



Rating
Buy

Emerging Europe
Russia

Industrials / Manufacturing

Company
HMS Group

Reuters
HMSGq.L

Bloomberg
HMSG LI

Exchange
LSE
Ticker
HMSGq

Date
19 February 2013

Coverage Change

Price at 18 Feb 2013 (USD)	4.05
Price Target (USD)	6.80
52-week range (USD)	5.54 - 3.90

Pumping value; initiating with Buy

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Well positioned to benefit from spending on Russia's infrastructure

We initiate coverage of HMS Group with a Buy rating and a target price of USD6.8 per GDR. HMS Group is the Russia's leading pump, compressor and flow control equipment producer for oil & gas, power generation, utilities and water supply in Russia and CIS countries. We believe the company's large installed base, strong positions in all key markets segments, competitive price and client relationship along and unique R&D capabilities make it well positioned to benefit from the investments in Russia's infrastructure.

Strong market positions

Formed in 1993, the company has grown organically and through M&A, accumulating most of its capacities from the former Soviet Union. As a result, HMS Group currently controls 98% of installed oil pipeline pumps, 87% of water injection and water well pumps and 70% of nuclear power pumps in Russia. Such a significant installed base gives the company good opportunities for aftermarket services, which currently accounts for c. 10% of total sales. The company has strong positions in nearly all segments where it is represented, being a clear market leader in oil pipeline pumps (75% market share in 2011), submersible water well pumps (69%) and pump stations (50%). The significant R&D and construction base also allows HMS Group to provide high-margin integrated solutions products.

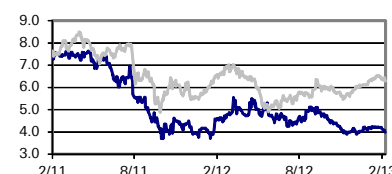
We forecast HMSG's top line to grow at CAGR of 12.5% over 2012-15

We forecast HMSG's top line to increase from RUB33.7bn in 2012 to RUB48.0bn in 2015 based on significant investments into the development of oil & gas fields in East Siberia, upgrade of Russian refineries, construction of new facilities in the power generation and the government's program on renovation of outdated water utilities. With the increasing company presence in after-market services, EPC and modular equipment segments, this should translate into 15% and 22% 2012-15E CAGR of EBITDA and EPS, respectively.

Strong upside potential; significant discounts to peers; risks

We value HMS Group on DCF. We apply WACC of 13.9% (7.5% RFR, 50%/50% debt/equity structure, 17.0% CoE and 7.5% after-tax CoD) and a terminal growth rate of 3%. The company trades at 49% and 23% discounts to its foreign and Russian peers, respectively, on FY2013E EV/EBITDA. For its FY2013E P/E multiple, the corresponding discounts are 60% and 45%, which we believe is too high for the low liquidity of HSM Group's shares. Key risks: oil price contraction, input costs increase, intensifying competition and balance sheet risk; low liquidity of shares (for details, see page 4).

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-4.3	2.5	-12.6
Russian RTS Index	-1.4	14.8	-4.7

Forecasts And Ratios

Year End Dec 31	2010A	2011A	2012E	2013E	2014E
EBITDA	3,466	5,479	5,403	6,158	7,301
P/E (DB EPS) (x)	-	6.3	7.3	6.6	5.0
EV/EBITDA (x)	-	5.0	5.0	4.4	3.6

Source: Deutsche Bank estimates, company data

Deutsche Bank AG/London

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Model updated: 18 February 2013

Running the numbers

Emerging Europe

Russia

Industrials / Manufacturing

HMS Group

Reuters: HMSGq.L Bloomberg: HMSG LI

Buy

Price (18 Feb 13) USD 4.05

Target Price USD 6.80

52 Week range USD 3.90 - 5.54

Market Cap (m) EURm 355

USDm 474

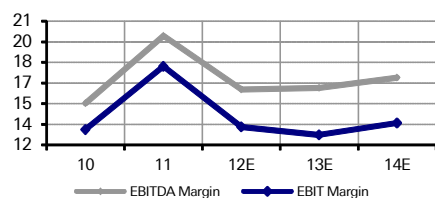
Company Profile

HMS Group is a Russian pumps producer providing pumps equipment for companies in oil & gas, water utilities, power generation and some other sectors, including metallurgy and chemicals. HMS currently controls 98% of installed oil pipelines pumps, 87% of water injection and water well pumps and 70% of nuclear power pumps. The company has strong positions in nearly all of the segments where it is represented, being a clear market leader in oil pipelines pumps (75% market share in 2011), submersible water well pumps (69%) and pumps stations (50%).

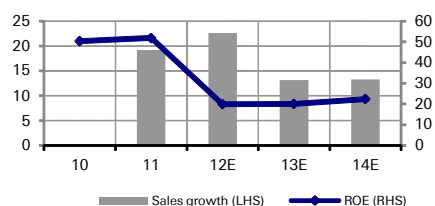
Price Performance



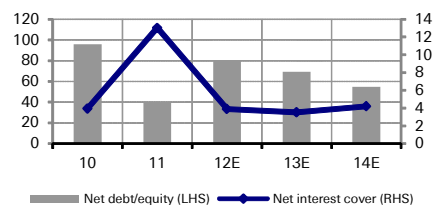
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2010	2011	2012E	2013E	2014E
DB EPS (RUB)	12.69	27.75	16.74	18.62	24.56
Reported EPS (RUB)	12.69	27.75	16.74	18.62	24.56
DPS (RUB)	0.14	12.80	4.54	5.10	6.66
BVPS (RUB)	25.2	81.8	85.7	99.8	119.3
Weighted average shares (m)	117	117	117	117	117
Average market cap (RUBm)	na	20,325	14,296	14,296	14,296
Enterprise value (RUBm)	na	27,482	27,010	27,090	26,583

Valuation Metrics

P/E (DB) (x)	na	6.3	7.3	6.6	5.0
P/E (Reported) (x)	na	6.3	7.3	6.6	5.0
P/BV (x)	0.00	1.61	1.44	1.22	1.02
FCF Yield (%)	na	nm	nm	4.6	9.4
Dividend Yield (%)	na	7.4	3.7	4.2	5.5
EV/Sales (x)	nm	1.0	0.8	0.7	0.6
EV/EBITDA (x)	nm	5.0	5.0	4.4	3.6
EV/EBIT (x)	nm	5.6	6.0	5.6	4.5

Income Statement (RUBm)

Sales revenue	23,070	27,496	33,712	38,144	43,207
Gross profit	5,913	8,834	10,046	11,411	13,202
EBITDA	3,466	5,479	5,403	6,158	7,301
Depreciation	440	612	913	1,299	1,427
Amortisation	0	0	0	0	0
EBIT	3,027	4,867	4,490	4,859	5,875
Net interest income/(expense)	-766	-374	-1,150	-1,376	-1,396
Associates/affiliates	15	93	0	0	0
Exceptionals/extraordinary	0	0	0	0	0
Other pre-tax income/(expense)	-112	-320	-506	-381	-432
Profit before tax	2,163	4,267	2,835	3,101	4,047
Income tax expense	582	890	709	711	928
Minorities	94	126	165	208	242
Other post-tax income/(expense)	0	0	0	0	0
Net profit	1,487	3,251	1,961	2,182	2,877
DB adjustments (including dilution)	0	0	0	0	0
DB Net profit	1,487	3,251	1,961	2,182	2,877

Cash Flow (RUBm)

Cash flow from operations	3,575	-1,595	2,706	2,527	3,225
Net Capex	-974	-1,180	-6,599	-1,867	-1,879
Free cash flow	2,601	-2,775	-3,893	660	1,346
Equity raised/(bought back)	0	0	0	0	0
Dividends paid	-320	-17	-1,500	-532	-598
Net inc/(dec) in borrowings	-234	1,711	7,321	337	-2,635
Other investing/financing cash flows	-2,453	2,342	0	0	0
Net cash flow	-406	1,261	1,928	466	-1,887
Change in working capital	-1,039	6,081	146	950	1,085

Balance Sheet (RUBm)

Cash and other liquid assets	351	1,598	3,526	3,992	2,105
Tangible fixed assets	5,949	8,226	14,195	15,098	15,900
Goodwill/intangible assets	2,094	2,858	2,762	2,638	2,524
Associates/investments	603	179	179	179	179
Other assets	13,481	15,155	20,293	22,893	25,585
Total assets	22,478	28,016	40,955	44,800	46,293
Interest bearing debt	4,639	6,408	13,728	14,065	11,430
Other liabilities	13,375	9,548	14,540	16,190	17,796
Total liabilities	18,015	15,956	28,268	30,256	29,227
Shareholders' equity	2,955	9,583	10,044	11,694	13,974
Minorities	1,508	2,477	2,642	2,850	3,092
Total shareholders' equity	4,463	12,060	12,686	14,545	17,066
Net debt	4,288	4,809	10,202	10,074	9,325

Key Company Metrics

Sales growth (%)	nm	19.2	22.6	13.1	13.3
DB EPS growth (%)	na	118.7	-39.7	11.2	31.9
EBITDA Margin (%)	15.0	19.9	16.0	16.1	16.9
EBIT Margin (%)	13.1	17.7	13.3	12.7	13.6
Payout ratio (%)	1.1	46.1	27.1	27.4	27.1
ROE (%)	50.3	51.9	20.0	20.1	22.4
Capex/sales (%)	4.3	4.3	19.6	4.9	4.3
Capex/depreciation (x)	2.3	2.0	7.2	1.4	1.3
Net debt/equity (%)	96.1	39.9	80.4	69.3	54.6
Net interest cover (x)	3.9	13.0	3.9	3.5	4.2

Source: Company data, Deutsche Bank estimates

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Investment thesis

Outlook

HMS Group is a Russian pump producer providing pump equipment for companies in oil & gas, water utilities, power generation and some other sectors, including metallurgy and chemicals. HMS Group currently controls 98% of installed oil pipeline pumps, 87% of water injection and water well pumps and 70% of nuclear power pumps. Such a large installed base gives the company good opportunities for aftermarket services, which currently account for 10% of total sales. The company has strong positions in nearly all of the segments where it is represented, being a clear market leader in oil pipeline pumps (75% market share in 2011), submersible water well pumps (69%) and pump stations (50%). We forecast HMSG's top line to increase from RUB33.7bn in 2012 to RUB48.0bn in 2015 based on significant investments into the development of oil & gas fields in East Siberia, upgrade of Russian refineries, construction of new facilities in power generation and the government's program on renovation of outdated water utilities. With the increasing company presence in aftermarket services, EPC and modular equipment segment, this should translate into 15% and 22% 2012-15 CAGR of EBITDA and net income, respectively. We initiate with a Buy.

Valuation

We value HMS Group on DCF. We apply WACC of 13.9%, based on a risk-free rate of 7.5%, equity premium of 6%, liquidity premium of 2.5% to reflect low liquidity of the stock and 1% premium for balance sheet risks, 45%/55% debt/equity structure, 17.0% CoE and 7.7% after-tax CoD. We use a terminal growth rate of 3%, which is in line with the long-term growth of the Russian economy.

Risks

The key downside risks include: 1) oil prices contraction, which may result in lower spending on oil infrastructure, the company's key focus; 2) raw materials inflation, particularly in ferrous metals, the key cost component; 3) a high concentration of client base with the top-five clients accounting for 49% of HMS Group's revenue (9M2012 data), however this share changes from year to year depending on the company's backlog structure; 4) possible delays in major Russian infrastructure projects; 5) higher competition from foreign players for sophisticated pump equipment in both the upstream and downstream segments; 6) execution risks related to more money and management's efforts to integrate the recent and potential acquisitions; 7) ruble weakness as the company's revenues and costs are in rubles; 8) low liquidity of shares with two-month ADV of USD0.8m; 9) a stretched balance sheet as the company nearly reached a covenant of 2.5x at 30 September 2012 after several acquisitions in 2012.



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SWOT

Figure 1: SWOT analysis

Strengths	Weaknesses
Diversified product mix, including pumps for several industries, compressors, oil & gas equipment	Stretched balance sheet (net debt to EBITDA 2012E at 1.9x (0.9x in 2011))
Strong market positions in nearly all the segments where the company is represented	Volatility of margins: the company's profitability depends on implemented projects
Market leader in water injection, oil pipelines, submersible water well pumps and pump stations	Low share of aftermarket – 10% of revenue (vs. 40% across peers)
Large installed base of pumps by the group's enterprises, potential demand for aftermarket	Lack of presence on international markets - mainly CIS and Iraq, weak participation in international projects
Ability to provide high-margin integrated solutions	Low opportunities to increase market share in most of the segments due to competitors' established relations with clients
Participation in key oil & gas projects, e.g., ESPO, Vankor	
Installed clients base, strong relations with Russian oil & gas majors and Rosatom	
Devoted management team: HMS Group founders are managers and shareholders	
Opportunities	Threats
Increase of integrated solutions products based on compressors after KKM acquisition	Decrease in oil & gas production resulted in lower demand for equipment and consequently lower capex
Expansion into international markets and participation in off-shore projects after Apollo acquisition	Raw materials inflation, particularly in ferrous metals, the key cost component
Participation in ongoing and future major oil & gas projects due to good references and installed equipment base	More money and management's efforts needed to integrate the recent acquisitions

Source: Deutsche Bank

Main catalysts

- Publication of FY12 results in April 2013;
- Publication of quarterly orders intake in April, July, October 2013;
- Announcement of tender win in large oil & gas projects (See figure tenders on tenders expected by the company in 2013);
- Announcement of new M&A deals.



Figure 2: Tenders/projects which HMS Group expects in 2013

Key Projects	Brief description
Rosneft	
Vankor aftermarket	Possible aftermarket contracts
Yurubcheno-Tokhomsk oilfield	Capex of USD200-300m. Oilfield to be connected to the ESPO pipeline
Komsomolskoe, Priobskoe oilfields	Achievement of associated gas utilization ratio up to 95%
Kharampurskoe oilfield	Construction, engineering and equipment delivery. Capex USD0.5-3bn. 2013-15
Lukoil & Bashneft JV	
Trebs and Titov fields	Potential delivery of Main OPS
Transneft	
Modernization of current pipeline system	Ongoing inflow of contracts
Zapolyarye – Pur-pe pipeline	Oil transportation from YANAO and Northern Krasnoyarsk region to ESPO-1
Yurubcheno-Tokhomskoe-Taishet pipeline	Construction of 4 OPS for oil transportation from Yurubcheno-Tokhomsk and Kuyumbinsk oilfields to ESPO-1
TNK-BP	
Russkoe & Tagulskoe oilfields	Capex in Russkoe is estimated around USD4.5bn, production start is scheduled for 2015. Production on Tagulskoe is planned in 2019
Bobrovskoe field	One of the largest oilfields in Orenburg region. Development started in 1970. Depletion of beginning reserves of 73%
Uvat group of oilfields	Main OPS. 21 oilfields in Tyumen region. Considered as a base for a new large center of crude-oil production in Western Siberia
East- and Novo- Urengoy gas & condensate fields	Giant gas field in Tyumen region, where total reserves exceed 560 bcm of gas and 96 mt of gas condensate
Gazprom	
Chayandinskoe oil-gas condensate field	Large field in Yakutiya region. C1+C2 reserves 1.24 tcm of gas, and 69 mt of oil & condensate. Oil & gas exploration by 2015
South Stream (KMPO)	Construction is planned to start in 2012-end, completion by 2015. Capex EUR8.6bn
KKM	Several contracts RUB1bn each with Russian oil majors and clients in Middle Asia
Gazprom Neft	
Messoyakhinskoe oilfield	Recoverable reserves C1+C2 520 mt of crude oil & condensate and 230 bcm of gas. Capex 2015-40 more than RUB500bn
NOVATEK	
Yarudeiskoe oil-gas condensate field	Currently at engineering survey stage
Iraq	
Rumaila brownfield and other projects of South Oil Company	Consortium headed by BP
Water utilities	
Central Asia	Irrigation stations for Uzbekistan and Turkmenistan
Nuclear	
Rosatom	Pumps and other equipment for Rostov NPS, Kalinin NPS, Baltic NPS, Leningrad NPS

Source: Company data, prioritized projects are highlighted with blue



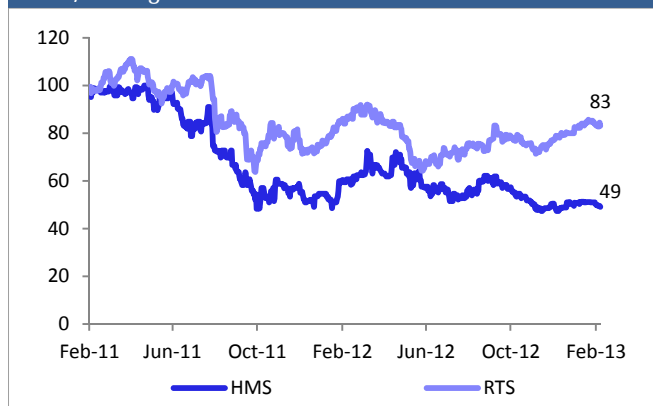
Share price performance

Low price for strong fundamentals and growth prospects

Since its IPO in February 2011, HMS Group has underperformed the RTS Index, having declined more than a half by now. Following the market dynamics during 2011, the company's share price was affected by expensive acquisitions of compressor company KKM and German pump manufacturer Apollo in July 2012, which induced share price movement opposite to that of the RTS. The both deals were fully financed with debt, having boosted the company's 9M12 Net debt/EBITDA ratio to 2.49x (barely within the internal covenant of 2.5x). The company paid 15x and 8.7x 2012EV/EBITDA for KKM and Apollo, correspondingly, much higher than its own 2012EV/EBITDA of 5x, aspired by future high-margin contracts. Increased debt burden along with the concerns about success of acquired companies' integration resulted in share decline.

