Siberia. Key modular equipment, EPC facilities are in Tyumen.

SWOT analysis

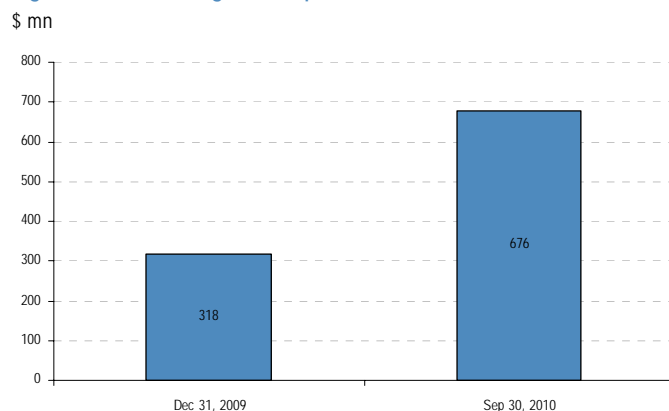
Strengths <ul style="list-style-type: none"> • Significant market share in core markets. • Unique technical specifications of the Russian market limits competition from international pump companies • Low cost manufacturing base. • High degree of vertical integration 	Weaknesses <ul style="list-style-type: none"> • Currently aftermarket revenue is limited to only 10% of group sales • Bargaining power of very large powerful customers. • Lack of international presence and limited range of products that meet international technical specifications
Threats <ul style="list-style-type: none"> • Increased price competition for mass-produced pumps, modular equipment. • Increased penetration of the Russian market by international peers. • Failure to complete the current ESPO/Samotlor-Purpe contract or secure follow-on contracts with large customers (such as ESPO) • Change in tax regime and regulatory environment for major customers, eg. oil and gas companies 	Opportunities <ul style="list-style-type: none"> • Expand with the existing customer base into new geographic markets. • Opportunities to make further bolt on acquisitions. • The level of outsourcing at auto customers is likely to continue to rise, and GKN is a potential beneficiary.

Source: J.P. Morgan estimates

Backlog stood at RUB20.6 bn/\$676 mn as of Sep 30, 2010 vs RUB9.5 bn/\$318mn as of Dec 31, 2009 as per HMS Group. Around a half of the \$676 mn backlog (c. RUB10 bn/\$320 mn) is high-margin contracts to construct, deliver of oil-trunk pumping units to ESPO/Purpe-Samotlor contracts. The backlog does not include standard pump sales where typical contract cycle is around 3 months and mass-produced pumps. HMS records large proportion of orders in 4Q which reflects industry's contracting cycle, hence backlog as of Jan 1, 2011 might rise further.

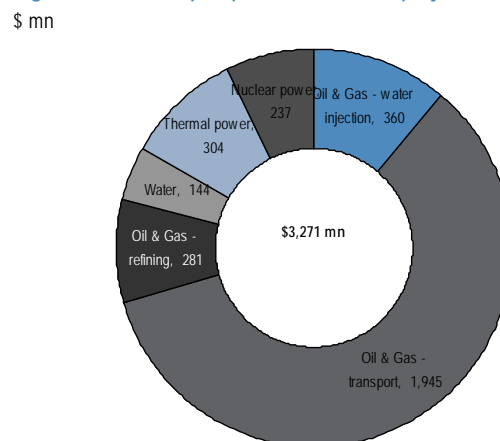
A number of projects in the near-term pipeline. We estimate that the company has a potential to add around RUB21.8 bn/\$711 mn to the backlog over the next 6-9 months. HMS is also well-positioned to win the follow-up contract to supply 20 pumping stations to ESPO-2 (stage 2), worth est. RUB20.5 bn/\$660 mn expected to be tendered in 2011, given the company is already supplying 12 pumping stations for the pipeline.

Figure 6: HMS backlog as of Sep 30, 2010



Source: Company data.

Figure 7: Potential pumps revenues from projects in 10E-15E

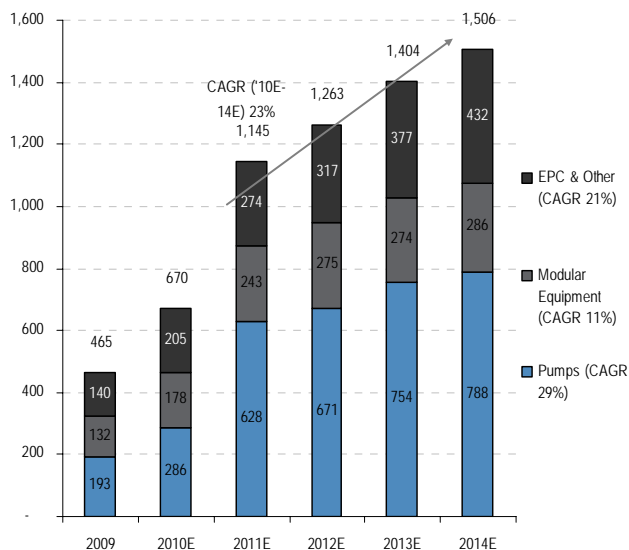


Source: J.P. Morgan estimates.

Diversified customer base, pole position to participate in many infrastructure projects. HMS Group has dozens of clients across oil & gas, power and water utilities, including Rosneft (17.8% of revenues in 2007-9M10), Gazprom (7.5%), Gazprom Neft (6.5%). Other customers are RosAtom, Mosenergo, Novatek, Russian Railways. Large infrastructure projects in oil transportation such as ESPO-2 and BPS-2 pipeline construction, tie-in pipelines in East Siberia would make Transneft one of the largest customers over the coming years.

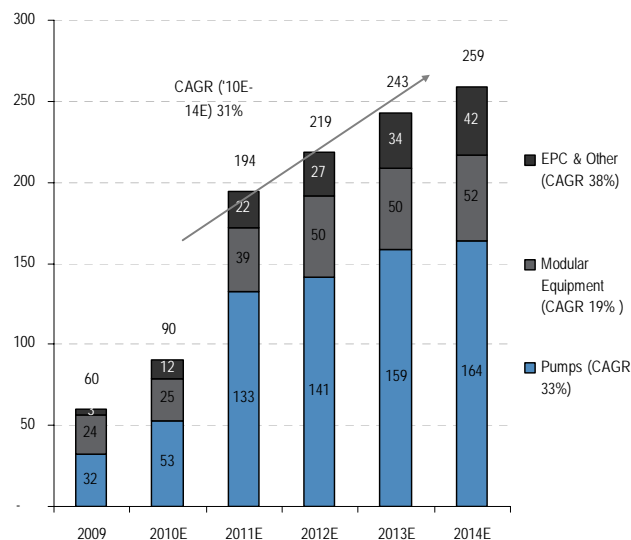
Total HMS Group revenues are expected to grow at over 20% CAGR (10E'-14E') from \$670 mn in '10E and \$1,505 mn in '14E primarily on the back of transportation pumps contracts. HMS further move into offering clients integrated solutions and an improvement of margins in construction business should improve overall HMS Group EBITDA margin from 12.9% in '09 to est. 16.9% in '11E and normalized level of c 17% in '11E-14E. Total HMS Group EBITDA is forecast to rise from \$60 mn in '09 to \$90 mn in '10E and \$259 mn in '14E (CAGR ('10E-'14E) = 31%).

Figure 8: Revenues breakdown, 2009-2014E, \$ million



Source: J.P. Morgan estimates, HMS Group IFRS accounts for 2009.

Figure 9: EBITDA breakdown, 2009-2014E, \$ million



Source: J.P. Morgan estimates, HMS Group IFRS accounts for 2009.

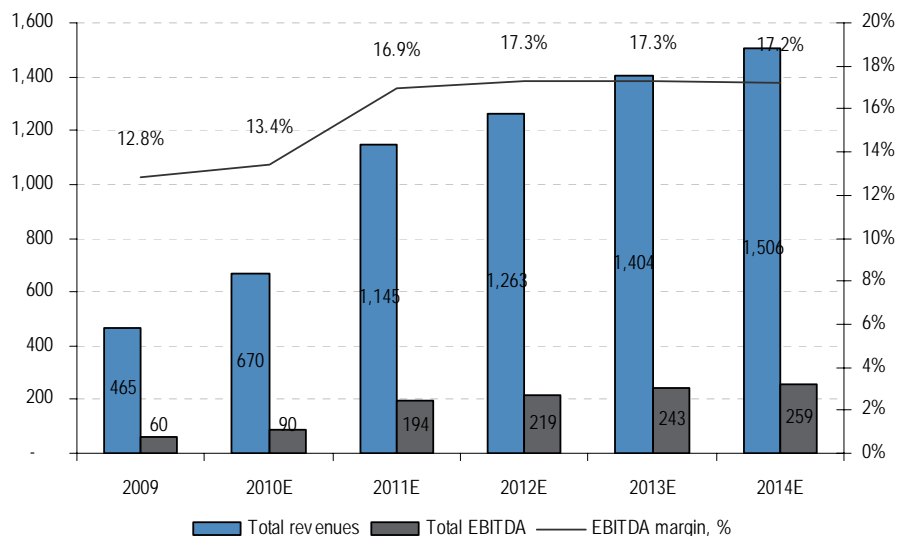
The company is already involved in a number of large high-margin projects such as construction of pump stations for ESPO/Purpe-Samotlor pipelines - the major revenue and EBITDA booster in '11E-'13E, according to our estimates. Modular equipment segment will grow in significance, especially on the back of rising supply of water injection pumping station, water utilities projects and state programme to increase utilization of associated gas (from current 60% to 95% by '12E). In EPC, acquisition of the controlling stake in GTNG R&D institute should increase Engineering, Research & Design revenues as well as open up a larger portion of the oil field & pipeline construction market worth \$6.6 bn in '10E, where we see HMS gaining market share

Pricing power, track record of cost control and EBITDA margins progression:

Most HMS's contracts for specialized pumps, modular equipment and construction projects would have fixed ruble price and costing agreed with the customer and therefore a set margin. HMS has leading positions in many product lines and a preferred supplier to many large companies and as a result can target and achieve specific margin levels, especially for unique equipment/projects – such as pumps for ESPO pipelines, super modules for Vankor field, R&D documentation for field developments and pipeline construction in W. Siberia.

HMS has a proved record of being able to control costs and maintain margins in difficult market conditions: EBITDA margin was up from 12% in 2008 to 13% in 2009 - HMS cut back on wage bill, SG&A costs and distribution costs. In our view, high-margin contracts in pumps division (ESPO) and acquisition of GTNG (which should allow access to costing data for construction projects) could mean margin improvement in '10E-'14E. Leading/solid position in other markets should allow sustaining the margin achieved historically. Overall we see EBITDA margin for HMS Group rising from c. 13% in post-crisis 2009 to around of 13.5-17.3% in '10E-'14E (primarily on the back of East Siberia pipeline contracts) and settle at around 17% by '14E.

Figure 10: HMS' Group EBITDA (\$ mn) and EBITDA margin forecast



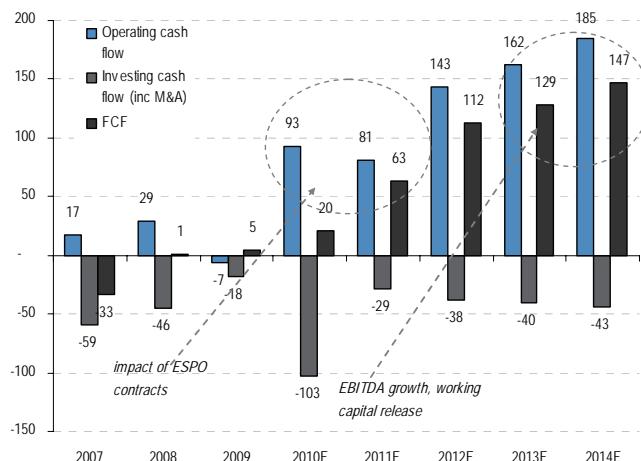
Source: J.P. Morgan estimates, HMS Group IFRS accounts for 2009.

Improving operating cash flow. HMS Group has been in expansion stage over the last three years and operating cash flow along with the borrowed funds have been used to invest back into the business (via maintenance capex), buy minority shares in subsidiaries and purchase new companies. Steady increase in operating cash and FCF was interrupted in 2009, when operating cash turned negative on fall in revenues and rise in working capital. In '10E-'11E, the operating cash flows should be boosted by improved profitability and a large (c. 50% - 9M IFRS account) prepayment for ESPO/Purpe-Samotlor contract.

Modest investing needs. The company plans to invest 2-2.5x depreciation annually on modernization and maintenance – which would imply around \$22-\$55 mn in – '10E-'14E. Capacity constraints should not be an issue in mid-term with relatively modest amount of fixed investment needed. Management estimates that overall capacity utilization at the moment is 80-85%, but the calculations are based on 1-shift working day (8-hour shift), while equipment can be operational for 24-hours, i.e. on 3-shifts basis. Theoretically, HMS can triple production on the existing manufacturing base. Additional investments into labour, supplies and management would be required, but it would be seen as operating costs rather than fixed investments by the company – the manufacturing base is already in place.

Figure 11: Cash flow break-down, 2007-2014E

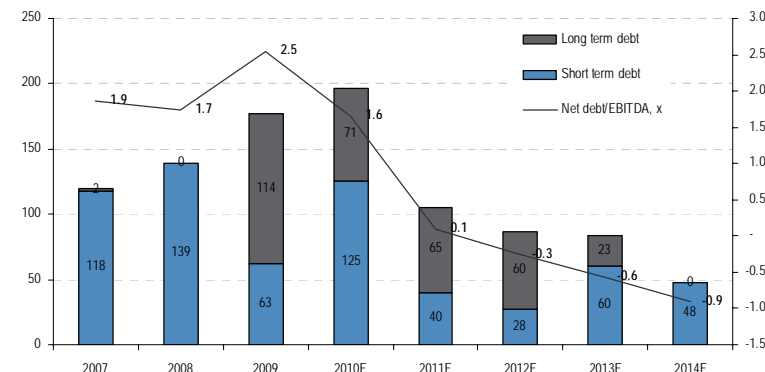
\$ million



Source: J.P. Morgan estimates, HMS Group IFRS accounts for 2009.

Figure 12: Net debt position

\$ million



Source J.P. Morgan estimates, HMS Group IFRS accounts for 2009.

HMS Group has been maintaining relatively steady net debt position, keeping Net Debt/EBITDA ratio below the 2.5x target set by the management. In 2009, the company re-financed most of its short-term debt into long-term one, with interest rates falling from 18.2% as of 1Q09 to 10.2% as of end 3Q10, according to the company. Almost entire debt exposure is fixed-rate and in Russian rubles. As of end 3Q10, the company had \$166 mn of total debt (\$30 mn short-term) and net debt position of \$104 mn.

IPO cash to be used to repay debt. The company used net proceeds from primary share issue (est. \$115 mn) to repay RUB3.3 bn/\$108 mn of existing debt. According to our estimates, the company would have close to zero net debt by end-2011, assuming that it meets our financial forecasts for this year. Net interest payments are also expected to decline from \$27 mn in 2010 to \$10 mn in 2011, including costs of IPO.

Net income might rise 4.5x over 4 years. As operating profit rises and net debt declines, we forecast that HMS Group net income would improve from \$36 mn in '10E to \$164 mn in '14E (CAGR = 47%). In '07-'09, the company showed net loss after minorities due to the corporate structure, where dividend was paid out to shareholders via minority (preferred) interest in subsidiaries. The current structure reduced minority interest to c. 9% of reported net income (9M10 IFRS accounts).

Growth strategy. Top management is keen to continue to grow the company both organically – by extending product range, gaining market share on competitors as well as via value-accretive and non-aggressive acquisitions. In our view, HMS Group strong position in fragmented pumps market makes it a natural assets consolidator. Management stated that proceeds from IPO would go to partially repay the debt and to pursue M&A opportunities.

Valuation points to double-digit upside to PT (end 2011), but we assume that the key follow-up contract with Transneft will be signed before year end: We valued the company based on a combination of target 11E multiples (EV/Sales, EV/EBITDA, EV/EBIT) and DCF (WACC = 13.4%, nominal terminal growth rate of 4.5%). The resulting PT (end-11) is \$12.2/ADR, with a potential 54% upside to the current market value (cob Mar 17). In our model we assumed that HMS Group will sign a follow-up contract with Transneft to deliver pumps and pumping stations for ESPO-2 (extension) project, worth RUB20.5 bn/\$680 mn over 2012-2015. We believe that the contract would add confidence to many investors looking at the company.

Risks

- Drop in oil prices might adversely affect the company as many HMS' clients are in the oil & gas.
- HMS future revenues dependant on state-spearheaded projects, and budget constraints could lead to delays and cancellations.
- HMS pricing power and ability to maintain margins might be eroded if company's is facing more competition from local and foreign suppliers.
- RUB weakness might have negative impact as most customers are in Russia and operating profit is in the local currency.
- HMS fixes prices for its contracts and is exposed to risk of price fluctuations for materials and supplies as well as currency volatility. HMS would carry the risk of sudden increase in costs of supplies and currency fluctuations over the whole contract period (which company does not hedge)
- WTO accession might result in harmonization of Russian specifications with international ones, making it easier for foreign manufacturers to sell in Russia
- Foreign companies are entering the market by buying into local producers, bringing technology at more competitive prices
- Russian manufacturers mostly produce standardized pumps with similar specs and little proprietary technology, which makes it easy to switch suppliers. It could also drive down prices. Technological constraints/lack of investment/ inertia are also evident in absence of Russian/CIS producers in the largest sub-segment of water utilities market: waste-water/wet pit pumps.
- Many customers have no problem manufacturing replacement parts in -house, which may limit the scope for maintenance/repairs, after-market revenues
- HMS Group's profitability is highly dependant on Transneft contracts: both the on-going and the follow-up which will constitute a significant part of revenues over the next 1-3 years. Inability to complete the current contract or obtain a follow-up contract would represent a significant risk to the company.

Valuation

Summary

Based on the revenue mix of HMS, we believe the group should be benchmarked and valued in relation to a range of pump and valve companies in Europe and the US, as well as equipment/service providers to the oil and gas industry in Russia. We applied the lower end of the multiples range for our PT calculations and as well as a DCF. The valuation summary is presented below.

Table 1: Valuation summary

\$ million

Forecast financials	Note	2011E
Revenues (2011E)		1,145
EBITDA (2011E)		194
EBIT (2011E)		169
Net income after minorities (2011E)		109
Multiple-based valuations		2011E
Target EV/Sales (2011E)		1.4
Target EV/EBITDA (2011E)		7.5
Target EV/EBIT (2011E)		10.0
Weighted average target EV	1	1,538
DCF-based valuations		2011E
Total PV of FCF (11E-15E)	2	451
Terminal free cash flow, \$ mn		145
Terminal growth rate (\$ nominal)		4.5%
Discount rate (WACC), %		13.4%
PV of terminal value	3	1,028
DCF-based EV	4=2+3	1,479
Summary valuations		2011E
Weighted average target EV	= 1	1,538
Weight of multiple-based valuations		50%
DCF-based EV	= 4	1,479
Weight of multiple-based valuations		50%
Target EV, \$ mn	5=1*50%+4*50%	1,509
less net debt (post IPO)	6	34
less minority interest (end 2010)	7	49
Target MCAP, \$ mn	8=5-6-7	1,426
No of shares/ADRs (ADR=1 share)	9	117
Target price per share/ADR	10=8/9	12.2

Source: J.P. Morgan estimates.

Overview

We regard HMS as unique, relative to other pumps companies, as a result of its tight focus on its domestic market and its very strong market position with limited competition. Due to the nature of the market in Russia, HMS also currently has only a modest proportion of revenue derived from aftermarket activities (less than 10% compared with an estimated range for the pumps market overall of between 25% and 60%). However, the currently modest aftermarket exposure should be regarded as a long-term growth opportunity and in the near-term it does not seem to have a negative impact on margins/returns of the group.

When looking to value HMS, we believe it should be benchmarked against a combination of pump/valve manufacturers, UK/European industrial companies and domestic and international oil field services companies. We tend to prefer to focus on EV/Sales, EV/EBIT and EV/EBITDA as well as PE multiples in relation to returns when calculating the implied value of industrial companies. The key valuation multiples together with the margins of the main peers are summarized below.

We would regard the most directly comparable companies to be KSB, Sulzer and Weir. KSB is a pure play pump manufacturer based in Germany with around a third of sales in 2009 generated from the energy and mining industry and a further 20% derived from the water industry. In the case of Sulzer, pumps accounted for 55% of group sales last year with the oil & gas (up and down-stream) accounting for 55% of the divisions sales in 2009 with power generation accounting for a further 21%. For Weir almost 40% of group sales are generated from the oil & gas and power generation end markets. While KSB is a direct industrial peer it should not be overlooked that it trades on low EV and PE multiples relative to our European industrial universe and other pump companies. We believe that this is currently justified given the relatively low margins of KSB. We believe the low returns of KSB makes direct comparisons with HMS of limited value.

Table 2: Breakdown of 2009 sales by end market for HMS and direct peers

	Pumps & valves	Oil & gas	Power generation	Water	Mining	Power & mining	Other
KSB	100%			20%		32%	47%
Sulzer group	55%	48%	19%				33%
Sulzer - Pumps only		56%	21%				23%
Weir	100%	22%	17%		59%		
HMS							

Source: J.P. Morgan estimates, Company data.

Table 3: Valuation summary

Country	Yr end	(local currency)		EV/Sales				EV/EBITDA				EV/EBIT				
		Share price	Market cap (m)	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E	
European Pump & Valve companies																
Burckhardt																
Compression*	Switz.	March	276.8	941	2.58	2.44	2.23	2.03	10.6	11.0	10.0	8.7	11.9	12.7	11.5	9.8
FLSmidth*	Denmark	Dec	432.9	23,030	0.94	1.08	0.98	0.86	8.0	9.1	8.2	6.8	9.7	11.1	9.8	8.1
KSB*	Germany	Dec	555.0	978	0.40	0.39	0.37	0.34	3.2	3.8	3.4	3.0	4.0	5.0	4.5	4.0
IMI	Britain	Dec	938.5	3,010	1.79	1.66	1.53	1.48	11.3	8.7	7.6	7.2	14.4	10.4	8.9	8.4
Sulzer*	Switz.	Dec	130.8	4,482	1.17	1.24	1.14	1.06	8.4	7.7	7.6	6.8	10.9	9.8	9.8	8.7
Weir	Britain	Dec	1606	3,385	2.64	2.24	1.90	1.74	15.7	10.7	8.9	8.4	17.9	11.8	9.9	9.3
Average					1.59	1.51	1.36	1.25	9.5	8.5	7.6	6.8	11.5	10.1	9.1	8.0
JPMC Pan Euro Cap Goods																
						1.48	1.34	1.22	1.13	13.4	10.2	8.2	7.0	17.5	13.3	10.7
US pump companies																
Dover	US	Dec	63.4	11,818	2.13	1.73	1.57	1.48	14.6	9.4	8.5	7.6	20.9	11.9	10.7	9.5
Flowserve*	US	Dec	121.0	6,741	1.54	1.67	1.54	1.41	9.5	10.1	8.9	7.8	11.0	11.9	9.9	8.6
IDEX*	US	Dec	41.2	3,398	2.78	2.44	2.20	2.02	14.6	11.6	10.1	9.1	18.7	14.2	14.7	10.5
ITT Corp	US	Dec	56.2	10,320	0.98	0.97	0.95	0.94	7.5	7.0	6.6	6.4	9.5	8.7	8.1	7.9
SPX Corp	US	Dec	75.1	3,799	0.94	0.93	0.86	0.80	9.7	10.0	8.9	7.7	12.5	13.3	11.5	9.7
US average					1.67	1.55	1.42	1.33	11.2	9.6	8.6	7.7	14.5	12.0	11.0	9.2
Suppliers into the oil & gas industry																
Hunting	UK	Dec	736	976	2.16	1.72	1.49	1.41	19.6	11.6	9.1	8.4	21.7	17.7	13.6	12.2
Schoeler																
Bleckman*	Austria	Dec	60.8	973	4.06	3.32	2.61	2.30	16.7	10.9	8.9	7.7	36.4	17.5	12.9	10.6
Industrial service companies																
AMEC	UK	Dec	1111	3,696	1.17	1.02	0.91	0.85	13.3	10.6	9.4	8.7	15.7	12.3	10.8	9.9
Wood Group	UK	Dec	619	3,282	1.08	1.08	1.04	1.04	12.8	13.5	11.6	11.1	17.8	17.5	14.3	13.7
Colfax*	US	Dec	20.7	897	1.75	1.70	1.54	1.41	11.1	11.2	9.4	8.2	13.6	14.0	11.5	9.6
Average industrial service					1.99		2.04		1.77	1.52	1.40	14.7	11.6	9.7	8.8	21.05
Eurasia																
Drilling Co.	Russia	Dec	31	4,553	3.10	2.46	2.02	1.93	14.0	11.3	9.1	8.7	22.3	16.8	12.5	11.9
CAToil	Russia	Jan	6.7	325	1.28	1.16	1.01	0.89	6.4	6.5	5.8	5.2	15.0	13.5	10.6	8.4
Integra Group																
**	Russia		3.5	651	0.99	0.87	0.69	0.61	7.6	6.6	4.9	4.1	NM	33.4	11.4	7.6
Average of Russian peers					2.40	2.00	1.68	1.56	11.2	9.9	8.3	7.7	20.9	17.1	13.1	11.4
HMS Group	Russia	Dec	7.9	926	2.17	1.51	0.88	0.80	16.9	11.2	5.2	4.6	NM	13.4	6.0	5.2

Source: J.P. Morgan estimates, Company data and *Bloomberg. ** = excluded from averages due to corporate structure/nature of the business. Priced as at COB 17 Mar 2011