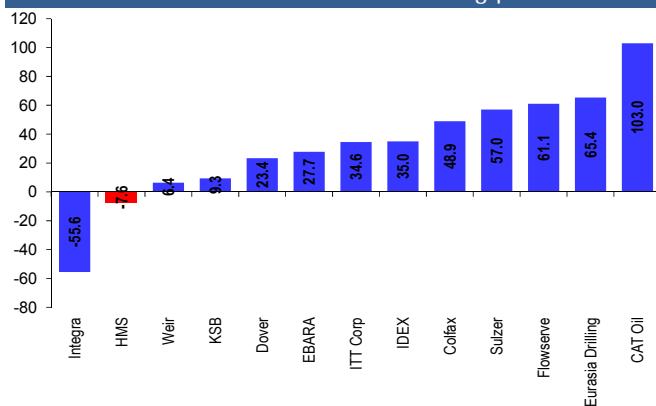
Although the market started to recover since November 2012, HMS Group's shares stuck at a mark of USD4, close to its historical lows. We believe the situation will start to improve once the signs of benefits of integration become noticeable, which we think will happen considering a good track-record of acquisitions by the Group and clear synergies HMS Group gets with the new companies. We note that as of 9M12 the company had RUB23.7bn (USD760m) backlog or one-third higher than at the end of 2011, among which RUB2.5bn was brought by compressors. We believe the current levels are a good entry point given that the stock trades with a significant discount to its foreign peers.

Figure 3: Since the IPO, HMSG underperformed the RTS Index, having declined more than a half



Source: Bloomberg Finance LP

Figure 4: For 2012, and the beginning of 2013, HMSG has lost 7.6% – one of the worst results among peers



Source: Bloomberg Finance LP



Valuation

DCF valuation

We use DCF analysis to arrive at our 12-month target price for HMS Group. Our valuation is based on our assumptions presented in the section in this report entitled "Financial projections". We have applied WACC of 13.9%, based on a risk-free rate of 7.5%, a 50:50 debt/equity structure, cost of equity of 17.0%, and after-tax cost of debt of 7.7%. Our cost of equity includes a liquidity risk premium of 2.5% and balance sheet risks of 1%. Our DCF model yields a 12-month target price of USD6.8.

Figure 5: We apply a WACC of 13.9% to value HMSG

WACC calculation	
Russia/FSU risk-free rate	7.5%
Russia/FSU equity risk premium	6.0%
Liquidity premium	2.5%
Balance sheet risk	1.0%
Cost of equity	17.0%
Pretax cost of debt	10%
Tax rate	23%
Cost of debt (after tax)	7.7%
Debt weight	50.0%
WACC	13.9%

Source: Deutsche Bank

Figure 6: Our DCF model results in a target price of USD6.8/share

RUBm	2013E	2014E	2015E	2016E	Cash flow estimate to assess terminal value
EBIT	4,859	5,875	6,721	8,037	8,037
Income taxes	-1,114	-1,347	-1,541	-1,843	-1,843
Capex	-1,867	-1,879	-1,950	-2,007	-1,871
Changes in WC	-950	-1,085	-1,078	-1,304	-1,304
D&A	1,087	1,192	1,298	1,407	1,407
Free cash flow	2,015	2,754	3,449	4,290	4,426
Discount factor		1.14	1.30	1.48	1.48
PV of future FCF		2,418.1	2,658.4	2,903.0	2,994.9
Total PV of future FCF (2014-16E)	7,980				
Terminal growth rate	3%				
Terminal value	41,812				
PV of Terminal Value	28,295				
EV	36,274				
12-month target EV	37,047				
Less: Net debt (end-2013)	10,074				
Less: Minority interest (end-2013)	2,850				
Less/Plus: Other adjustments	130				
Total equity value (12m target)	24,253				
Common equivalent shares outstanding	117.2				
12m target price, RUB	207.0				
USD/RUB exch.rate e.o.p. 2013	30.60				
12m target price, USD	6.8				

Source: Deutsche Bank



Figure 7: HMSG multiples at current and target price

at current price	2012E	2013E	2014E	2015E	2016E
EV/EBITDA	5.0	4.4	3.6	3.0	2.4
P/E	7.2	6.4	4.9	3.9	3.1
P/B	33.6	29.6	25.4	21.6	18.0
Div. Yield	3.8%	4.3%	5.5%	6.9%	8.8%
at target price	2012E	2013E	2014E	2015E	2016E
EV/EBITDA	6.8	6.0	5.0	4.3	3.5
P/E	12.4	11.1	8.4	6.7	5.3
P/B	1.9	1.7	1.4	1.2	1.0
Div. Yield	2%	2%	3%	4%	5%

Source: Deutsche Bank

Sensitivity analysis

Figure 8: Sensitivity of target price to WACC

WACC	10.9%	11.9%	12.9%	13.9%	14.9%	15.9%	16.9%
Terminal Growth							
0.0%	7.3	6.3	5.5	4.8	4.2	3.7	3.3
1.0%	8.3	7.1	6.2	5.4	4.7	4.1	3.6
2.0%	9.4	8.1	6.9	6.0	5.2	4.6	4.0
3.0%	10.9	9.2	7.9	6.8	5.9	5.1	4.4
4.0%	12.8	10.6	9.0	7.7	6.6	5.7	4.9
5.0%	15.3	12.5	10.4	8.8	7.5	6.4	5.5
6.0%	18.8	14.9	12.2	10.1	8.6	7.3	6.3

Source: Deutsche Bank

Figure 9: Sensitivity of target price to USD/RUB exchange rate

USD/RUB e.o.p. 2013	27.6	28.6	29.6	30.6	31.6	32.6	33.6	34.6
12 month target price in USD	7.5	7.2	7.0	6.8	6.6	6.3	6.2	6.0

Source: Deutsche Bank

Comparable analysis

The company trades at 49% and 23% discounts to its foreign and Russian peers, respectively, on FY2013E EV/EBITDA. For the FY2013E P/E multiple, the corresponding discounts are 60% and 45%, which we believe is too high for the low liquidity of HMS Group shares.



Figure 10: HMSG trades at large discounts to its foreign peers and Russian OFS companies

Rail companies		Rating	Current	Target	Upside	Mkt Cap	P/E		EV/EBITDA		Div yield %		EPS	EBITDA margin		ROE	ND/EBITDA		Absolute performance % ADV (YTD)					
02/15/2013			Price	Price	%	USD m	2012	2013	2012	2013	2012	2013	2012-14	2012	2013	2012	2013	2012	2013	1M	3M	YTD	USD m	
Company	Headquarter																							
HMS Group	Russia		3.98	6.8	71%	466	7.2	6.4	5.0	4.4	3.8	4.3	+21.1	16.0	16.1	15.5	15.0	1.9	1.6	-2.4	+1.7	-3.3	0.85	
Foreign peers																								
WEIR	UK	Buy	2182.00	2400	10%	7,147	14.6	13.9	9.8	8.9	1.7	1.7	+8.9	20.9	21.4	23.4	20.7	1.3	0.9	+14.5	+23.3	+16.1	24.0	
COLFAX CORP	US	Buy	42.25	46	9%	3,033	24.8	22.8	14.3	10.0	-	-	+38.1	8.0	12.6	- 7.7	8.1	5.1	2.8	+3.4	+15.3	+4.7	27.5	
ITT CORPORATION	US	Buy	26.46	27	2%	2,461	15.6	13.9	8.6	6.7	1.4	1.4	+13.8	10.3	11.2	14.2	16.7	- 2.1	- 2.2	+3.4	+23.9	+12.8	18.9	
DOVER	US	Hold	72.56	72	-1%	10,812	13.3	13.7	7.9	8.2	2.2	1.9	+14.8	20.0	20.4	15.5	17.2	1.2	1.2	+6.7	+15.0	+10.4	86.6	
Sulzer	SWZ	N/R	151.70	N/A	N/A	5,648	17.4	15.4	9.8	8.5	2.0	2.2	+13.0	13.8	14.6	13.3	13.7	0.3	- 0.1	+4.2	+11.5	+5.3	13.5	
KSB	Germ	N/R	482.50	N/A	N/A	1,082	307.7	275.7	3.1	2.7			+9.9	8.9	9.2	10.1	10.5	- 0.9	- 1.0	+6.4	+15.6	+3.9	0.5	
IDEX	US	N/R	48.92	N/A	N/A	4,044	18.2	16.7	10.4	9.4	1.5	1.7	+7.7	22.0	22.7	13.5	14.4	1.0	0.7	+2.7	+15.1	+5.1	21.8	
Flowserve	US	N/R	157.66	N/A	N/A	7,881	17.5	15.9	10.6	9.7	0.9	1.0	+6.5	16.7	17.3	21.3	24.9	0.7	0.6	+1.3	+16.3	+7.4	64.3	
EBARA	JPN	N/R	393.00	N/A	N/A	1,770	55.4	16.1	6.7	5.9	1.3	1.3	-39.8	7.9	9.0	2.8	6.9	1.6	1.1	+7.4	+30.1	+9.2	17.4	
Median foreign peers							17.5	15.9	9.8	8.5	1.5	1.5	+9.9	13.8	14.6	13.5	14.4	1.0	0.7	4.2	15.6	7.4		
Russian peers																								
EURASIA DRILLING	Russia	Hold	38.86	40	3%	5,707	13.8	12.1	7.7	6.6	1.8	2.1	+14.4	24.3	24.9	28.5	26.3	0.4	0.3	+5.3	+17.2	+8.9	5.0	
C.A.T. OIL	Russia	Buy	8.79	9.5	8%	573	24.1	11.3	6.6	4.7	-	-	+63.2	22.8	23.9	7.9	15.4	0.8	0.5	+11.5	+59.8	+30.4	1.1	
INTEGRA	Russia	Sell	0.43	0.3	-30%	83	NM	7.6	1.6	1.3	-	-	NA	7.7	10.5	- 7.7	- 2.1	4.2	3.1	+22.2	-1.5	+2.4	0.0	
Median Russian peers (excl. Integra)							18.9	11.7	7.1	5.6	0.9	1.0	+38.8	23.6	24.4	18.2	20.9	0.6	0.4	8.4	38.5	19.6		
HMSG discount(-)/Premium(+) to foreign peers							-59%	-60%	-50%	-49%	2.3	2.7	11.2	2.2	1.5	2.0	0.6	85%	139%	-7	-14	-11		
HMSG discount(-)/Premium(+) to Russian peers							-62%	-45%	-31%	-23%	2.9	3.2	-17.7	-7.5	-8.3	-2.7	-5.9	214%	287%	-11	-37	-23		

Source: Deutsche Bank, Bloomberg Finance LP

As HMS Group's business comprises several segments (pumps, compressors, modular equipment sale and design & construction), its peer group includes pumps producers, oil servicing companies providing pumps and modular equipment for oil & gas industry and from 2012 compressors producers. In Russia there are no other public pumps producers aside from HMS Group, so we compare the company with such oil servicing companies as Integra, C.A.T Oil and Eurasia Drilling.

Among international companies, we outline Flowserve and Sulzer as the closest peers to HMS Group, as both companies produce pumps in three key segments of HMS Group's pumps division – oil & gas, water utilities and power generation.

- **Flowserve** is a global manufacturer of flow control equipment, including pumps, valves and seals, headquartered in the US. The company sells its products to customers in oil & gas, chemical, power generation and some other industries all over the globe; almost one-third of its revenue comes from North America, 23% from Europe and 19% from Asia Pacific. The company's aftermarket service brings 40% of its business.
- **Sulzer's** main business segments comprise pumps division accounting for half of the company's revenue, surface engineering products ('Metco'), separation and mixing systems ('Chemtech') and rotating equipment ('Turbo'). The company's pump sales are split between the oil & gas industry, hydrocarbons, power generation, water and some other industries. Although the company is based in Switzerland, the geography of pump sales is diversified with 31% from Europe, 21% from America and 26% from Asia Pacific.

We emphasize European Weir and KSB; American Colfax, ITT, IDEX, Dover and Japanese EBARA as other companies worth comparing with HMS Group.

- **Weir** is primarily a supplier of pumps for the Mining and upstream oil & gas industries with the revenue split approximately 40% mining, 40% upstream oil & gas, 10% power generation and 10% other industrial. It varies from year to year, but about 50% of revenues come from spares and service, one of the highest aftermarket exposures in the sector. The mainstay products are slurry



pumps for mining and pressure pumps for hydraulic fracturing of shale gas. North America constitutes 42% of sales, Europe 12% and Asia Pacific 12%.

- **Colfax** is a US-based manufacturer with nearly USD4bn sales (after M&A in 2012). Colfax reports two segments: fabrication technology and gas & fluid handling. Products include welding equipment and consumables, engineered fans, compressors, screw pumps and fluid handling. The welding business commands roughly 12% of global market share; gas & fluid handling serves the power generation, oil & gas, commercial marine and general industrial markets. Colfax has a high global presence with more than 80% of sales from outside the US.
- **KSB** is a German producer of pumps, valves and related systems, specializing in centrifugal pumps; the company ranks among the world's top-ten valve manufacturers. The key distribution market is Europe, where the company operates production facilities in Germany and France; its second-largest market is Asia Pacific.
- **ITT** is a USD2bn global manufacturer of engineered industrial products. The company spun off its defense and water businesses in 2011 to concentrate on its primary products, which include industrial pumps, friction materials for automotive and truck application, electronic connectors, aircraft fueling systems and motion control products. The company derives 60% of sales outside North America and roughly 30% of revenue from aftermarket applications.
- **IDEX** is a US-based engineering company comprising four business segments, among which Fluid & Metering one providing positive displacement pumps, flow meters, compressors and injectors in a variety of industries, including alternative energy, oil & gas, water and wastewater. The company also provides medical equipment, dispensing solutions and fire & safety equipment.
- **Dover** is diversified industrial manufacturer headquartered in US. The company comprises four segments: Communication Technologies, Energy, Engineered Systems (incl. fluid solutions), and Printing & Identification. Energy segment produces equipment for drilling, oil production and downstream, while fluid solutions platform manufactures products for the transfer, monitoring and measuring of liquids. More than half of the company's revenue comes from North America.
- **EBARA** is Japan-based producer of pumps, compressors, turbines and chillers (Fluid machinery and systems segment), environmental engineering equipment and components. The company predominantly sells its products domestically (56% of revenue in 2011), however is also represented in Asia market (24% of sales), North America and Europe.
- Russian peers, **Integra, C.A.T Oil and Eurasia Drilling**, produce drilling and submersible equipment for upstream, so have no intersections with HMS Group.



Figure 11: Flowserve and Sulzer are the closest peers of HMSG

Peers	Country	Revenue as of 2011, USDm	EBITDA margin, %	Pumps, % of total Sales	Oil & Gas	Water Utilities	Power Gen	Modular Equipment	EPC	After market
HMSG	Russia	936	20%	57%	36%	8%	3%	21%	22%	10%
Weir	UK	3 676	19.6%	100%	38%		11%			50%
Flowserve	US	4 510	15.6%	100%	40%	4%	16%			40%
Colfax (as of 2012)	US	3 978	9%	100%	23%		11%			55%
Sulzer	Switzerland	4 051	13.5%	49%	12%	8%	12%			43%
KSB	Germany	2 912	9%	100%	32%	20%				n/a
ITT	US	2 119	15.5%	36%	18% (O&G + Power)					30%
IDEX	US	1 838	21%	44%	44% (pumps + ME)			Metering equipment		10%
Dover	US	7 950	19%	24%	24%			9% 'Fluid solutions'		19%
EBARA	Japan	4 700	11.2%	70%						n/a
Integra	Russia	616	16.5%							
C.A.T. Oil	Russia	391	19.5%							
Eurasia Drilling	Russia	2 752	21.5%							

Source: Companies' data, Deutsche Bank



Financial projections

Revenue projections

We base our forecasts of the company's top-line growth on the Frost & Sullivan market projections, adjusting them for new available data (we use a discount of 5-15% depending on the segment and difference between actual market data and initially projected by Frost & Sullivan) and assuming the company will manage to keep its market share in most of the segments where it has presence.

Figure 12: We forecast top line 2012-15 CAGR of 12.8% based on the market growth projections and assumptions that the company will maintain its market share in most segments

Revenues, RUB m	2010	2011E	2012E	2013E	2014E	2015E	2012-15 CAGR	Comments
Total revenue by divisions	23 070	27 496	33 712	38 144	43 207	48 021	12.5%	
Chng., yoy		19%	23%	13%	13%	11%		
Pumps (incl. aftermarket)	10 712	15 647	17 387	19 042	20 569	22 294	8.6%	Pumps to show the slowest growth as a result of declining sales in oil pipelines segment due to gradual completion of ESPO-related projects. Change in growth rates of ME in 2012-13 reflects revenue recognition from Vankor project in 2012 and high base effect in 2013
Chng., yoy		46%	11%	10%	8%	8%		
oil & gas equipment	5 805	5 898	8 125	8 255	9 442	10 854	10.1%	
Chng., yoy		2%	38%	2%	14%	15%		
EPC	6 135	5 947	6 880	7 375	8 938	9 786	12.5%	
Chng., yoy		-3%	16%	7%	21%	9%		
compressors	0	0	1 320	3 472	4 258	5 087	56.3%/15%	New segment compressors will grow with 15% CAGR, if based on total 2012 revenue estimation
Chng., yoy				163%	23%	19%		
Revenue breakdown by segment								
pumps	46%	57%	52%	50%	48%	46%		Growth of the compressors will mainly be at the expense of pumps, which lags behind the other two segments
oil & gas equipment	25%	21%	24%	22%	22%	23%		
EPC	27%	22%	20%	19%	21%	20%		
compressors	0%	0%	4%	9%	10%	11%		
Pumps								
sale of pumps, incl	5 921	12 646	10 926	11 891	12 516	13 269	6.7%	Ordinary equipment
Oil							0.3%	Declining sales reflect completion of ESPO-related projects
	3 243	9 830	7 402	7 843	7 706	7 471		
Water Utilities	1 813	2 064	2 555	2 914	3 421	4 057	16.7%	
Power generation	865	752	969	1 134	1 388	1 741	21.6%	
Aftermarket in pumps								
	1 855	2 352	2 697	3 052	3 673	4 322	17.0%	We expect the company to increase the share of after sales service
other pumps								
	611	649	751	819	928	1 043	11.6%	We assume 5% share of other pumps market (M&M, chemicals)
M&A (DGHM, BMBP, Apollo)								
	0	0	3 014	3 280	3 453	3 660	6.7%	We distinguish the companies acquired in late 11-12 and increase their revenue with HMSG's one

Source: Deutsche Bank estimates, company actual data



Figure 12: We forecast top line 2012-15 CAGR of 12.8% based on the market growth projections and assumptions that the company will maintain its market share in most segments (Cont'd)

Oil & gas equipment

Pump Stations	3 007	2 846	3 854	3 697	4 149	4 654	6.5%	Decrease in 2013 on the high base effect of 2012 after Vankor revenue recognition
Automated Group Metering Units	761	905	1 032	1 091	1 214	1 504	13.4%	
Associated Gas Processing & Transport Units	382	350	532	592	692	824	15.7%	
Other equipment	1 656	1 193	1 409	1 497	1 763	2 017	12.7%	
Sibneftemash	0	604	1 298	1 379	1 623	1 857	12.7%	Growth with other ME equipment as the company's core products are tanks and vessels