Table 4: Valuation summary 2

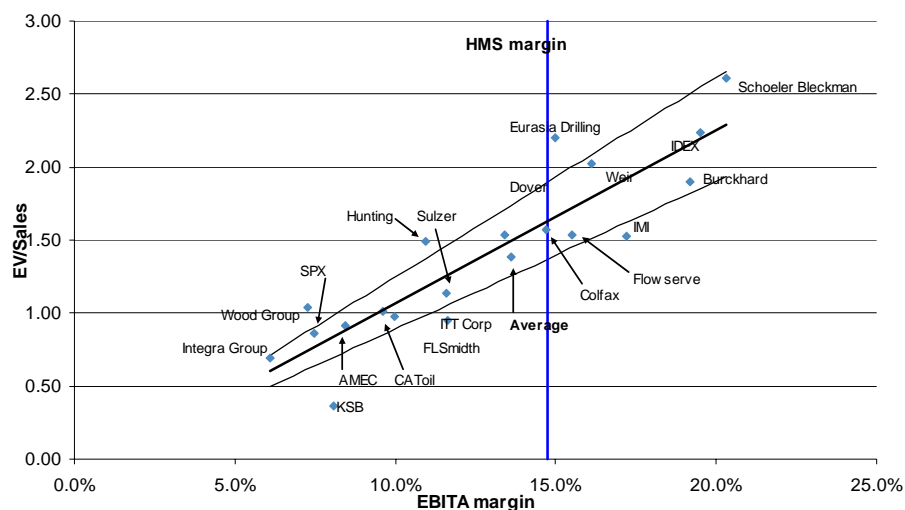
	PE				Dividend Yield				EBITDA margin				EBITA margin			
	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E
European Pump & Valve companies																
Burckhardt Compression*	16.6	17.6	15.6	13.6	1.8%	1.7%	2.0%	2.3%	24.4%	22.2%	22.4%	23.3%	21.6%	19.3%	19.5%	20.8%
FLSmidth*	13.6	17.7	14.6	11.9	1.6%	2.1%	2.2%	2.6%	11.8%	11.8%	12.0%	12.7%	9.7%	9.7%	10.0%	10.7%
KSB*	9.1	11.4	9.8	8.4	2.2%	1.3%	1.8%	2.2%	12.3%	10.2%	10.6%	11.4%	9.9%	7.8%	8.1%	8.7%
IMI	20.5	14.2	12.3	11.4	0.0%	2.8%	3.2%	3.5%	15.8%	19.1%	20.0%	20.4%	12.4%	16.0%	17.2%	17.7%
Sulzer*	16.2	14.7	14.7	12.9	2.1%	2.3%	2.3%	2.6%	14.1%	16.0%	15.0%	15.4%	10.7%	12.7%	11.6%	12.1%
Weir	25.1	16.0	13.3	12.5	0.0%	1.7%	1.9%	2.1%	16.8%	21.0%	21.3%	20.7%	14.7%	19.0%	19.2%	18.7%
Average	16.8	15.3	13.4	11.8	1.3%	2.0%	2.2%	2.5%	15.9%	16.7%	16.9%	17.3%	13.2%	14.1%	14.3%	14.8%
JPMC Pan Euro Cap Goods	29.3	18.0	14.7	12.4	1.5%	1.9%	2.4%	2.9%	10.2%	13.1%	14.3%	15.2%	6.1%	10.0%	11.4%	12.3%
US pump companies																
Dover	31.8	16.9	15.3	13.9	1.6%	1.7%	1.7%	1.7%	14.7%	18.3%	18.5%	19.5%	10.2%	14.5%	14.7%	15.5%
Flowserve*	15.8	17.4	15.3	13.0	0.9%	1.0%	1.0%	NA	16.2%	16.5%	17.2%	18.2%	14.1%	14.0%	15.5%	16.4%
IDEX*	29.2	21.4	17.8	15.5	1.2%	1.5%	1.5%	1.5%	19.0%	21.0%	21.7%	22.2%	14.8%	17.2%	15.0%	19.3%
ITT Corp	14.9	12.7	12.1	11.7	1.4%	1.7%	1.8%	1.9%	12.9%	13.9%	14.4%	14.7%	10.3%	11.2%	11.6%	11.9%
SPX Corp	21.4	20.7	16.5	13.3	1.3%	1.4%	2.0%	2.0%	9.7%	9.3%	9.7%	10.4%	7.5%	7.0%	7.5%	8.3%
US average	22.6	17.8	15.4	13.5	1.3%	1.4%	1.6%	1.8%	14.5%	15.8%	16.3%	17.0%	11.4%	12.8%	12.9%	14.3%
Suppliers into the oil & gas industry																
Hunting	42.3	34.4	26.7	23.5	0.0%	1.5%	1.5%	1.5%	11.0%	14.8%	16.4%	16.8%	9.9%	9.7%	10.9%	11.6%
Schoeler Bleckman*	63.3	35.6	18.2	14.9	0.8%	1.6%	1.9%	2.4%	24.4%	30.6%	29.2%	30.0%	11.2%	18.9%	20.3%	21.8%
Industrial service companies																
AMEC	23.4	18.7	16.1	14.5	0.0%	1.8%	2.1%	2.2%	8.8%	9.6%	9.7%	9.8%	7.4%	8.2%	8.4%	8.6%
Wood Group	14.8	16.5	13.3	12.1	1.6%	1.7%	1.6%	1.6%	8.5%	8.0%	9.0%	9.3%	6.1%	6.2%	7.3%	7.6%
Colfax*	37.6	55.8	18.0	15.1	NA	NA	NA	NA	15.7%	15.1%	16.4%	17.3%	12.8%	12.1%	13.4%	14.7%
Average of service and oil & gas companies	36.3	32.2	18.5	16.0	0.6%	1.7%	1.8%	1.9%	13.7%	15.6%	16.1%	16.6%	9.5%	11.0%	12.1%	12.9%
Eurasia Drilling Company	28.4	20.4	15.0	13.8	0.8%	0.7%	1.0%	1.1%	22.2%	21.8%	22.2%	22.3%	13.9%	14.7%	16.1%	16.3%
CAToil	32.3	21.3	16.4	13.0	0.0%	0.0%	3.0%	3.9%	19.9%	17.9%	17.5%	17.2%	8.5%	8.6%	9.6%	10.6%
Integra Group **	NM	NM	17.9	9.8	0.0%	0.0%	0.0%	1.0%	13.0%	13.1%	14.1%	14.9%	-0.5%	2.6%	6.1%	8.1%
Average of Russian peers	30.4	20.8	15.7	13.4	0.4%	0.4%	2.0%	2.5%	21.0%	19.8%	19.8%	19.7%	11.2%	11.6%	12.9%	13.4%
HMS Group	NM	NM	0.1	0.0	0.0%	0.0%	2.9%	3.5%	12.8%	13.4%	16.9%	17.3%	7.3%	11.2%	14.7%	15.3%

Source: J.P. Morgan estimates, Company data and *Bloomberg consensus forecasts, ** = excluded from averages due to corporate structure/nature of the business. Priced as at COB 17 Mar 2011

Enterprise value multiples: EV/Sales vs EBIT margin

Figure 13 below, shows the EV/sales and EBITA margin for a range of international pump and valve producers, as well as a range of international and Russian companies that provide services and equipment to the oil and gas industry. The vertical line marks our forecast EBITA margin for 2011E. The chart also includes a trend line with bands 15% above and below the trend line. For PT (end-2011) calculations, we conservatively assumed that HMS would be trading towards lower end of EV/Sales, and EV/EBIT multiples.

Figure 13: 2011E EV/sales and EBITA margin (2011E) and trend line with bands +/- 15%



Source: J.P. Morgan estimates, Company data.

EV/EBITDA

Based on 2011E forecasts, our industrial universe and the range of international pump manufacturers are trading on EV/EBITDA multiples between 7.5 and 8.6 (excluding KSB) with most companies clustered tightly around the average of 8.0. Given the exposure of HMS to the oil & gas industry in Russia, we believe it is appropriate to also benchmark the group against the Russian oil field services companies (Eurasia Drilling Co, CAToil and Integra Group). Our current forecasts for these companies indicate that the EBITDA margin is set to average almost 17% compared with our forecast of 13-17% for HMS ('10E-'14E). For valuation purposes, we assumed that HMS should trade on target 2011E EV/EBITDA multiple of 7.5x, which is the lower end of the range for comparable companies.

Table 5: EV-based multiple range for comparable companies (2011E), x

2011E	Low	High
EV/sales multiple	1.4	1.9
EV/EBITDA	7.5	8.6
EV/EBIT	10	11.5

Source: J.P. Morgan estimates.

DCF

For completeness, we have included a DCF valuation for the group. The base assumptions for our DCF are summarized below:

- a discount rate (WACC) of 13.4%. We have used a higher WACC to reflect the de-leveraging of the group post IPO and relatively low initial liquidity of the shares
- standard equity risk premium of 4.0% and volatility risk premium for Russia of 4.5% and 1% liquidity risk premium
- perpetuity growth (US nominal) of 4.5%. It comprises of 2.5-2-3% forecast real GDP growth rate and 1.5-2.5% USD inflation.
- a terminal EBITDA margin of c. 17% in '15E - this compares with our forecast group margin of c. 13.5%-17.2% in 2010E-2014E
- there are no further changes in the group structure (acquisitions or disposals).

We expect the group EBITDA margin to rise steadily, to c.17% in '11E-12E from the 7.3% achieved in 2009, on the back of the ESPO/Purpe-Samotlor and other infrastructure contracts. Between '12E and '15E, we have assumed the EBITDA margin stabilizes around 17% as a result of higher proportion of lower margin/high value construction projects. Table 7 below shows the sensitivity of the equity value of the group to changes in the EBITDA and terminal growth rate. For our base case, we have assumed a terminal growth rate of 4.5%. We believe this to be conservative given the targets of the oil & gas, nuclear and water industries in Russia and the commitment of the government to develop these resources.

Table 6: Equity valuations sensitivity to terminal growth and WACC

\$ million

		Terminal growth							
WACC	1,396	3.0%	3.5%	4.0%	4.5%	5.0%	5.5%	6.0%	6.5%
	12.0%	1,435	1,503	1,579	1,665	1,763	1,877	2,009	2,165
	12.5%	1,358	1,417	1,484	1,559	1,644	1,741	1,853	1,983
	13.0%	1,288	1,341	1,400	1,465	1,539	1,623	1,719	1,829
	13.5%	1,225	1,272	1,324	1,382	1,447	1,520	1,603	1,697
	14.0%	1,167	1,210	1,256	1,308	1,365	1,429	1,501	1,583
	14.5%	1,115	1,153	1,195	1,241	1,292	1,348	1,412	1,483
	15.0%	1,067	1,102	1,139	1,181	1,226	1,276	1,332	1,394
	15.5%	1,023	1,054	1,088	1,126	1,166	1,211	1,261	1,316

Source: J.P. Morgan estimates.

The sensitivity of the implied fair value of the shares to changes in perpetuity growth and discount rate is summarized below in Table 7. Our WACC is based on long bond yield of 5%, standard equity risk premium of 4.0% and Russian volatility equity risk premium of 4.5%. We also applied 1% liquidity premium to the shares.

Table 7: Equity valuations sensitivity to terminal growth and EBITDA margin

\$ million

		EBITDA Margin							
Terminal growth	1,396	14.0%	15.0%	16.0%	17.0%	18.0%	19.0%	20.0%	21.0%
	3.0%	1,029	1,100	1,171	1,243	1,314	1,385	1,456	1,528
	3.5%	1,067	1,141	1,216	1,291	1,366	1,441	1,516	1,591
	4.0%	1,108	1,187	1,266	1,345	1,424	1,502	1,581	1,660
	4.5%	1,155	1,238	1,321	1,405	1,488	1,571	1,654	1,738
	5.0%	1,207	1,295	1,383	1,471	1,560	1,648	1,736	1,824
	5.5%	1,265	1,359	1,453	1,547	1,640	1,734	1,828	1,922
	6.0%	1,332	1,432	1,532	1,632	1,732	1,832	1,932	2,032
	6.5%	1,408	1,515	1,623	1,730	1,837	1,945	2,052	2,159

Source: J.P. Morgan estimates.

Below is the summary DCF calculations.

Table 8: Summary DCF calculations

\$ million

\$ mn	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E
Revenue	524	565	465	670	1,145	1,263	1,404	1,506	1,463
Costs excl. depreciation	-468	-498	-406	-580	-951	-1,044	-1,161	-1,247	-1,216
EBITDA	56	67	60	90	194	219	243	259	247
Depreciation	-11	-14	-11	-13	-14	-15	-16	-17	-19
Warranties, other costs	-12	-15	-15	-2	-11	-11	-11	-10	-10
Operating income (EBIT)	34	38	34	75	169	193	216	231	219
Less: taxes on EBIT	-7	-8	-7	-12	-42	-49	-56	-61	-60
Less: Capex	-59	-45	-16	-100	-29	-38	-40	-43	-47
Less: Changes in WC	-20	-14	-32	37	-61	-21	-21	-11	0
Plus: Depreciation	11	14	11	13	14	15	16	17	19
Plus: Warranties, other non-cash costs	8	17	14	7	11	12	14	15	14
Free cash flow to firm	-33	1	5	20	63	112	129	147	145
Discount factor (1+WACC)		1.00	1.00	1.00	1.00	1.13	1.29	1.46	1.65
PV of explicit forecast FCF		1	5	20	63	99	100	101	88
Total PV of explicit forecast FCF (2011E-2015E)	451								
Terminal free cash flow, \$ mn	145								
Terminal growth rate (\$ nominal)	4.5%								
Terminal discount rate	13.4%								
Terminal value, \$ mn	1,701								
PV of terminal value	1,028								
Implied enterprise value, \$ mn	1,479								
Less: Net debt (cash), \$ mn (prev. year)	34								
Less: Minority interest plus Assoc., \$ mn	49								
Total equity value, \$ mn	1,396								
Common shares outstanding, mn	117								
Fair value per common share, \$	11.9								

Source: J.P. Morgan estimates.

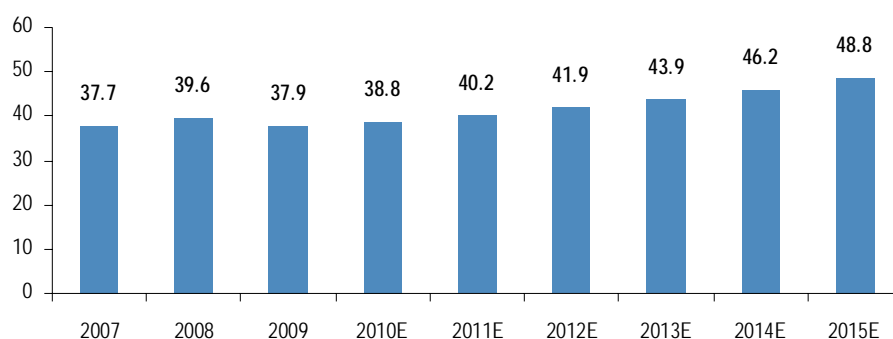
Industry overview

Global Pump market

A pump is a device used to move fluids such as liquids, gases or slurries. A pump displaces a fluid by physical or mechanical action. They come in an extremely broad range of sizes from very small high accuracy pumps used in hospitals to administer medication (in 0.3ml per second) to very large pumps that may transport oil, gas or water. A large oil pipe line may pump crude oil at around $7\text{m}^3\text{s}^{-1}$. The world of pumps can be split into two main product categories: positive displacement pumps and centrifugal, with the latter category accounting for around 73% of the global market in 2009. We regard the market for positive displacement pumps to be mature, as these products are typically less energy efficient than centrifugal pumps. With the users of large pumps focusing ever more closely on energy consumption we expect the growth in the global pumps industry to be driven primarily by increasing demand for the more energy efficient centrifugal pumps.

The global pumps market was worth \$37.9bn in 2009 according to the latest data from Frost & Sullivan. On the whole, we expect demand for pumps to track the overall trend in global GDP but with a multiplier of around 1.5x, though some industrial segments/regions may grow at a significantly higher rate. Hence, it is no surprise that in 2009, the global market for pumps declined on the back of many companies cutting capital investment spending. A key driver of the above global GDP growth is the prospect of very strong demand from the natural resources sector and a desire to modernize the current installed base on the back of a need to improve energy efficiency. Over the next five years we expect the global pumps market to grow at an average rate of around 5% per annum. The revenue development for the global pumps market is summarized in Figure 14.

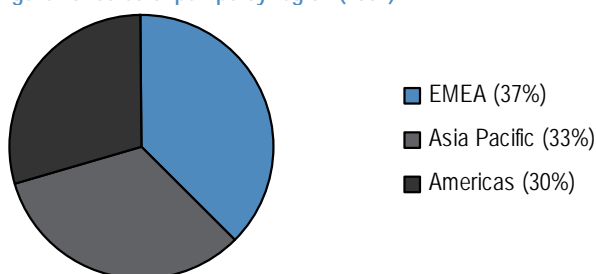
Figure 14: Revenue development of the global pumps market (\$ bn)



Source: J.P. Morgan and Frost & Sullivan. Note: Frost & Sullivan forecasts are limited by end Sep'15E.

Despite the marked decline in demand for pumps in 2009, the EMEA region remained the largest region in terms of sales accounting for almost 38% of the world market. The breakdown of the pump market by region can be seen in Figure 15.

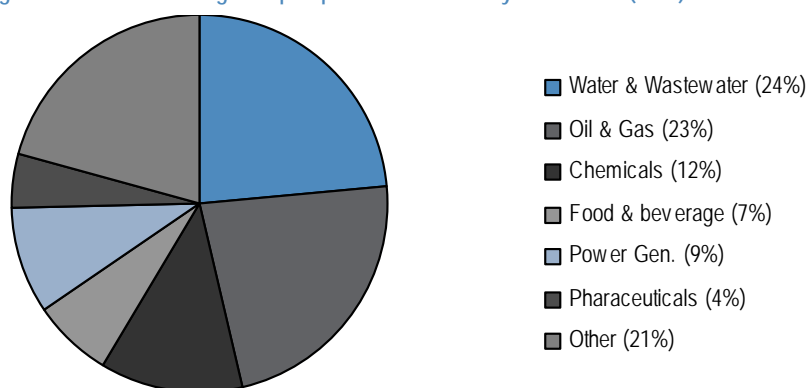
Figure 15: Sales of pumps by region (2009)



Source: J.P. Morgan and Frost & Sullivan

The most important end markets for the pumps industry on a global basis are the water/wastewater and oil & gas markets, which in 2009 accounted for 24% and 23% respectively. The next largest segment is the chemicals industry which accounted for approximately 12% of the world market in 2009. The breakdown of the global

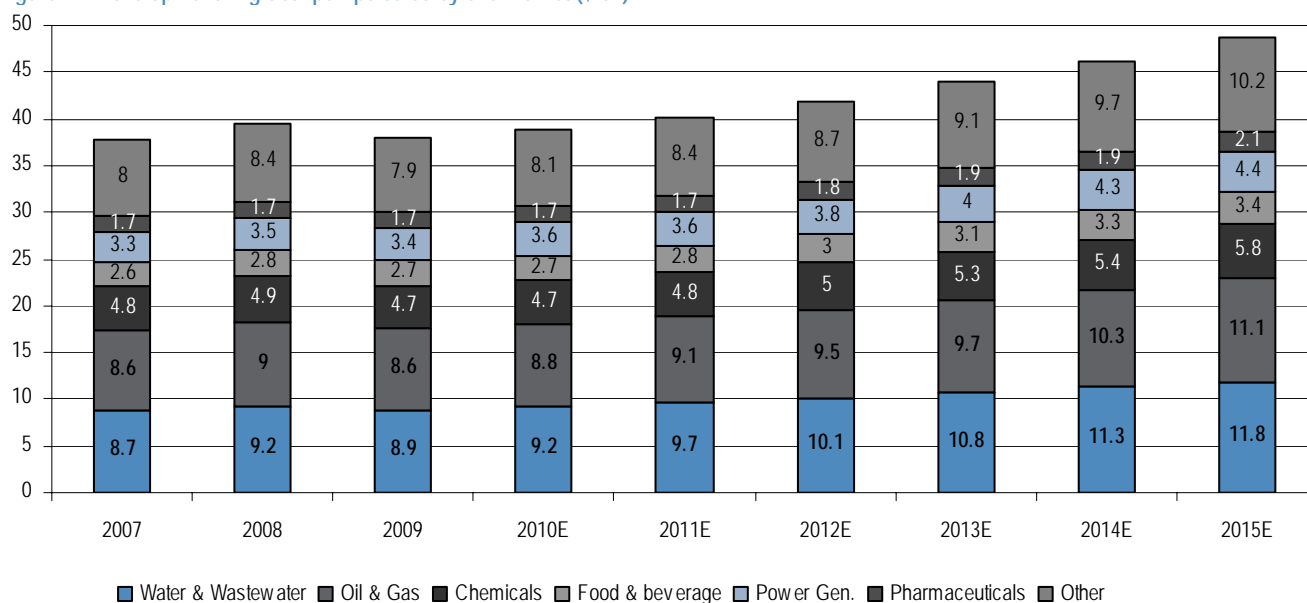
Figure 16: Breakdown of global pump market revenue by end market (2009)



Source: J.P. Morgan and Frost & Sullivan.

Looking ahead over the next few years we expect each of these end markets to grow at broadly similar rates. However, the growth rate in each end market is likely to vary significantly by geography. For example, we expect demand from the oil & gas industry in Russia to grow at over 20% per annum over the next 5 years ('10E-'15E) which compares with trend growth in the global pumps industry of around 5% of the same period.

Figure 17: Development in global pumps sales by end market (\$ bn)



Source: J.P. Morgan and Frost & Sullivan

We believe the global pumps industry is a generally fragmented industry in terms of equipment manufacturers. Few companies have a range of products that address a wide range of end markets as well as having a broad geographic footprint. We would regard the companies that address the largest range of end markets, broadest geographic footprint and an ability to offer bespoke solutions as Tier 1 suppliers. We would also include in Tier 1 companies that supply a narrower range of end markets but with a leading global market share.

We regard Tier 2 suppliers as medium sized companies, or a small division of larger companies, that are focused on a limited number of end markets and a tight geographic focus. However, they should have a strong position in their chosen end markets.

Tier 3 suppliers are small companies with a very limited product offering servicing only their local market. We have summarized the players in some of these segments in Table 9.

Table 9: Key pump producers

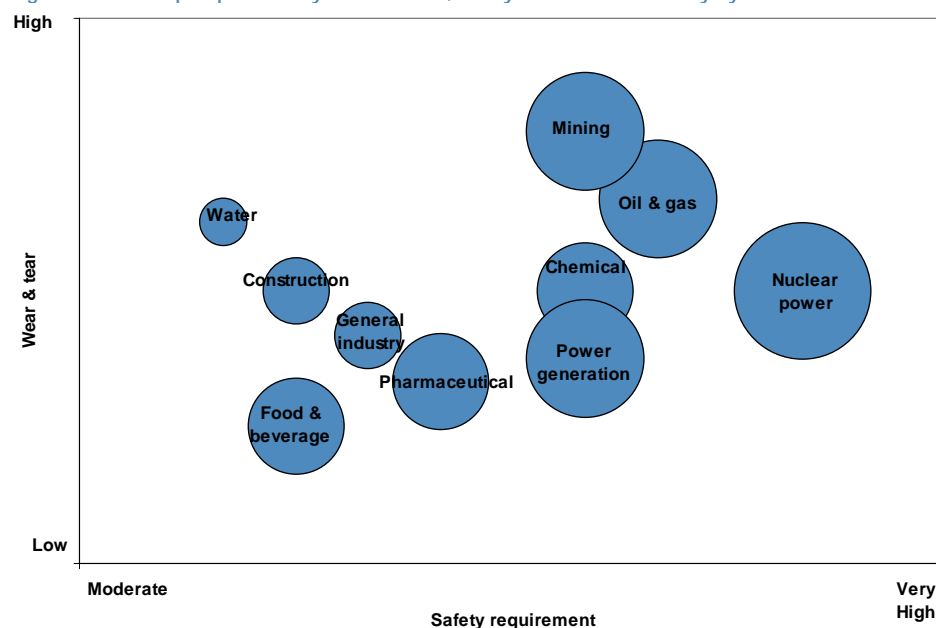
	Characteristics	Company
Tier 1	Large companies with comprehensive and global product offering	Dover Corp (US), Ebara (Japan), Flowserve (US), FLSmidth (Denmark), KSB (Germany), IDEX (US), Sulzer (Switz.) Weir (UK)
Tier 2	Medium sized companies with a focus on niches and/or regions	HMS (Russia), Andritz (Austria), SPX Corp (US)
Tier 3	Small local companies with limited product offering	

Source: J.P. Morgan estimates.

Aftermarket – typically more profitable than OE

For many pump producers the aftermarket is both a sizable and lucrative segment of the business. The aftermarket is particularly important to applications where safety and performance are critical. Figure 18 illustrates our view of the relative importance of safety and wear & tear for a range of end markets for the pumps industry (shown on the x and y axis). The size of the bubble is an indication of the level of the barriers to entry. The larger the bubble the more difficult is to enter the market and/or displace an incumbent. We believe that the nuclear power industry has the most stringent safety requirements and the highest barriers to entry while the wear and tear is moderate. At the other extreme, the safety requirements of the water treatment industry are more modest and barriers to entry are relatively low, though the wear and tear is relatively high.

Figure 18: Global pumps industry - wear & tear, safety and barriers to entry by end market



Source: J.P. Morgan estimates.

The barriers to entry in the aftermarket are determined by a combination of regulatory requirements, the level of product sophistication and how conservative the plant operator/owner may be. We estimate that for many companies, the trading profit margin in aftermarket is likely to be between 1.5x and 2.5x the level achieved on the sale of original equipment, based on discussions with many industrial companies.

The relative importance of the aftermarket to a company's revenue and margin progression is likely to be dependent on a number of key factors:

- Where we are in the capital investment cycle
- Safety/regulatory requirements
- How aggressive the operating environment of the pump may be
- Barriers to entry

- The strength of the distribution/service network
- The level of customer's in-house engineering capabilities

We estimate that for the major pump and valve manufacturers the aftermarket can accounts for between 25% and 60% of annual revenue. However, the proportion for any given company can vary significantly through a business cycle, with the aftermarket accounting for a high proportion of sales during an economic downturn and lower proportion of sales during capital investment spending booms. For the Minerals division of Weir, we estimate that the aftermarket currently accounts for around 60% of revenue up from >40% in 2008.

International vs Russian pumps market: comparative analysis. In the following table we listed the key differences between international and Russian pumps markets and their relatively importance when analyzing companies.