EPC

Oilfield Infrastructure construction	2 944	2 290	3 133	3 474	4 138	4 509	12.9%	
Crude Oil Transportation construction	906	704	711	766	942	1 062	14.3%	
Gas Transportation Construction	761	592	629	652	768	824	9.4%	
Project & Design	1 525	2 367	2 407	2 482	3 090	3 391	12.1%	

Source: Deutsche Bank estimates, company actual data

Figure 13: We assume the company will keep its market positions in key segments of its presence

	2010	2011	2012E	2013E	2014E	2015E	Comments
Oil							
Water injection	61%	42%	70%	60%	60%	60%	Shrink of 42% and hike of 70% in 2012 reflect the revenue recognition from the Vankor project; we assume the share to return to 60% further
Oil refining	22%	33%	33%	33%	33%	33%	However, after the Apollo acquisition the company has the opportunity to increase its share; we cautiously assume it flat
Oil pipelines	77%	75%	75%	75%	75%	75%	We believe the company will be able to keep its share even given the declining market
Water Utilities							
Submersible water Well Pumps	67%	69%	69%	69%	69%	69%	
Water utilities (clean water and dry-pit sewage)	49%	49%	49%	49%	49%	49%	
Household vibration	20%	18%	18%	18%	18%	18%	
Power generation							
Nuclear Power (exc.MCP)	19%	11%	15%	15%	15%	15%	
Thermal Power	53%	37%	37%	37%	37%	37%	
Other	5%	5%	5%	5%	5%	5%	
Modular equipment							
Pump Stations	57%	50%	60%	54%	54%	54%	Vankor project weighs on 2011 and supports 2012 numbers. Further we assume 54%
Automated Group Metering Units	33%	39%	40%	40%	40%	40%	
Associated Gas Processing & Transport Units	10%	8%	10%	10%	10%	10%	
Other equipment	14%	9%	10%	10%	10%	10%	
EPC							
Oilfield Infrastructure construction	3%	2%	3%	3%	3%	3%	
Crude Oil Transportation construction	2%	1%	1%	1%	1%	1%	
Gas Transportation Construction	1%	1%	1%	1%	1%	1%	
Project & Design	7%	9%	9%	9%	9%	9%	
Compressors							
	4%	9%	10%	9%	10%	10%	

Source: Deutsche Bank estimates



Figure 14: We expect EBITDA margin to be in a range of 16-18% in 2013-15

RUB m	2010	2011	2012E	2013E	2014E	2015E	2012-15 CAGR	Comments
Gross profit (post D&A)	5 573	8 375	9 321	10 324	12 010	13 540	13.3%	
gross margin								Decline of gross margin in 2012 vs. 2011 is due to the end of ESPO-2, further volatility of margins is due to volatility in Deutsche Bank's forecast for metals (the key component in HMSG's costs)
	24.2%	30.5%	27.6%	27.1%	27.8%	28.2%		
SG&A	2 547	3 584	4 830	5 465	6 135	6 819	12.2%	Hike in SG&A share in 2012 is due to acquired subsidiaries. We believe the company will gradually start to optimize operation of these companies
as % of Revenue								
	11.0%	13.0%	14.3%	14.3%	14.2%	14.2%		
EBITDA	3 466	5 479	5 403	6 158	7 301	8 280	15.3%	19.9% hike in 2011 was due to ESPO project. HMSG gives guidance of 16-18%, we expect the company to move towards it in the near future
EBITDA margin	15.0%	19.9%	16.0%	16.1%	16.9%	17.2%		
Net finance costs								Growth of net finance costs in 2012 and 2013 is due to loans attracted for financing the acquisitions made in 2H12
	437	374	837	1 115	1 463	1 478	20.9%	
Net income	1 581	3 377	2 126	2 390	3 119	3 902	22.4%	
Net margin								An increase in 2015 net margin is due to flat net finance costs
	6.9%	12.3%	6.3%	6.3%	7.2%	8.1%		
NI attributable to shareholders	1 487	3 251	1 961	2 182	2 877	3 604	22.5%	
Net margin	6.4%	11.8%	5.8%	5.7%	6.7%	7.5%		
EPS, RUB	12.7	27.7	16.7	18.6	24.6	30.8	22.5%	

Source: Company data, Deutsche Bank estimates



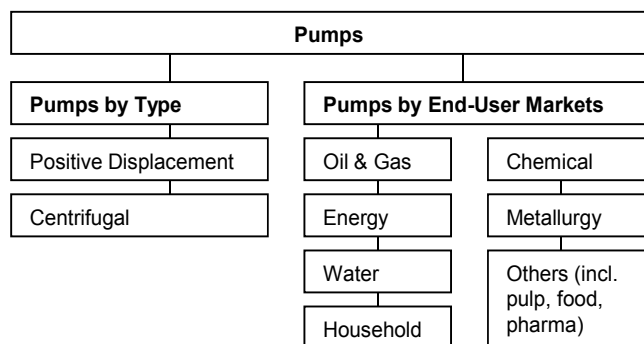
Market analysis

Pumps to transfer liquids during the production process

In many production processes transfer of liquids plays a critical role. In nature, liquids move gaining energy from elevation changes (waterfall), some external force (wind waves) or pressure drops, which forces fluids to move from areas of high pressure to areas of low pressure (backflow in the sea). To artificially initiate liquids movement, the latest physical property is used, laying the basis for operation of pumps, either centrifugal or positive displacement pumps. The difference between these two broad types lies in their working principle: while centrifugal pumps move liquids, when the pressure within the casing decreases due to centrifugal force that appeared during the rotation of impellers, positive displacement pumps rely on rotary or reciprocating parts to create a low pressure area to capture the liquid and then displace it. The first type of pumps is more common and, according to Frost & Sullivan, occupied 73% of the global market several years ago due to being relatively inexpensive and economically efficient; however, it is mainly used to move low viscosity liquids, while for higher viscosity liquids the second type of pumps is more appropriate.

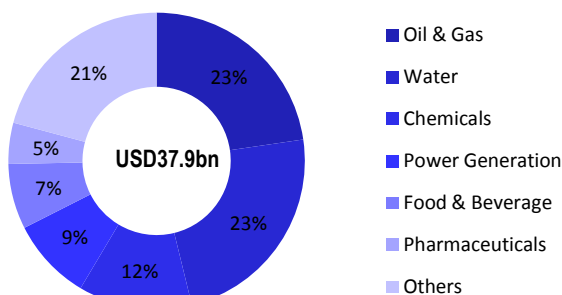
Pumps are used in various industries, including medicine and food; however, the main users are industrial producers in such segments as oil & gas (23% of global market in 2009), water (24%), chemicals (12%) and power generation (10%).

Figure 15: Type of pumps divided into positive displacement and centrifugal



Source: Frost & Sullivan

Figure 16: Industrial producers are main users of pumps in the global market (2009)



Source: Frost & Sullivan

Oil & gas industry

In oil production pumps are used at all stages from drilling to refinery. **Drilling mud pumps** are a positive displacement type, which circulates heavy drilling fluid in the well to bring the fragments of rock to the surface, keeping the drill bit clean and cool and maintaining pressure to prevent leakage of hydrocarbons. The oil recovery process consists of three phases: primarily, crude oil moves to the surface either naturally (under pressure of reservoir) or being artificially lifted by **submersible pumps**, at the second phase, pressurized gas and water through water injection wells flow back to the reservoir, thus increasing pressure there and stimulating hydrocarbons to rise; at this stage, extraction of c.30% of substance is possible. The third phase allows enhancing oil recovery, injecting steam, chemical reagents or gas. For the last two phases **injection pumps** are used. From fields crude oil is usually transported to refineries



through pipelines, as well as oil products, which have to be delivered to customers from the plants. Pumps, incorporated into pump stations, are located along the pipeline providing the liquid injection in the beginning of the line and adjusting pressure further throughout the length to move the product. In refining processes, pumps deliver crude oil to hot furnaces for vaporization, after which the separated fractions are transported to different stations.

Figure 17: In oil production, pumps are used at all stages from drilling to refinery

Drilling	Extraction	Transportation	Refinery
Pumps circulate drilling fluid to remove cuttings; keep the drill bit clean and cool; maintain pressure in the well	Submersible pumps artificially lift the oil to the surface; Injection pumps move water or other substances back to reservoir to stimulate oil movement	Pumps provide liquid injection at initial injection station; adjust pressure further throughout the length of the pipeline	Pumps deliver crude oil to hot furnaces; provide transportation of the separated fractions

Source: Deutsche Bank

In gas production, **compressors** play the same role as pumps do in oil production; however, they also compress the gas reducing its volume. Compressors could be divided into two broad categories, similar to pumps – centrifugal and positive displacement.

Pumps and compressors united into modules to design **pump and compressor stations** represent modular equipment. This category encompasses other equipment used in oil & gas production, such as **separator modules**, which separate well fluids into oil, gas and sludge components and dehydrate oil; **metering equipment** allowing to measure the amounts of oil, gas and water in the well and control quantity and quality of the oil & gas transferred in a pipeline or at a refinery; **gas transportation modules** move the associated gas to the end user or for further processing.

Power generation

In a variety of power generating stations, pumps have also found application. In thermal and nuclear power stations, boiler feed pumps provide water to boilers, which, when evaporated, turns into steam. The steam is cooled by water delivered to a condenser by circulation pumps, while the appeared condensate is moved back to the boiler by condensate pumps. Thus, pumps ensure circulation of water throughout the entire power generation process.

Water utilities

Provision of water supply to consumers comprises water recovery, transportation and distribution; at each of these stages pumps play a critical role. To extract water from shallow wells, jet pumps are used, while for deep-well systems submersible water pumps are more appropriate. The extracted water is pumped through filters to reservoirs, where it is then delivered to household water supply systems. Sewage and sludge pumps help to remove remaining solids and liquids after the water treatment process.

Mining, pharmaceuticals, food & beverage

In mining, pumps serve to inject solution into ore deposits (usually in uranium, copper, potassium production) and take the ore to the surface, for dewatering and drainage, processing water in metal recovery plant. Pumps are also used in the pharmaceutical industry to process and mix liquids and in breweries and dairies to transfer fluids.



Figure 18: Pumps are also used in a variety of other industries

Power Generation	Water Utilities	Mining	Other
Pumps provide water to boilers;	Pumps extract water from wells;	Pumps inject solution into ore deposits;	Pumps in pharmaceutical industry process and mix liquids;
Move water to cool the steam;	Move raw water through filters to distribution systems;	take the ore to the surface;	Pumps in breweries and dairies transfer fluids etc.
Deliver condensate back to the boiler	Remove sewage and sludge	dewater; process water in metal	

Source: Deutsche Bank

Main drivers

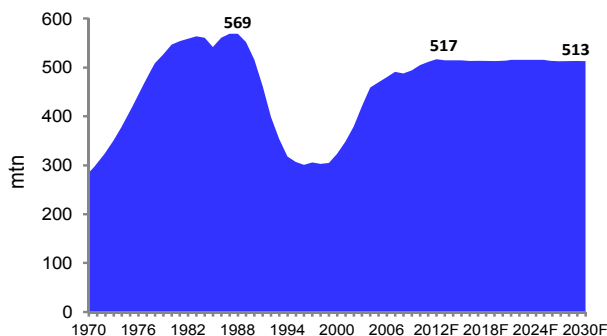
- Oil & Gas exploration growth;
- New pipelines construction;
- Oil refineries modernization;
- Water utilities reconstruction;
- Power generation capacities expansion.

Oil & gas exploration growth: driven by state ambitions

Oil output structure to gradually shift toward new deposits

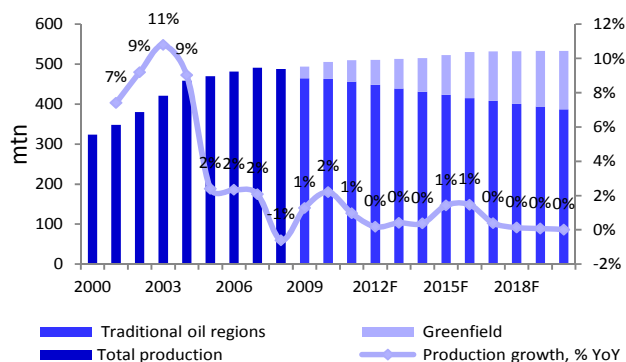
After the Soviet Union's collapse, oil production in Russia plummeted to about 6mbd; however, during the past decade the country has managed to establish capacity, large enough to get close to the production peaks of the Soviet oil industry. In 2012 Russia extracted an estimated 10.3mb per day or 3.8bn bbl annually (517mt). The main producing regions are West Siberia and Volga-Urals, which account for 6.5mbd and 2.1mbd of liquids, respectively. However, oil production in both regions is in the mature phase with the reserves having been developed in the USSR; the depletion rate of proven reserves in West Siberia accounts for about 50%, while in Volga-Urals it reaches 70%. According to the *Forecast of long-term Russian social-economic development for the period up to 2030* published by the government this year, oil production will gradually decrease to 513mt in 2030 with a temporary hike to 516mt in the beginning of 2020s. To at least maintain oil production at this level, Russia needs to explore new deposits. REnergyCo estimates the share of greenfields in total oil production will gradually increase, achieving 27% by 2020 vs. 10% currently.

Figure 19: For the past decade Russia has stably increased its production capacity to get close to the peaks of the Soviet oil industry



Source: GKS, MinEco

Figure 20: Greenfields will take an increasingly higher share of the total oil production in the near future



Source: Company Data (based on REnergyCo)



East Siberia is the major 'greenfield' region

Although new deposits are explored all over the country from the Caspian region to Sakhalin, the key projects are concentrated in East Siberia, including development of immense Vankor and unique Yurubcheno-Tokhomscoe oilfields. East Siberian deposits will be finally linked to West Siberian fields and the Pacific Ocean via ESPO pipeline, allowing Russia to export liquids from these deposits to North American and Asian markets.

Most of the current exploration projects are mid to long term with the production likely to start after 2015. For this year, two oilfields are planned for launching – Trebs & Titov in Timan-Pechora and Prirazlomnoye deposit in Barents Sea (one year later than declared).

Figure 21: Most of the developing projects are mid to long term

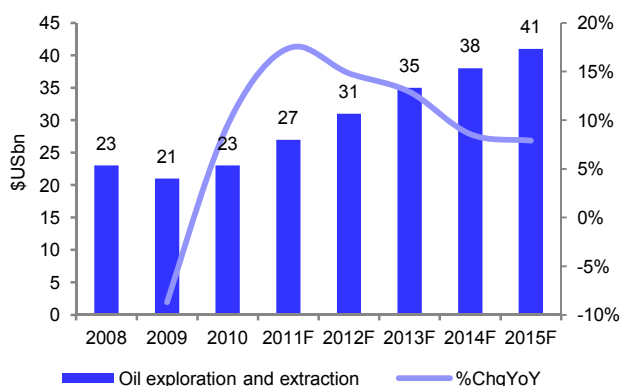
Project	Region	Operator	Capacity, mt	Timeline	Capex, USDbn
Vankor	East Siberia	Rosneft	524	2009-2017	12.3
Verkhnechonsk	East Siberia	TNK-BP/Rosneft	202	2009-2015	4.6
Talakanskoye	East Siberia	Surgutneftegaz	135	2010-2014	7.7
Yurubcheno-Tokhomscoe	East Siberia	Rosneft	237	2009-2016	n/a
Trebs & Titov	Timan-Pechora	Lukoil/Bashneft	142	2011-2014	6.2
Russkoye	Zapolyarye	TNK-BP	306	2009-2015	4.4
Sakhalin offshore	Far East	Rosneft/Gazprom	394	2006-2030	210
Prirazlomnoye	Barents Sea	Gazpromneft	46	2009-2012	2.3
Filanovsky oilfield	Caspian region	Lukoil	220	2012-2015	4.8

Source: Frost & Sullivan, Deutsche Bank

Oil majors to increase capex during the next several years

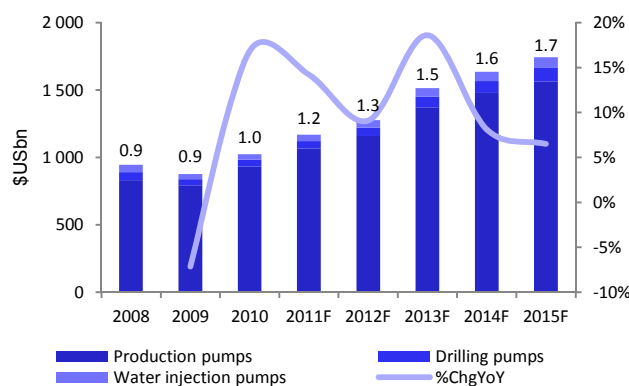
The Russian government estimates necessary capital expenditures into oil exploration to exceed USD600bn for 2012-30. Based on the announced projects, Frost & Sullivan expects capex in oil exploration to experience 10% 2012-15 CAGR from the base of estimated USD31bn, which lays the ground for decent growth across all segments of oil production pumps equipment. For 2012-13, the Deutsche Bank research team's estimates are in line with Frost & Sullivan, but for later periods our team gives a more conservative view being cautious about the time of projects launched. Historically, 2-4% of these capital expenditures go to pumps and pumps-based solutions.

Figure 22: Capex in oil exploration and extraction should see 10% 2012-15 CAGR



Source: Frost & Sullivan

Figure 23: Oil production pumps will show 11% 2012-15E CAGR supported by capital expenditures of oil majors



Source: Deutsche Bank estimates based on adjusted Frost & Sullivan projections



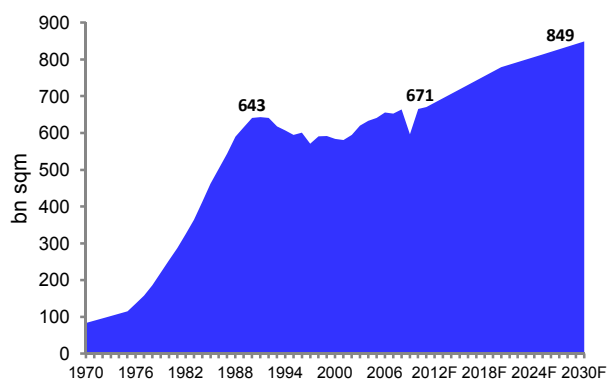
Exploration of new deposits is supported by the Russian government

To facilitate exploration of new deposits, the Russian government has recently introduced several initiatives. First, export duty concessions on crude oil from the deposits with below 16.3% IRR. Finalized in 1Q2013, this initiative will from now on apply to such difficult for exploration fields as Timan-Pechora and the northern part of West Siberia, as well as East Siberia and Caspian offshore. This, in addition to MET concessions for oil deposits in East Siberia extended until 2022, will likely give a boost to the development of greenfield projects, which in turn will facilitate pump sales. Second, 60:66 tax system, which came in force more than a year ago and decreased export duty on crude oil to 60% (from 65%) and unified export duties on light and heavy oil products to 66% of crude oil rate, partially shifted the tax burden from upstream to downstream, stimulating investments in exploration.

Russia is to boost gas production by 2030

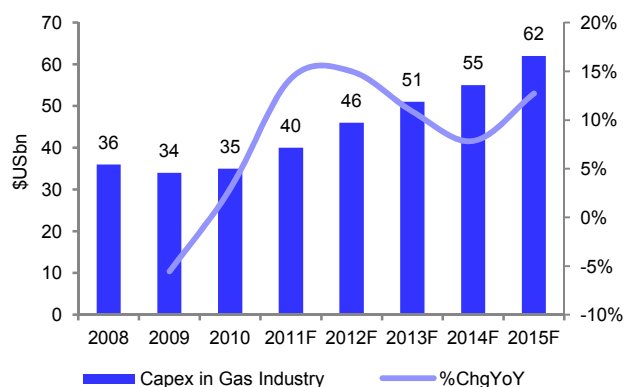
After a slowdown in the 90s, gas production in Russia resumed and rapidly exceeded the level of 1991, achieving 671bn sqm in 2011. More than 90% of gas production falls on YNAO, particularly the Nadym-Pur-Taz region and Yamal peninsula. The innovation scenario of Russian strategy assumes further growth into 2030 to reach 849-870bn sqm as a result of further development of Yamal gas deposits, as well as East Siberia and Far East gas fields. There are some risks in realization of the Shtokman development project due to its high capital intensity and complexity, so its fulfillment depends on the future gas price. Our oil & gas team is currently skeptical about the gas market noting falling demand in Europe, increased competition from other suppliers and relatively low flexibility of Russian companies in pricing for European customers. The Russian government expects total capital expenditures in gas production at USD300bn for 2012-30. Incorporating the announced projects, Frost & Sullivan expects capex in the gas industry to experience 10.5% 2012-15 CAGR to USD62bn.

Figure 24: Russian Energy Strategy assumes 1.3x growth in gas production by 2030



Source: GKS, MinEco

Figure 25: Capex in gas industry to show 10.5% 2012-15 CAGR



Source: Frost & Sullivan

Oil & Gas transportation: maintaining export share

Pipelines being constructed to connect new deposits with key seaways

Referring again to the country's strategy, we note that Russia plans to increase annual oil export to 247mt (or 48% of oil production) by 2030 compared to 244mt (47%) in 2011 and gas export to 245.4bn sqm (or 29% of gas production) compared to 190bn sqm (28%) in 2011. To maintain declared share of export, the Russian government represented by Transneft and Gazprom has launched several pipeline projects across the country to link the developing deposits with key seaways.



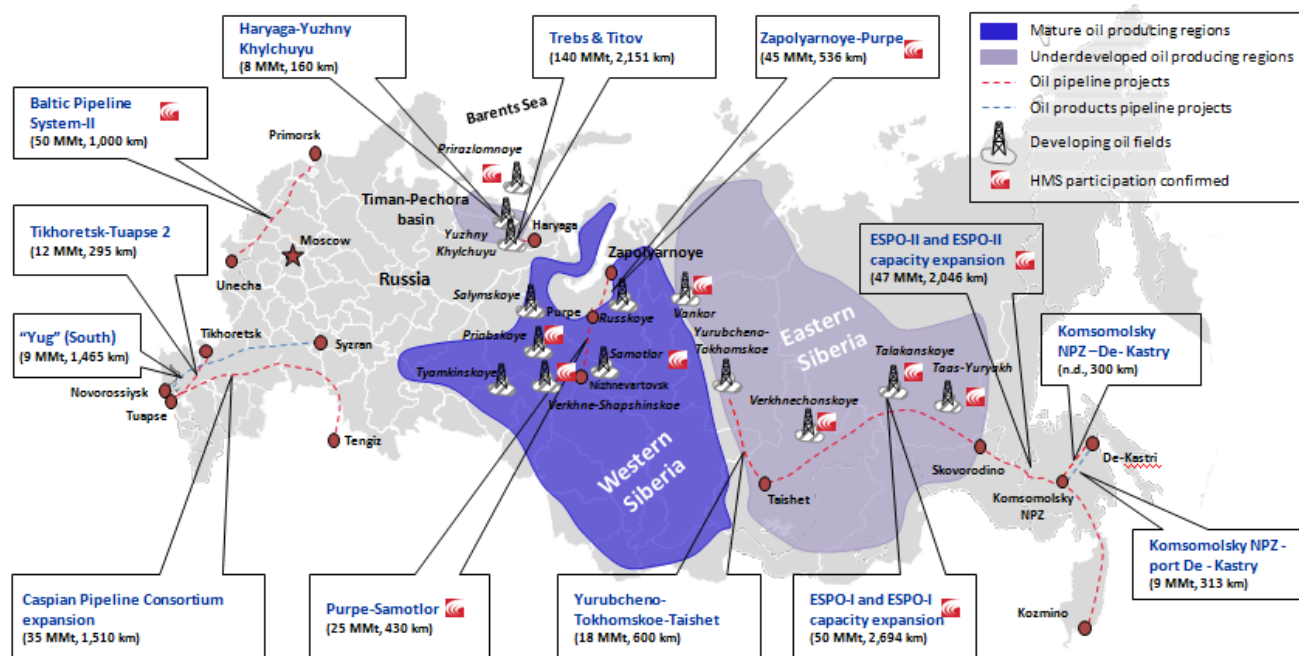
Figure 26: ESPO is the major project in oil transportation

Project	Region	Range, km	Capacity	Timeline	Capex, USDbn
Oil pipelines					
ESPO-I extension	Pacific Ocean	n/a	20	2010-2013	6.5
ESPO-II extension	Pacific Ocean	300	17	2012-2015	5.5
Komsomolsky NPZ-port De Kasty oil pipeline	Pacific Ocean	300	n/a	2012-2014	1.4
Zapolyarnoye-Purpe	links YNAO deposits	536	45	2011-2015	3.9
Yurubcheno-Tokhomscoe-Kuyumba-Taishet	links E.Siberia deposits with ESPO	600	18	2012-2013	2.0
Project 'South'	Black Sea	1465	9	2011-2013	2.6
Gas pipelines					
Bovanenkovo-Uchta	Karskoe sea	1100	140	2008-2015	33
Uchta-Torzhok	Karskoe sea	1300	81.5	2008-2013	7.8
Sakhalin-Khabarovsk-Vladivostok	Far East	1837	30	2009-2020	15.6
South Stream	Black Sea	1000	63	2012-2015	10

Source: Frost & Sullivan, Deutsche Bank

East Siberia-Pacific Ocean has been the key oil pipeline project of the last several years. Connecting West and East Siberia oilfields with the Far East seaport Kozmino, it provides Russia with an opportunity to enhance oil supply to US and Asian markets. The first phase of the project – ESPO-I, connecting Taishet with Skovordino, was finished in 2009; however, at the moment it is expanded with five new pumping stations, which should be constructed by 2013 and increase capacity to 50mt a year. The second phase ESPO-II, connecting Skovordino and Kozmino, was finished in December 2012, so the main work now is conducted at Yurubcheno-Tokhomscoe-Taishet pipeline in East Siberia and Zapolyarnoye-Purpe in YNAO (Yamalo-Nenets region). North and South Stream have been the major projects in the gas industry with the first launched in 2011 and the other to be launched by 2015. North Stream pipeline connects Russian seaport Vyborg with Germany lying on the Baltic seafloor, while South Stream goes to Italy and Austria through Balkan countries lying on the seafloor of the Black Sea.

Figure 27: Geographical position of main O&G production and transportation projects



Source: Company data



Oil Refinery: catching up with the developed world

Refinery depth is low, but should increase supported by government initiatives

Oil products output significantly shrank in the 90s and although recovering during the last decade achieved only 258mtn in 2011. Russian refinery system, being inherited from the Soviet Union, has so far differentiated by low refining complexity. Average refining depth accounted for about 71% across Russia in 2011, which is much lower than in developed countries with 85-95%. To achieve this level in the future (by 2030, according to Energy strategy), the Russian government implemented several measures to incentivize modernization in the industry. In 2011 it signed an agreement with 11 O&G producers, under which the companies agreed to refine at least 20% of the produced crude oil since 2015, while all the fuel should comply with Euro-5 standards.

Introduction of higher ecological standards of fuel to stimulate refinery

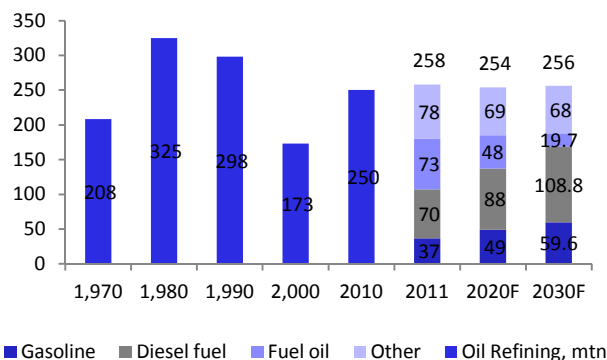
While the European Union already introduced ecological standards Euro-5 in 2009, Russia finally banned Euro-2 this year. The significant delay is explained by unpreparedness of Russian companies to produce higher quality fuel. Although, Euro-3 is scheduled to be cancelled in 2014 and Euro-4 in 2016, the possibility of postponing cannot be excluded considering such cases happened in 2011, when Euro-2 was banned and then permitted again due to fuel shortage. The Russian government stimulates oil companies to transfer to higher standards of fuel quality introducing differentiating excise taxes on petroleum products.

Another driver is introduction of the 60:66 tax leveling export duties for light and heavy oil products, thus making the production of the latter less profitable. This measure should facilitate modernization of capacity by major producers to increase light oil output.

Capex in refinery to grow faster than in production

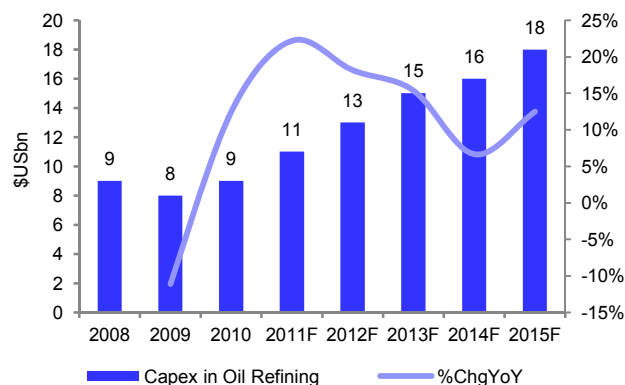
Russian government estimates total capex to oil refinery at USD260bn until 2030, mainly aimed at upgrading current capacity and construction of several new refineries, including that in Nizhnekamsk, Tatarstan Rep. Frost & Sullivan estimates capital expenditures in refining to see 11.5% 2012-15 CAGR from USD13bn base.

Figure 28: Oil refining is expected to stay stable by 2030, but the depth of refining will substantially increase



Source: GKS, MinEco

Figure 29: Capex in oil refining to show 11.5% 2012-15 CAGR



Source: Frost & Sullivan



Water utilities & power generation: state-induced modernization

Water utilities driven by state development programs

The main drivers of the water utilities segment is the state-funded development programs, such as Russian Water Strategy, Federal target program 'Housing' and clean water programs of some particular municipalities. Russian Water Strategy relates to water conservation issues and modernization of water facilities. The Russian program 'Clean Water' is aimed to improve quality of drinking water, increase efficiency of water equipment and enhance water supply from wells in some regions, thus driving demand for submersible water well pumps. This program is planned for six years beginning from 2011 and is financed by government-private sources at a total of USD50bn. The state program on modernization of public utilities sector, assuming about USD130bn until 2020, will induce demand for equipment related to clean water supply and sewage, while the program 'Housing' (USD6bn until 2013), providing population with affordable houses, will facilitate demand for household pumps.

According to Frost & Sullivan, total capex into the water utilities segment will grow with 18.6% 2012-15 CAGR to reach USD33.7bn.

Nuclear power electricity to increase 2x by 2030

Like in other segments, the main drivers in power generation are state programs, including Russian Energy Program and State Nuclear Development program. Russian Energy Strategy approved in 2009 assumed 2-2.5x growth in electricity production on the base of nuclear capacities. This statement was supplemented by State Nuclear Development program stipulating construction of 26 reactors until 2020 (two per year since 2013). Additionally, state-owned Rosatom supervising construction of NPPs in Russia has several projects abroad (China, India, Turkey, etc.), which will allow its subcontractors to participate. Each reactor requires 360-370 various pumps. According to Ministry of Economy, total capex for the domestic nuclear industry will amount to USD100-139bn for 2009-30.

Thermal power generating companies follow capacity provision agreements (DPM in Russian), according to which generating companies are obliged to introduce new capacities with stipulated characteristics in case the capacity is guaranteed to be paid for some period.



Summary of HMS Group's key market segments

Figure 30: The water utilities segment is expected to show the highest growth across segments

Segment	Sales 2010 (USDm)	Sales 2011E (USDm)	Share in segment '11	2012-15CAGR	Main drivers
Pumps	2 124	2 715	100%	11.4%	Water Utilities
O&G	1 185	1 644	60.6%	9.1%	Pumps for oil
Water Injection	41.2	49.5	1.8%	13.5%	Growth in oil fields
Oil refining	76.5	76.5	3.8%	9.8%	Modernization and
Oil pipelines	83.9	371	13.7%	-4.2%	Completion of large
Drilling	49.2	54	2%	16.3%	Growth in oil fields
Submersible pumps	934	1 067	39.3%	10.5%	Growth in oil fields
Water Utilities	403	457.4	16.8%	17.2%	Sewage pumps
Submersible water well	42	49.1	1.8%	13.5%	State programs on
Dry-pit sewage	46.7	54.7	2%	22%	Capacity
Household vibration	45	52.7	1.9%	12.5%	Population demand,
Wet-pit sewage	219.2	248.4	9.2%	18.1%	Capacity
Household submersible	50.1	52.5	1.9%	15%	Population demand,
Power generation	133.6	171.9	6.3%	11.1%	Thermal power
Nuclear, ex MCP	33.2	39.3	1.4%	0.7%	Stable demand for
Thermal	47.3	56	2.1%	26.1%	DPM agreements
MCP	53.1	76.5	2.8%	0.7%	Stable demand for
Other	403.1	441.5	16.3%	11.9%	Metallurgy &
Metals & Mining	42.6	49.1	1.8%	16.2%	
Chemical industry	33.9	38	1.4%	16.2%	
Other	326.6	354.4	13.1%	10.7%	
Modular equipment	758.3	857.1	100%	13.1%	Growth in oil and
Pump stations	172.6	194.8	23%	10.6%	
Automated Group	75.1	78.8	9%	13.6%	
Associated Gas	126	154.7	18%	15.9%	
Other	384.2	429	50%	13%	
EPC	9.4	10.9	100%	11%	
Construction	8.6	10	92%	11%	
Project & Design	0.7	0.9	8%	11%	
Compressors	945	1 014	16.1%	16.1%	Growth in gas fields

Source: Deutsche Bank estimates based on adjusted Frost & Sullivan projections

Russian pump market

Russian pump market geared towards oil & gas

The Russian pump market amounted to USD2.1bn in 2010, representing about 5% of the global market. Submersible oil pumps occupy the highest share – 46%, which together with the surface oil pump sales sum up to more than 50%. Such a bias towards the oil & gas industry compared to the global market reflects the peculiarity of the Russian economic structure largely based on extractive industries. The other two largest segments – water utilities and power generation – account for 19% and 6%, respectively – slightly lower than the world average.

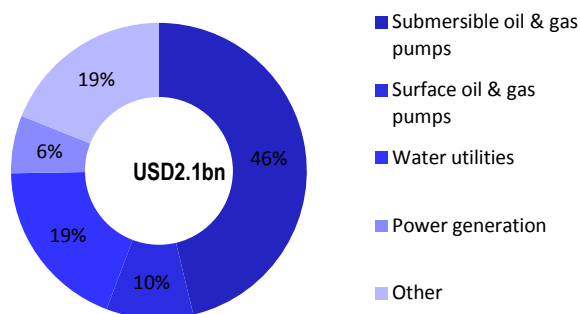
The Russian market to show double-digit growth into 2015

In 2010 Russian market started to recover, showing decent 20% yoy growth and achieving the level of 2008 in terms of sales volumes. We expect it to keep showing double-digit growth into 2015, basing our forecasts on Frost & Sullivan estimates and incorporating new available market data from HMS Group. We expect the Russian market to grow with 11.4% CAGR in 2012-15 supported by a number of implemented government programs, particularly those aimed at modernization of capacities in water utilities (17.2% 2012-15 CAGR), power generation (11.1%) and oil refinery (9.8%), as well as gradual shift of hydrocarbons output structure towards new deposits by increase of oil & gas exploration and transportation. Sales of surface pumps will likely show 21.3% 2010-15 CAGR; growth in the past three years is weighed by decreasing oil transportation pump sales due to the end of the large ESPO project. Submersible



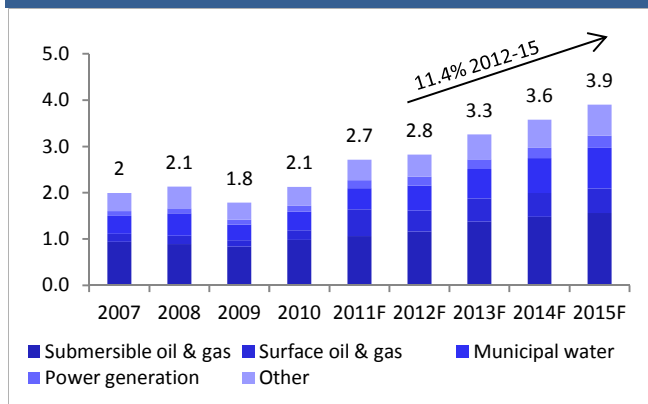
pumps market will likely show a below-industry average growth due to longer life cycle of pumping equipment.