Table 10: Comparative analysis of Russian and international pumps markets

	Russian market			International market			Comment
Regulations	✓	✓	✓		✓		International regulations are open standard compared to state-controlled and approved regulation in Russia
Client relationship	✓	✓	✓		✓	✓	Most large contracts are tendered, but track-record is critical in securing contracts in Russia. Internationally, product quality and price are more important
Installed base		✓	✓			✓	Installed base is quite concentrated in the hands of few suppliers, but usually serviced by customer in-house in Russia
After-market			✓	✓	✓	✓	Internationally highly profitable, particularly in demanding applications. In Russia is marginal to revenues except for power industry
Competitive pricing	✓	✓		✓	✓	✓	Very competitive prices in internationally, less so in Russia, where competition limited by barriers to entry, client relationship

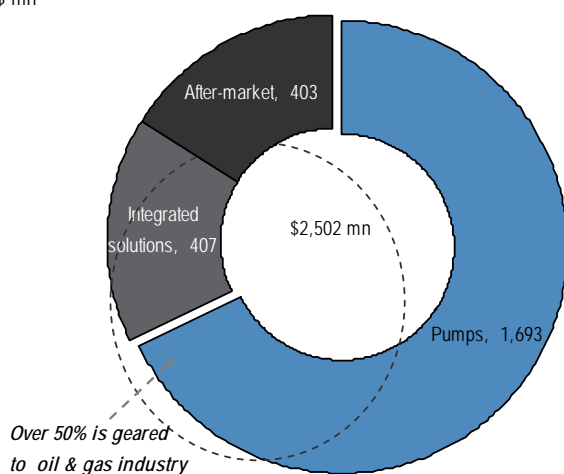
Source: J.P. Morgan estimates.

Russian pumps market

Pumps market in Russia: over 50% are pumps for oil & gas industry. According to Frost & Sullivan, the total Russian pumps market was worth \$2,502 mn in '09, split between \$1,693 mn worth for equipment, \$407 mn paid for integrated solutions and \$403 mn for after-market services. Given a prominent role of oil & gas extraction industry in Russia (17% of GDP in 2009 as per Interfax), it is not surprising that pumps for oil & gas industry accounted for over 50% of total pumps revenues \$921 mn in 2009. Pumps for water utilities are second largest segment (19% of total; \$318 mn), followed by power generation pumps (6%, \$100 mn). Other industrial pumps for various industries accounted for a total of 21% or \$354 mn in 2009.

Figure 19: Total pumps, integrated solutions & after-market in 2009

\$ mn



Source: J.P. Morgan estimates based on Frost & Sullivan report. RUB amounts converted in to USD as average FX rate of RUB31.7 per USD

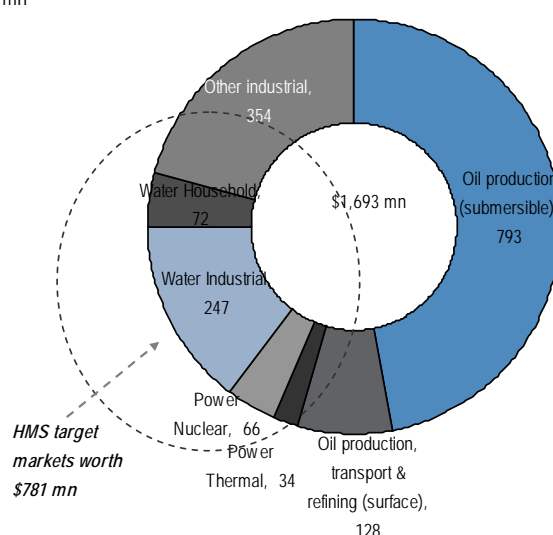
/Pumps market pic

Note:

- (1) pumps & pumps systems: pump design & pump manufacturing, coupling, motor, baseplate
- (2) integrated solution: pump system, valves, frequency inverter, pipe work, auxiliary systems (safety, fire-fighting, etc.)
- (3) after-market: spare parts, retrofitting pumps, repair & maintenance services

Figure 20: Total pumps only revenues in 2009

\$ mn



Source: J.P. Morgan estimates based on Frost & Sullivan report. RUB amounts converted in to USD as average FX rate of RUB31.7 per USD

Note:

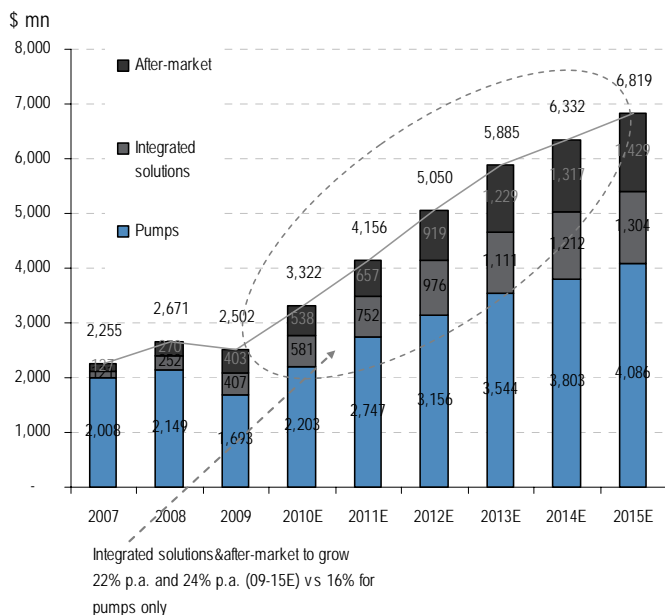
- (1) oil production (submersibles): Electrical submersible (ESP), sucker rod plunger (SRP), rotary progressive cavity pump (PCP)
- (2) surface oil pumps: radial flow & rotary for oil transportation, pumps for water injection (reservoir pressure maintenance), radial flow and centrifugal pumps for refining & petchem
- (3) power nuclear: main circulation pumps and secondary units pumps (non-MPC)
- (4) power thermal: boiler feed pumps, condensation pumps, circulation pumps
- (5) water utilities: submersible water well, wet-pit sewage & wastewater and dry-pit sewage & clean water
- (6) households: vibration & centrifugal (submersible) pumps
- (7) pumps for food&beverages, pharma, pulp&paper, construction, etc.

Double-digit annual growth across all segments between '09 and '14E.

According to Frost & Sullivan, the historic growth in total pumps, integrated solutions & after-market was 19.3% p.a. in '02-'08, when the market essentially tripled in size from RUB22.8 bn/\$0.78 bn in 2002 to RUB65.7 bn/\$2.63 bn in 2008. The economic slowdown in '08-'09 did not affect the market too dramatically, it was up 13.8% y/y to RUB79.4 bn in '09, but decreased in USD terms to \$2.50bn – on 27% RUB depreciation over the period. The market has appeared to have resumed double-digit growth in 2010 and is expected to show 19% annual growth rate in '10E-'14E, according to market analysis prepared by Frost & Sullivan. In our view, the large development and infrastructure projects in oil & gas industry (such as

ESPO/Purpe-Samotlor and BPS-2 construction, development of E. Siberian fields), modernization of water utilities, and construction of a number of new power blocks should drive the growth in the pumps markets. Please see Appendix 1 for more detail on potential projects.

Figure 21: Pumps, integrated solutions & after-market revenues, 2007-2015E

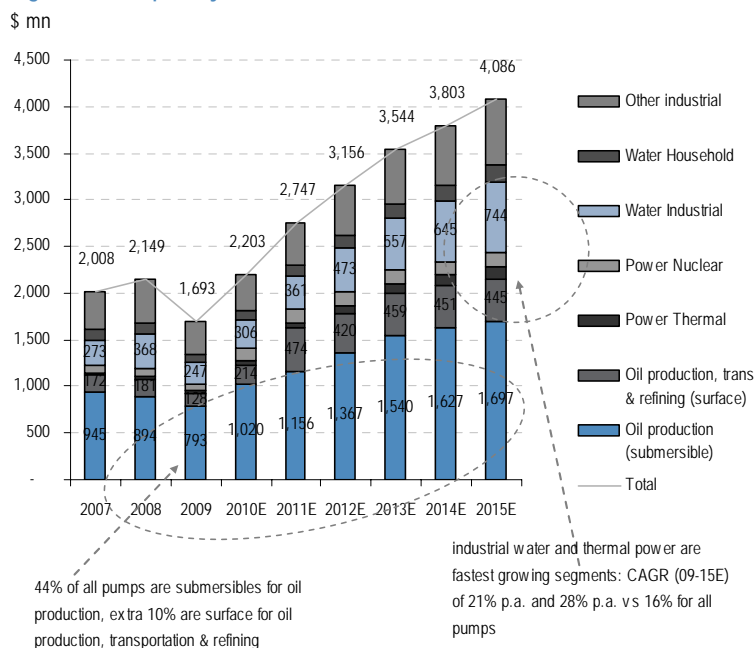


Source: J.P. Morgan estimates based on Frost & Sullivan report. RUB amounts converted in to USD as average FX rate of RUB31.7 per USD.

Note:

- (1) pumps & pumps systems: pump design & pump manufacturing, coupling, motor, baseplate
- (2) integrated solution: pump system, valves, frequency inverter, pipe work, auxiliary systems (safety, fire-fighting, etc.)
- (3) after-market: spare parts, retrofitting pumps, repair & maintenance services

Figure 22: Pumps only market revenues, 2007-2015E



Source: J.P. Morgan estimates based on Frost & Sullivan report. RUB amounts converted in to USD as average FX rate of RUB31.7 per USD.

Pumps market is divided between various Russian producers. According to Frost & Sullivan, there are dozens of small, medium sized and large companies in the Russian pumps market. Most manufacturers have been in the market for decades, *operating in their own niche segments with well-established client base and product range*. An average market share of a domestic player would be around 5-15% per segment (Source: Frost & Sullivan) with market leaders dominating in sub-segments/product lines. HMS has a stronger than average position in pumps for power utilities (we estimate it at 25% as of end-09 based on Frost & Sullivan report) with 42% share in pumps for thermal power plants by value. For many manufacturers, pump production is supplementary business to their main activity. For example, second largest producer of water injection pumps for the oil industry (HMS share of 59% in 09 – Frost & Sullivan) was Votkinsk Plant State Production Association (12% - Frost & Sullivan), which also produces intercontinental ballistic missiles. At the same time, small private producers can not offer R&D, integrated solutions and after-market services and would miss on any large-scale high-margin projects, which would require all these capabilities. Hence, there seems to be room for more specialization, and consolidation in the pumps markets, which should benefit market leaders in our view.

Competition: foreign vs Russian producers. The Russian pump manufacturers dominate the internal market with 65%-100% share in most sub-segments of the pump markets (with only exception of wet-pit and wastewater treatment pumps which are almost 100% imported). In our view, the key reasons for market dominance are:

- established long-term relationship with clients, extensive installed base of Russian-manufactured equipment. HMS's oil trunk pipeline pumps account for 98% of Transneft trunk pumps all installed to-date (Frost & Sullivan)
- geographical proximity to clients of manufacturing and maintenance facilities
- local R&D facilities - critical for new equipment orders and compliance with Russian technical specifications. All new projects in oil & gas, water and power sectors in Russia start at R&D Institutes, which provide full technical documentation for subsequent tenders and contracts. Ability to provide design, engineering & manufacture under one roof and locally is a major competitive advantage.
- strict technical specifications and requirements, security clearance for high-spec machinery, such as for nuclear industry
- import substitution/preference for local manufacturers by state-controlled companies (Transneft, power sector, water utilities)
- lower prices: similar-spec imported equipment could be 3-13x more expensive than Russian-produced equivalent. HMS' submersible water well pumps have price range of \$679-\$3,241/unit vs. Grundfos' \$4,576-\$14,279/unit, according to HMS Group.
- positive track record (reference) for equipment previously deployed. This requirement is a must for many tenders

Risks: While competitive position of Russian/CIS manufacturers looks unassailable at the moment, there are mid-term risks which could be identified:

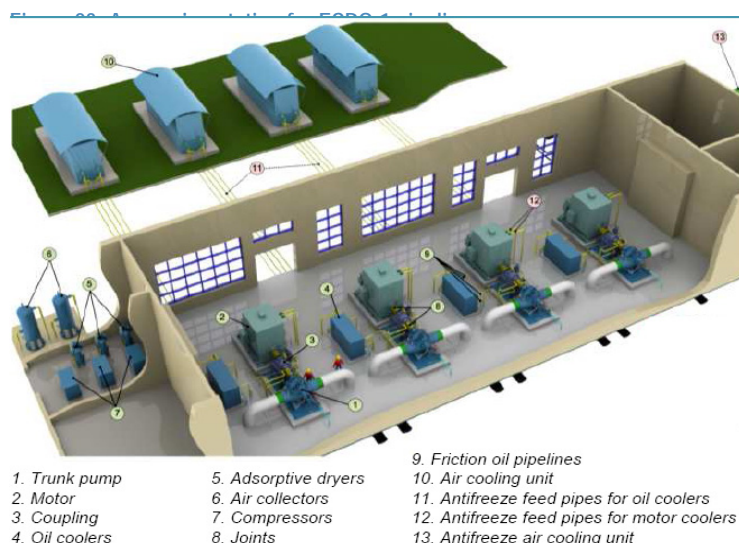
- WTO accession might result in harmonization of Russian specifications with international ones, making it easier for foreign manufacturers to sell in Russia. However, it might take at least 5-10 years for entry barriers to disappear
- Foreign companies are entering the market by buying into local producers, bringing better technology at more competitive prices
- Russian manufacturers mostly produce standardized pumps with similar specs and little proprietary technology, which makes it easy to switch suppliers. It could also drive down prices. Technological constraints/ lack of investment/ inertia are also evident in absence of Russian/CIS producers in the largest sub-segment of water utilities market: waste-water/wet pit pumps.
- Many customers have no problem manufacturing replacement parts in-house, which limits scope for maintenance, after-market revenues. However, overhaul (capital repairs) is done by HMS Group with spare parts which are manufactured by the HMS Group.

Table 11: Market position of Russian and foreign pump manufacturers

Segment	Type of competition (% of the market)	Comment
Submersible pumps for oil production	Near-monopoly of Russia-based manufacturers (inc JV) - 95%	HMS has little presence in the segment
Surface oil pumps for drilling, water injection, oil refining	Russian manufacturers have 80% share	HMS had 59% share ('09) in water injection, plans to expand product range in oil refining pumps (28% share)
Oil transportation	Russian/CIS manufacturers have over 90% share	Pumps mostly for new trunk and tie-in pipelines. Sulzer and Flowserve have presence, but experience is mixed
Thermal power generation	Russian manufacturers have 70-75% share	Foreign players have well-established presence in thermal power, KSB has 16% in the thermal power market (HMS: 42% in '09)
Nuclear power generation	Near 100% monopoly of Russian/CIS producers	Foreign players target nuclear market, but unlikely to become major competitors mid-term
Water utilities	Clean water/dry-pit: 100% Russian; waste-water/wet pit: 100% foreign; water well - 65% domestic (HMS)	Waste-water/wet pit pumps were not produced in the Former Soviet Union. Lack of local producers in this largest sub-segment of the market (20 years post Soviet Union collapse) might indicate lack of investment, technology constraints. Italian & German producers have 25% of water well pumps market
Household pumps	Russian manufacturers dominate: 70-75% of the market	Chinese producers made in-roads (35% of total in '09, 44% in '08)

Source: Frost & Sullivan, J.P. Morgan estimates.

Integrated solutions & after-market: critical for revenues and margins in mid-term. According to Frost & Sullivan, one of the on-going trends in the Russian pumps market is the shift away from sale of stand-alone pumps and towards integrated solutions, where a pump company offers design/manufacture of pump packages or complete systems for specific applications. For example, HMS won a tender to design and supply 30 super modular blocks for Vankor project. Total HMS revenues for 2008-9M10 for Vankor projects were RUB3.1 bn and deliveries are continuing. Each block is an approximately five-story construction containing a range of pumps and other equipment (water injection pumps, oil transportation pumps, pumps for oil preparation and separation, metering equipment, etc). Another example is on-going contract to 20 pumping stations to pipelines in East Siberia. According to HMS Group, they prepared specifications for hardware design for ESPO pumping stations; designed, tested and constructed pumps and coordinated full cycle procurement. The total amount of these projects is RUB12.4 bn/\$400 mn to HMS with high double digit EBITDA margin.



Source: Company reports.

Overall, integrated solutions could **add 8-30% to total contract value**, while **EBITDA margins** for integrated solutions-type projects could be **twice as high as for pumps only: 30% + vs around 15% for standard pumps**, according to HMS.

Table 12: Pumps, integrated solution & after-market revenues at HMS in 2009,

RUB, 000

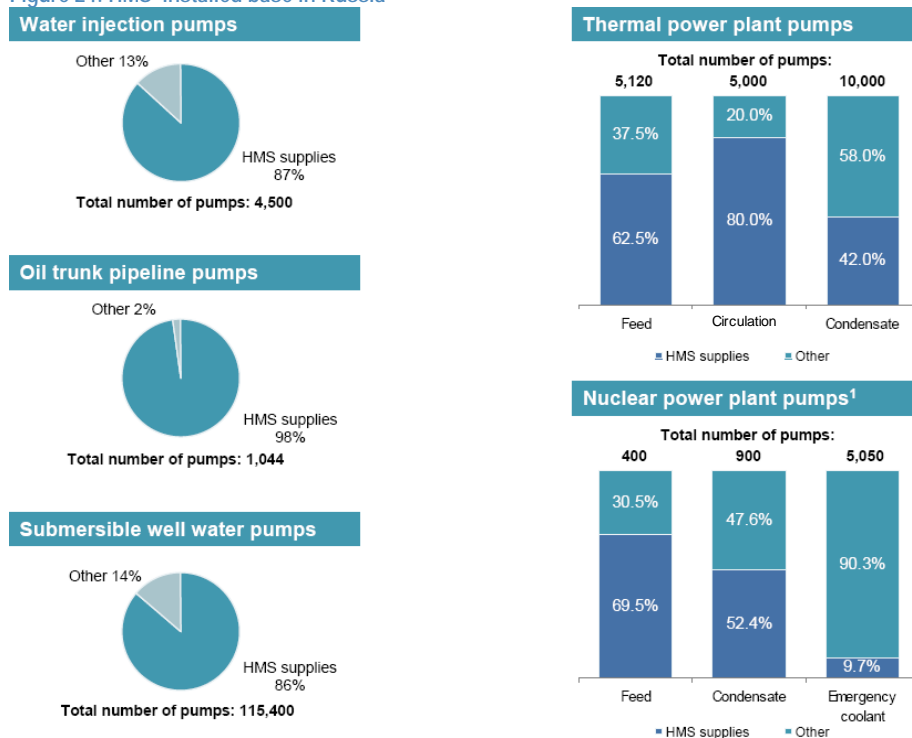
Industry	Segment	What is included into solution	What is included into aftermarket	Pumps revenue	Solutions revenue	After-market revenue	Total, %	Total, '000 RUB
Oil	Water injection pumps	flow meters, pressure gauges, frequency inverter, valves	Spare parts, upgrade kits, overhaul, commissioning	66%	20%	14%	100%	1,011
Oil	Refining	flow meters, pressure gauges, frequency inverter, valves + automation, safety systems	Spare parts, upgrade critical (sales, bearings), overhaul, commissioning	60%	24%	16%	100%	881
Oil	Transportation	flow meters, pressure gauges, frequency inverter, valves + automation, safety systems + motor cooling, ventilation, diesel drive	Spare parts, installation, overhaul, upgrade, commissioning	54%	16%	30%	100%	1,002
W/average				60%	20%	20%	100%	2,894
Power	Nuclear (ex MCP)	flow meters, pressure gauges, frequency inverter, valves + automation, safety systems + motor cooling, ventilation, turbine drive	Spare parts, installation, overhaul, upgrade, commissioning	49%	32%	19%	100%	443
Power	Thermal	flow meters, pressure gauges, frequency inverter, safety system, automation	Spare parts, installation, overhaul, upgrade, commissioning	54%	30%	16%	100%	812
W/average				53%	30%	17%	100%	1,255
Water	Submersible water well	flow meters, pressure gauges, frequency inverter, automation	Pump parts	90%	7%	3%	100%	725
Water	Water utilities	flow meters, pressure gauges, frequency inverters	Pump parts, overhaul	87%	9%	4%	100%	464
W/average				89%	8%	3%	100%	1,189

Source: J.P. Morgan estimates based on Frost & Sullivan report.

Peculiarities of Russian after-market and potential of HMS' installed base.

Along with integrated solutions, pumps companies can also offer after-market service, which is production of spare parts, services of overhaul and modernization of installed equipment. In Russia, many after-market services are performed by in-house divisions - a lasting legacy of the Soviet times. Many large oil companies would be able to produce and install spare parts and under-take on overhaul. HMS started to offer **modernization/upgrade services to oil companies** as part of legislative drive to improve energy efficiency of the Russian economy, according to HMS. It could be potentially a significant source of revenues to HMS, given a significant installed base of company's equipment in the oil industry. After-market for **power utilities** might continue to expand as pumping equipment becomes more sophisticated and utilities sign up for multi-year service contracts. After-market is less important **for water industry**: low price of water submersible well pumps makes its uneconomical to repair them, while pumps for clean water are made to last and the wear is often low and, as a result, after-market is slim.

Figure 24: HMS' installed base in Russia



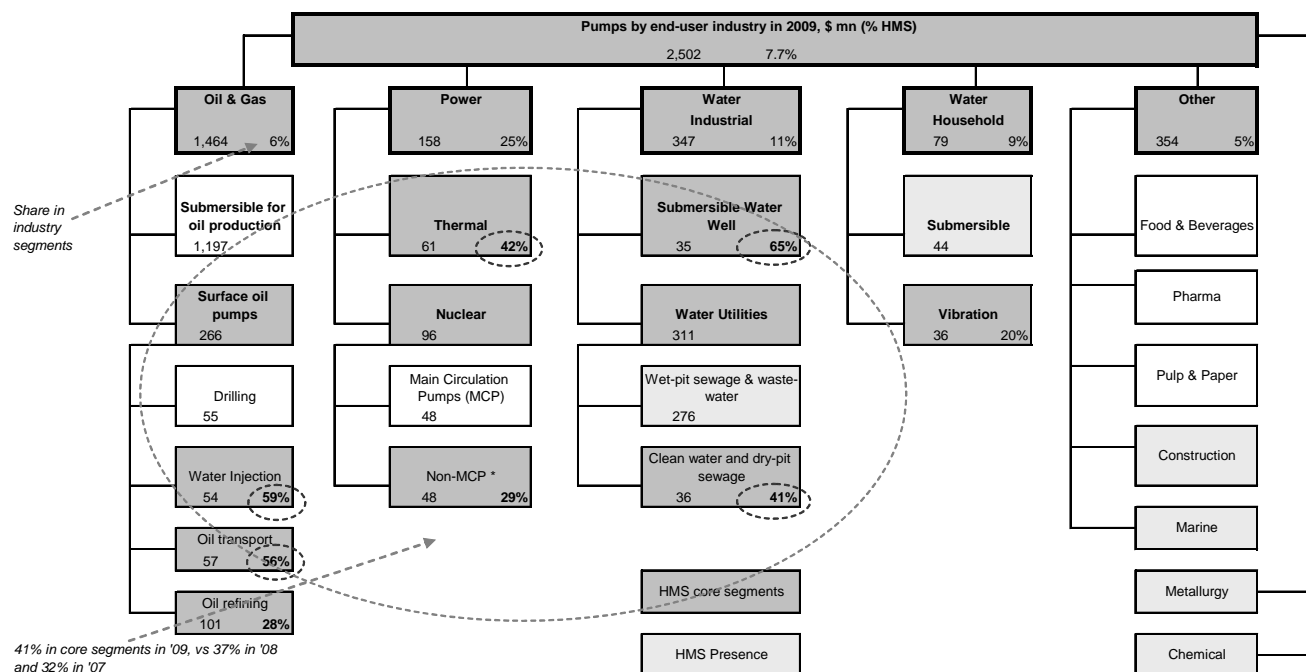
Source: Frost & Sullivan.

One of HMS' competitive advantages is the number of pumps already in operation throughout Russia. As the installed base ages, we would expect HMS not only to sell replacement equipment, but also offer modernization/overhaul services during leaner times – thus smoothing replacement cycles – especially in the oil industry, which revenues and expenditures are linked to the level of oil prices.

HMS' pumps: stable historic market share, dominance in water injection, transport pumps for oil industry. HMS operates across all pumps segments: Oil & Gas, Power, Water and Other Industrial pumps. The company specializes in some core sub-segments:

Figure 25: Russian pumps, integrated solutions & after-market revenues in 2009 and HMS' market share (%)

\$ mn



Source: Frost&Sullivan, J.P. Morgan estimates, Company data for segmental presence. Note: Frost & Sullivan data converted into USD at average FX rate.

(1) water injection pumps for maintaining reservoir pressure for the oil industry: HMS had 59% total market share in \$54 mn sub-segment in '09 (based on Frost & Sullivan). The water injections pumps market is forecast to grow by 17% annually to reach \$122 mn by '14E (Frost & Sullivan). We forecast that HMS revenues in the segment could rise with the market from \$32 mn in '09 to \$64 mn in '14E- mostly on the back of new equipment supplies to major oil field development projects as well as replacement and modernization business on existing pumps/installed base of 3,900 units ('09).

(2) pumps for oil transportation, both trunk pipelines and tie-ins. According to Frost & Sullivan, Transneft is the single largest customer in the market, which is primarily driven by demand for pumps for new pipelines. Large on-going projects include East-Siberia Pacific Ocean pipelines: essentially two pipeline projects dubbed ESPO-1 (Taishet-Skovorodino) and ESPO-2 (Skovorodino-Kozmino). ESPO-1 (stage 1) construction is complete and to be officially launched in Jan 11. ESPO-2 is under construction. HMS is currently supplying pumps for both branches of the pipeline as well as for the 1st stage of Purpe-Samotlor pipeline with the total value of the contracts in the backlog (as of Sep 30, 2010) of c. \$340 mn (Source: HMS Group).

ESPO-2 (stage 2) contract. HMS Group is expecting to supply complete pumps stations under integrated solutions project to ESPO (stage 2). It is similar in scope to the on-going contract. According to HMS group, the new contract would be to supply additional 20 pumping stations (which would include 80 pumps) - worth est. RUB20.5 bn (\$660 mn). Based on on-going ESPO contract, this follow up contract could reach RUR 3.5 bn/\$111 mn in 2012, RUR 6 bn/\$180 mn in 2013 and in 2014, RUR 5 bn/\$145 mn in 2015. The contracting will take place in 2011, the first deliveries are expected to take place in 2012, the rest of equipment deliveries and commissioning are expected to take place in 2013-2014.