Figure 31: Pump sales to oil & gas industry account for more than 50% (2010)



Source: Frost & Sullivan

Figure 32: The Russian pump market should see 11.4% 2012-15 CAGR



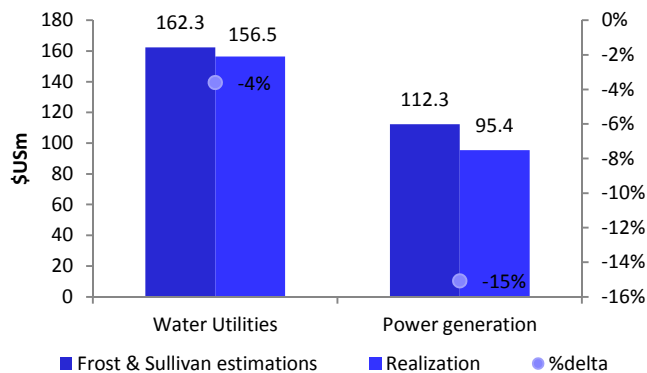
Source: Deutsche Bank estimates based on adjusted Frost & Sullivan projections

Figure 33: Market growth to be the result of water, power and surface O&G (excl. oil transportation) pump sales

Segment	CAGR 10-15	CAGR 12-15	2007	2008	2009	2010	2011	2012	2013	2014	2015
Submersible pumps	9.7%	10.5%	0.9	0.9	0.8	1.0	1.1	1.2	1.4	1.5	1.6
Surface pumps	21.3%	5.4%	0.2	0.2	0.1	0.2	0.6	0.5	0.5	0.5	0.5
Oil transportation	17.1%	-4.2%	0.05	0.05	0.03	0.08	0.37	0.21	0.14	0.15	0.17
Water utilities	16.7%	17.2%	0.4	0.5	0.3	0.4	0.5	0.5	0.6	0.7	0.9
Power generation	14.3%	11.1%	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.3
Other	10.9%	11.9%	0.4	0.5	0.4	0.4	0.4	0.5	0.5	0.6	0.7
Total	13.5%	11.4%	2.0	2.1	1.8	2.1	2.7	2.8	3.3	3.6	3.9

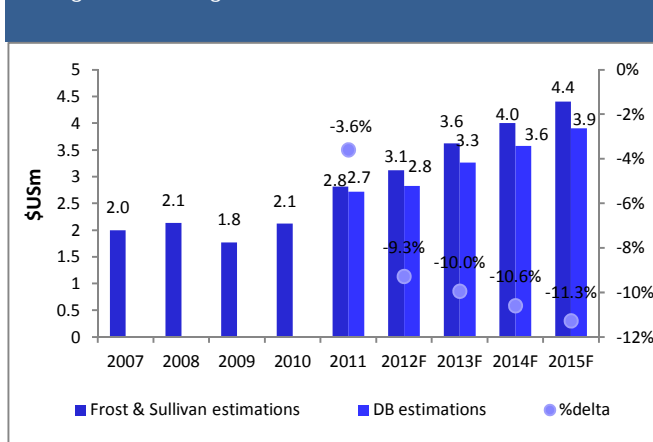
Source: Deutsche Bank estimates based on adjusted Frost & Sullivan projections

Figure 34: In 2011, market sales were 4% lower in water and 15% lower in power segments, than Frost & Sullivan estimations



Source: Frost & Sullivan, Company data

Figure 35: We adjust 2013 market sales by 10% on average across segments vs. Frost & Sullivan estimates



Source: Frost & Sullivan, Deutsche Bank

Market players are niche producers with well established client bases and facilities

In the Soviet Union, the planned economic system assumed specialization of pumps producers in some kinds of pumps, while a significant part of the production was concentrated at the enterprises with other production activity steam. After the Soviet Union collapse in the beginning of the 90s, many pumping plants servicing Russian industrial producers turned out to be outside the country (including NPO Frunze in



Ukraine, MoldovHydroMash in Moldova, Bobruisk plant in Belarus, etc.), so the broken connections were re-established by intermediaries. In the 2000s pumps production in Russia resumed and started to diversify, while integration processes outlined, however, have not changed the industry landscape significantly.

The industry consists of dozens of companies operating in their own niche segments with well established client base, distribution system and facilities. An average market share ranges from 5% to 15%; however, in all the segments, the three largest companies control the majority of the market and in some segments there is a clear leader with more than 50% share (i.e., HMS Group in O&G transportation and CDBMB in circulation pumps). In several companies pumps production is a non-core business (i.e., in Voronezh, Russian defense enterprise). In the near future the process of consolidation will likely continue with the largest companies increasing their market share at the expense of smaller ones, which cannot provide more complex high-margin product demanding R&D and integrated solution, as well as of those for which pumps are not the key line of business.

Strong relations with key customers prevent competitors from industry entry

In nearly all the segments, there are one or several key customers (excluding household pumps, where pumps are sold to dealers and distributors), which gives these companies some kind of bargaining power and forces the producers to invest in quality and performance to have a successful track-record and build long-term partnerships.

The strong relationships with customers and established production base have become a high entry barrier to the market. The entrance of foreign companies is also restricted by their remoteness from the Russian clients and higher pricing, import substitution policy of state-control companies (i.e., Transneft) and that the most of the equipment for which pumps are deployed were produced domestically in the Soviet Union. Thus, the share of foreign competitors does not exceed 30% across the majority of the segments, achieving 40% only in submersible household pumps; curiously, wet-pit sewage pumps are almost completely imported as they were not produced in the USSR and only a couple of Russian companies try to produce them at the moment.



Figure 36: Sector-wise snapshot of the Russian pump market

Segment	Share 2010	2012-15 CAGR	Key Customers	% of domestic producers	Top-3 share	Main producers (as of 2010)
Submersible O&G	44%	10.5%	VIOC	80-90%	70%	Borets (41%), Novomet-Perm (17%), Almaz (12%)
Surface O&G	12%	12.4%	VIOC			
Drilling	2.3%	16.3%	(Vertical integrated oil companies)	70-80%	67%	IzhNefteMash (31%), VZBT (26%), UralMash (10%)
Water Injection	2%	13.5%		80%	87%	HMSG (61%) , Nasosy PPD (15%), Votkinsk (11%)
Oil Refining	3.6%	9.8%		75%	70%	VolgogradNeftemash (26%), HMSG (22%) , Weir (22%)
O&G transportation	4%	-4.2%	Transneft	> 90%	92%	HMSG (77%) , Uralhydromash (10%), Flowserve (5%)
Thermal power	2.2%	26.1%	TGK, OGK	70-75%	69%	HMSG (47%) , KSB (15%), Sigma (7%)
Nuclear power	4.1%	0.7%	Rosatom			
MCP	2.5%	0.7%		90%	>93%	CDBMB (85%), NPO Frunze (8%), Other (7%)
Non-MCP	1.6%	0.7%		75%	60%	NPO Frunze (25%), HMSG (19%) , UralhydroMash (10%)
Water utilities	14.5%	18.1%	Municipalities			
Water Well	2%	13.5%		67%	87%	HMSG (67%) , KEMZ (10%), Grundfos (10%)
Dry-pit sewage	2.2%	22%		100%	78%	HMSG (49%) , Kataisk plant (22%), Ena (7%)
Wet-pit sewage	10.3%	18.1%		5%	55%	Grundfos (29%), Wilo (14%), KSB (12%)
Household pumps	4.5%	13.7%	Municipalities			
Vibration	2.1%	12.5%		70-75%	53%	HMSG (20%) , Tekhnopribor (18%), Lepse (15%)
Submersible	2.4%	15%		60%	72%	Jilex (37%), Grundfos (18%), Wilo (17%)
Other	19%	12%	M&M conglomerates, petrochemical plants	60-70%		
Mining	2%	16.2%			40%	HMSG (14%) , Weir (15%), Bobruisk plant (11%)
Chemicals	1.6%	16.2%			40%	Kataisk(18%), MoldovaHydroMash(10%), Sulzer (12%)
Other	15.4%	10.7%				

Source: Frost & Sullivan, Deutsche Bank

Russian compressor market

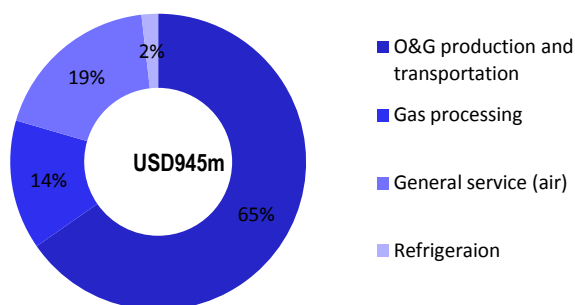
The Russian compressor market to outstrip pumps market

The Russian compressor market amounted to USD945m in 2010 or 12% of the global market and was mainly represented by sales to the oil & gas industry (79%). The second-largest segment was general service, which accounted for 19%. This category includes sales to industrial manufacturing companies, metals and mining producers, construction and transportation (airports, seaports) sectors. The remaining 2% was represented by the refrigeration segment, which encompasses compressors for food-processing, chemicals, retail and marine industries.

After a slowdown in 2009, the market showed 18% yoy growth, and similar to the pumps market, will likely expand with double-digit growth during the next several years. We use Frost & Sullivan estimates for the compressors market, correcting them as we did for the pumps market. According to our estimates, compressors sales will grow with 16.1% 2012-15 CAGR mainly driven by oil & gas production and the transportation segment. Such significant growth is explained by much higher exposure of compressors market to gas industry, in which the government expects impressive production growth.

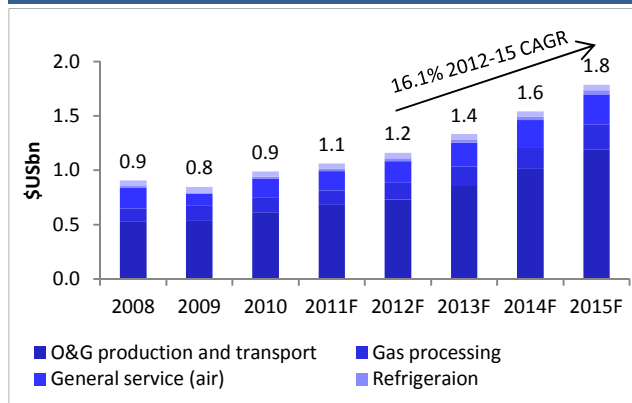


Figure 37: Compressor sales to oil & gas industry account for about 80% (2010)



Source: Frost & Sullivan

Figure 38: Russian compressor market to see 16.1% 2012-15 CAGR



Source: Deutsche Bank estimates based on adjusted Frost & Sullivan estimations

Figure 39: Market growth to be driven by O&G production and transportation

Segment	CAGR 10-15	CAGR 12-15	2008	2009	2010	2011	2012	2013	2014	2015
O&G production and transport	14.2%	17.7%	0.5	0.5	0.6	0.7	0.8	0.9	1.1	1.3
Gas processing	11.2%	13.5%	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2
General service (air)	9.7%	12.1%	0.2	0.1	0.2	0.2	0.2	0.2	0.3	0.3
Refrigeration	17.2%	14.0%	0.02	0.01	0.02	0.02	0.03	0.03	0.03	0.04
Total	13%	16.1%	0.9	0.8	0.9	1.1	1.2	1.4	1.6	1.8

Source: Deutsche Bank estimates based on adjusted Frost & Sullivan estimations

The structure of the pump and compressor markets is similar to the client bases overlapping

The structure of the compressors market is similar to that of pumps with a number of large, medium and small-sized producers, among which the three-largest companies usually control the majority of the market. The client bases mainly overlap with that of pumps and include large vertical-integrated oil & gas companies, among which Lukoil, Gazpromneft, Surgutneftegaz, etc. For this reason, building long-term relations with the clients is crucial for the compressors producers as well. The entry barriers are high, so in O&G production and the transportation segment, Russian companies occupy more than 80% of the market. However, in the segment of refrigeration compressors the situation is opposite with the only relatively large Russian company producing such equipment is KKM, acquired by HMS Group in 2012.

Figure 40: Sector-wise snapshot of the Russian compressor market

Segment	Share 2010	CAGR 12-15	Key Customers	% of domestic producers	Top-3 share	Main producers (as of 2010)
O&G prod & transport	65%	17.7%	VIOC	>80%	61%	IskraTurboGaz(33%), KMPO (15%), NPO Frunze (13%), KKM (7%)
Gas processing	14%	13.5%		10%	46%	Mitsubishi (19%), CKD Nove Energo (15%), Exterran (12%)
General service (air)	19%	12.1%			38%	Atlas Copco (17%), Chelyabinsk plant (12%), Thomassen (9%)
Refrigeration	2%	14.0%			67%	IskraTurboGaz (33%), KMPO (15%), NPO Frunze(13%), KKM (10%)

Source: Company data, Deutsche Bank



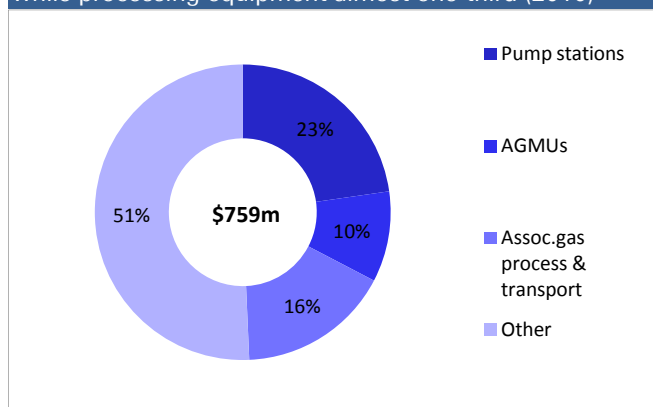
Russian oil & gas equipment and EPC market

O&G equipment market to fully recover from 2009's downfall and grow with the pump market

The Russian modular equipment market valued at USD759m in 2010 and was divided between various categories of oil & gas equipment. The largest segment was represented by pump stations, which occupied 23% of the total amount. Sales of gas processing equipment accounted for 16%, while metering equipment took 10%.

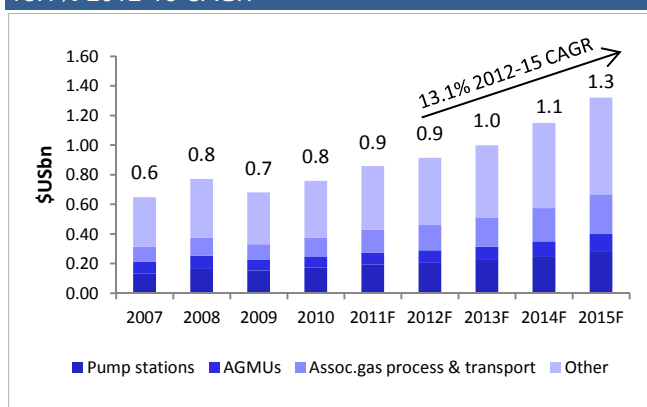
Unlike the pumps and compressors markets, oil & gas equipment did not manage to fully recover after 2009's downfall; however, it should do in the near future. For the oil & gas equipment market we use Frost & Sullivan forecast without corrections for 2012 as the dynamics of the market in 2010 showed that the forecasts of the analysts could be achievable and make 5% discount for 2013. Thus, we expect the oil & gas equipment market to have 13.1% 2012-15 CAGR driven by projects in oil & gas production and transportation. Associated gas and transportation equipment segment should demonstrate the highest growth of 18%, also benefiting from tightening regulation of the associated gas utilization (increase in utilization rate to 95%) that came in force in 2012.

Figure 41: Pump stations account for 23% of the market, while processing equipment almost one-third (2010)



Source: Frost & Sullivan

Figure 42: Russian oil & gas equipment market to see 13.1% 2012-15 CAGR



Source: Deutsche Bank estimates based on adjusted Frost & Sullivan estimations

Figure 43: Market growth will be driven by O&G metering and associated gas processing equipment

Segment	CAGR 10-15	CAGR 12-15	2007	2008	2009	2010	2011	2012	2013	2014	2015
Pump stations	11.9%	12.2%	0.14	0.17	0.15	0.17	0.19	0.21	0.22	0.25	0.28
AGMUs	11.9%	15.3%	0.08	0.09	0.07	0.08	0.08	0.08	0.09	0.10	0.12
Assoc. gas process & transport	18.0%	17.7%	0.10	0.12	0.11	0.13	0.15	0.17	0.19	0.23	0.27
Other	12.1%	12.1%	0.33	0.40	0.35	0.38	0.43	0.45	0.49	0.57	0.65
Total	13%	13.8%	0.6	0.8	0.7	0.8	0.9	0.9	1.0	1.1	1.3

Source: Deutsche Bank estimates based on adjusted Frost & Sullivan estimations

Oil & gas equipment market is entirely dominated by Russian producers

Some specific kinds of modular equipment, such as pump stations and associated gas processing equipment, are provided by pumps and compressors producers (i.e., HMSG, including KKM, and NPO Frunze), while others are produced by specialized enterprises (i.e., OZNA). The main customers are the largest state and privately-owned companies, such as Rosneft, Lukoil and Surgutneftegaz in the oil industry and Gazprom and Novatek in the gas industry. The entry barriers are high, and the Russian producers dominate across all segments due to more attractive pricing, proximity to clients and provision of after-sales services.



Figure 44: Sector-wise snapshot of the Russian module equipment market

Segment	Share 2010	2010-15 CAGR	Key Customers	% of domestic producers	Top-3 share	Main producers (as of 2010)
Oil & gas equipment	100%	13%	VIOC			
Pump Stations	23%	12%		>92%	>92%	HMSG (57%) , OZNA (35%), Others (8%)
AGMUs	10%	12%		>84%	>84%	OZNA (51%), HMSG (33%) , Others (16%)
Assoc.gas processing	17%	18%		98%	58%	KKM (29%) , NPO Frunze (19%), HMSG (10%)
O&G metering	11%	12%		>65%	59%	OZNA (37%), TEK (15%), Nefteavtomatika (7%)
O&G&W processing	16%	11.7%		>68%	57%	MNGK (20%), Generatsia (18%), OZNA (19%)

Source: Frost & Sullivan, Deutsche Bank

EPC to bring higher margin

EPC, or Engineering, Procurement and Construction, represents a type of contract under which a company designs the equipment, assessing the necessary time and budgeting, procures the materials and selects the suppliers, builds the project and supervises it. Such contracts bring higher margin to producers, while customers get one-stop supply and more convenient after-sales service. Oil & gas companies, which acquire licenses to develop new deposits, are the main customers of design and engineering services; the operators of mature deposits could sign an EPC contract for oil/gasfield infrastructure improvement to sustain supply levels, while transportation EPC contracts are ordered either to refurbish the infrastructure or to develop pipelines for new deposits. EPC for water industry comprises heat and water supply and sewages.

To have a strong presence in this segment, companies have to establish large R&D basis. Although oil majors may have their own in-house design facilities, as well as project management departments, the trend for outsourcing this function has appeared. The largest players at this market are the companies established in the beginning of the 90s to serve the infrastructure needs of main oil & gas producers, such as Globalstroy Engineering (for Lukoil), Stroytransgaz and Stroygazmontazh (Gazprom); however, their total revenue did not exceed 50% in 2009. Although in 2009 Frost & Sullivan assessed the volumes of each of these segments, in 2010 it did not give the estimations due to the complexity of the industry.

Integrated solutions and aftermarket

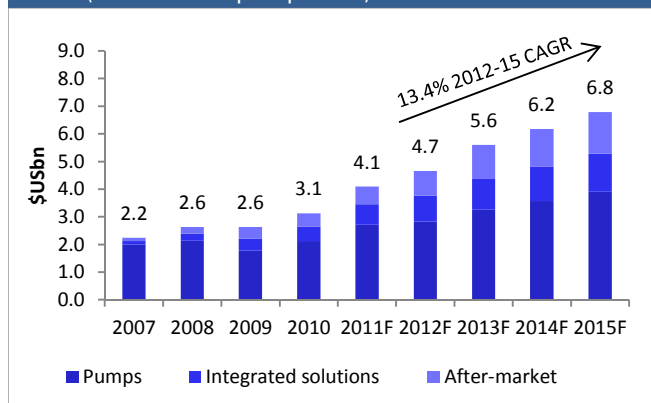
Integrated solutions and aftermarket are main drivers of the markets

Integrated solutions represent a system of pumps or compressors, as well as oil & gas equipment, which is designed for specific application and working environment, allowing customers to get fully assembled packages on-site. Aftermarket is after sales services, including repair and overhaul. Although integrated solutions are provided in all the markets, Frost & Sullivan gives estimates only for pumps and compressors, referring to complexity of their assessment on the equipment market.

These two segments have so far been the main drivers of the pumps and compressors markets. With the increasing demand for integrated solutions from customers, we expect its growth in 2012-15 at 13.5% on the pumps market and 17% on the compressors market, which is higher than sales of ordinary equipment. We also see good prospects for after-market, particularly in the power generation segment, where most of the NPPs were installed in the Soviet Union. We expect after-market to experience 20% 2012-15 CAGR on the pumps market and 17% on the compressors market.

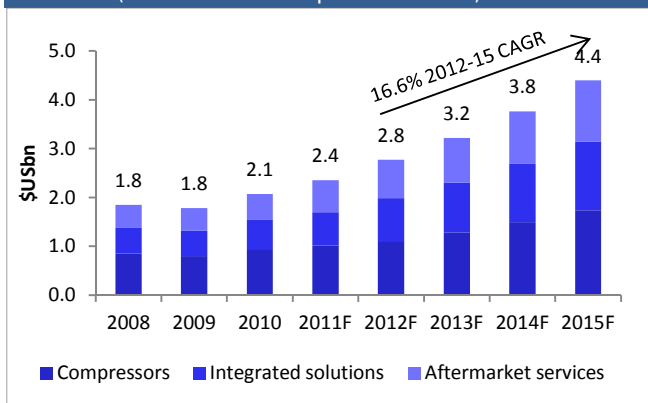


Figure 45: Total pumps market to see 13.4% 2012-15 CAGR (vs. 11.4% in pump sales)



Source: Deutsche Bank estimates based on adjusted Frost & Sullivan estimations

Figure 46: Total compressors market to see 16.6% 2012-15 CAGR (vs. 16.1% in compressors sales)



Source: Deutsche Bank estimates based on adjusted Frost & Sullivan estimations

Figure 47: Market growth will be driven by O&G metering and associated gas processing equipment

Segment	CAGR 10-15	CAGR 12-15	2007	2008	2009	2010	2011	2012	2013	2014	2015
Pumps	16.7%	11.7%	2.2	2.6	2.6	3.1	4.1	4.7	5.6	6.2	6.8
Pump sales	12.9%	11.4%	2.0	2.1	1.8	2.1	2.7	2.8	3.3	3.6	3.9
Integrated	21.3%	13.5%	0.1	0.3	0.4	0.5	0.7	0.9	1.1	1.2	1.4
After-market	25.5%	19.5%	0.1	0.2	0.4	0.5	0.6	0.9	1.2	1.4	1.5
Compressors	16.2%	16.6%	n/a	1.8	1.8	2.1	2.4	2.8	3.2	3.8	4.4
Compressors	12.9%	16.1%		0.9	0.8	0.9	1.0	1.1	1.3	1.5	1.7
Integrated	18.6%	16.9%		0.5	0.5	0.6	0.7	0.9	1.0	1.2	1.4
After-market	18.9%	16.9%		0.5	0.5	0.5	0.7	0.8	0.9	1.1	1.3

Source: Deutsche Bank estimates based on adjusted Frost & Sullivan estimations

Ability to provide integrated solutions is a strong competitive advantage

The demand for integrated solutions has been increasing during the last years: large companies in oil & gas and power generation industries prefer to get customized product fully assembled and installed by one producer, who will further provide its technical support, repair and retrofitting. To response to this demand appropriately, companies should have strong R&D base to design and develop the products and be able to construct the whole system. Ability to provide integrated solutions is a strong competitive advantage allowing companies to increase their market share as some Russian pump producers, such as Votkinsk plant (Russian defense enterprise occupying 11% of water injection pumps market) don't specialize in design of equipment and will gradually lose some of their clients. Integrated solutions in turn facilitate demand for aftermarket, increasing the share of recurring revenue of the company.

Ongoing capacity modernization will benefit companies with a large installed base

We also note that the ongoing programs of modernization in oil refinery, water utilities and power generation industries will increase the demand for equipment of pumps producers particularly those worked yet in Soviet Union as they produce the products well fit to the installed equipment. The main beneficiary here will be HMS Group controlling most of the submersible water well pumps (87%); nuclear and thermal pumps (70% and 57%, respectively).



Company overview

Pumping up strength

HMS Group was founded by German Tsoy and the Molchanov brothers in 1993 and was first engaged in pumps trading connecting producers of the equipment across CIS with Russian customers. In the beginning of the 2000s the company started to acquire production assets, focusing mainly on the oil & gas industry. With the acquisition of several R&D institutes and construction companies, HMS Group has become a strong player in the pumps market, able to provide lucrative integrated solutions and after-market services. Currently, the company is represented in the oil & gas sector, producing pumps and other equipment for oil extraction, transportation and refinery; water utilities; power generation and some other sectors, including metallurgy and chemicals. The main business segments comprise pumps division, modular equipment, EPC and compressors.

In 2011, the company went public placing 37% of its GDRs on LSE (USD8.25/GDR, 1GDR equals 1 share). Management, including the company's founders, remained shareholders of the rest of capital.

Figure 48: Market growth to be driven by O&G metering and associated gas processing equipment

Segment	Sales 2011 (USDm)	Share in total revenue, 2011	Market share, DB est	Share of installed base	HMSG USD Sales 2012-15 CAGR*	Market Sales 2012-15 CAGR	Comment
Pumps (excl. after market)	532.4	57%	17%		7.2%	11.4%	
O&G	334.5	36%	20%		0.3%	9.1%	For market – decline in oil pipeline pump sales is compensated by growth in submersible & drilling pumps.
Water Injection	20.9	2%	42%	87%	7.6%	13.5%	Slower growth due to high base effect of 2012 after revenue recognition from Vankor.
Oil refining	33.6	4%	33%		9.5%	9.8%	
Oil pipelines	280	30%	75%	98%	-4.4%	-4.2%	
Water Utilities	70.2	8%	15%		16.7%	17.2%	
Submersible	34	4%	69%	87%	13.2%	13.5%	
Dry-pit sewage	26.7	3%	49%		21.7%	22%	
Household	9.6	1%	18%		12.2%	12.5%	
Power generation	24.8	3%	15%		21.6%	11.1%	Market figures reflect 0.7% growth in the MCP segment.
Nuclear, ex MCP	4.2	0.4%	11%	70%	0.5%	0.7%	
Thermal	20.6	2%	37%	57%	25.8%	26.1%	
Other	22.1	2%	5%		11.6%	11.9%	
Aftermarket	80	8.6%	6%		17.0%		
O&G equipment	200.7	21%	23%		10.1%	13.1%	High exposure to the pump station segment.
Pump stations	96.8	10%	50%		10.3%	10.6%	
Automated Group	30.8	3%	39%		13.4%	13.6%	
Other	73.1	5%	8%		13.5%	13.8%	
EPC	202.3	22%	1%		12.5%	11%	
Compressors	-	-	9.2%		15.7%	16.1%	On a high base of 2012

Source: Frost & Sullivan, Deutsche Bank estimates, *CAGR may differ from that highlighted in Figure 11 due to USD/RUB exchange rate fluctuations



Ownership structure and management: remaining at the helm

Founders of HSM Group, German Tsoy and the Molchanov brothers, occupy managing positions in the company and own some share capital. German Tsoy is a chairman of BoD and during his work at HMS Group occupied different executive positions, including CEO of the group in the late 2000s. Artem Molchanov became CEO in 2008, his brother Kirill Molchanov has been First Deputy of CEO since 2006. Although all three founders have company shares, the largest stake belongs to Vladimir Lukyanenko (27.4%), who became a shareholder in 1995. Previously he worked in executive positions in NPO Frunze, while in 2010 became a non-executive member of HMS Group's BoD.

Figure 49: Founders are managers and shareholders

Shareholder	Share as of April-12	Share as of Nov-12	Position in HMSG	Comment
German Tsoy	17.5%	19.8%	Chairman of BoD	Founder
Vladimir Lukyanenko	24.2%	27.4%	Non-executive director	Occupied executive positions in NPO Frunze; became shareholder in 1995
Other managers	21.3%	24.4%		
Artem Molchanov	5.4%		CEO	Founder
Kirill Molchanov	1.6%		1- Deputy CEO	Founder
Nikolay Yamburenko	5.5%		Head of Pumps Division	Former head of Livgidromash
Yury Skrynnik	2.7%		Head of Compressors business segment	Former chief representative of NPO Frunze (Ukraine) in Russia
Other managers	6%			
Free-float	37%	28.5%		

Source: Company data, Deutsche Bank



M&A activity: from trading to integrated solutions

Figure 50: In 20 years, HMSG has evolved from trading to pump- and compressor-based integrated solutions

Stage	Timeline	Acquisition	Division	Comment
Pumps Trading	1993-2002	No	No	After SU collapse, German Tsoy and Molchanov brothers , HMSG's founders, were involved in pumps trading linking producers across CIS with customers in Russia. HMSG appeared on the base of Hydromashservice, which specialized in pumps trading
Pump Design & Manufacturing	2003	Livgidromash Pumps)	(HMSG Pumps	First production asset. Head of Livgidromash N.Yamburenko became a shareholder and a member of BoD. Now he is also the head of Pumps Division.
ME Design & Manufacturing	2004-2006	Neftemash (Tyumen), Niznevarovskremsservice Bavlensky plant 'Electrodvigatel' (HMSG-Household pumps)	ME ME Household pumps	In 2004 HMSG started to diversify into modular equipment, responding to increasing demand from O&G industry
Construction	2007-2008	Nasosenergomash in Sumy (Ukraine) Livnynasos VNIIAEN in Sumy (47%) Tomskgazstroy Sibkomplektmontaznaladka Dmitrovgradkhimmasch (30%) Promburvod in Minsk	Sumy Pumps Pumps EPC EPC EPC Pumps Pumps	A breakthrough acquisition was related to V.Lukyanenko , who occupied executive positions in NPO Frunze. In 2005 he became a shareholder of HMSG, and this year HMSG consolidated Nasosenergomash (affiliated with Sumy NPO Frunze) By 2008 HMSG acquired the rest two enterprises affiliated with NPO - Hydromash (nowadays consolidated with Nasosenergomash) and R&D institute VNIIAEN After the acquisition of plants in Belarus and Dimitrovgradkhimmasch, HMSG's capacity covered 87% of installed water injection pumps and 98% of oil pipeline pumps in Russia
Pump-based integrated solution	2009-2012	Sibnefteavtomatika (Tyumen) Sibneftemash Rostovsky Vodokanalproekt Giprotymenneftegaz (GTNG)	ME ME EPC EPC	With the acquisition of Giprotymenneftegaz in 2010 the company started to produce pump-based integrated solutions
Pump & compressor-based	2012	Bobruisk Machine Building plant Kazankompressormash Apollo Goessnitz in Germany	Building Pumps Compressors Pumps	KKM allowed the company to diversify into compressors market

Source: Company data, Deutsche Bank

The company rapidly responds to appearing demand via M&A

In the company's M&A activity, a tendency to quickly respond to appearing demand is noticeable. With O&G production starting to increase in Russia in the beginning of the 2000s, the company decided to switch to pumps manufacturing, having acquired the Livgidromash plant. With expansion into the O&G equipment segment and consolidation of Nasosenergomash in Sumy, the company established a solid presence in the market. Further development of the company during the past five years was accompanied by acquisitions of research institutes and construction companies which allowed it to supply higher-margin integrated solutions products. The last acquisition of Apollo, German pumps producer, was mainly aimed at obtaining expertise and references of the company in off-shore production, while acquisition of Kazankompressormash was sort of vertical integration as the company supplied compressors for HMSG's integrated solutions.

In the future, we believe the company will try to expand into the segments where its presence is relatively low, such as oil refining, mining and chemicals, as well as off-shore projects after the acquisition of Apollo. In the long term, the company could turn its attention to foreign markets, particularly those of CIS with a high share of extractive industries in economic structure.

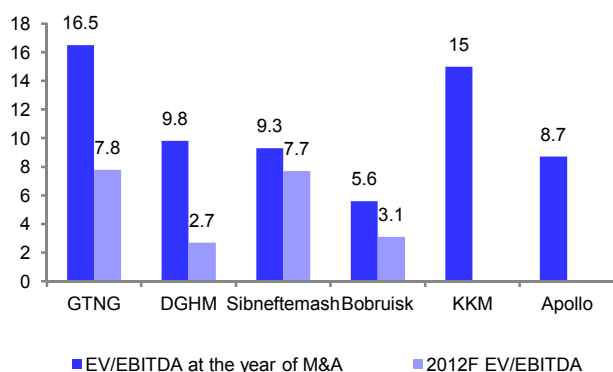


High average EV/EBITDA multiple for acquisitions reflects value of future contracts

Using available data on the company's M&A activity, we estimate an average EV/EBITDA for acquisitions at 10.8x with the most expensive purchase being engineering company GTNG in 2010 with 16.5x and the most inexpensive being Bobruisk pumps producer in 2011 with 5.6x. Such a high average multiple reflects expectation of new contracts to be signed thanks to the acquired company. Thus, although GTNG was purchased at record value, EBITDA growth into 2012 assumes 7.8x 2012 EV/EBITDA, while EBITDA incorporation from two large turnkey contracts signed in the end of 2011 due to GTNG acquisition will likely result in 3.1x 2012 EV/EBITDA.

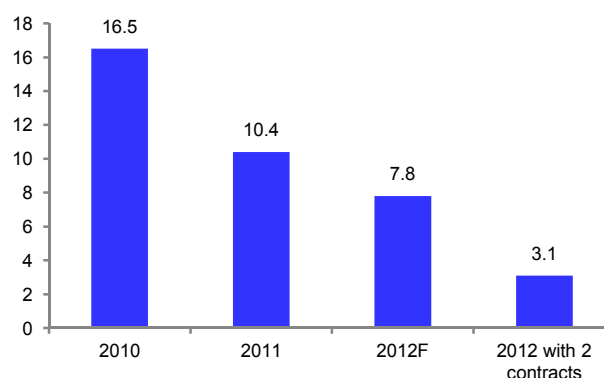
HMSG Group compares its latest deal of the KKM acquisition for 15x 2012 EV/EBITDA with that of GTNG, expecting 43.3% CAGR in EBITDA by 2015. Incorporating this forecast, we estimate KKM's 2015E EV/EBITDA at 5x, which equals the 2012 EV/EBITDA multiple for HMSG Group.

Figure 51: Average EV/EBITDA for acquired companies equals 10.8x



Source: Company data

Figure 52: High multiple of GTNG purchase will subside, if we incorporate future growth and new contracts signed due to GTNG



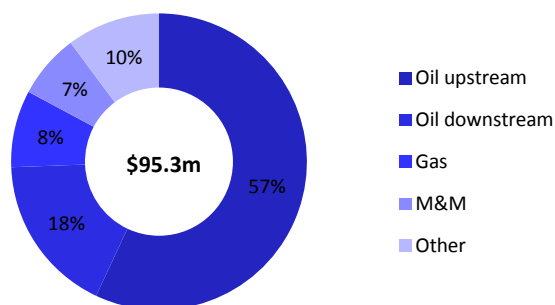
Source: Company data

KKM's top-line growth in line with the industry

In 2011 KKM's revenue amounted to c. USD85m (RUB2.8bn). Most of this amount (83%) was represented by sales to the oil & gas industry, while metals and mining accounted for 7%. According to HMSG data, KKM will show 25% top-line growth in 2012 achieving USD109m; however, in the group's consolidated results roughly half will be reflected. For 9M12 the company showed 11.3% EBITDA margin due to high operating costs, which are to be decreased in the mid-term. At the moment of acquisition, KKM's total debt amounted to USD7.2m.