The only national supplier able to test ESPO pumps. The company believes that it is highly likely that it will win the contract. HMS Group is the sole supplier of such pump type in the CIS with own dedicated R&D, and has jointly with Transneft developed EPSO project-specific pump design. The company has been a supplier of Transneft for over 40 years with the large installed base (over 1000 units running). According to HMS Group, the mission-critical nature of pumping equipment means that Transneft requires mandatory run tests of all pump units under full workload at a manufacturer's testing facility. The only national supplier able to test pumps under such demanding conditions is HMS Group, with new test facility built at Nasosenergomash specifically for ESPO pumps testing.

According to HMS Group, it is also supplying pumps for field and tie-in pipelines to Russian oil companies and is expected to participate in tenders for pumps for Purpe-Samotlor pipeline (2d stage), worth RUB1 bn/\$32 mn, Zapolyarnoye-Purpe pipeline stage 1 (RUB4 bn/\$119 mn), Yurubchenko-Takhomskoye (Y-T) – Taishet pipeline (RUB2 bn/\$64 mn).

Table 13: ESPO pipeline project

RU bn

Project		Capacity (mn tons)	Start	Complete	Pumping stations	Pumps per station	Total pumps	Supplied by	Contract value	Status
ESPO-1 (stage 1)	construction	20	2006	2011	7	4	28	Sulzer	\$300 mn?	complete
ESPO-1 (stage 2)	expansion	30	2010	2013	5	4	20	HMS	part of RUB12.4 bn	on-going
					2	4	8	Turbonasos		on-going
ESPO-2 (stage 1) & Purpe-Samotlor	construction	30	2009	2013	7	4	28	HMS	part of RUB12.4 bn	on-going
ESPO-2 (stage 2)	expansion	17	2012	2015	20	8	80		Est. RUB21-25bn	to be tendered in 2011
Total					41	4	164			

Source: J.P. Morgan estimates, Company data for HMS numbers, En.rian.ru.

In our view, project-driven nature of revenues in the transport pumps business could mean a large rise in the pumps revenues in '11E-'13E, from \$32 mn in '09 to the peak of c. \$412 mn in '13E as major pipelines are being constructed with subsequent fall to \$397 mn in '14E, when higher proportion of revenues might be coming from smaller projects and the after-market - repairs and maintenance.

(3) pumps for oil refining and petrochemicals. It is a large segment of the market, where HMS share was 28% in '09 (revenues of \$28 mn). The company is looking to expand its product range in this segment, but the competition from Russian/CIS suppliers and foreign producers is tough. There is an urgent need for many refineries to upgrade its kit (including pumps) to meet fuel specification requirements. However, a potential change in the Russian tax regime (which would mean higher taxes for downstream) might limit attractiveness of the segment to HMS, in our view. We assume a steady 19% annual rise in revenues in the segment from \$28 mn in '09 to \$61 mn in '14E based on the list of upgrade projects supplied by Frost & Sullivan.

(4) pumps for thermal power plants. According to Frost & Sullivan, HMS is the major supplier of boiler feed pumps, condensation pumps, circulation pumps for thermal power plants in Russia. Its market share was 42% with total revenues of \$26 mn in '09 (Frost & Sullivan). A pipeline of new capacity construction projects (24,000 MW of additional generating capacity) would require c. \$0.7 bn worth of pumping equipment & integrated solutions for the thermal power utilities in '10E-

'14E (calculations based on Frost & Sullivan). If we assume that HMS Group would maintain its share of the market, it could potentially win tenders worth c. \$320 mn in '10E-14E'. For modeling purposes, we assumed that only 75% of all projects will go ahead as planned, implying total revenues from the sub-segment of \$245 mn or around \$49 mn p.a. on average, according to our estimates. See Appendix 1 for more detail.

(5) pumps for nuclear power plants. Company's expertise in producing non-MCP (non-main circulation pumps) for nuclear industry puts it into a good position to partake in the State Nuclear Development Programme, which stipulates construction of 26 new nuclear reactors in Russia until 2020 (Frost & Sullivan). Each nuclear reactor would require 360-370 various pumps. Further 15 nuclear reactors are to be retrofitted by 2015. In addition, the Russian Nuclear Agency RosAtom will be commissioning a number of projects internationally, including the Mokhovtse NPP (Slovakia), Blene NPP (Bulgaria), Tianwan NPP (China), Kudankulam NPP (India), Akkuyu NPP (Turkey) – as per Frost & Sullivan. HMS's revenues from the segment were a modest RUB0.44 bn/\$14 mn in '09, based on company's accounts, but successful bidding throughout 2010 led to an order book for non-MCP pumps growing to 1.1 bn/\$36 mn as of Sep 30, 2010. We estimate that cumulative revenues from the segment would be around \$174 mn in '10E-14E or \$35 mn p.a. on average in '10E-'14E.

(6) submersible water well pumps. HMS' Group owns two companies specializing in submersible pumps production – LyvnyNasos in Russia and PromBurVod in Belarus. The scale of operations and entrenched market position allows HMS Group to claim 65% market share in this segment – RUB0.72 bn/\$23 mn in revenues in '09 (Source: Frost & Sullivan). The company's leading position in the segment is unlikely to be challenged by foreign competition, which is noticeable. HMS' product range is at least 3.5x cheaper than pumps produced, for example, by Grundfos (8% of the market in '09), according to HMS Group. We assume that the submersible water well pumps market would grow in line with GDP (volume wise), plus we see inflation adjustment to prices.

(7) clean water and dry pit sewage pumps As in the power industry, demand for clean water/dry pit sewage pumps is expected to be driven by state initiatives, such as "Clean Water" Regional Programme, Federal social housing Programme "Zhilische" - which should create demand for new pumps, according to Frost & Sullivan. Further privatization of water utilities and creation of public-private enterprises might bring in private investment in the sector. Total investments into water utilities might be as high as RUB3 trl/\$96 bn in '10E-'14E (based on Source: Frost & Sullivan), including RUB88 bn/\$2.9 bn in pumping equipment and solutions. We estimate that around RUB10 bn/\$327 mn could be spent on clean water/dry pit sewage pumps, where HMS had 41% market share in '09. We estimate that it could mean \$24 mn in annual revenues from the segment in '10E-'14E, adjusting for the probability of projects going ahead. We note that the Russian/CIS pumps producers are hardly present in the largest segment of water pumps market - waste water/wet pit pumps segment – due to lack of technology – which accounts for over 88% of total investments into pumps by water utilities. However, there are emerging Russian players in the segment.

(8) household vibration pumps. HMS' subsidiary HMS Household Pumps (former Bavlensky ElektroDvigatel) produces household pumps such as Rucheyek and Malysh – well known generic brands in Russia. We understand that company's policy is to maintain the market share (20% in '09) in this relatively low-margin RUB1.1 bn/\$36 mn segment. Chinese producers have taken a large portion of the household pumps market (27% in '07, 44% in '08, 35% in '09), but quality issues and weaker Ruble allowed for a bit of come-back for Russian producers. We forecast the household demand to rise in line with GDP only (no price inflation due to expected competition from other producers), which would mean HMS sales in the segment will double to \$16 mn by '14E.

Table 14: Summary of HMS position in the Russian pumps market in 2009

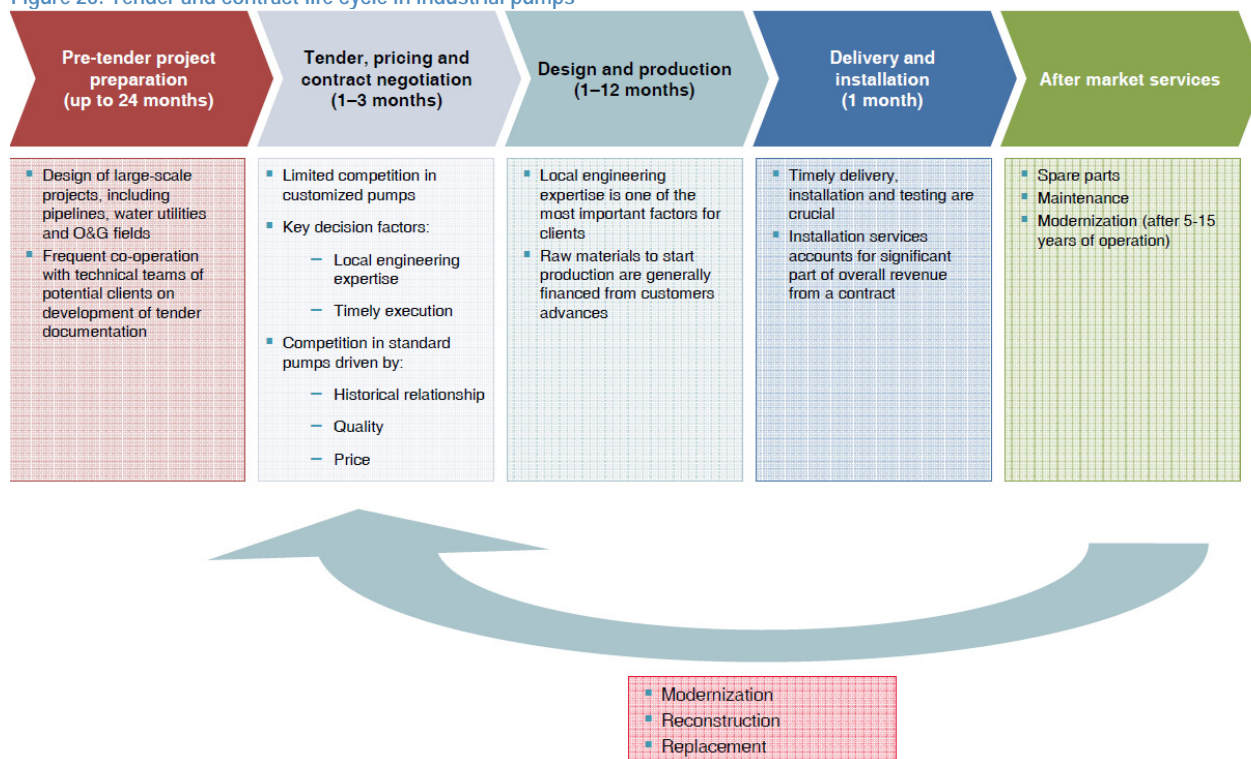
\$ mn

Pumps	Market size	HMS market share	HMS revenues	HMS subsidiary	Largest competitor (share %)	Company's comment	Competitive advantage
Oil & Gas							
Water injection pumps	54	59%	32	HMS Pumps (RU)/ NasosEnergoMash (UA)	Votkinsk (12%), Nasosy PPD (10%)	Mostly RU competition	HMS has 87% share of installed base (3,900 units)
Oil pipeline pumps	57	56%	32	NasosEnergoMash (UA)	Flowserve US (18%), UralHydroMash (11%)	Transneft to favour RU-produced equipment	Nearly 100% of installed base (1,000 units) are HMS-made
Pumps for oil refining and petchem	101	28%	28	HMS Pumps /LivnyGidroMash (RU)	Volgograd NefteMash (18%), <i>foreign manufacturers (22%)</i>	Track record is critical	Client relationship
Water							
Submersible water well pumps	35	65%	23	Livny Nasos (RU), PromBurZavod (BY)	KEMZ (UA, 11%), KSB (8%), Grudfos (5%)	Reliability is the key	87% of all water well pumps running in Russia (100,000 units) are HMS-made
Municipal water/Water utilities pumps	36	41%	15	HMS Pumps (LivGidroMash (RU)	Kataisk plant (18%), Moscow pump plant (9%)	Low margins, large number of producers	Track record
Household vibration pumps	36	20%	7	HMS Household pumps (Bavlensky/RU)	<i>Chinese manufacturers (35%)</i> , TekhnoPribor BY 18%	Competitive pricing to be maintained	Marketing
Power							
Non- Main Circulation Pumps - Nuclear	48	29%	14	NasosEnergoMash (UA)	NPO Frunze UA (38%), UralHydromash (26%)	Entry barriers, competitors offer complimentary equipment	R&D facility, track record
Pumps for thermal power stations	62	42%	26	NasosEnergoMash (UA)	KSB (16%), Kataisk (7%)	Large number of producers	57% of installed base (11,000 units) are HMS-made
Core pumps market *	429	41%	176				
Other industrial pumps							
Pumps for chemical industry	29				Various		
Pumps for metallurgy	60						
Other industrial pumps (pharma, construction, pulp& paper, food & beverages)	355	5%	18		Various		
Total target market	813	24%	194				
Total pumps market	2,502	7.7%	194				

Source: J.P. Morgan estimates, Company data. HMSModel_JMP/Markets. Note to LW : market share is based on total market, incl. integrated solutions & after-market (p. 29 of F&S

Large projects & tender process. HMS market share across various pump segments was relatively stable or rising throughout the last 3 years with overall share in core segments up from 32% in '07 to 41% in '09 (Source: Frost & Sullivan). The smoothness of revenues is somewhat deceptive, as the under-lying contracts are usually won at tenders (with exception of mass-produced pumps), which in turn depend on size and timing of various projects across oil & gas, water and power industries. Tenders usually take place at year-end (Oct-Dec), with certain smaller contracts offered mid-year. HMS' participation in ESPO/Purpe-Samotlor contract means that over 50% of RUB20.6 bn/\$676 mn backlog as of Sep 30, 2010 is down to three contracts signed with Transneft in 1H10. As a result, we expect that revenues and profitability of HMS Group in 2010-2011 could be significantly higher than in 2008-2009.

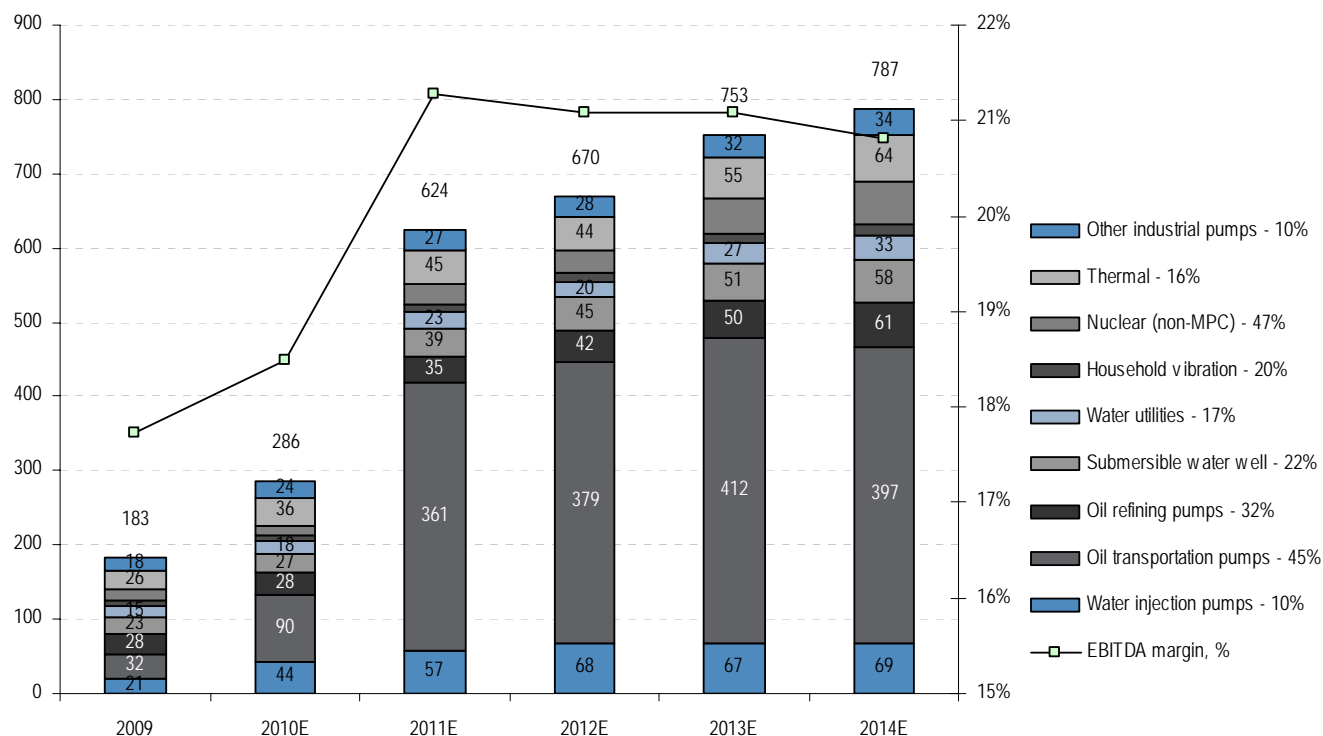
Figure 26: Tender and contract life cycle in industrial pumps



Source: Company reports.

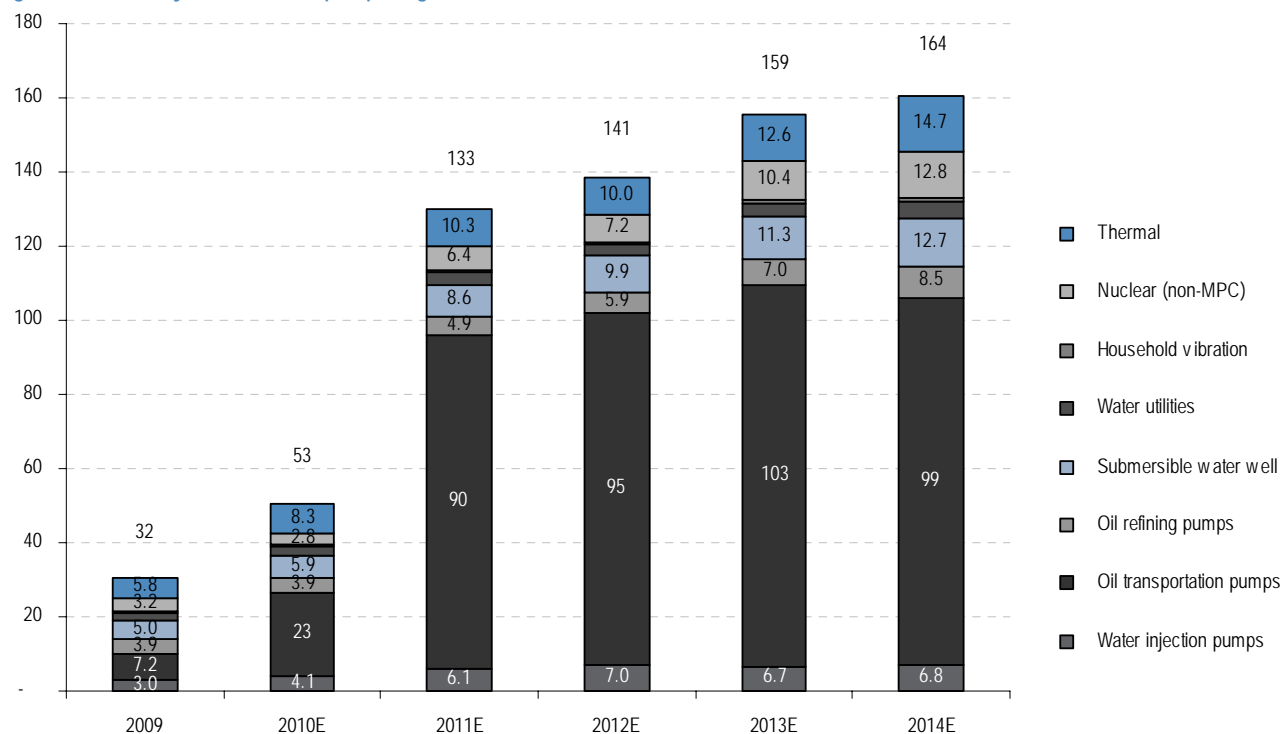
HMS' management positions HMS Group as the one capable of under-taking such projects in the future, citing HMS' track-record of successfully completed large projects. In pumps, as well as in modular equipment and EPC services, HMS states that it can offer to the client the full service over the entire life of the product, starting at pre-tender documentation preparation (at specialized R&D centers) to design and production (at pump manufacturing facilities in Ukraine, Russia and Belarus) to installation/project management (by HMS' engineering, procurement and construction division) to after-market services for spare parts (at manufacturing facilities) or maintenance (by HMS' repair and maintenance divisions).

Figure 27: Summary of pumps revenues & CAGR, 2009-2014E, \$ million



Source: J.P. Morgan estimates, Frost & Sullivan, Company data for total pumps revenues for 2009.

Figure 28: Summary of EBITDA for pumps segment, 2009-2014E, \$ million



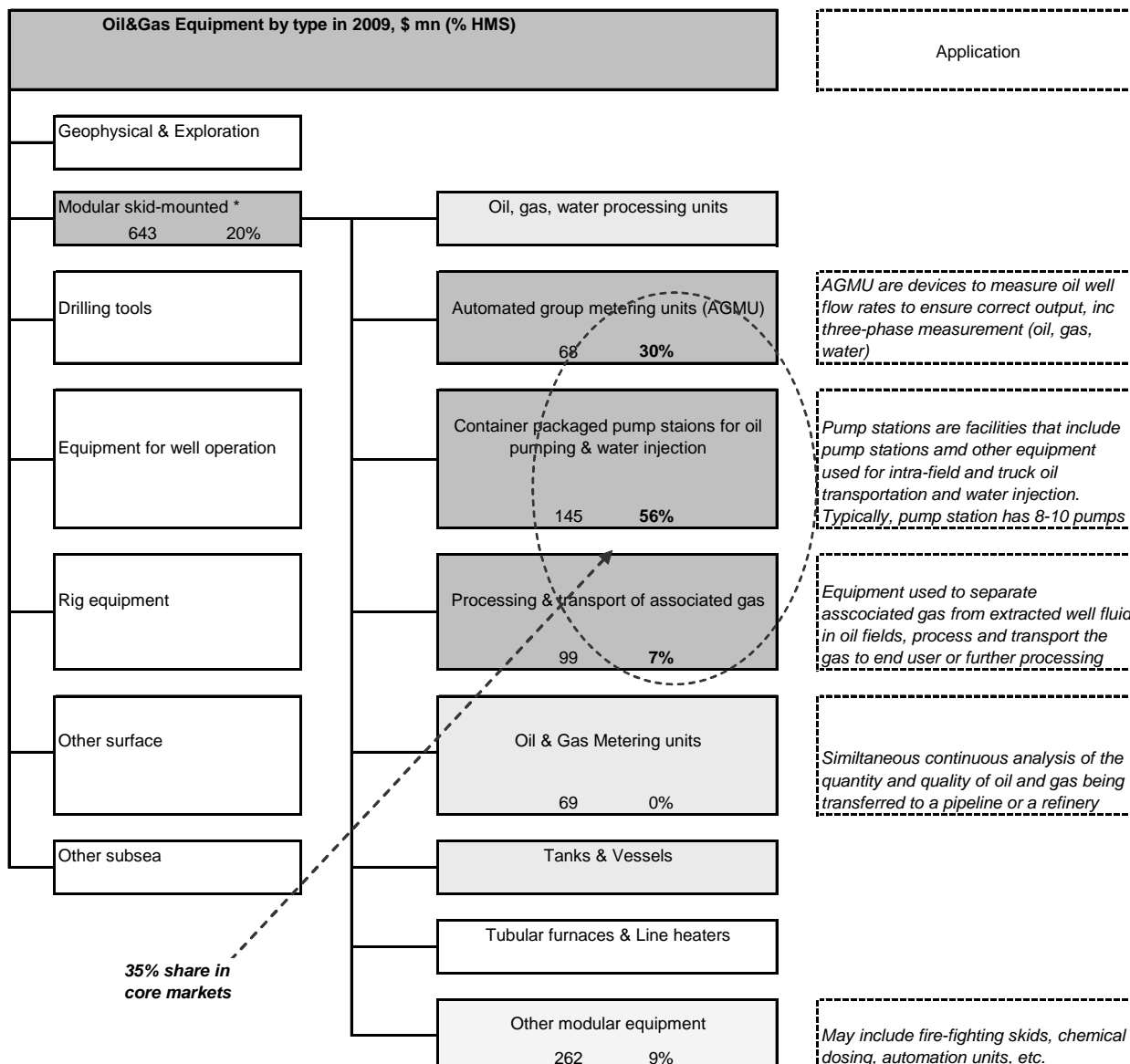
Source: J.P. Morgan estimates, Frost & Sullivan, Company data for total EBITDA in 2009.

Modular equipment market: a part of the package.

Another area of HMS' operations is design, manufacture and installation of skid-mounted/modular process equipment primarily for oil & gas companies, as well as water utilities and power sectors. Modular blocks are essentially various pieces of pumping and other equipment mounted on a platform (skid) or housed inside a metal structure. These could range from a single skid package to a complete process plant, consisting of many individual skid/modular units. The value of modular/skid-mounted equipment market in Russia was RUB20.5 bn/\$643 mn in '09 (based on Frost & Sullivan).

Figure 29: Oil & Gas Equipment and modular skid-mounted segment

\$ mn



Source: Frost & Sullivan, J.P. Morgan estimates./O&G Equip picture

Pump stations. HMS has a large share in the pumping stations segment of the modular equipment market. It is an extension of their pump business and allows offering a client the full package of a pumping station rather than an individual pump. Usually, it would also mean a higher margin on the contract. Pumping stations segment was worth \$145 mn in '09 with HMS claiming 56% market share (Source: Frost & Sullivan). HMS' Neftemash subsidiary (with sales of \$116 mn in '09 under Russian accounting standards as per www.e-disclosure.ru) is the main production facility in the segment. Given expected increase in pumps market revenues in '10E-'15E, we would expect HMS to sell a growing number of pumping stations, keeping its leading market share in the segment. We see sales up from \$81 mn in '09 to \$118 mn in '10E to \$194mn in '14E (CAGR ('10E-14E) = 13%).

Automated Group Metering Equipment (AGMU). The metering equipment is a high margin business. HMS' subsidiary SIBNA (SibNefteAvtomatika) – which specializes in the design & manufacture of metering equipment – had 18% EBIT margin under Russian accounting standards (RAS) in '09, according to our calculations. The segment is competitive: OZNA (a company which has a technology co-operation agreement with Schlumberger since Jul 09) is the leader, with 50% market share in '09 vs. HMS' 30% (Source: Frost & Sullivan). Demand for AGMUs is expected to rise, especially if the Russian government finally introduces the oil quality bank, which would require upgrade of existing AGMUs. We expect AGMU revenues to rise from \$20 mn in '09 to \$23 mn in '10E and \$30 mn in '14E (CAGR = 8%) based on assumption that HMS would keep its current market share.

Associated gas processing and transport units. It is a relatively new segment for HMS, it is traditionally dominated by compressor manufacturers. Flaring of associated gas in Russia is a major concern for the government which aims to increase associated gas use from c. 60% currently (Source: Oil & Gas Eurasia) to 95% by Jan 12. TNK-BP alone would invest \$1.8 bn between 2010 and 2013 (Source: Bloomberg, Nov 22) to meet the target. Part of TNK-BP's \$1.8bn associated gas utilisation project is a \$700m investment in its own energy projects, such as gas processing facilities and power plants, which will supply electricity for the firm's own oil field operations. We understand from the company that HMS is in the pilot project to design, manufacture and install a pilot gas processing unit for TNK-BP, worth \$2-5 mn. If the pilot is successful, an order for a further order might follow according to the company. We expect HMS revenues from the segment to more than triple from \$7 mn in '09 to \$22 mn in '14E (CAGR = 22%).

Table 15: Modular equipment market and HMS' market share in '09

\$ mn

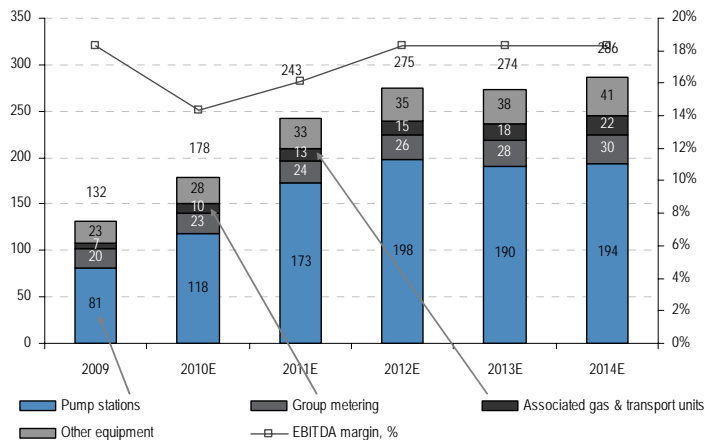
	Market size	HMS market share	HMS Revenues	HMS subsidiary	Largest competitor (share %)	Company's comment	Competitive advantage
Pump stations	145	56%	81	Neftemash (RU)	Ozna (32%)	New equip't to tie-in fields to trunk pipeline	Large installed base, OZNA buys pumps from HMS
Automated group metering units	68	30%	21	Neftemash (RU)	Ozna (50%)	Neftecontrol system might dramatically increase demand	R&D facilities, offer as part of integrated solution
Associated gas processing & transport unit	100	7%	7	Neftemash (RU)	Kazancompressormash (32%)	New segment for HMS, compressor manufacturers dominate	Pilot project with TNK-BP on-going
CORE MODULAR MARKET	313	35%	109				
Oil & Gas Metering Units	70			SibNA		Foreign companies (such as Emerson) produce parts which are locally assembled into units	
Supplementary Equipment & Services	263	9%	23	Nizhnevartovsk RemService (NRS) - RU	Various	Part of full service for clients	Proximity to clients
MODULAR EQUIP'T	646	20%	132				
OIL & GAS EQUIPMENT	2,600	5.1%	132				

Source: Frost & Sullivan, Company for comments and J.P. Morgan estimates. HMSModel/Markets

Low-tech and competitive segment, but a necessary part of the package. The modular equipment business is an integral part of HMS' product offering and allowed the company to win and complete a number of large, high-margin projects, such as supplying modular equipment to Vankor field. The business is relatively labour intensive, with 2,140 employees across three HMS subsidiaries (Source: HMS) and there is relatively little know-how in modular manufacturing process – as disclosed in HMS' subsidiary Neftemash 2009 Russian annual accounts (with a note that it was a crisis year with manufacturers scrabbling for contracts): "...Many machine building plants [in Russia] which are similarly equipped are launching production of our types of equipment. It happens because all Neftemash products are still produced under the design dating back to 1970-1980s and has no patent protection and does not require use of modern technology or materials, it is not unique". In our view, HMS' main competitive advantage in the segment is ability to offer the entire set of services, including pre-tender technical documentation, full project documentation, design & engineering as well as manufacturing of equipment and skids/modules for them. Quality control over the whole process and ability to use own manufacturing/installation/service base probably outweighs the risk of price competition in the segment and rules out the option of outsourcing the entire business.

Figure 30: HMS Group revenues in modular segment, 2009-2014E

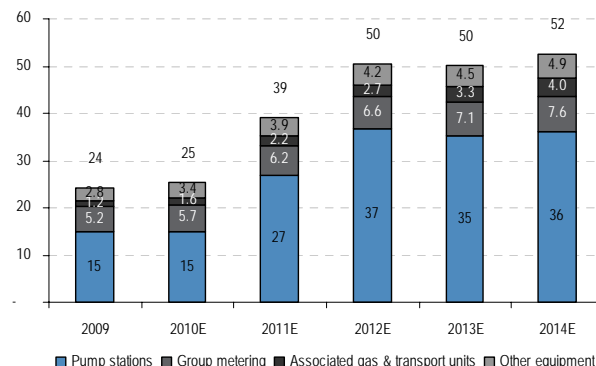
\$ million



Source: Company reports for 2009 and J.P. Morgan estimates.

Figure 31: EBITDA in modular segment, 2009-2014E

\$ million



Source: Company reports for 2009 and J.P. Morgan estimates.

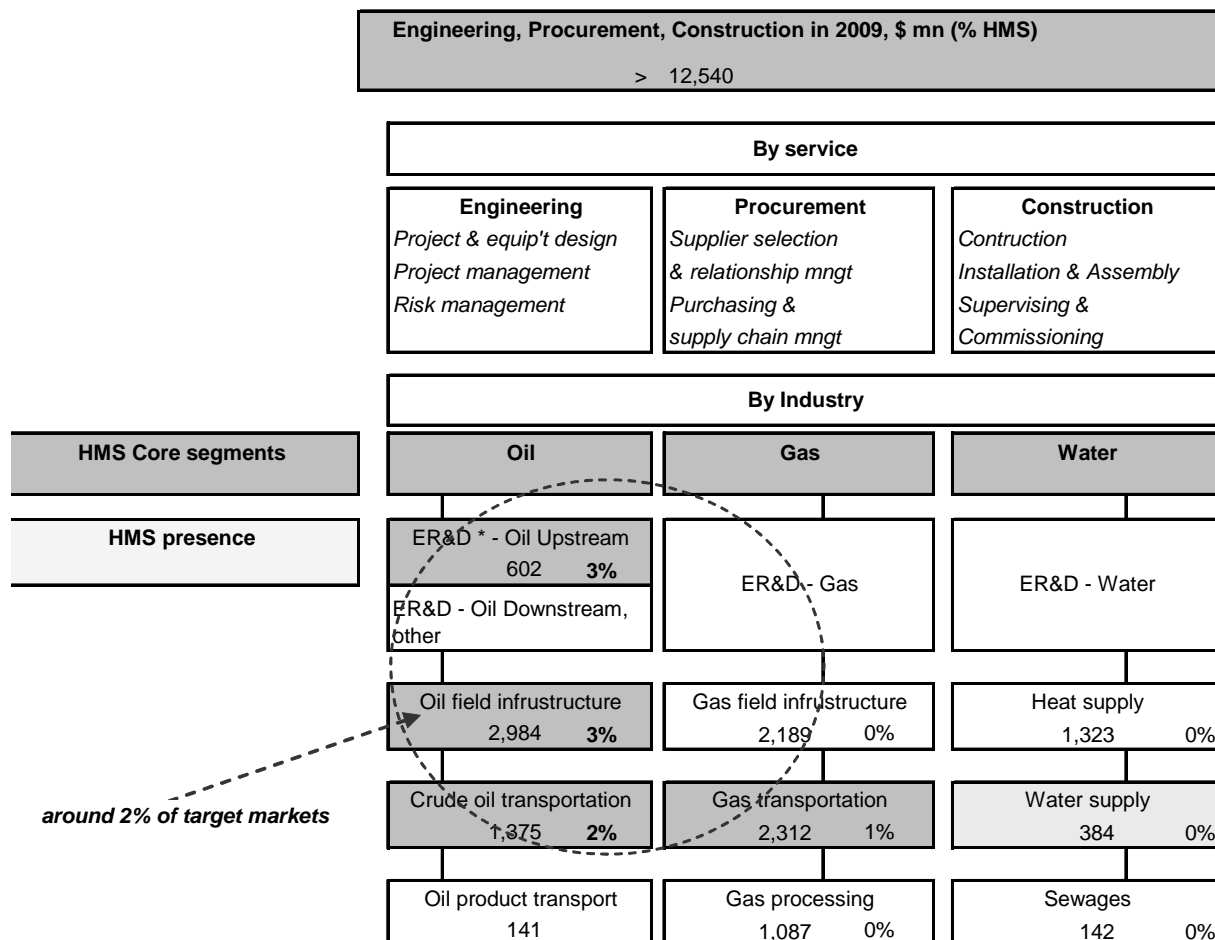
EPC (Engineering, Procurement, Construction) – among the big boys.

EPC market is by far the largest for HMS: according to Frost & Sullivan, the total value of Engineering, Procurement and Construction work in Russia was over RUB398 bn/\$12.5 bn in '09. With total EPC revenues of RUB4.1 bn/\$130 mn in '09, HMS Group accounts for about 1% of total market and around 2% of target EPC segments: (1) oil field construction, (2) crude oil transportation, (3) gas transportation and (4) Engineering, Research & Design.

As with the modular equipment business, the presence in the EPC segment allows the company to offer a package of services, aim for large complex projects with high overall margin. A good example would be Transneft/ESPO contract, where HMS offers procurement services as part of multi-million contract or contract for water treatment facility construction in Turkmenia where HMS delivered pumps and modular equipment as well as designed station and organized work for its construction.

Figure 32: EPC market size and HMS' market share in '09

\$ mn



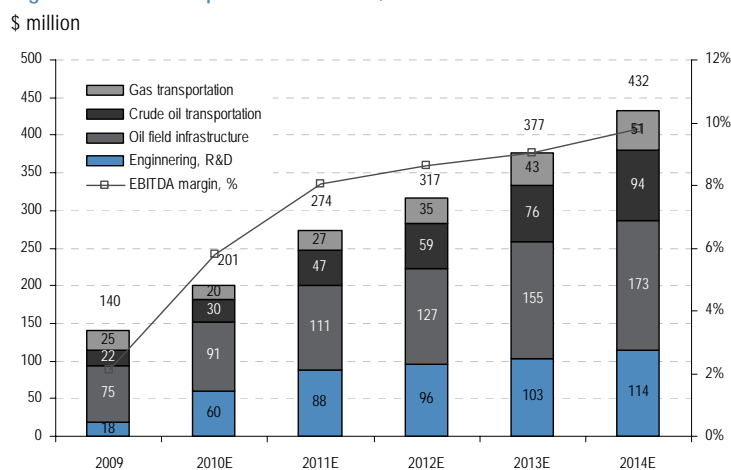
Source: Frost & Sullivan, Company data for segment presence. * = 10% according to Frost & Sullivan (incl. pro-forma GTNG)

Unique insight into Russian oil field development. A recent acquisition of 51% in GiproyumenNefteGas (GTNG) R&D Institute is also giving HMS a larger foothold in a vast and very important in Russia ER&D segment of the market. According to HMS, the Institute employs 1,176 people (as of end Sep 10) and designed over 200 oil and gas condensate fields in Russia, including the largest - Samotlorskoye (TNK-BP), Fedorovskoye (SurgutNG), Priobskoye (Rosneft/Gazprom Neft). Institute's clients include TNK-BP, Shell, Lukoil, Exxon, with exclusive relationships with Gazprom Neft and Rosneft.

Some 3% of entire oil & gas capex (RUB2,271 bn/\$71 bn in '09) is spent on project documentation (according to HMS management), which is the first essential step in any oil & gas development in Russia – the work under-taken by R&D Institutes such as GTNG. The documentation specifies stages of development, equipment specifications and costing of the project. This insight could be made available to other HMS' subsidiaries which could decide to bid in subsequent tenders having a first hand knowledge of the project and therefore being able to bid for complex projects including design and construction. HMS' management believes that it would allow the company to expand its position in EPC segment as well as other oil and gas market segments and have a better control of costs/improve margins.

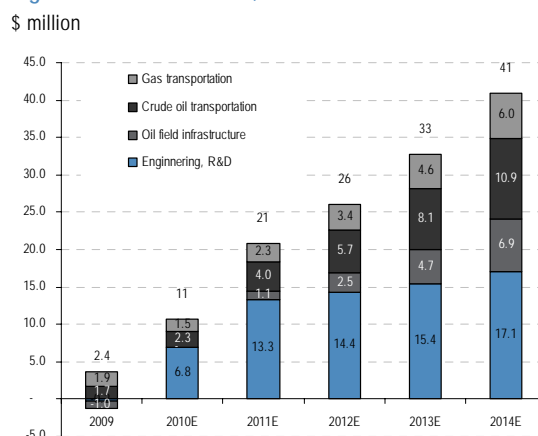
Assume a growing share of oil field construction business. HMS reported RUB4.1 bn/\$130 mn in EPC revenues in '09, with oil field infrastructure accounting for over 50% of the total based on Frost & Sullivan report. EBITDA margin in the business was zero, which could have been a result of the financial crises. We see growing revenues on the back of contribution from newly acquired GTNG, higher share in oil field construction segment (from 2% in '09 to 4.5% in '14E) and overall increase in EPC market value (from \$10.6 bn in '09 to \$22.3 bn in '14E – Frost & Sullivan). We estimate that EBITDA margins should improve from 6% in '07, 4% in '08 and 0% in '09 to 6%-10% in '10E-'14E. Contribution from ER&D division is the main reason – GTNG reported 23% EBIT margin in '09 under RAS.

Figure 33: HMS Group revenues in EPC, 2009-2014E



Source: J.P. Morgan estimates, Company data for 2009.

Figure 34: EBITDA in EPC, 2009-2014E



Source: J.P. Morgan estimates, Company data for 2009.

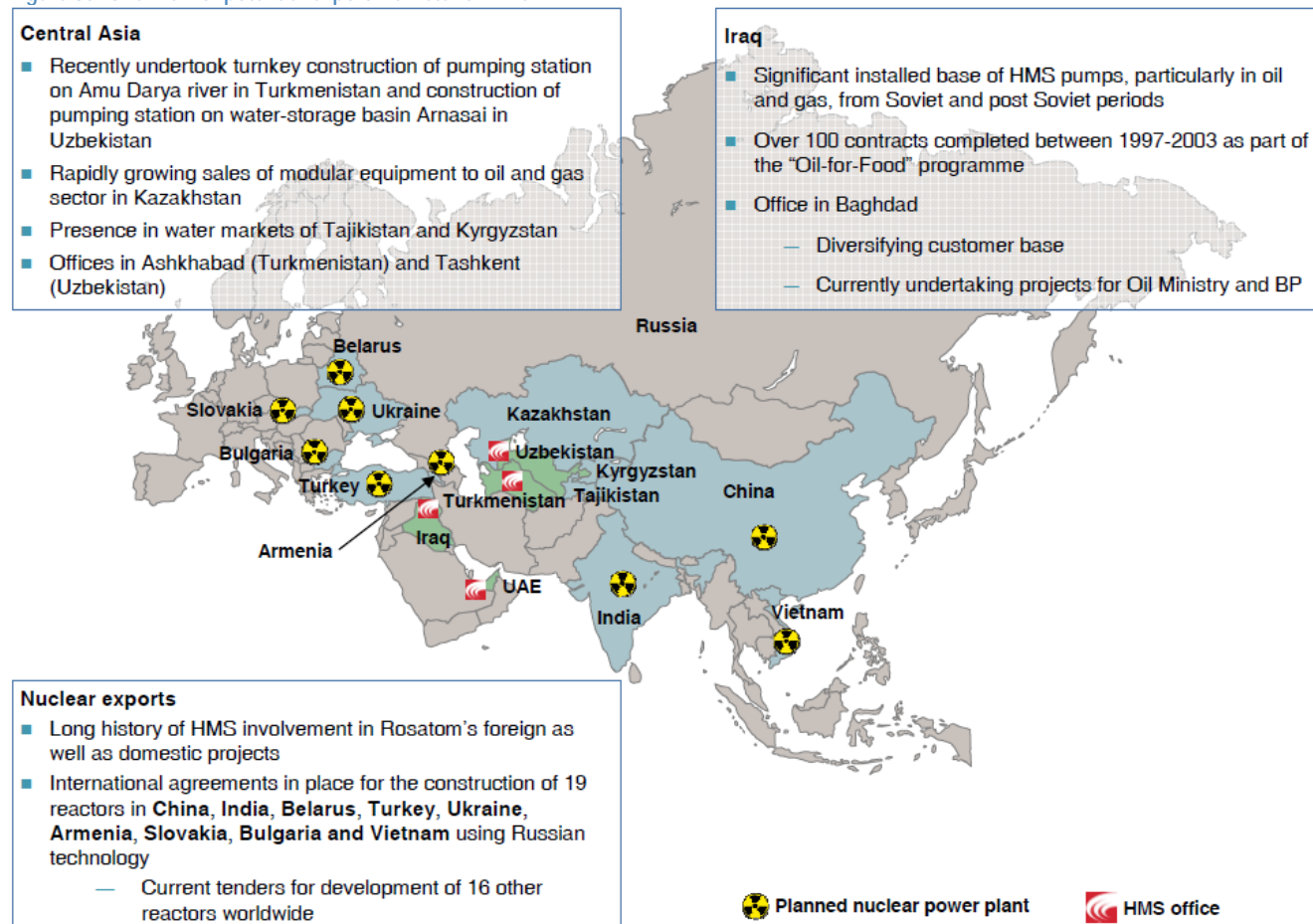
Export markets for HMS

HMS is well recognized in Russia, and has long-established connections to Former Soviet Union countries (FSU), Eastern/Southern Europe and Middle East, China and India. HMS' subsidiaries supplied pumps equipment to international markets for decades and the company is keen to continue with the business.

HMS has office in Ashkhabad, the capital of Turkmenistan where HMS built a water treatment stations for the Ministry of Water Industry. The contract for design, manufacture and turn-key contraction of a pilot facility was signed in Dec 08 for RUB504 mn/\$16 mn (Source: HMS). There is also an office in Tashkent, Uzbekistan.

There is an office in Baghdad (Iraq) – the country where HMS has a significant installed base of pumps (including water injection pumps at super-giant Rumaila field, jointly developed by BP and CNPC. Rumaila's two main reservoirs (the Main Pay and Mishrif) have reduced reservoir pressure and from 2011, water injection will be a priority in order to maintain reservoir pressure and improve oil flows (Source: Energy Intelligence Group). As more water is injected, more water-handling facilities will be needed on the surface to separate the oil from the water, clean it up and reinject the produced water. We understand from the company that HMS could potentially be involved in modernization work for some of the legacy equipment (water treatment, water injection) installed at the field in the Soviet and post-Soviet times. HMS Group is currently undertaking survey projects for BP and Oil Ministry of Iraq. Their size appears to be relatively small but they could provide possibilities for future growth based on the survey results.

Figure 35: Overview of potential export markets for HMS



Source: Company reports.

Financial analysis

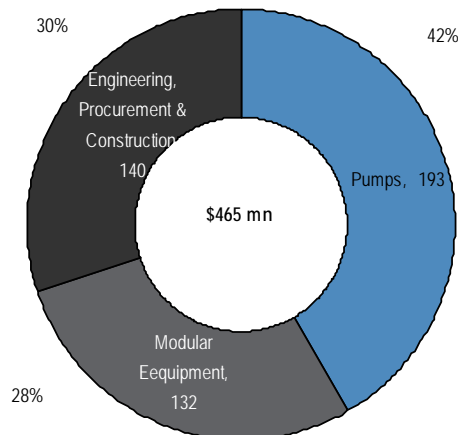
Strong 9M10 performance.

HMS is primarily a pump design & manufacturing company. Design, manufacturing and installation of pumps accounted for \$193 mn and \$250 mn of revenues in 2009 and for 9M10 - 42% and 47% of total respectively (Source: 2009 and 9M10 IFRS accounts). It is the most profitable business segment - EBITDA margin was 17% in '09 and 20% in for 9M10. Modular segment (manufacturing of metal structures housing pumping & other equipment) contributed \$132 mn to revenues in both '09 and 9M10, 28% and 25% of the total respectively. EBITDA margin of the business was 18% in '09 and 11% in 9M10. EPC (engineering, procurement and construction) revenues were \$140 mn in '09 and \$149 mn for 9M10 – 30% and 27% of the total. EBITDA margin was 2% and 7% respectively.

Key dates to watch. The company is to publish full year results on April 26th 2011 and 1Q11 numbers on June 8, 2011. The annual financials would be accompanied by backlog as of Dec 31, 2010, according to HMS Group.

Figure 36: HMS revenues by segment in '09

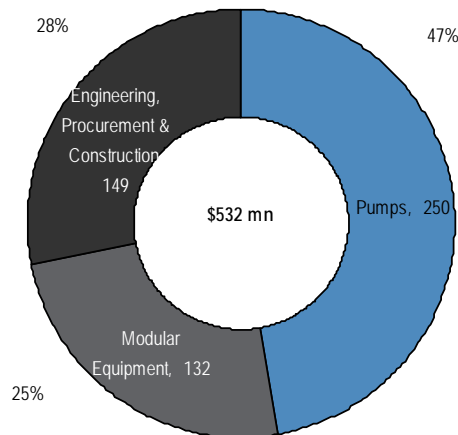
\$ million



Source: Company 2009 IFRS report, converted at average RUB:\$ exchange rate, J.P. Morgan estimates.

Figure 37: HMS revenues by segment in 9M'10

\$ million

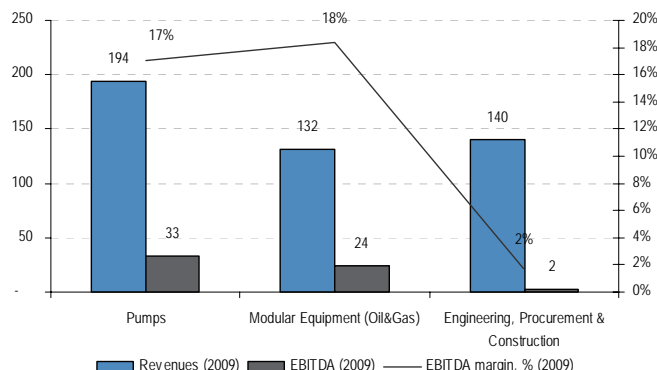


Source: Company 9M10 IFRS report, converted at average RUB:\$ exchange rate and J.P. Morgan estimates.

We believe that revenues and margins fluctuations across segments are mainly due to timing of the completion of major projects: pumps/modules deliveries to Rosneft's Vankor field in 2009 lifted modular segment margin in '09, pumps contract with Transneft for ESPO/Purpe-Samotlor (East Siberian pipelines) improved EBITDA margin in pumps division in 9M'10.

Figure 38: HMS revenues and EBITDA in '09

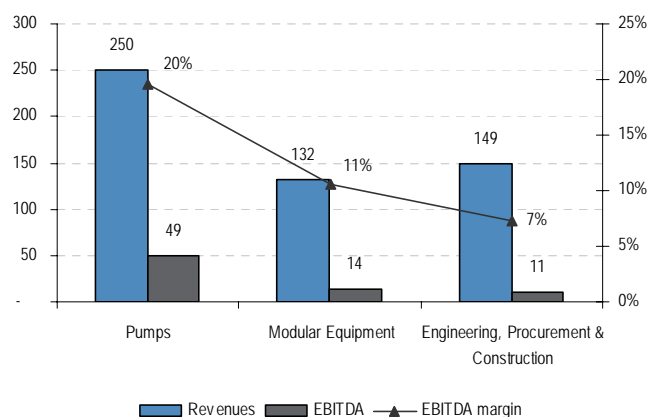
\$ million, %



Source: Company 2009 IFRS report, converted at average RUB:\$ exchange rate and J.P. Morgan estimates.

Figure 39: HMS revenues and EBITDA in 9M10

\$ million, %



Source: Company 2009 IFRS report, converted at average RUB:\$ exchange rate and J.P. Morgan estimates.

Acquisition of GTNG: useful asset but at a substantial goodwill. In June 2010, HMS Group acquired 51% voting/38.26% of total equity of Gyprotyumenneftegaz (GTNG) for \$81 mn - the leading design and engineering institute servicing oil & gas industry in Russia, which significantly enhanced HMS Group's EPC segment allowing the Group to extend the range of services (Source: HMS 9M10 IFRS accounts). For 9M10, GTNG had revenues of \$50 mn, EBITDA of \$6 mn (EBITDA margin of 12.6%) and net income of \$2.5 mn. Fair value of acquired interest was \$29 mn (due to large non-controlling interest of 61.7%) and HMS Group recorded \$51 mn on its balance sheet (as of Sep 30, 2010). Under IFRS accounting rules, we believe, HMS Group would not need to amortize the goodwill, which would otherwise have reduced reported net income in the coming years. However, HMS Group would need to carry out an impairment test on GTNG on annual basis and reduction in the fair value might lead to impairment charges and reduced net income for the group.

Margin forecast is based on historic performance and mid-term project pipeline. We analyzed HMS' historic revenues and made our forecasts by business divisions: pumps, modular and EPC. The segment revenues are further broken down into product lines: water injection pumps, oil transportation pumps, water well submersibles, etc in pumps segment, pumping water/oil stations, automated metering stations, etc in modular equipment and into oil field construction, gas pipe construction and ER&D (engineering, research and design) in EPC.