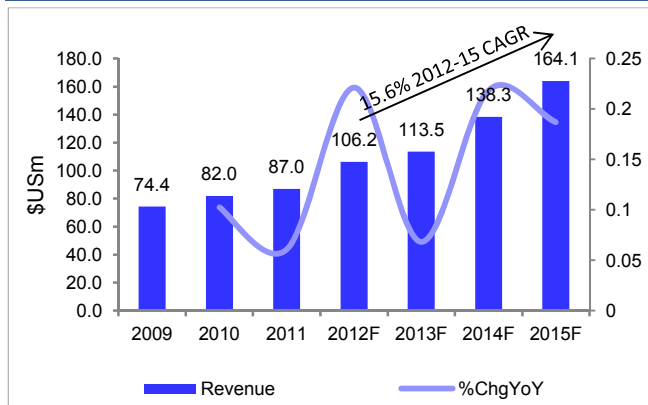


Figure 53: Oil & gas industry accounts for more than 80% in total KKM's revenue



Source: Company data

Figure 54: KKM's revenue will show 16.1% 2012-15 CAGR, in line with the industry



Source: Deutsche Bank estimates based on adjusted Frost & Sullivan estimations

KKM acquisition to bring synergies at low integration expenses

HMSG Group suggests the acquisition of KKM will bring several crucial advantages, such as:

- **Presence on compressors market.** With KKM, HMSG Group instantly enters the compressors market with 7% share. The market should outstrip the pumps market with 16% 2012-15 CAGR;
- **Strengthening relations with the current clients.** The client base of the companies overlap each other, so to strengthen the relations with key customers, HMS Group now could offer another product line and, more important, compressor-based integrated solutions;
- **Synergies and low integration costs.** Compressors and pumps are made from the same raw materials and under similar technology, so the consolidated company will be able to save on procurement, production and service, gaining from effect of scale and spending low on integration.

Apollo acquisition to bring a bunch of synergies in distribution and R&D

The value of the deal corresponded to 1.57x 2012 EV/sales and 8.7x 2012 EV/EBITDA, according to HMS Group. Management remained shareholders and continue to run the business. In 2011 Apollo's revenue amounted to EUR20.3m, net profit to EUR1.3m and net debt to EUR1.6m.

Apollo Goessnitz is an old German pumps engineering and producing company, specialized in centrifugal pumps for oil refining, petrochemicals, thermal power generation and off-shore works. The main rationale for the acquisition was the company's strong expertise and references, particularly in oil refining and off-shore production. HMS Group expects to get synergies with the company in the following directions:

- **Distribution.** HMS Group expects to strengthen its positions in the Russian oil refinery segment dominated by foreign suppliers, as well as in the thermal power segment by selling high-end Apollo pumps through its own distribution channels. The company also plans to provide Apollo's pumps to foreign markets in CIS and Iraq and use Apollo's international sales network for its own products;
- **Raw material.** HMS Group will gain access to suppliers of key components, while Apollo will decrease costs of production of its low-end products;
- **High-capacity products.** The company will be able to organize the production of high-capacity products based on Apollo technologies, using its production base;
- **R&D.** Joined R&D facilities will enhance the company's product and allow participation in international engineering projects.



Financial analysis

HMS Group's revenue: highly exposed to oil & gas

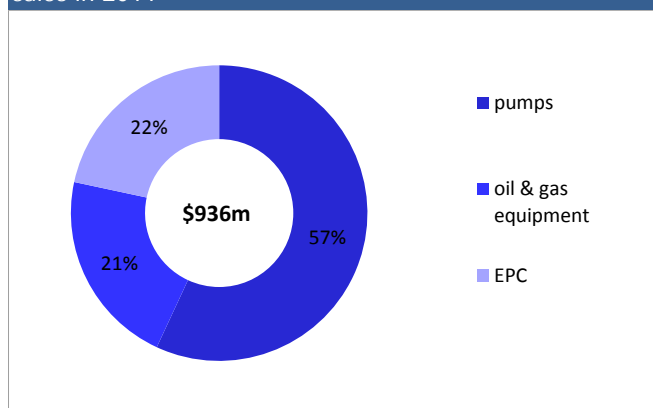
Pumps – the largest division of the company

HMS Group's total revenue accounted for USD936m (RUB27.5bn) in 2011, having shown 19% yoy growth. More than half of this amount (57%) came from the pumps division, while the rest was almost equally split between modular equipment (21%) and EPC unit (22%). Such categorization is accepted in management accounting and assumes that the revenue is recognized according to the division, to which the enterprise implementing the project belongs. So, revenue from sale of equipment incorporating pumps would be reflected in O&G equipment in case it was supervised by an enterprise from this division, while EPC division, assembling research institutes and construction subsidiaries, could implement a project on equipment delivery and construction.

In 2012, a new division – compressors – was added

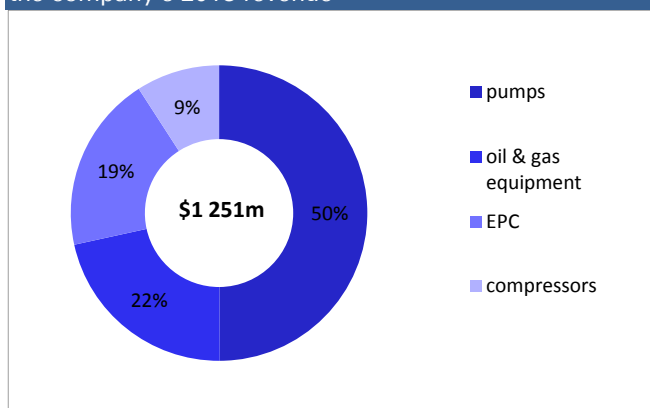
With the acquisition of KazanKompressorMash in 2012, HMS Group entered the compressors market. We expect this new business segment to bring 9.1% to the company's total revenue in 2013, leaving the pumps division with 50% share and equally dividing the rest between O&G equipment and EPC.

Figure 55: Pumps division accounted for 57% of total sales in 2011



Source: Company data

Figure 56: Acquired compressors unit should bring 9% to the company's 2013 revenue



Source: Deutsche Bank estimates

Integrated solutions took one-third of the revenue in 2011 and should level off at 25%

Because of such a revenue recognition peculiarity, more complicated projects demanding a customized approach and one-source supply from design to commissioning and construction ('integrated solutions') could be recognized in any of the three divisions, differentiating by integration level from non-modular design to turnkey solution. In 2011 aggregated revenue from these projects accounted for 34% of the total HMS Group's output. The company expects it to level off at 25% in the mid-term, which is close to the global average of 25-30%.

After-market to sustain 10%

Besides integrated solutions, revenue from pumps and modular equipment divisions includes after-market. HMS Group has strong positions in after-market benefiting from the large pumps base installed by the group's plants in the Soviet period. However, in

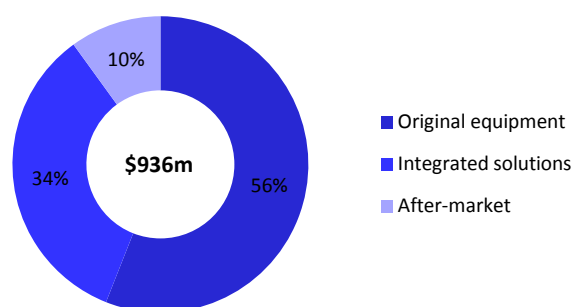


terms of revenue, it accounts only for 10% – quite low compared to many foreign peers, such as Weir earning more than 50% of its output from after-market. Although, the company expects to sustain its 10% level in the mid-term, we note that the increasing base of installed integrated solutions equipment would likely result in higher demand for the company's after-market services in the future.

The lion's share of revenue comes from oil & gas

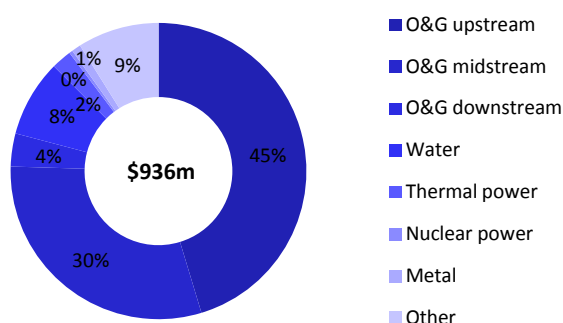
Oil & gas, water utilities and power generation represent the company's core business segments; however, it also has presence in metallurgy, chemicals and some other industries. In 2011 almost 80% of the company's output came from oil & gas, with 45% from upstream only, while the other two largest segments accounted for 8.4% and 2.6%, respectively. Sales to the O&G industry include the result of O&G equipment division, sales of O&G pumps and fulfillment of EPC contracts in O&G.

Figure 57: In 2011, integrated solutions accounted for 34% of the revenue, while after-market for only 10%



Source: Company data

Figure 58: Sales to oil & gas industry brought almost 80% of the output in 2011



Source: Company data

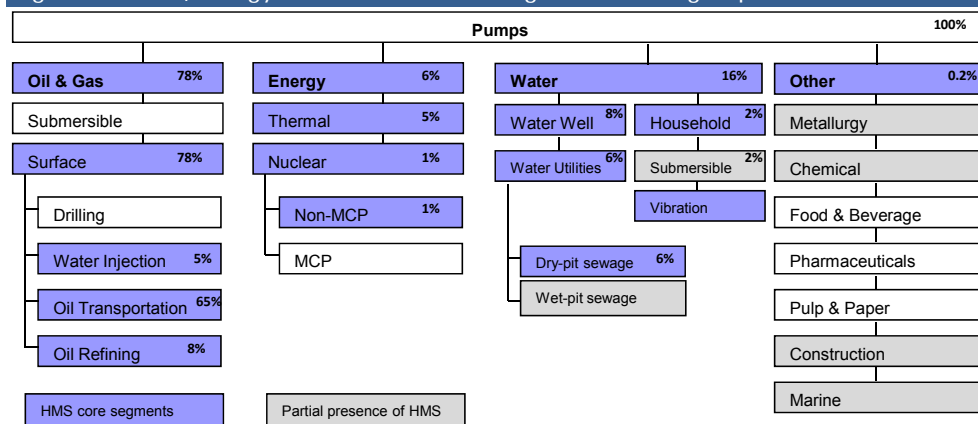
HMS Group is a clear leader in water injection, oil transportation and submersible water well pumps

On the modular equipment market the HMS Group has strong positions in two segments – pump stations with 57% market share and automated group metering units with 33% market share; the company produces some other modular equipment as well, but occupies an insignificant share. In 2011, sales of pump stations amounted to almost 50% of the division revenue.

HMS Group specializes in production of surface O&G pumps, among which pumps for oil transportation and refinery, as well as water injection pumps used in oil production. Together these three types accounted for almost 80% of the group's pump sales in 2011 with oil transportation only occupying 65% due to HMSG's participation in the ESPO project. The company is an undisputed leader in the water injection market with 61% share and oil transportation market with 77%. In water pumps supply, HMSG also occupies leading positions in the submersible water well pumps market commanding 67% share and dry-pit sewage market with 49% share. Water pump sales brought 16% to the overall division's sales in 2011. The rest was mainly represented by pump sales to the power generation industry with HMSG being a leader in pump supply to thermal energy accounting for 47% share.



Figure 59: O&G, energy and water are core segments of the group



Source: Frost & Sullivan

International presence: confined, but holds promise

International presence is mainly confined to CIS and Iraq

Although, the company implements some projects for foreign customers, they do not significantly impact the group's output as, in total, they account for only 4%. HMSG has strong relations with CIS countries, particularly in Central Asia, where it recently constructed irrigation stations (Turkmenistan and Uzbekistan); the company also notices growing demand for its modular equipment from Kazakh companies. The group participates in development of brownfield Runaila in Iraq – the project led by BP, due to a large base of pumps equipment installed by the group's enterprises in the Soviet period; such an international project has a positive impact on the company's reputation.

Acquired German pumps producer Apollo should allow to expand into new markets

German pumps engineering and production company Apollo, acquired last year, will likely allow the group to expand its presence in international markets, using the company's sales network. For example, Apollo delivers process pumps for offshore Gudrun O&G field in the North Sea operated by Norwegian Statoil; a new contract was signed in October 2012.

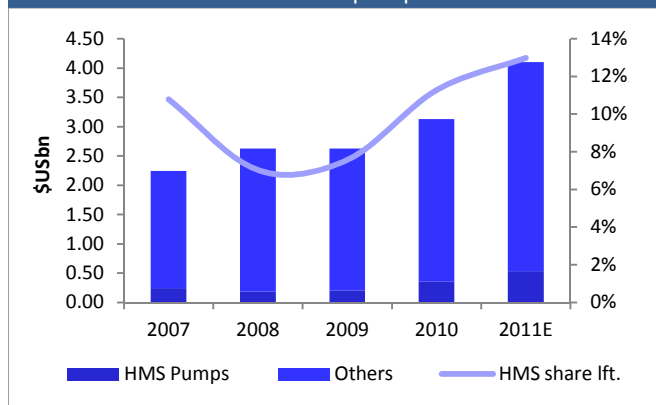
Relative performance: recovering market share

After drop in 2008-09 HMSG's market share recovered in both pumps and ME markets

Since 2008 HMS Group has strengthened its position in total pumps and oil & gas equipment markets growing organically and through acquisitions. In 2010 the company's pumps division accounted for 11% of the total pumps market and we estimate it to reach 13% in 2011 as a result of strong sales of O&G pumps. In the oil & gas equipment market, the company occupied 25% in 2010 and we do not expect it to significantly change in 2011. The drop of HMS Group's share in the both markets in 2008-09 was caused by switching customers to more inexpensive unbranded producers, but in 2010 it recovered and exceeded its pre-crisis level.

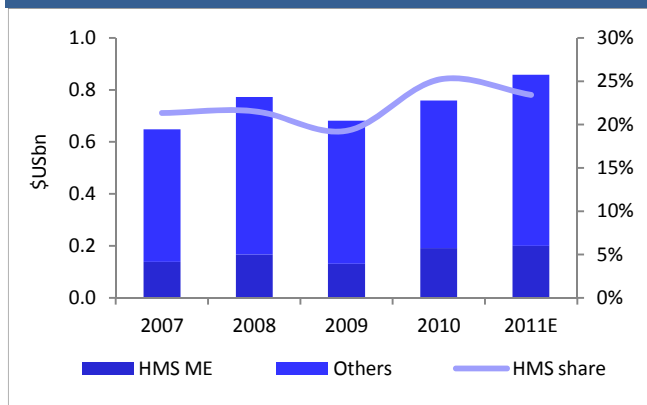


Figure 60: Since 2008 drop, HMSG's share has recovered and achieved 13% of the total pumps market



Source: Frost & Sullivan, Deutsche Bank

Figure 61: HMSG's share on the oil & gas equipment market bounced to record 25% in 2010



Source: Frost & Sullivan, Deutsche Bank

Pumps to grow with the market, oil & gas equipment to outstrip by 2015

The Russian pump market is mature with most of the segments being controlled by several key players. Main producers have established strong relations with the clients, so entry as well as significant increase in market share is possible mainly through M&A. Thus, we assume the company's pumps division will grow with the industry showing 8.6% 2012-15 CAGR. We expected the company's oil & gas equipment segment to grow with 10.4% CAGR vs. 13.1% across the market due to high exposure to the pump stations segment.

Backlog analysis

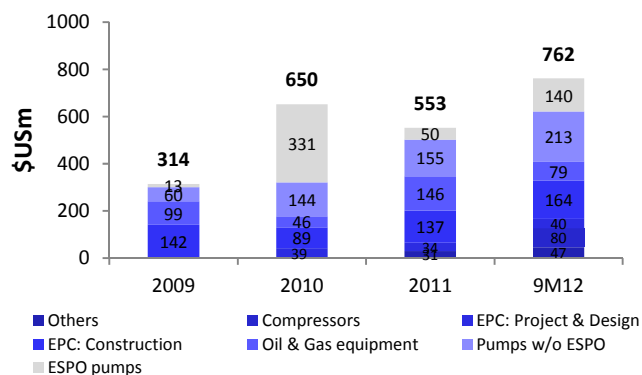
ESPO contract was almost fully replaced in 2012

For the past several years the company's order book showed a growth dynamics having achieved USD762m in 9M12. A 15% shrink (10% in RUB terms) in 2011 was on a high base of the previous year when the company obtained a key contract with Transneft for ESPO pumps delivery; the contract amounted to more than USD300m or 51% of the total backlog that year. Notwithstanding fears, the company managed to almost fully replace this contract, having won several new large projects, such as delivery of pumping stations for the second stage of Vankor and the turnkey project on the Srednebotuobinskoe O&G field. This resulted in backlog excluding ESPO soaring by 67% yoy.

In 2012 HMSG continued to increase its backlog portfolio, having added a number of large follow-up contracts, such as ESPO-1 expansion, project at Dulisminskoye oilfield and in Turkmenistan. As of 9M12, half of the company's order book was represented by the pumps division, with ESPO pumps accounting for 19%. Orders for O&G equipment occupied only 11% share, while EPC reached 30%.