Table 16: HMS' revenues break-down

\$ million

HMS' Revenue forecast	'09	10E	11E	12E	13E	14E	Rev's CAGR (10E- '14E)	Market CAGR (10E- '14E)	Note
Pumps									
Water injection pumps	21	44	57	68	67	69	12%	15%	Sharp rise in '10 vs market, than in line with drilling volumes
Oil transportation pumps	32	90	361	379	412	397	45%	30%	Assume high (95%) chance of winning ESPO-2 (ext), BPS-2 contracts
Oil refining pumps	28	28	35	42	50	61	21%	21%	Based on participation in known upgrade programs
Submersible water well	23	27	39	45	51	58	21%	17%	Market growth and stable 65% market share
Water utilities	15	18	23	20	27	33	17%	23%	Based on participation in projects listed in the pipeline
Household vibration	7	8	10	12	14	16	19%	18%	Increase in line with GDP growth and CPI
Nuclear (non-MPC)	14	12	28	32	46	56	47%	6%	Based on participation in known projects and higher after-market
Thermal	26	36	45	44	55	64	15%	30%	Segment might peak in 2014 based on current projects
Other industrial pumps	18	24	27	28	32	34	10%	14%	Close to the market growth
Total pumps	183	286	624	670	753	787	29%	19%	
Modular Equipment									
Pump stations	81	118	173	198	190	194	13%	10%	Supported by transportation, water injection pumps growth
Group metering units	20	23	24	26	28	30	7%	7%	In line with the market
Assoc'd gas processing & transport units	7	10	13	15	18	22	22%	15%	Potential increase in the market share
Supplementary equipment	23	28	33	35	38	41	10%	10%	In line with total segment sales growth
Total modular	132	178	243	275	274	286	13%	11%	
EPC & Other									
Engineering, R&D	18	60	88	96	103	114	17%	12%	Acquisition of GTNG in Jun'10
Oil field infrastructure	75	91	111	127	155	173	17%	10%	Market share up from 2.5% in '09 to 4.5% in '14E on GTNG purchase
Crude oil transportation	22	30	47	59	76	94	33%	15%	Higher market share on access to ER&D data
Gas transportation	25	20	27	35	43	51	27%	10%	Higher market share on access to ER&D data
Total EPC	140	201	274	317	377	432	21%	11%	
All other	11	4	4	1	1	1			
HMS revenues	465	670	1,145	1,263	1,404	1,506	21%	14%	

Source: J.P. Morgan estimates.

For 2009, we have HMS' revenues by segment (as reported by company) and by product line (based on market size and HMS' market share in various pumps/modular equipment lines/EPC activity in 2009 as per Frost & Sullivan). The sector research report prepared by the consultants also gives us their estimates of size/growth in core market segments in '10E-'14E, based in turn on list of on-going and prospective infrastructure projects in Russia (see Appendix 1). In the project list, Frost & Sullivan give us assumptions for overall expected capex for various projects as well as total investments required into the pumping equipment. We assume that HMS will participate in most of the projects and win enough contracts to maintain market share in the respective products. We also assume that HMS would have retained its share in after-market (repairs & maintenance).

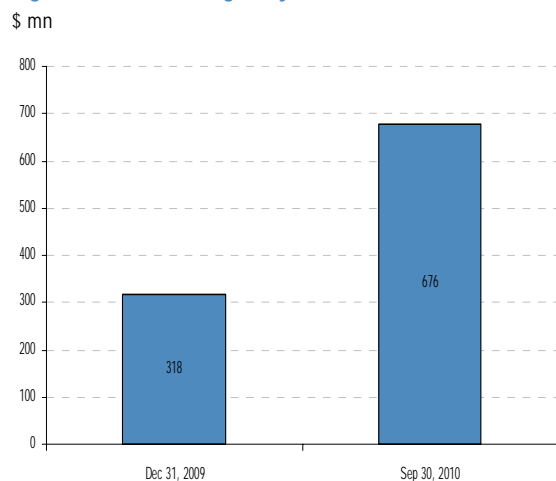
Essentially, the list of projects is the pool of HMS' potential contracts and an indication of the future backlog for the company's pumping division. For modular and EPC markets, we relied on consultants' assumptions for overall market size in '10E-14E – they also tally with our estimates for capex growth in the Oil & Gas

sector – the main customer for the divisions. Conservatively, we assumed that forecasts are around 75% accurate. At the same time, we see higher market share for HMS in certain segments of modular equipment and EPC markets. We estimate that the company should gain share in modules for associated gas transport and processing (from 7% in '09 to 10% in '14E) and we see a doubling of presence in oil field infrastructure segment (from 2.5% to 4.5%) of the EPC market.

Backlog of RUB 20.6bn/\$676 mn as of Sep 30 2010, might expand. Majority of HMS revenues are linked to contracts signed with major clients. According to HMS, backlog (incomplete part of contracts signed) stood at RUB20.6 bn as of Sep 30, 2010 vs RUB9.5 bn as of Dec 31, 2009. The bulk of the current backlog is RUB10.3 bn/\$341 mn the high-margin contract to supply pumps for East Siberian pipelines (ESPO-1, ESPO-2, Purpe-Samotlor).

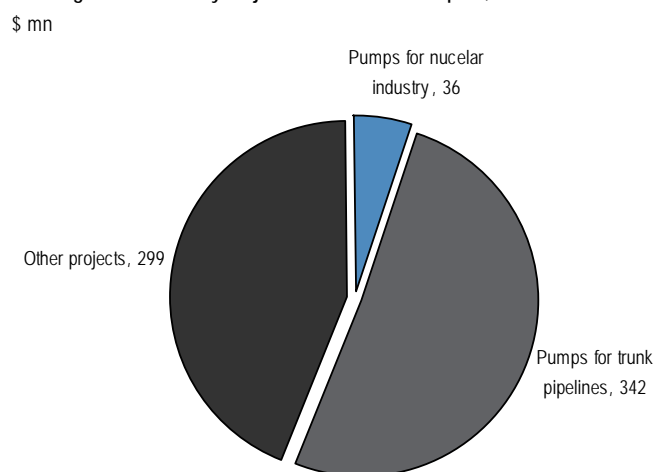
The backlog does not include standard pump sales where typical contract cycle is around 3 months or other equipment which is sold on the basis of call-off contracts (est. at RUB2-3 bn/\$64-96 mn by the company). According to the company, HMS records most orders in 4Q/beginning of 1Q which reflects industry's contracting cycle, hence backlog as of Jan 1, 2011 could rise further. Beyond 2010, HMS is gearing up to participate in tenders in a number of infrastructure projects in Russia, with potential total value of pumping equipment supplies of RUB607 bn/\$20 bn in '10-'15. Assuming that HMS maintains market share in its core pumps segments (and wins correspondent number of tenders) and 75% of projects are going ahead, it would mean cumulative revenues of around \$3 bn in '10E-'15E or over. \$500 mn annually for pumping division only. The expansion of modular and EPC markets should add to the backlog in those segments.

Figure 40: HMS backlog analysis



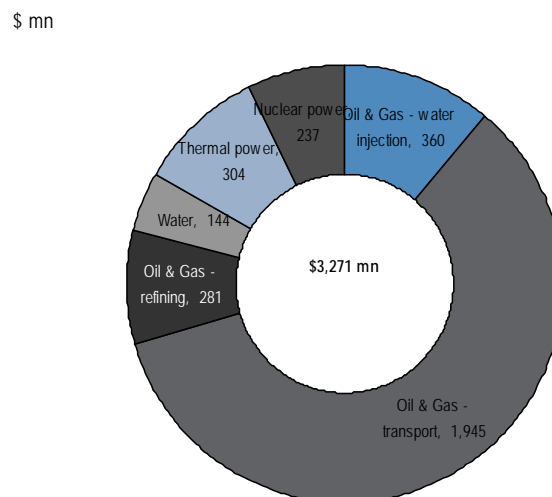
Source: Company data.

Backlog break-down by major contracts as of Sep 30, 2010



Source: Company data.

Figure 41: Potential pumps revenues from infrastructure projects in 10E-15E



Source: J.P. Morgan estimates.

A number of projects in near-term pipeline.

We estimate that the company has a potential to add around RUB21.8 bn/\$711 mn to the backlog over the next 6-9 months. HMS is also well-positioned to be a front-runner for est. RUB20.5 bn/\$660 mn worth of pumping stations (20 stations at c. RUB1 mn each) for ESPO-2 extension (ESPO-2 Stage 2), expected to be tendered in 2011, given the company is already supplying 12 pumping stations for the pipeline and is the only CIS supplier which can run mandatory tests for the ESPO pumps. The backlog does not include supply of smaller water well and household pumps as well as equipment which is ordered on on-going basis – such revenues accounted for over RUB2-3 bn/\$64-96 mn in '09, according to the company.

Table 17: Potential project pipeline over 6-12 months and mid-term

RUB bn, \$ million

Segment	Project	Company	RUB mn	\$ mn	Year	Pump equipment
Pumps/Modular (Oil & Gas)	Vankor field	Rosneft	1,000	33	2011-2012	Tender for FWKO - Free Water Knock Out pump equipment
Pumps (Oil & Gas)	Vankor field	Rosneft	3,000	98	2011-2012	2d stage of Vankor development, contract break-down similar to the on-going RUB3 bn contract, inc. RUB2-2.5 bn for modular equipment & pumps, RUB400 mn for project development (GTNG)
Pumps (N. Power)	Belena Nuclear Stations	RosAtom	1,700	55	2011-2015	Supply of non-MCP pumps
EPC	Yurubchenko-Takhomskoye (Y-T) field dev't	Rosneft	3,000	98	2011-2012	The project has been designed by HMS' subsidiary GTNG
Pumps (Oil & Gas)	Tie-in pipeline from Y-T field to Taishet	Rosneft	2,475	81	2011-2012	9 stations, RUB250-300 mn per pumping stations
Pumps (Water)	Grozny Water treatment (VEB-financed)		4,000	130		
Pumps (Oil & Gas)	Purpe-Samotlor pipeline (2d stage)	Transneft	1,000	33	2011	Currently work on 1st stage now - 2 pumping stations. In talks for 2 extra ones (RUB500 mn each)
Pumps (Oil & Gas)	Zapolyarnoye-Purpe pipeline	Transneft	3,700	121	2011	6 pumping stations: 5 regular ones (RUB500 mn each) + one larger one (RUB1-1.2 bn).
Modular (Oil & Gas)	Priobskoye field development	Rosneft	900	29	2011	6 water injection stations: 4-8 pumps per station, RUB300 mn each station. Contract might be shared with OZNA
Modular (Oil&Gas)	Modular equipment & integrated solution for associated gas gathering & processing units	TNK-BP	1,050	34	2011+	Currently in the pilot project to design/manufacture/install 6MW station for TNK-BP. Est. price \$2-\$5 mn (RUB60-150 mn). Potential for 10 modules
Total	Potential additions to backlog over 6-12 months		21,825	711		
Pumps (Oil & Gas)	20 pumping stations for ESPO-2 (stage 2)	Transneft	20,500	668	2012-2013	20 pumping stations for ESPO-2 expansion is yet to be tendered.
Modular (Oil&Gas)	Gas processing & transport modular equipment	TNK-BP	945	31	2011+	Currently in the pilot project (1 unit), can potentially order 10 units, each worth \$2-\$5 mn
Pumps (Oil & Gas)	Zapolyarnoye-Purpe pipeline	Transneft	3,300	108	2012+	Pumps for stage 2 (expansion from 25 mn tons to 50 mn tons)
Pumps (Oil & Gas)	Oil & Oil product pipeline Komsomolsk Refinery - De-Kastri	Transneft	3,080	100	2012+	The total value of pumps&solutions is RUB7bn/\$179 mn, assume 56% share in the potential contract
Pumps (N. Power)	Leningradskaya NPP	RosAtom	600	20	2011+	Total value of pumps for the project: RUB1.2bn/\$40 mn, assume 50% probability of tender win
Pumps (N. Power)	Novovoronezhskaya NPP	RosAtom	400	13	2011+	Total value of pumps for the project: RUB0.8bn/\$26 mn, assume 50% probability of tender win
Pumps (N. Power)	Rostovskaya NPP	RosAtom	300	10	2011+	Total value of pumps for the project: RUB0.6bn/\$20 mn, assume 50% probability of tender win
Modular (Oil&Gas)	Samotlorskoye & other fields development	TNK-BP	1,830	60	2011+	Total value of modular equipment to be supplied to TNK-BP is est. at RUB18.3 bn/\$596 mn in '11E-15E. Assume 20% share and 50% probability of tender win
Total	Potential additions beyond 12 months		30,955	1,009		

Source: J.P. Morgan estimates.

Pricing and margins: a degree of control.

Most HMS's contracts for specialized equipment, specific projects and construction projects would have fixed overall ruble price and costing (agreed with the customer) and therefore target margin estimates, according to HMS. I.e. the company has certain control over profitability level, especially for unique equipment made specifically for a customer – such as pumps for ESPO pipelines, super modules for Vankor field. Usually, a customer will make a pre-payment and HMS' would proceed to sign contracts for materials/equipment/sub-contractor services necessary for the project – usually done within around 3 months of signing the original contract with the customer. HMS would carry the risk of sudden increase in costs of supplies and currency fluctuations over the whole contract period (which company does not hedge), but HMS' management stated that they would factor in potential price increases into the original costing of the contract and would have a safety cushion. According to the management, there were very few cases when this safety margin was breached. For short-term contracts (less than 3 months) and mass-produced equipment (water well submersibles, household pumps), the company can pass some of the rising costs onto the customer – especially where HMS has low production costs and is a price setter in the segment (water well submersibles).

Table 18: HMS' EBITDA break-down, 2009-2014Ec

\$ mn

HMS' EBITDA forecast	09	10E	11E	12E	13E	14E	Est. EBITDA Margin ('09)	EBITDA Margin ('10E-'14E)	Note
Pumps									
Water injection pumps	3.0	4.1	6.1	7.0	6.7	6.8	14%	10%	
Oil transportation pumps	7.2	23	90	95	103	99	23%	25%	E. Siberian pipeline contract
Oil refining pumps	3.9	3.9	4.9	5.9	7.0	8.5	14%	14%	
Submersible water well	5.0	5.9	8.6	9.9	11.3	12.7	22%	22%	65% market share, low cost production
Water utilities	2.1	2.5	3.2	2.8	3.7	4.6	14%	14%	Limited range
Household vibration	0.4	0.5	0.6	0.7	0.8	1.0	6%	6%	Competition, 20% market share
Nuclear (non-MPC)	3.2	2.8	6.4	7.2	10.4	12.8	23%	23%	Usually high-margin contracts
Thermal	5.8	8.3	10.3	10.0	12.6	14.7	23%	23%	
Other industrial pumps	1.8	2.4	2.7	2.8	3.2	3.4	10%	10%	
Total pumps	32	53	124	141	159	165	20%	21%	Transportation, power utilities pumps
Modular Equipment									
Pump stations	15	15	27	37	35	36	19%	17%	Price competition
Group metering	5.2	5.7	6.2	6.6	7.1	7.6	25%	25%	High-value segment
Associated gas transport units	1.2	1.6	2.2	2.7	3.3	4.0	17%	18%	Stricter rules on associated gas utilization
Supplementary equipment	2.8	3.4	3.9	4.2	4.5	4.9	12%	12%	
Total modular	24	25	39	50	50	52	18%	17%	
EPC & Other									
Engineering, R&D	-	0.2	6.8	13.3	14.4	15.4	-1%	15%	Purchase of GTNG, access to costing data. GTNG 9M10 IFRS EBITDA = 12.6%
Oil field infrastructure	-	1.0	-	1.1	2.5	4.7	-1%	2%	
Crude oil transportation	1.7	2.3	4.0	5.7	8.1	10.9	8%	10%	
Gas transportation	1.9	1.5	2.3	3.4	4.6	6.0	8%	10%	
	2.4	11	19	26	33	41	2%	8%	Historic margin (ex GTNG) in '07-'08 was 5-6%
Total EPC									
All other	0.6	1.0	1.3	1.3	1.4	1.5			
	60	90	194	219	243	259	13%	17%	Transportation/power utilities pumps, recovery of EPC margins
HMS Group EBITDA									

Source: J.P. Morgan estimates, Frost & Sullivan, Company data for total segments 2009.

We modeled HMS' group profitability by applying target EBIT/EBITDA margins to core product lines in pumps, modular and EPC businesses, which are, in turn, based on historic accounts. We used publicly available Russian accounting data for HMS' subsidiaries, which gave us some indication for level of profitability for various products. For example, HMS's subsidiary HMS Pumps (LyvGidroMash) mainly produces water injection pumps, smaller water utilities and other industrial pumps. LivnyNasos is manufacturer of water well submersible pumps, HMS Household Pumps (Elektrodvigatel) produces household vibration ones. In Modular segment, Neftemash is the main manufacturing base for skid/modular equipment and SibNA is the design and manufacturing facilities for metering products. In EPC segment, TomskGasSroy builds gas and oil pipelines; GTNG and RVKP is in ER&D and SibKomplektMontazhNaladka (SKMN) does oil field facilities construction. We understand limitations of such approach, but we made adjustments for margins made by trading subsidiaries and SG&A and other costs at group level. We also cross-checked the results against segment information reported by HMS' Group under IFRS.

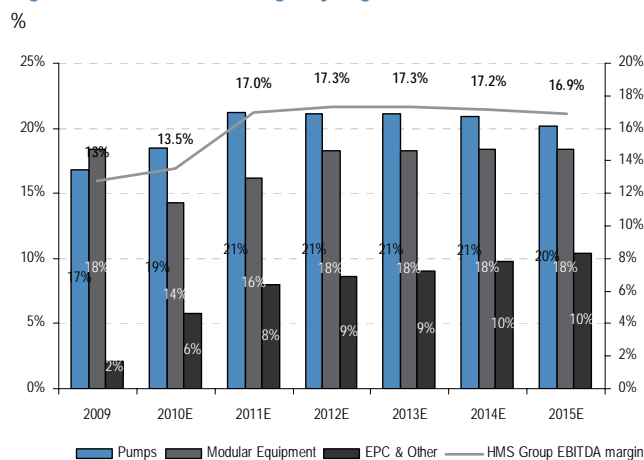
Table 19: HMS' Subsidiaries' revenues under RAS (\$ mn) and est. EBITDA margin, %

Purchased in	Subsidiaries	Main product	End-users	RAS Revenues (2009) *	Est. EBITDA margin under RAS (2009) **
Pumps					
2003	HMS Pumps (LivGidromash)	Mid-size surface water pumps, water injection pumps, refining pumps	City water utilities	44	14%
2004	HMS Household pumps (Bavlensky ElektroDvigatel)	Small submersible electric water pumps for households	Households	8	6%
2005	NasosEnergoMash (Ukraine) *	Large pumps for oil transportation, nuclear and thermal plants	Transneft, Power utilities	42	23%
2006	LivnyNasos	Mid-size submersible electric water well pumps for rural/town water utilities	Rural/Town water utilities	25	22%
2007	DimitrovGradKhimMash (DGKhM)	Production of Industrial pumps for oil&gas and chemical industry	Oil&gas companies		
2007	VNIIAEN OJSC (Design & Research Institute)	R&D for large oil transportation and power utilities pumps	Transneft, Oil&gas companies, Water utilities		
2008	PromBurZavod (Belarus)	Mid-size submersible electric water well pumps for rural/town water utilities	Rural/Town water utilities	9	9%
2008	NPO Gidromash *	Design of pumps for oil&gas and thermal power plants	Oil&Gas, Power utilities	13	32%
Modular					
2004	HMS Neftemash (Neftemash)	Oil, water pumping stations, oil/gas metering stations	Transneft, Oil&gas companies, Water utilities	117	13%
2006	NizhnevartovskRemService (NRS)	Maintenance & Repair of pumps & equipment	Transneft, Oil&gas companies, Water utilities	28	7%
2009	SibNefteAvtomatika (SIBNA)	Design of metering equipment	Oil&Gas, Power & water utilities	3	24%
EPC					
2007	TomskGazSroy	Oil&Gas pipeline construction	Transneft, Oil&gas companies	49	20%
2007	Trest SibKomplektMontazhNaladka (SKMN)	Oil field facilities construction	Oil&gas companies	90	1%
2008	Institute Rostovsky Vodokanalproekt (RVKP)	Project design for water utilities	Water utilities	1.5	neg.
2010	GiproTyumenNefteGas (GTNG)	Project design for oil&gas field development	Oil&Gas companies	73	25%
All subsidiaries	Hydromashservice	Trading of pumps, integrated solutions			c.9%

Source: J.P. Morgan estimates, Company data. Note: * = RAS data is available on regulatory disclosure web-site: www.e-disclosure.ru * = two entities have been combined since acquisition, ** = data does not include margins of the trading companies

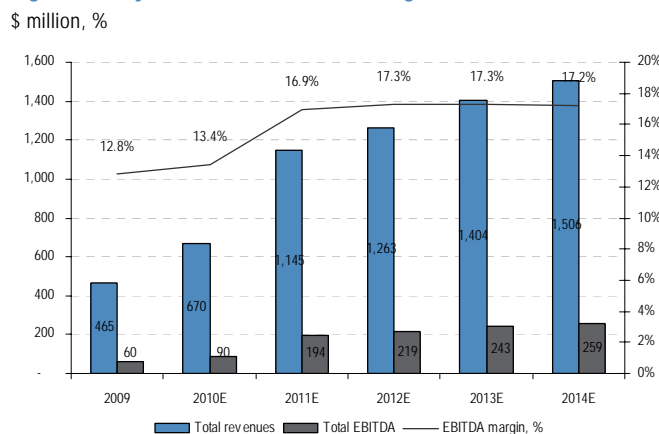
Cost control: critical for margin sustainability. For EBITDA margins to be sustainable (as we assume) – especially in the mass-produced segment of the market, HMS' management should be able to efficiently control the cost base. According to HMS 2009 accounts, total costs of goods sold accounted for 81% of revenues in '07- and 76% in '09, raising gross margin from 19% to 24%, SG&A was 9-12% of revenues over the same period, distribution costs –3%, other operating expenses – 1%. Total operating costs were 94% in '07 and 93% in '09 with EBIT margin of 6 and 7% respectively. Adding back depreciation (2% of revenues) and non-cash costs (including warranties) of 2-3% of revenues would give us EBITDA margin of 11% in '07 and 13% in '09. In our view, high-margin contracts in pumps division (pipelines, nuclear) and acquisition of GTNG (which should allow access to costing data for construction projects) would lead to margin improvement in '10E-14E. We assume that overall cost structure would remain close to historic levels.

Figure 42: HMS EBITDA margin by segment, 2009-2014E



Source: J.P. Morgan estimates, Company data for 2009.

Figure 43: Key financials and EBITDA margins, 2009-2014E

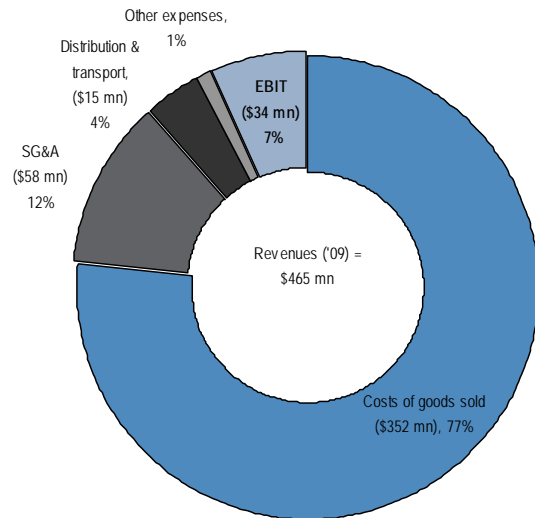


Source: J.P. Morgan estimates, Company data for 2009.

Natural hedging for material costs, tight wage control. According to HMS, within the costs of goods sold, supplies and material account for 55% of total COGS, labour for additional 16% and costs of re-sold components for 15% of COGS ('09). Main component of raw materials and supplies are ferrous metals (up to 40%) - purchased primarily from local producers. High quality casting and forging (for oil transportation and nuclear industry pumps) are ordered in South Korea where HMS has a list of several potential suppliers and currently deals with four.

Figure 44: Costs as % of revenues in '09

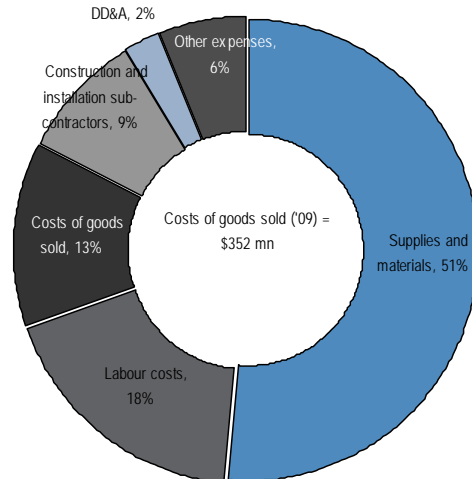
\$ mn



Source: Company 2009 IFRS report, converted at average RUB:\$ exchange rate and J.P. Morgan estimates.

Figure 45: Break-down of costs of goods sold in 09

\$ mn



Source: Company 2009 IFRS report, converted at average RUB:\$ exchange rate and J.P. Morgan estimates.

Natural hedging of commodity prices and currency risks. The company says that the nature of the business allows it to have a natural hedging of commodity prices and currency risks by fixing supplier prices and making advance payments for long-term contracts and passing on price increases to clients for short-term contracts. Labour costs are tightly controlled: the company reduced number of employees (and wage bill) in a difficult 2009: from 10,055 as of end '08 to 9,950 as of end'09 and since increased it to 11,029 (end Sep'10) due to M&A and selective hiring to certain subsidiaries, based on data provided by HMS. There is no obligation to increase wages with inflation (as at many state-rub companies) and HMS' management watches the labour market situation for any wage adjustments. According to HMS, most personnel working in manufacturing (c. 60% of total) would have variable (hours-worked) salaries, admin staff would be on fixed Ruble-denominated salaries. Top management has a bonus incentive scheme.

Table 20: Break-down of revenues and costs in '08-'09

\$ mn

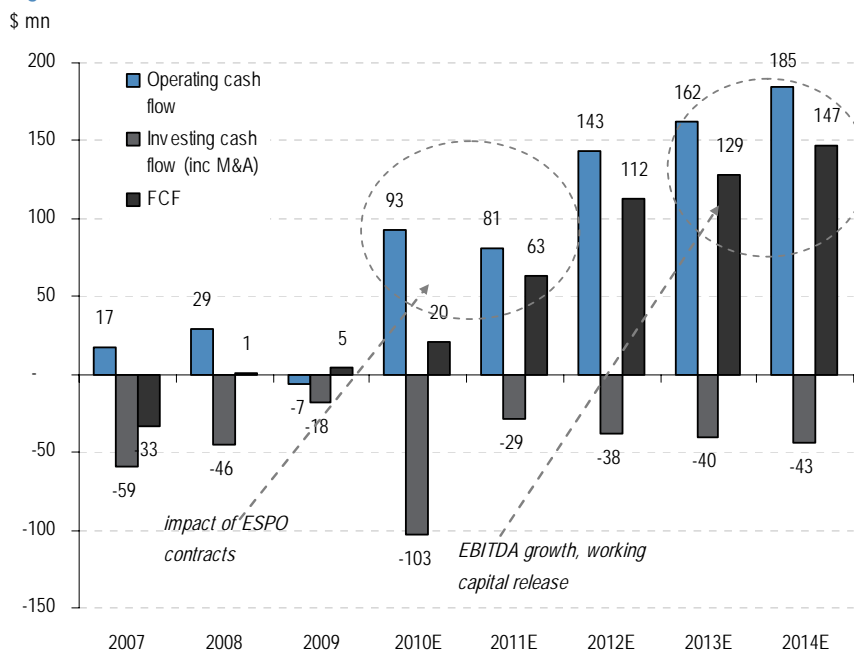
	2007	% of total	2008	% of total	2009	% of total	Comment
Revenues	524	100%	565	100%	465	100%	Advance of 30-50% for large projects
Costs of goods sold	423	81%	433	77%	352	76%	Pre-payment of 15-30% to suppliers
SG&A	48	9%	66	12%	58	12%	
Distribution & transport	16	3%	21	4%	15	3%	Domestic suppliers
Other expenses	4	1%	6	1%	7	1%	
EBIT	34	6%	38	7%	34	7%	
DD&A	11	2%	14	2%	11	2%	
Other costs	12	2%	15	3%	15	3%	
EBITDA	56	11%	67	12%	60	13%	Higher margin on lower revenues in '09 due to high-margin contacts (BPS, Vankor)
Costs of goods sold	423	100%	433	100%	352	100%	
Supplies and materials	210	50%	223	51%	195	55%	Centralized procurement, annual review
Labour costs	61	15%	79	18%	57	16%	No indexation obligation in labour contracts
Costs of goods sold	102	24%	55	13%	54	15%	Depends on amount of 3d party equipment
Construction and installation sub-contractors	18	4%	39	9%	14	4%	
DD&A	8	2%	10	2%	8	2%	
Other expenses	22	5%	27	6%	24	7%	
Supplies and materials	210		223		195		
ferrous metals						30-40%	Local suppliers
casting & forging						10-20%	Supplied by South Korea (15 on supplier list)
motors						10-15%	
component parts						c. 10%	
cables						< 10%	
other						< 10%	

Source: Company 2009 IFRS report, converted at average RUB:\$ exchange rate and J.P. Morgan estimates.

Cashflows, operating, investing and financing:

HMS Group has been in expansion stage over the last three years and operating cash flow along with the borrowed funds have been used to invest back into the business (via maintenance capex), buy minority shares in subsidiaries and purchase new companies. Steady increase in operating cash and FCF was interrupted in 2009, when operating cash turned negative on rise in working capital and the company cut back drastically on capex. In 2010, the cash flows were boosted by improved profitability and large prepayment for ESPO contract. Based on HMS' 2009 IFRS accounts, the money has been spent on raising capex back to required levels (around 1.5x DD&A), purchase of minority stakes in subsidiaries (\$3 mn) and acquisition of new companies (\$77 mn). We see relatively healthy operating cash flow position going forward, especially in 2012-2013, when HMS Group is expected to carry out ESPO contracts with very high pre-payment rate from Transneft. We assume capex at 2-2.5x of depreciation levels and taxes at c.19-20% of EBIT (corporate income tax rate in Russia is 20%, in Ukraine – 24%) in '10E-'14E.

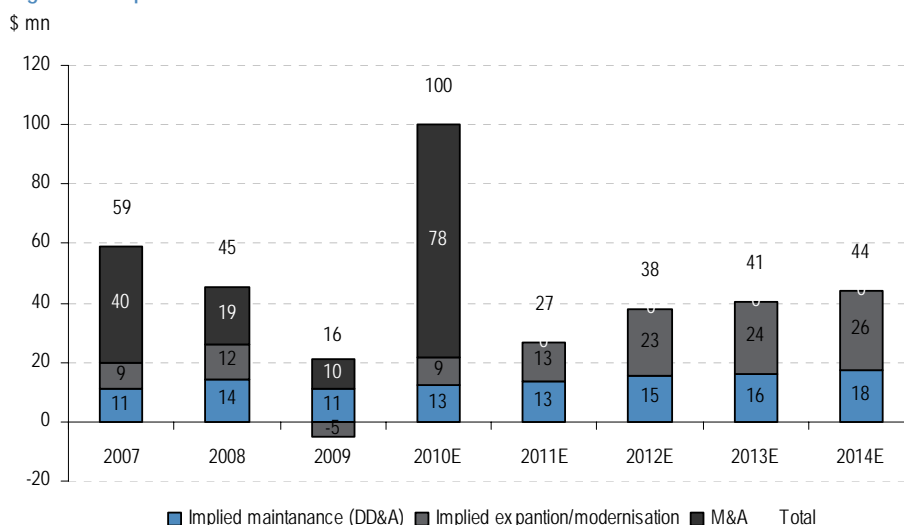
Figure 46: Cash flow break-down, 2007-2014E



Source: Company 2007-2009 IFRS report, converted at average RUB:\$ exchange rate and J.P. Morgan estimates./Cash flow

Capex: 2-2.5x depreciation to maintain production base, scope for more activity without extra investments: The company stated that it plans to invest 2-2.5x depreciation annually on modernization and maintenance – which would imply capex (ex M&A) of around \$22-\$55 mn in ‘10E-‘14E. Capacity constraints should not be a major issue in mid-term with relatively modest amount of fixed investment, in our view. Management estimates that overall capacity utilization at the moment is 80-85%. However, the calculations are based on 1-shift working day (8-hour shift), while equipment can be operational for 24-hours, i.e. on 3-shifts basis. Theoretically, HMS can triple production on the existing manufacturing base. Additional investments into labour, supplies and management would be required, but it would be seen as variable expenses, rather than fixed investments by the company – the manufacturing base is already in place.

Figure 47: Capex break-down for 2007-2014E

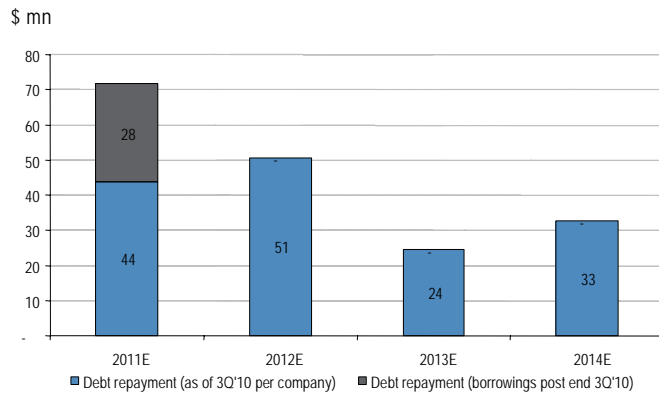


Source: Company 2007-2009 IFRS report, converted at average RUB:\$ exchange rate and J.P. Morgan estimates.. Note: M&A calculations do not include possible exercise of option to buy the remainder of GTNG in 2012

Debt: relatively comfortable position. HMS Group has been maintaining relatively steady net debt position, keeping Net Debt/EBITDA ratio below the 2.5x target set by the management – based on HMS' 2009 accounts. In 2009, the company re-financed most of its short-term debt into long-term one. Almost entire debt exposure is in Russian rubles. As of end 3Q10, the company had \$166 mn of total debt (\$30 mn short-term) and net debt position of \$104 mn.

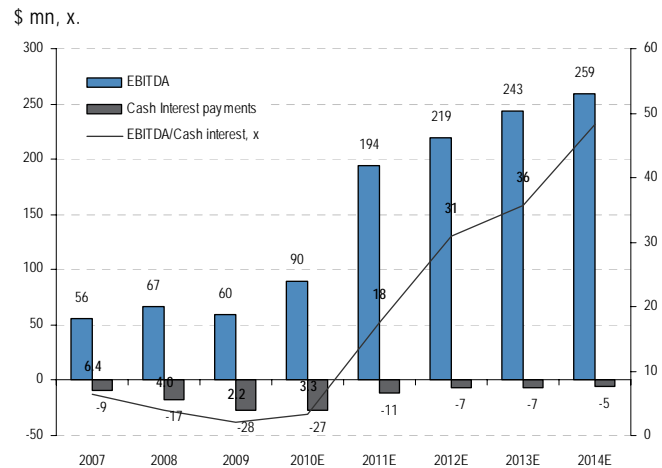
IPO cash used to repay debt. HMS Group used net proceeds from primary share issue (est. \$115 mn) to repay RUB3.3 bn/\$108 mn of existing debt (according to press release) – essentially all of the short-term debt due in 2011-2012 (est. \$123 mn). According to our estimates, the company would have close to zero net debt by end-2011, assuming that it meets our financial forecasts for this year. Net interest payments are also expected to decline from \$27 mn in 2010 to \$10 mn in 2011, including costs of IPO.

Figure 48: Repayment schedule as of end-2010, 2010-2014E



Source: Company reports and J.P. Morgan estimates.

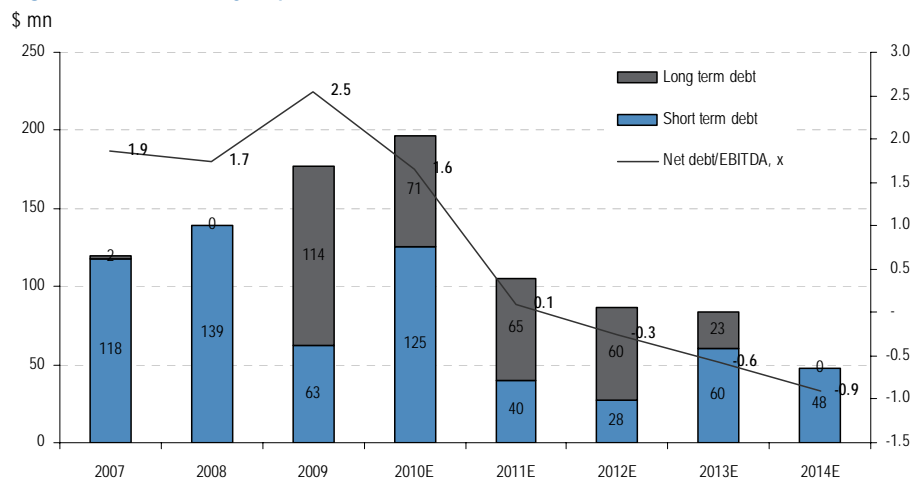
Figure 49: Interest paid and interest cover ratio post IPO



Source: Company reports and J.P. Morgan estimates.

HMS Group has been successful in pushing its cost of borrowing down from 18.8% in 4Q08 to 10.2% as of 3Q10 – majority of company's debt is fixed rate. Interest cover ratio (EBITDA over cash interest) was tight in 2009 at 2.2x, but should improve to 3.3x by end 10E and remain comfortably above 10x over the forecast period.

Figure 50: Net debt analysis post- IPO, 2007-2014E



Source: Company 2007-2009 IFRS report, converted at average RUB:\$ exchange rate, Company data.

Net income dynamic. We believe that growing revenues and improved profitability should see reported net income rising from \$2.6 mn in '09 to \$39 mn in '10E - the company has already reported net income of \$36 mn for 9M10. Overall, we forecast that net income will rise by 47% p.a. in '10E-'14E. In '07-'09, the company shown net loss after minorities due to the corporate structure, where dividend was paid out to shareholders via minority preferred interest in subsidiaries. The current structure reduced minority interest to 8.7% of reported net income (9M10).

Table 21: Summary financial forecast, \$ million

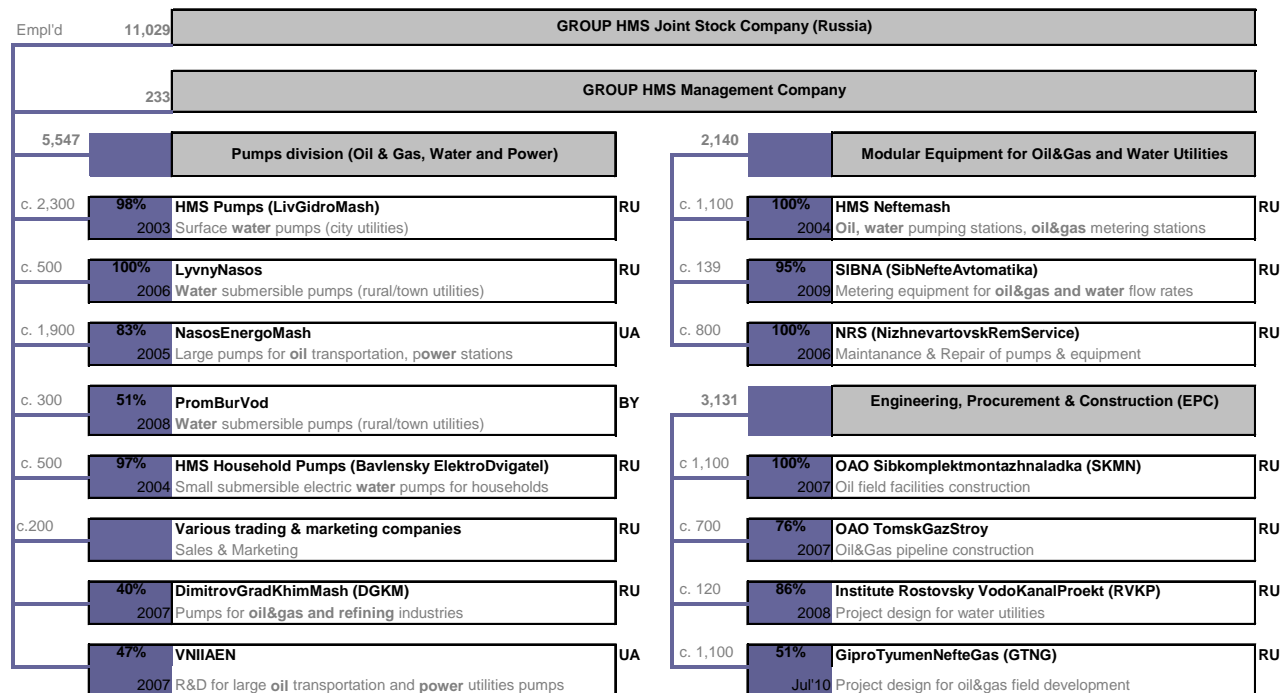
Revenues	9M09	9M10	y/y	2008	2009	2010E	2011E	2012E	2013E	2014E	CAGR ('10-14E)
RUB:USD rate (average)	32.7	30.34		24.9	31.7	30.4	28.8	30.1	31.3	32.4	
Pumps	133	250		174	193	286	628	671	754	788	29%
Modular	106	132		181	132	178	243	275	274	286	13%
EPC	71	149		209	140	201	274	317	377	432	21%
Total revenues	310	532	71%	565	465	665	1,145	1,263	1,404	1,506	23%
EBITDA											
Pumps	17	49	66%	33	33	54	134	143	160	165	32%
Modular	21	14		21	24	25	39	50	50	52	20%
EPC	3	11		13	2	11	21	26	33	41	40%
Total EBITDA	41	74	79%	67	60	90	194	219	243	259	30%
DD&A	-8	-9		-14	-11	-13	-14	-15	-16	-17	8%
Warranties & other costs	-12	2		-16	-15	-2	-6	-6	-7	-7	34%
Total EBIT	24	67	173%	36	34	75	174	197	220	234	33%
Net interest	-19	-21		-19	-25	-25	-8	-2	2	7	
Associates	1	0		2	1	0	-	-	-	-	
Earnings before tax	6	47	687%	20	9	51	166	196	222	241	48%
Tax	-4	-11		-8	-7	-12	-42	-49	-56	-61	
Net income	2	36	n.m.	12	3	39	125	146	165	179	46%
Minorities	-3.1	-3.1		-14.2	-3.2	-3.3	-10.2	-12.1	-13.8	-15.0	
Net income after minorities	-1	33	n.m.	-2.7	-0.4	36	115	134	152	164	47%
EBITDA margin, %	13.2%	13.8%		11.8%	12.8%	13.5%	16.9%	17.3%	17.3%	17.2%	
EBIT margin, %	7.9%	13%		6.4%	7.4%	11.3%	15.2%	15.6%	15.7%	15.5%	
Net income margin, %	n.m.	6%		n.m.	n.m.	5%	10%	11%	11%	11%	
Effective tax rate				42%	70%	23%	25%	25%	25%	26%	
Cash flow	9M09	9M10	y/y	2008	2009	2010E	2011E	2012E	2013E	2014E	
EBT	6	47		38	34	75	169	193	216	231	
DD&A	8	9		14	11	13	14	15	16	17	
Change in working capital	- 19	82		- 14	- 32	37	- 61	- 21	- 21	- 11	
Taxes	- 7	- 5		- 8	- 7	- 12	- 42	- 49	- 56	- 61	
Net interest	- 20	- 23		- 17	- 28	- 27	- 11	- 7	- 7	- 5	
Other	29	18		17	14	7	11	12	14	15	
Operating cash flow	-4	127	n.m.	29	- 7	93	81	143	162	185	
Capex	- 6	- 16		- 26	- 6	- 22	- 29	- 38	- 40	- 43	
M&A	- 11	- 77		- 20	- 12	- 81	-	-	-	-	
Other	- 2	3		0	2	3	-	-	-	-	
Investing cash flow	- 20	- 89	357%	- 45	- 16	- 100	- 29	- 38	- 40	- 43	
Equity raised	-	17		1	-	17	115	-	-	-	
Debt raised/re-paid	23	7		40	38	37	- 104	- 13	-	- 33	
Other	- 4	- 19		- 1	- 7	- 19	-	-	-	-	
Dividends paid	- 0	- 5		-	-	-	- 27	- 32	- 37	- 40	
Financing cash flow	19	- 0	n.m.	41	31	35	- 17	- 45	- 37	- 73	
Free cash flow	- 23	38	n.m.	- 16	- 23	- 7	52	105	122	142	
Net debt position	9M09	9M10	y/y	2008	2009	2010E	2011E	2012E	2013E	2014E	
Gross debt											
long-term	67	31		0	114	71	65	60	23	0	
short-term	83	135		139	63	125	40	28	60	48	
Total gross debt	151	166	10%	139	177	196	105	87	84	48	
cash	- 17	- 62		-23	-25	-48	-87	-143	-222	-284	
Net debt/(cash)	133	104	-22%	116	152	148	18	-56	-139	-236	

Source: Company's IFRS financials for corresponding periods, converted at average RUB:\$ exchange rates and J.P. Morgan estimates.

Corporate & ownership structure

HMS Group was formed through a series of acquisitions by the group of managers who started their carriers back in 1993 as traders in pumps and supplies.

Figure 51: HMS Group corporate structure as of end 9M10



Source: J.P. Morgan estimates, Company data. HMSModel_JMP/Structure

In 2003, the company entered the manufacturing business by acquiring LivGidroMash (now HMS Pumps) – one of the largest manufacturers of water and other industrial pumps of the former Soviet Union. **In 2004**, HMS Group bought Neftemash, another large company, specializing in production of modular equipment. **In 2005**, the Ukrainian producer of large pumps for oil transportation and power industries - NasosEnergomash - became the part of the group. **In 2006**, HMS Group purchased TNK-BP's in-house repair and maintenance division for pumps and modular equipment. **In 2006-2007**, the construction division was formed through acquisitions of two large construction companies: TomskGazStroy for pipelines and SibKomplektMontazhNaladka (SKMN) for oil field surface infrastructure. The net result of M&A activity was the creation of integrated group, which can offer full integrated solutions (design-manufacturing-engineering – construction - maintenance) to its clients across oil & gas, water and power utilities industries.

Management, strategy & dividend policy

HMS Group is majority owned by the top management and the key active investors post IPO. Key shareholders of the company have been with the company since its early days. Prior to IPO., the company's management held 63.41% of shares (via beneficial ownership): Chairman of the Board German Tsoy holds 26.62%, CEO Artem Molchanov 9.02%, Head of Pumps Division Nikolay Yamburenko 7.86%, Head of NASosEnergosh Vladimir Yamburenko 6.07%, other top managers 11.02%. Vladimir Lukyanenko (36.59% prior to IPO) is a financial investor and a member of Board of Directors, who became shareholder as a result of friendly merger with NasosEnergomash (Ukraine). The company states that HMS Group is the core business of the largest shareholders, reducing scope for potential conflict of interest. Post IPO, the top management and Mr. Lukyanenko maintained control over the group with close to 63% of total shares. Free float is currently estimated at just over 37%.

Table 22: Shareholder structure pre and post IPO

mn shares

	Total pre-IPO	as %	Total sold	as %	Total post-IPO	as %
Vladimir Lukyanenko	37,580,448	36.6%	12,891,835	29.5%	24,688,613	21.1%
German Tsoy (Chairman)	27,914,451	27.2%	7,096,747	16.3%	20,817,704	17.8%
Artem Molchanov (CEO)	9,261,799	9.0%	2,209,956	5.1%	7,051,843	6.0%
Nikolay Yamburenko (Head of Pumps)	8,073,877	7.9%	1,926,506	4.4%	6,147,371	5.2%
Vladimir Yamburenko (Head of NasosEnergomash)	6,235,393	6.1%	1,487,826	3.4%	4,747,567	4.1%
Yuri Skrynnik (Head of Strategy)	3,602,856	3.5%	859,677	2.0%	2,743,179	2.3%
Kirill Molchanov (1st Deputy CEO)	2,897,639	2.8%	691,405	1.6%	2,206,234	1.9%
All BoD and senior management	7,033,537	6.9%	1,912,627	4.4%	5,120,910	4.4%
Principal & selling shareholders	102,600,000	100%	29,076,579	66.6%	73,523,421	62.8%
BNY Limited (free float) - primary shares			14,563,427	33.4%	14,563,427	12.4%
BNY Limited (free float) - secondary shares					29,076,579	24.8%
Free float					43,640,006	37.2%
Total shares	102,600,000	100%	43,640,006	100%	117,163,427	100%

Source: J.P. Morgan estimates, Company data.

Growth strategy. Top management is keen to continue to grow the company both organically – by extending product range, gaining market share on competitors as well as via value-accretive and non-aggressive acquisitions. In our view, HMS Group strong position in fragmented pumps market makes it a natural assets consolidator. Management stated that proceeds from IPO would go to partially repay the debt and to pursue M&A opportunities. There is also a stated goal to increase share in most subsidiaries closer to 100%. The company's management set a number of financial goals which it would follow (Source: HMS Group):

1. maximum target leverage of 2.5x EV/EBITDA, much lower than ratio currently in loan covenants: 4-4.5x,
2. continue to borrow in RUB to match the operating cash flows
3. maintain comfortable maturity profile and relationship with leading Russian and foreign banks. Loans are currently taken mostly from Sberbank (90%) as well as from UniCredit and NOMOS banks
4. the company currently intends to pay at least 25% of IFRS net income in dividends, subject to capital spending requirements

Figure 52: Summary of M&A strategy

	Core focus for potential acquisitions	Acquisition objectives and rationale
Oil and gas	<ul style="list-style-type: none"> ▪ Flow control solutions in oil and gas ▪ Pumps for oil and gas, chemical and petrochemical applications ▪ Modular equipment, tanks and vessels 	<ul style="list-style-type: none"> ▪ Increase of market share ▪ Diversification of product offering ▪ Expansion into new segments
Power	<ul style="list-style-type: none"> ▪ Pumps for nuclear and thermal power generation, marine applications ▪ Pumps for nuclear and thermal power generation, oil refining, chemical and petrochemical applications ▪ Pumps for thermal power generation, water utilities 	<ul style="list-style-type: none"> ▪ Increase of market share ▪ Diversification of product offering
Water	<ul style="list-style-type: none"> ▪ Pumps for wet-pit sewage applications ▪ Pumps for water utilities, nuclear and thermal power generation ▪ Modular equipment for wastewater treatment 	<ul style="list-style-type: none"> ▪ Diversification of product offering ▪ Strengthening positions in water segment ▪ Increase of market share ▪ Expansion into wastewater treatment segment
Other	<ul style="list-style-type: none"> ▪ Pumps for oil refining and metals and mining ▪ Pumps for oil refining, oil transportation, water utilities and vessels ▪ Pumps for oil transportation, oil refining, metals and mining ▪ Pumps for chemical applications, nuclear power generation, water utilities 	<ul style="list-style-type: none"> ▪ Diversification of product offering ▪ Expansion into new segments ▪ Increase of market share

Source: Company.

Appendix I: Major investment projects in Russia and potential value to HMS

Oil & Gas E&P (\$ mn)													
Oil fields	Company	Reserves, mn tons	Project timeline		Total capex (\$ mn)	Capex 10E-'15E	Est. value of pumps 11E-'15E	2010	2011	2012	2013	2014	2015
			Launch	Complete									
Vankor & other fields	Rosneft	524	2009	2017	11,857	10,154	32	1,734	1,725	1,753	1,692	1,645	1,606
Verkhnechonsk	TNK-BP	202	2009	2015	4,434	3,856		659	655	666	643	624	610
Tyamkinsk (Uvat)	TNK-BP	75	2010	2012	2,804	2,804		933	928	943			
Samotlor	TNK-BP	400	2009	2014	5,389	4,480		909	904	918	887	862	
Russkoye	TNK-BP	305	2009	2015	5,206	4,434	32	757	753	765	739	718	701
Talakan & Alinsk	SurgutNG	135	2010	2014	7,499	7,499	32	1,521	1,513	1,537	1,485	1,443	
Prirazlomnoye	Gazprom	46	2009	2011	2,299	1,543		774	770				
Other		394	2010	2015	201,402	48,336		7,468	7,427	7,547	7,288	7,082	11,524
Replacement & upgrade						39,193		6,056	6,022	6,120	5,909	5,742	9,344
Total						122,300		20,811	20,696	20,250	18,642	18,116	23,785
Total investments on pump systems for E&P (water injection, oil production, drilling)						9,035		1,538	1,529	1,496	1,377	1,338	1,757
Total investments on pump systems for E&P (water injection, oil production, drilling) inc solutions						10,972		1,867	1,857	1,817	1,672	1,625	2,134
Total investments on pump systems for E&P (water injection only) & as share of total pumps				3.7% of total	3.7%	405		69	68	67	62	60	79
HMS market share						59%		59%	59%	59%	59%	59%	59%
HMS estimated revenue (\$ mn)						239		41	40	40	36	35	46
Total potential revenues from new water injection pumps						239		41	40	40	36	35	46
Other services						120		3	14	25	27	30	22
Total potential revenues from new water injection pumps						353		44	52	62	62	64	67

Source: Frost & Sullivan, J.P. Morgan estimates.