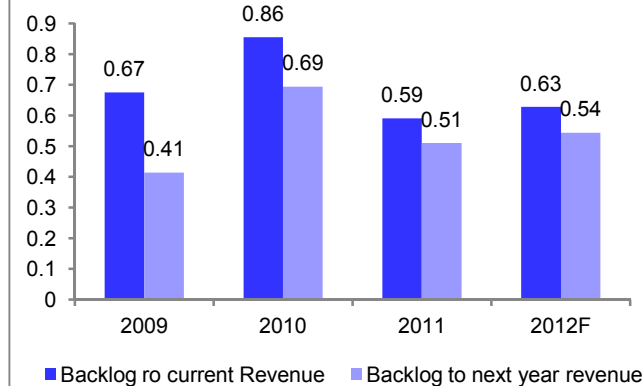


Figure 62: Record 2010 backlog including ESPO project was overtaken in 9M12



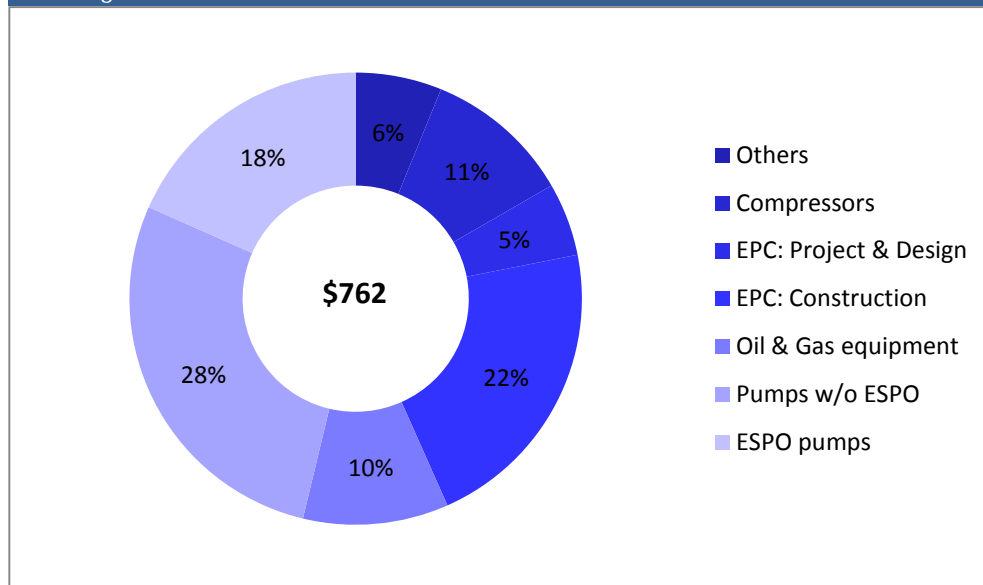
Source: Company data

Figure 63: The company's backlog has historically been less than last twelve month revenue due a great number of short term projects (less than one year) and revenue from sales of pumps



Source: Company data

Figure 64: Half of the company's 9M12 order book was represented by pumps, including ESPO with 19%



Source: Company data

Selected projects overview



Figure 65: The largest ongoing projects and those completed last year

Key Projects	Product	Timeline	Amount	Comment
2011-2012, >RUB 1bn				
Vankor 2- stage (East Siberia)	ME: Water processing, contracts	2 2011-2012	USD70m (RUB1.3bn + RUB0.8bn)	Follow-up contract to the water treatment system designed by HMSG in 2010. Completed.
Srednebotuobinskoe O&G field (Taas-Yuriah, East Siberia)	EPC: turnkey project + additional construction works	2011-2012	USD84.2m (RUB1.8bn + RUB0.8bn)	HMS decided to partially exit project under the 1- contract as it required additional investments due to poor design documentation provided; work under 2- contract continued.
ESPO-I and ESPO-II	Pumps: pumping units for pump stations	2010-2012	USD400m (RUB12.4bn)	As of Dec-12, on ESPO-I 93% of revenue was recognized, on ESPO-II 97% was recognized
After 2012, >RUB0.9- 1bn				
ESPO-I expansion	Pumps: pumping units for pump stations	2012-2013/2014	USD157 (RUB4.6bn)	Follow-up contract to ESPO-I, as of Dec-12, 19% of the revenue was recognized
Dulisminskoye oilfield 2- stage (East Siberia)	EPC: O&G field infrastructure	2012-2013	USD49m (RUB1.6bn)	Follow-up contract to the 1- stage of crude oil metering station constructed by HMSG in 2011.
Gas processing plant in Komi	Compressors: turnkey project for a compressor station	2012-2013	USD29m (RUB907m)	Besides this project, HMSG also agreed on delivery of compressor packages to a number of oilfields totally amounted to USD19m
Project in Turkmenistan	EPC: Reconstruction of water- pumping stations	2012-2014	USD85 (RUB2.6bn)	Follow-up contract to water pumping station construction in 2011. 0% of revenue is recognized.

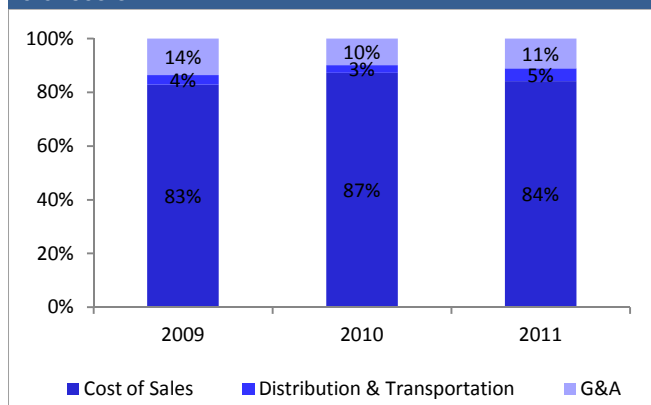
Source: Company data, Deutsche Bank

Cost structure: raw materials and labor dominate

In total expenses, cost of sales occupies more than 80%, half of it – raw materials

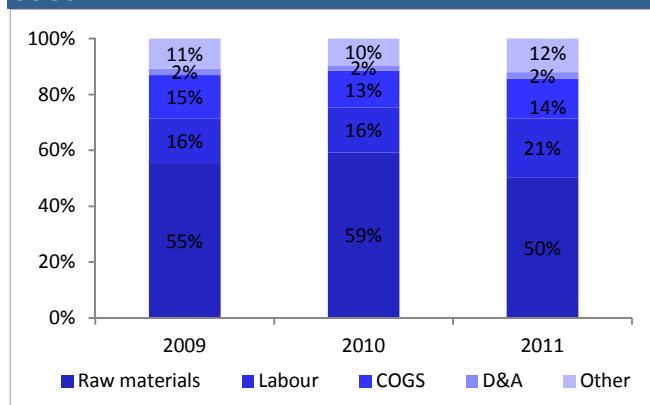
Cost of sales commanded more than 80% of aggregated expenses in 2011, while SG&A accounted for 16%. About 50-60% of the company's cost of sales was represented by raw materials – mainly ferrous metals. The main suppliers are local; however, there are also several foreign producers, particularly in South Korea, who provide HMSG with stainless casting for nuclear pumps and oil transportation high capacity pumps. With the decrease in metals prices, the share of raw materials shrank to 50% in 2011, and as this trend preserved in 2012, we estimate the share could fall further to 46%. The second-largest expenses are labor accounting for about 20%, growth by 5ppt in 2011 was caused by consolidation of acquired companies. Following new acquisitions in 2012, we expect labor costs to increase to about 24% with a gradual decrease in following years due to costs optimization.

Figure 66: SG&A expenses represent less than 20% of total costs



Source: Company data, Deutsche Bank

Figure 67: Raw materials constitute half of company's COGS



Source: Company data, Deutsche Bank



Margins: the result of project mix

Integrated solutions bring the highest margin of 25-30%

HMSG's business model based on building a book of orders allows the company, to some extent, estimate its future margin as the price of orders is usually stipulated. The company has discretion to choose between projects collecting a portfolio with the highest margin. Customized equipment designed for particular purposes of a client brings the highest margin of 25-30% as producers have some kind of leverage here to put higher price, while sales of ordinary equipment gives only 10-15%. On the other hand, under contract a company bears risks of expenses hike uncovered by the contract price, which are lower when a company sells bare pumps and has an opportunity to partially roll them over to customers. However, if the company gets prepayment, it can place an order to supplier and fix the prices.

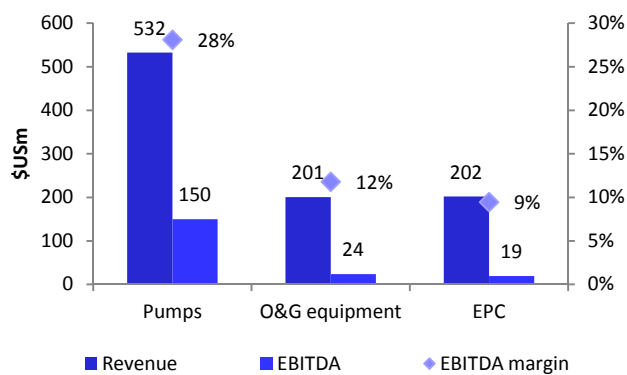
In 2011, EBITDA margin reached a record 20% as a result of ESPO project

EBITDA margin, thus, significantly depends on project mix. In 2011 HMSG earned a record EBITDA margin of 20% due to its participation in the high-margin project – delivery of integrated pumps equipment for ESPO. As a result of this project, the pumps division earned 28% of EBITDA margin. The EPC segment has historically showed the poorest result suffering from tough competition with other construction companies and in-house construction departments of key customers. With the gradual change in project mix related to replacement of the ESPO contract, EBITDA margin started to decrease having achieved 16% in 4Q11.

Vankor-2 and ESPO expansion supported the company's profitability in 2012

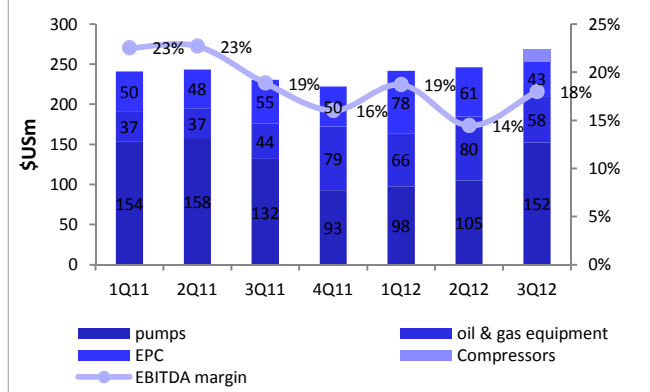
In 2012 the main supportive factors for the company's profitability were Vankor-2 project, which boosted O&G division margin in 1Q12 to almost 30% and the follow-up ESPO expansion project, which increased the pumps division's margin to c.30% in 3Q12. The main factors weighing on the company's performance were EBITDA contraction of the EPC unit due to aggressive price policy applied to penetrate new markets and losses born as a result of an incident on the Srednebotuobinskoye oilfield, where poorly prepared documentation by the client induced additional investments. We also note that the acquired compressors producer, KKM, in 2012 works at 11.3% margin and its improvement is possible only in the mid-term as the enterprise is one of the key enterprises in Kazan, thus the company cannot quickly optimize the expenses there.

Figure 68: In 2011, pumps division registered a record 28% EBITDA margin as a result of ESPO contract



Source: Company data, Deutsche Bank

Figure 69: With the change in project mix the company's EBITDA gradually decreased



Source: Company data, Deutsche Bank



For 2012, we expect EBITDA margin at 16%

Although the company guided EBITDA margin at 20% during the year, we expect it to be 17%, taking into account the insufficient project mix and poor performance of EPC division. For the next several years we expect the margin to achieve the 18% level supported by integrated solutions projects, such as ESPO expansion and compressor turnkey project.

CF: affected by large projects and M&A activity

Changes in CFO mainly induced by WC volatility

Volatility in working capital is the main source of drastic changes in operating cash flow for the past couple of years. In 2010, the company received a large prepayment for ESPO that boosted cash flow to USD118m; however, its release in 2011 had the opposite effect with CFO shrinking to -USD54m. In the future, we expect more stable dynamics of working capital around 23% of sales level.

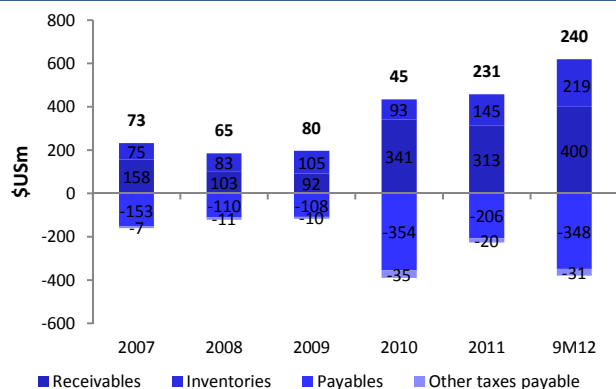
The available cash mainly goes toward maintenance needs and acquisition of new companies. The company estimates its average maintenance expenses at 1.7-2.0x of depreciation, which assumes USD35-40m in 2012-15. In 2012, HMSG's acquisition expenses amounted to USD210m (RUB6.7bn) after purchase of GTNG, KKM and Apollo.

Dividend policy assumes 4% dividend yield for 2013

According to the company's dividend policy, not less than 25% of net income is distributed for dividends. In 1H12 HMSG paid USD49m (RUB1.5bn) or 44% of net income implying 7.3% dividend yield. If the company follows the policy, we expect dividend yield at 4.1% for the next year.

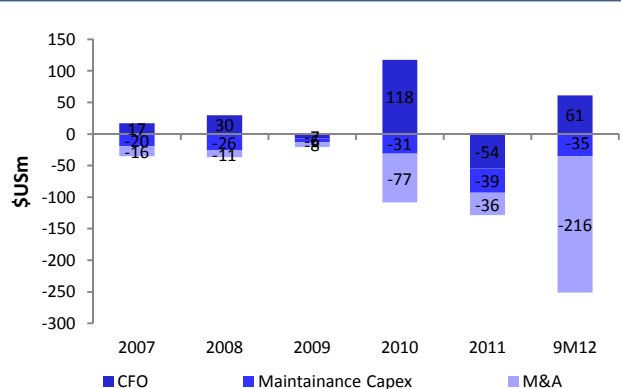
In spring 2012 the company approved a buy-back program, for which it plans to spend USD25m until 2015 to support its share price. We welcome the decision considering the share price has shrunk more than twice since IPO in 2011. However, we also note that the company's management purchased shares from the market, as a result of which free-float has decreased by 8.75% to 28.5%.

Figure 70: In 2010, WC decreased as a result of ESPO prepayment, while in 2011 rebounded after its release



Source: Company data, Deutsche Bank

Figure 71: In 9M12, HMSG registered record investment outflow after three acquisitions



Source: Company data, Deutsche Bank



Net debt soared after acquisitions

The acquisitions of 2012 were fully financed with debt...

Although, the company acquired assets each year since 2003 partially financing the deals with debt, it has managed to maintain the net debt/EBITDA ratio within the internal covenant of 2.5x getting particularly close to it in 9M12.

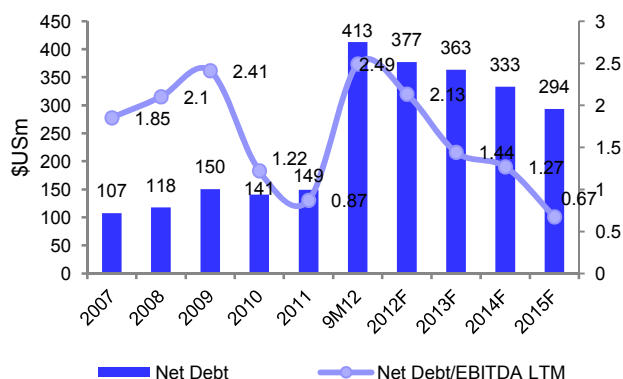
In July 2012, HMSG acquired 77.8% of Kazankompressormash for USD168m (RUB5.5bn) and 75% of Apollo Goessnitz for EUR25m (RUB1bn), financing both deals fully with debt. For the KKM acquisition, HMSG attracted c. USD92m (RUB3bn) three-year bond issue maturing in February 2015 and USD76m (RUB2.5bn) of Sberbank loan. Out of RUB2.5bn, RUB1.3bn is a short-term bridge loan carrying maturity in December 2012, while RUB1.2bn is under a revolving credit facility. For Apollo, HMSG attracted a two-year bridge loan from Sberbank.

...however, the company managed to successfully refinance the debt

Following this acquisition, S&P lowered HMSG's long-term rating to 'B+' from 'BB-' with a negative outlook noting the risks of the company not to restore its liquidity position in the near future. However, in January 2013 S&P revised the outlook to stable after the company's successful refinance. HMSG signed a loan agreement for the provision of a seven-year unsecured loan of EUR26m (RUB1bn) with Sberbank to replace the two-year bridge loan. In February, the company also placed five-year RUB3bn bonds.

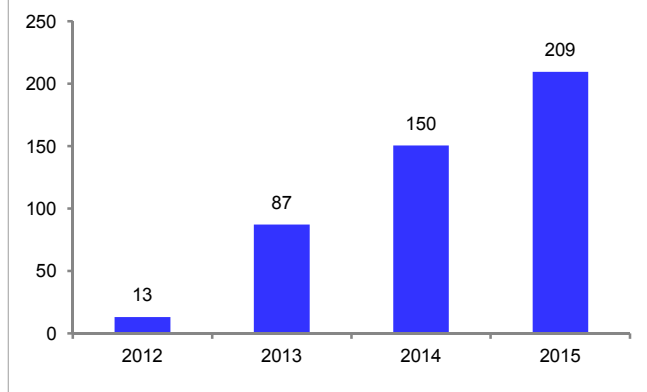
As of 9M12 the company's total debt amounted to USD452m with 15% of it being short term. The bulk of repayment falls on 2015, when the company has to return USD209m. 97% of the company's debt is in rubles, which corresponds to the company's revenue structure.

Figure 72: After acquisitions made in 2012, net debt to EBITDA was close to critical 2.5x



Source: Company data, Deutsche Bank estimates

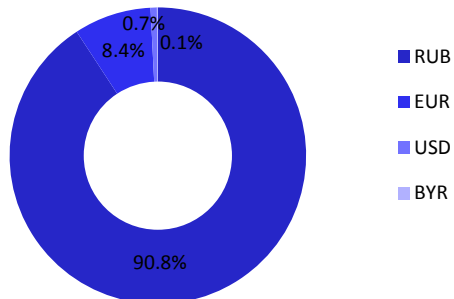
Figure 73: Almost half of the current total debt should be repaid in 2015



Source: Company data, Deutsche Bank estimates

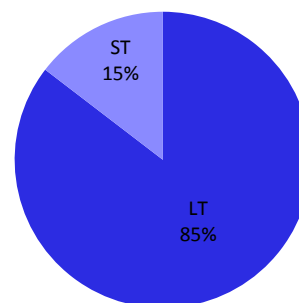


Figure 74: After acquisitions, we estimate 90% of total debt to be in RUB and 8% in EUR



Source: Company data, Deutsche Bank estimates

Figure 75: As of 9M12 15% of the debt was short term, effective interest rate equaled 11%



Source: Company data, Deutsche Bank estimates



We wish to acknowledge the significant contribution made by Irina Plakhova on the preparation of this report.



Appendix 1

Important Disclosures

Additional information available upon request

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Company	Ticker	Recent price*	Disclosure
HMS Group	HMSGq.L	4.06 (USD) 18 Feb 13	NA

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies

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Historical recommendations and target price: HMS Group (HMSGq.L)

(as of 2/18/2013)



Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

*New Recommendation Structure
as of September 9,2002



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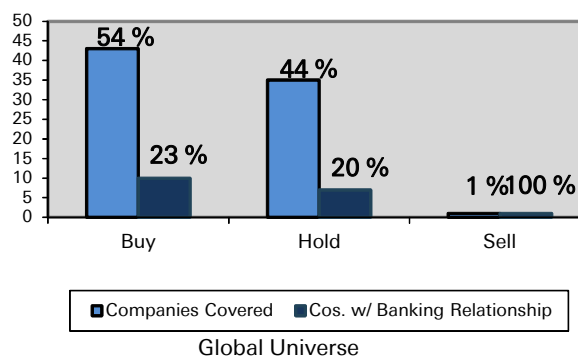
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