Oil & Gas pipeline pumps (\$ mn)							Estimated HMS Revs						
Projects	Length	Capacity (mn t/year)	Project timeline		Total capex	Total capex	Est. value	2010	2011	2012	2013	2014	2015
			Start	Finish		2010-2015	of pumps						
ESPO 1		2694	20	2006	2011	14,446	1,605	executed					
ESPO 1 extension			30	2010	2013	6,420	6,420	executed					
ESPO 2		2046	30	2009	2013	9,085	7,384		84	303	21		
ESPO 2 extension		300	17	2012	2015	5,522	5,522	658			111	183	178
BTS-2 extension		1000	30+20	2009	2012	3,852	3,210				25		
Zapolyarnoye-Purpe		536	45	2011	2015	3,852	3,852	225			92	59	
Purpe-Samotlor		430	25	2010	2012	1,445	1,445	executed					
Purpe-Samotlor stage 2						0	0		12	12			
Project Yug (South)		1465	9	2011	2013/2014	2,600	2,600	100				28	27
Haryaga - Yuzhny Khylichuyu		160	8	2010	2012/2014	2,889	2,889						
CPC-2		1510	35	2012	2014	2,825	2,825						
Yurubchenko-Takhomskoye - Taishet		600	18	2012	2014	2,022	2,022	64			62		
Tikhoretsk-Tuapse 2		295	12	2011	2012	642	642						
Komsomolsk Refinery - Port de Kasty (product pipeline)		313	9	2012	2014	1,605	1,605	177				49	48
Komsomolsk Refinery - Port de Kasty (oil pipeline)		300		2012	2014	1,445	1,445						
Potential HMS revenues from new projects (\$ mn)						1,440		84	316	323	320	253	145
Total capex into new projects						43,466							
Other projects (total capex)						37,841		0	1,971	4,007	7,738	11,278	12,847
Replacement & upgrade (total capex)						26,906		1,399	1,392	4,243	5,463	6,635	7,774
Total capex, inc						108,214							
Total investments in pump systems for pipelines						1,284							
Including integrated solutions						1,926							
Capex into pumps & integrated solutions (ex new projects)													
Other projects								0	17	35	68	99	113
Replacement & upgrade								25	25	75	96	117	137
Total capex into pumps & integrated solutions, inc								25	42	110	164	216	250
HMS market share						56%		56%	56%	56%	56%	56%	56%
Probability of other projects								75%	75%	75%	75%	75%	75%
Probability of repairs & maintenance revenues								50%	50%	50%	50%	75%	75%
HMS' estimated revenues													
Est. revenues from replacement & modernization						168		7	7	21	27	49	57
Est. revenues from other projects						333		0	17	35	68	99	113
Est. revenues from new projects						1,440		84	316	323	320	253	145
Total estimated revenues from transportation pumps						1,941		90	340	379	415	401	315

Source: Frost & Sullivan, J.P. Morgan estimates.

Pumps as % of total						1.2%						
Refining & petrochemical pumps (\$ mn)												
Refineries	Company	Description	Project timeline		Total capex, \$ mn	Total capex 2010-2015	2010	2011	2012	2013	2014	2015
			Start	Finish								
Komsomolsk refinery		Upgrade	2010	2012	792	792	263	262	266	0	0	0
Tuapse refinery		Upgrade	2010	2014	130	130	26	26	27	26	25	0
Kuybyshev refinery		Upgrade	2010	2015	225	225	38	38	39	37	36	36
Syzran refinery		Upgrade	2010	2015	803	803	137	136	139	134	130	127
NovoKuybyshev refinery		Upgrade	2010	2015	771	771	132	131	133	129	125	122
Achinsk refinery		Upgrade	2010	2014	422	422	86	85	87	84	81	0
Angarsk refinery		Upgrade	2010	2014	390	390	79	79	80	77	75	0
Nakhodka refinery		Upgrade	2009	2017	8,676	5,784	988	982	998	964	937	915
Grozny refinery		Upgrade	2011	2014	388	388	0	98	100	96	94	0
Saratov refinery		Upgrade	2011	2012	297	297	0	147	150	0	0	0
Volgograd refinery		Upgrade	2011		360	360	0	360	0	0	0	0
N/ Novgorod refinery		Upgrade	2011	2015	959	959	0	196	200	193	187	183
Kirishi refinery		Upgrade	2011	2020	6,331	5,595	0	1,146	1,165	1,125	1,093	1,067
Yaroslavl refinery		Upgrade	2011		131	131	0	131	0	0	0	0
Moscow refinery		Upgrade	2011	2020	1,055	480	0	98	100	96	94	91
Omsk refinery		Upgrade	2010	2017	225	161	27	27	28	27	26	25
Ufa refinery		Upgrade	2011	2014	291	291	0	74	75	72	70	0
Ufaorgsintez		Upgrade	2011	2014	129	129	0	33	33	32	31	0
Salavatorgsintez		Upgrade	2011		1,801	164	0	164	0	0	0	0
Orsknefteorgsintez		Upgrade	2010	2012	297	297	99	98	100	0	0	0
Khabarovsk		Upgrade	2009	2012	1,319	1,319	439	437	444	0	0	0
Mariy refinery		Upgrade	2011	2015	2,398	2,398	0	491	499	482	468	457
TANECO		Upgrade	2009	2015	7,069	7,069	1,207	1,201	1,220	1,178	1,145	1,118
Verkhotursk refinery		Construction	2011	2014	2,329	2,329	0	589	599	578	562	0
Tomsk refinery		Construction	2011	2015	1,799	1,799	0	368	374	361	351	343
Yaisk refinery		Construction	2008	2014	714	487	99	98	100	96	94	0
Other projects						28,915	0	1,506	3,062	5,912	8,618	9,817
Upgrade & replacement						16,112	838	833	2,541	3,271	3,973	4,655
Total capex						78,997	4,459	9,838	12,556	14,972	18,216	18,956
Total capex on pumping systems for refining						835	47	104	133	158	193	200
Total capex on pumping systems for refining & complex solutions							1,285	73	160	204	244	308
HMS market share							28%	20	44	56	67	85
Probability of contracts won/projects executed						risk adj	100%	75%	75%	75%	75%	75%
Estimated HMS revenues from refining & petchem pumps						279	28	33	42	50	61	64

Source: Frost & Sullivan, J.P. Morgan estimates. Note: Est. revenues for 2010 is adjusted to take into account actual reported as of 9M10 and backlog as of Sep 30, 2010

Water utilities										
Projects	Description	Project timeline		Total capex	Total capex	2010	2011	2012	2013	2014
		Start	Finish							
JSC Evraziysky	Water supply in Rostov region	2009	2026	704	235	40	40	40	39	38
	Inv project Clean Don	2009	2019	106	58	10	10	10	10	9
	Water supply & sewage in Azov & Black Sea region	2009	2013	141	113	28	28	29	28	0
JSK RKS	Modernization of water supply in Perm	2009	2011	16	10	5	5	0	0	0
	Modernization of water supply in Petrozavodsk	2009	2012	13	10	3	3	3	0	0
	Dev't of new heat system in Vladimir & oblast	2009	2012	12	9	3	3	3	0	0
	Modernization of biological treatment facilities	2009	2011	12	8	4	4	0	0	0
	Water supply system in Kirov	2009	2011	4	2	1	1	0	0	0
JSK Rosvodokanal	Barnaul vodokanal	2009	2011	228	157	79	78	0	0	0
	Kaluga vodokanal	2009	2011	109	69	35	35	0	0	0
	Krasnodar vodokanal	2009	2011	62	41	21	21	0	0	0
	Omsk vodokanal	2009	2010	52	26	26	0	0	0	0
	Orenburg vodokanal	2009	2011	31	21	10	10	0	0	0
	Tver vodokanal	2009	2015	81	70	12	12	12	12	11
	Tyumen vodokanal	2009	2011	89	59	30	29	0	0	0
State programs - St Petersburg		2010	2025	8,811	3,304	564	561	570	551	535
Grozvodokanal		2010	2011	3,452	3,452	1,731	1,721	0	0	0
Dev't program for the Far East & Baikal		2010	2013	3	3	1	1	1	1	0
FGUP Special construction Moscow		2010	2013	33	33	8	8	8	8	0
Water utilities & env. Protection		2010		239	239	239	0	0	0	0
Regional clean water (unconfirmed)		2011	2017	48,200	16,067	2,744	2,729	2,773	2,678	2,602
Water strategy (ex Clean water)	water supply	2009	2020	5,917	2,959	505	503	511	493	479
	reconstruction	2009	2020	5,980	2,990	511	508	516	498	484
	flood protection	2009	2020	10,481	5,241	895	890	905	873	849
Federal Programme of social housing construction		2011	2015	19,923	19,923	3,403	3,384	3,439	3,320	3,227
Modernization of municipal infrastructure objects		2011	2012	221	221	73	73	74	0	0
Other investments					54,784	0	2,854	5,801	11,202	16,328
Replacement					18,360	955	950	2,895	3,727	4,528
Total investments in water utilities					128,462	11,937	14,461	17,590	23,440	29,090
Total investments on water utilities pumps					2,987	278	336	409	545	676
Total investments on water utilities pumps inc integrated solutions					3,852	354	429	522	696	864
Total investments on water utilities pumps (RU make only)				11% of total	11%	41	49	60	80	99
HMS share in RU make only					41%	41%	41%	41%	41%	41%
Probability of contracts won/projects executed					100%	100%	75%	75%	75%	75%
Est. revenues from new pumps						17	20	18	24	30
Est. after-market						-	1	1	2	2
Estimated HMS revenues from water utilities pumps					152	17	21	20	26	33

Source: Frost & Sullivan, J.P. Morgan estimates.

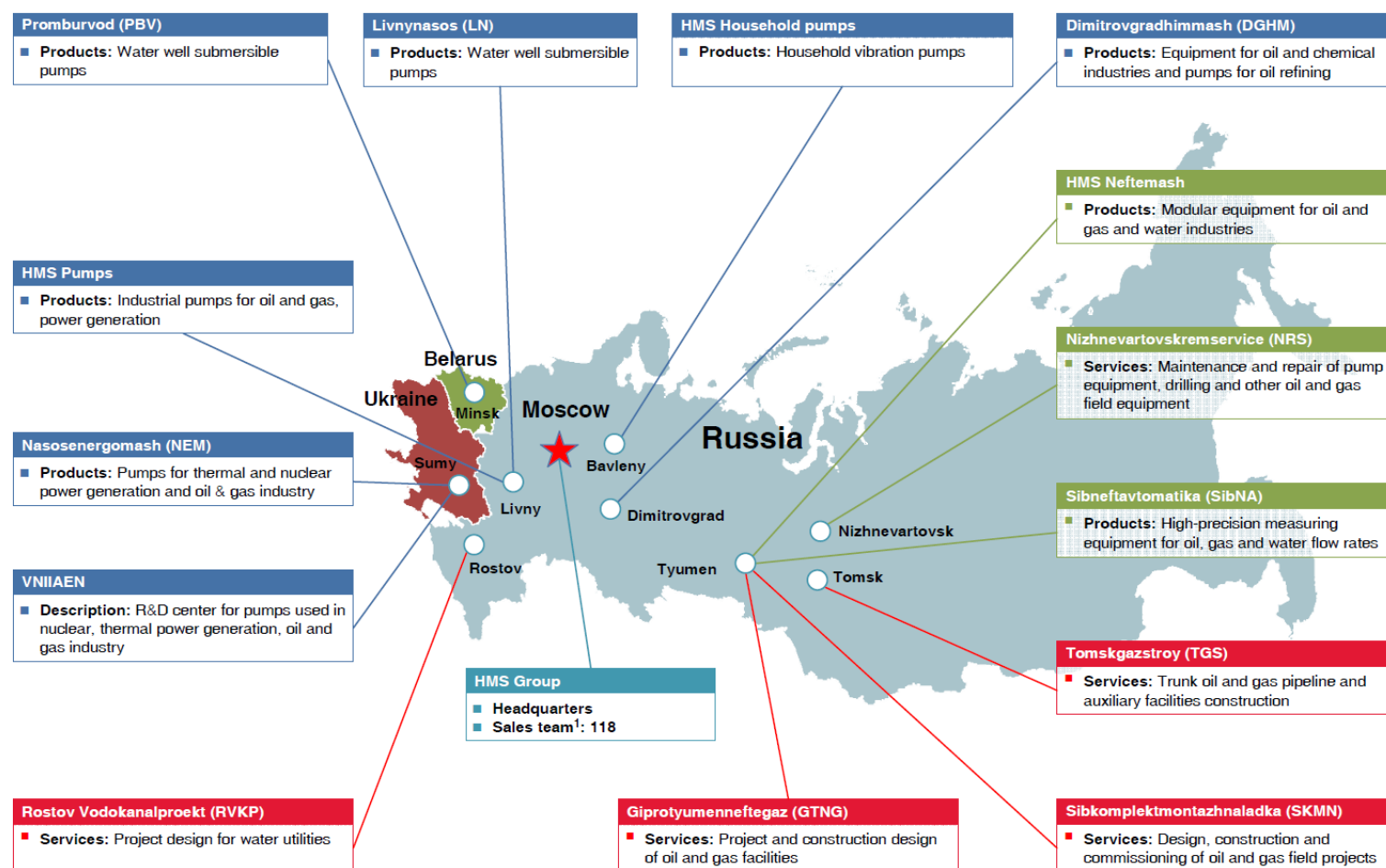
Nuclear power, non-MPC (\$ mn)													
Power plants		Generation capacity	Project timeline		Total capex	Total capex	Est. value of pumps	2010	2011	2012	2013	2014	2015
			Start	Finish									
Rostov NPP	reactor 2	1,000	2005	2011	989	33		16	16	0	0	0	0
	reactor 3	1,100	2009	2015	2,084	1,531		261	260	264	255	248	242
	reactor 4	1,100	2011	2017	1,543	1,543		0	316	321	310	301	294
Kalininsk	reactor 4	1,000	2006	2012	1,611	419		139	139	141	0	0	0
Beloyarsk	reactor 4	800	2007	2013	2,149	1,105		278	276	281	271	0	0
Novovoronezh NPP-2	reactor 1	1,100	2007	2013	2,164	1,039		261	260	264	255	0	0
	reactor 2	1,100	2008	2014	2,107	1,518		308	306	311	301	292	0
Leningrad NPP-2	reactor 1	1,100	2008	2014	2,241	1,614		327	326	331	319	310	0
	reactor 2	1,100	2009	2015	2,177	1,984		339	337	342	331	321	314
	reactor 3	1,100	2010	2016	1,853	1,853		316	315	320	309	300	293
Kursk NPP-2	reactor 4	1,100	2011	2017	1,543	1,366		0	280	284	275	267	261
	reactor 1	1,100	2010	2016	1,853	1,853		316	315	320	309	300	293
	reactor 2	1,100	2012	2018	985	747		0	0	0	256	249	243
	reactor 3	1,100	2013	2019	908	524		0	0	0	179	174	170
	reactor 4	1,100	2014	2020	597	183		0	0	0	0	92	90
	reactor 1	1,100	2012	2018	1,230	1,012		0	0	265	256	249	243
Smolensk NPP-2	reactor 2	1,100	2013	2019	908	524		0	0	0	179	174	170
	reactor 3	1,100	2014	2020	597	183		0	0	0	0	92	90
	reactor 4	1,100	2015	2021	295	34		0	0	0	0	0	34
Kolsk NPP-2	reactor 1	1,100	2015	2021	295	34		0	0	0	0	0	34
NPP Mochovce (Slovakia)	reactor 3 & 4	440	2010	2013	1,752	1,752		440	438	445	429	0	0
NPP Belene (Bulgaria)	reactor 1	1,000	2011	2015	4,093	4,093		0	838	852	823	799	780
NPP Kudamkulon (India)	reactor 3 & 4	1,000	2012	2017	2,288	1,373		0	0	359	347	337	329
NPP Tianwan (China)	reactor 3 & 4	1,000	2011	2016	2,878	2,302		0	472	479	463	450	439
NPP Akkuyu (Turkey)	reactor 1-4	1,200	2014	2019	2,098	279		0	0	0	0	141	138
Other projects (Ukraine, Belarus, Armenia, Vietman)		1,200	2012	2019	78,574	49,675		0	2,588	5,260	10,157	14,806	16,865
Repair & maintenance			2010	2015	15,827	15,827		823	819	2,496	3,213	3,903	4,573
Total capex						94,399		3,827	8,299	13,335	19,237	23,807	25,895
Pumping equipment (inc MCP)						867							
Pumping equipment (inc MCP) & integrated solutions						1,316							
Pumping equipment (ex MCP) & integrated solutions						50% of total		24	53	85	122	151	165
HMS share						29%		50%	50%	50%	50%	50%	50%
Probability of contracts won/projects executed						75%		100%	100%	75%	75%	75%	75%
Estimated revenues from non-MCP nuclear pumps equipment								12	26	32	46	57	62
Estimated HMS's nuclear pumps segment revenues						235		12	26	32	46	57	62

Source: Frost & Sullivan, J.P. Morgan estimates. Note: We made the forecast of HMS revenues from various pumps segments by using total capex for pumps and integrated pumps solutions as calculated by Frost & Sullivan. We assumed that capex for existing projects will be allocated proportionally between years of execution, other projects will mostly materialize in '14E-'15E (30% and 50% of total respectively from 5% in '10E) and maintenance & repairs will also be more prominent in capex towards '14E-'15E (from 5% of total in '10 to 30% of total in '15E). We then estimated the capex which could be allocated to the pumping product where HMS is present. For example: For nuclear power plants, HMS produces non-MCP pumps only, which are 50% of total nuclear pumps market. We then applied HMS market share to this sub-segment of the market (est. 50% in '10E, 29% in '09). We also assumed 75% probability of contracts being won/projects going ahead in most cases, except for 2010/2011 (contract won/ very likely to be won).

Thermal power (\$ mn)												
Power generation companies	Generation capacity	Project timeline		Total capex	Total capex 2010-2015	2010	2011	2012	2013	2014	2015	
		Start	Finish									
TGK-1	1,520	2006	2015	3,723	2,330	398	396	402	388	377	368	
TGK-2	1,410	2006	2015	1,012	898	153	153	155	150	145	142	
TGK-3 Mosenergo	1,992	2006	2014	2,853	1,282	260	259	263	254	247	0	
TGK-4 Kvadra	1,040	2006	2015	972	662	113	113	114	110	107	105	
TGK-5	710	2007	2014	716	457	93	92	94	90	88	0	
TGK-6	750	2007	2014	714	526	107	106	108	104	101	0	
TGK-7 Volga	470	2006	2012	654	351	117	116	118	0	0	0	
TGK-8	890	2006	2013	1,275	578	145	144	147	142	0	0	
TGK-9	1,409	2006	2017	1,311	673	115	114	116	112	109	106	
TGK-10 Fortum	2,359	2006	2015	1,851	1,503	257	255	259	250	243	238	
TGK-11	302	2007	2015	1,057	839	143	143	145	140	136	133	
TGK-12 Kuzbassenergo	428	2006	2013	1,001	695	175	174	176	170	0	0	
TGK-13 Yenisei	320	2006	2013	497	338	85	84	86	83	0	0	
TGK-14	27	2006	2010	315	253	253	0	0	0	0	0	
OGK-1	2,130	2006	2015	2,687	1,357	232	230	234	226	220	215	
OGK-2	1,860	2006	2016	1,466	1,015	173	172	175	169	164	161	
OGK-3	2,042	2006	2014	2,037	1,486	301	300	305	294	286	0	
OGK-4	2,509	2006	2014	3,388	2,474	502	499	507	490	476	0	
OGK-5	1,600	2007	2013	2,031	1,039	261	260	264	255	0	0	
OGK-6	1,821	2007	2014	8,181	7,587	1,539	1,531	1,555	1,502	1,460	0	
Other	1,510	2010	2015	24,675	24,675	0	1,285	2,613	5,045	7,354	8,377	
Modernization & repairs		2010	2015	11,079	11,079	576	573	1,747	2,249	2,732	3,201	
Total capex					62,098	5,999	6,999	9,584	12,225	14,246	13,046	
Pumping equipment investment					0	0	0	0	0	0	0	
Pumping equipment investment with integrated solutions					851	81	95	130	165	193	176	
HMS share					42%	45%	45%	45%	45%	45%	45%	
Probability of project going ahead					75%	100%	100%	75%	75%	75%	75%	
Estimated HMS revenues from pumps for thermal power plants					303	36	43	44	56	65	60	

Source: Frost & Sullivan, J.P. Morgan estimates.

Appendix II: Map of production assets



Source: Company data

Note: Number of employees as of 9M 2010

¹ Total number of HMS' sales people for 9m 2010 is 192

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Russia Equity Research
21 March 2011

J.P.Morgan CAZENOVE

Valuation Methodology and Risks

HMS Group (*Overweight; Price Target \$12.20*)

Valuation Methodology

HMS Group's PT (end-11E) is based on a combination of target 11E multiples (EV/Sales=1.4x, EV/EBIT=7.5 and EV/EBITDA=10x) and DCF (WACC = 13.4%, terminal growth rate of 4.5%), We note, however, that our PT (end-2011) of \$12.2/ADR assumes that HMS Group will sign a RUB20.5bbn/\$680 mn follow-up contract with Transneft before end 2011.

Risks to Our View

- (1) Lower oil prices might adversely affect HMS as many of their clients are in oil & gas
- (2) The Group relies on a limited number of key clients
- (3) RUB weakness might have a negative impact as operating profit is in rubles
- (4) HMS Group valuations and PT (end-11) is heavily dependant on signing est. \$660 mn follow-up contract with Transneft

HMS Group: Summary of Financials

Profit and Loss Statement						Cash flow statement					
\$ in millions, year end Dec	FY09	FY10E	FY11E	FY12E	FY13E	\$ in millions, year end Dec	FY09	FY10E	FY11E	FY12E	FY13E
Revenues	465	670	1,145	1,263	1,404	EBIT	34	75	169	193	216
% change Y/Y	(17.6%)	43.9%	70.9%	10.3%	11.2%	Depreciation & amortisation	11	13	14	15	16
Gross Margin (%)	24.4%	21.7%	25.9%	26.5%	26.6%	Change in working capital/Other	(27)	39	(63)	(25)	(27)
EBITDA	60	90	194	219	243	Taxes	-	-	-	-	-
% change Y/Y	(11.1%)	51.2%	115.4%	12.8%	11.0%	Cash flow from operations	33	129	131	194	216
EBITDA Margin	12.8%	13.4%	16.9%	17.3%	17.3%	Capex	-	-	-	-	-
EBIT	34	75	169	193	216	Disposal/(Purchase)/Other	-	-	-	-	-
% change Y/Y	(10.2%)	120.0%	124.4%	14.3%	12.2%	Net Interest	-	-	-	-	-
EBIT Margin	7.3%	11.2%	14.7%	15.3%	15.4%	Free cash flow	-	-	-	-	-
Net Interest	(25)	(25)	(8)	(2)	2	Equity raised/repaid	-	-	-	-	-
Earnings before tax	9	51	161	191	218	Debt Raised/repaid	-	-	-	-	-
% change Y/Y	(56.7%)	443.9%	218.5%	18.8%	14.1%	Other	-	-	-	-	-
Tax	(7)	(12)	(42)	(49)	(56)	Dividends paid	-	-	-	-	-
as a % of EBT	-	-	-	-	-	Beginning cash	23	25	51	90	146
Net Income (Reported)	(1)	36	109	130	148	Ending cash	25	51	90	146	225
% change Y/Y	(40.6%)	(6,120.7%)	206.5%	18.8%	14.1%	DPS	-	-	-	-	-
Shares Outstanding	117.16	117.16	117.16	117.16	117.16						
EPS (reported)	-0.01	0.30	0.93	1.11	1.26						
% change Y/Y	-	(6120.7%)	206.5%	18.8%	14.1%						
Balance sheet						Ratio Analysis					
\$ in millions, year end Dec	FY09	FY10E	FY11E	FY12E	FY13E	\$ in millions, year end Dec	FY09	FY10E	FY11E	FY12E	FY13E
Cash and cash equivalents	25	48	87	143	222	EBITDA margin	12.8%	13.4%	16.9%	17.3%	17.3%
Accounts receivable	92	318	217	237	265	Operating margin	-	-	-	-	-
Inventories	106	148	255	280	312	Net profit margin	NM	5.3%	9.5%	10.3%	10.5%
Others	3	4	4	4	4	SG&A/Sales	-	-	-	-	-
Current assets	227	521	566	668	806	Sales per share growth	-	-	-	-	-
LT investments	17	20	21	20	19	EPS growth	-	(6120.7%)	206.5%	18.8%	14.1%
Net fixed assets	-	-	-	-	-	ROE	-	-	-	-	-
Total assets	391	804	889	1,004	1,160	ROCE	-	-	-	-	-
Liabilities						Interest coverage (x)	-	-	-	-	-
ST loans	63	125	40	28	60	Net debt to equity	154.7%	77.7%	3.1%	(9.5%)	(17.7%)
Payables	108	382	319	347	386	Net debt	152	145	14	-59	-142
Others	19	56	59	56	54	Net debt/EBITDA (ny)	-	-	-	-	-
Total current liabilities	190	563	418	431	500						
Long term debt	114	71	65	60	23						
Other liabilities	11	32	34	33	31						
Total liabilities	315	666	517	523	555						
Shareholders' equity	76	138	403	549	717						
BVPS	1	1	3	5	6						

Source: Company reports and J.P. Morgan estimates.

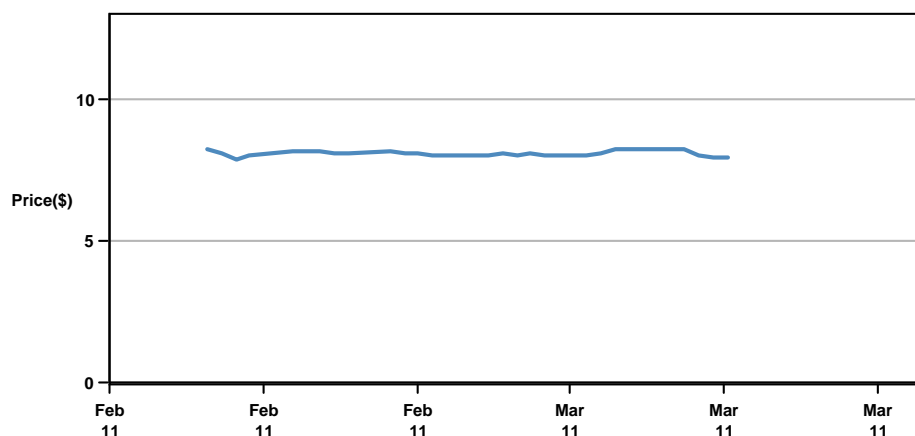
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HMS Group (HMSGq.L) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.

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